



FARM COMMONS

Choosing a Business Entity: Flowchart

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DISCLAIMER: This guide does not provide legal advice or establish an attorney client relationship between the reader and author. Always consult an attorney regarding your specific situation.

So you are thinking about creating an entity? *Start here.*

Are you comfortable never being able to sell the farm business at a profit?

YES

NO

Are you okay with having separate personal and business bank accounts and doing paperwork to protect your personal assets from liability and gain some tax benefits?

Proceed to Next Page

NO

YES

NO

Are at least two individuals involved?

Is your farm operation dedicated exclusively to a non-profit cause that benefits the general public such as education or scientific advancement?

YES

NO

YES

You may be recognized in your state as an **Unincorporated Nonprofit Association**. Note that some states require that at least three individuals are involved to get this status. So be sure to check your state's laws.*

You may consider joining forces with an existing non-profit that is aligned with your cause.

You might consider forming a **Nonprofit Organization** in your state. However, to get the tax benefits of a 501(c)(3) non-profit you'll have to file an application separately with the federal government and you must meet certain tests. So let's start with a few questions:

Commerciality Test: Are the main services or products you're offering competing with for-profit companies? Even though selling fresh farm food to people may seem like a good cause, you're competing with businesses. If that's your cause, you won't meet this test.

Public Support Test: Do you expect that 1/3 of your revenue will come from public support such as donations from the general public and/or grants from government agencies or foundations (i.e. not from sales of products or services)?

YES

NO

If you say YES to both tests, you'll most likely qualify as a **501(c)(3) non-profit**. You'll have to file Form 1023 with the IRS and pay a processing fee of \$400 or \$800 depending on your anticipated annual gross revenues. The process can take up to six months. If this is too long to wait you may need to consider another path. Also note that you'll still have to pay taxes on any profits you make that are unrelated to your stated public benefit.*

If you answered NO to either test, then it's likely that you won't qualify for the 501(c)(3) tax exemption status. You can still be incorporated as a nonprofit organization in your state, which could be good for publicity, but you won't get any tax benefits and anyone that makes a donation won't get a tax write-off. You may want to consider another entity. **Proceed to next page.**

*Now that you have an idea about what entity might work for you, read more about it in our guide. Don't forget to review our chapter on anti-corporate farming laws, as well.

Okay, so a nonprofit isn't right for you.

Many more entities are out there to choose from.
The following questions will help guide you to find the best fit.

Are you okay with having separate personal and business bank accounts and doing paperwork to protect your personal assets from liability and gain some tax benefits?

YES

NO

Do you plan to seek funding from venture capitalists or to "go public" (meaning selling shares to the public)?

YES

NO

Consider forming a Corporation and following regular taxation (often called forming a "**C Corporation**"). Venture capitalists tend to prefer the C corporation structure and it is required if you ever do a direct public offering.*

Then it's best not to officially form an entity. You'll be recognized as a **Sole Proprietorship** (if it's just you) or **General Partnership** (if it's more than you). Each individual involved will be subject to self employment (SE) payroll tax on most of the net business income.*

Are you the only individual involved?

NO

Proceed to next page.

YES

Will you make more income than the average farmer in your situation? If so, you may be eligible to reduce your Self Employment (SE) tax for business income above and beyond an average farmer's income. Would you like to take advantage of this?

YES

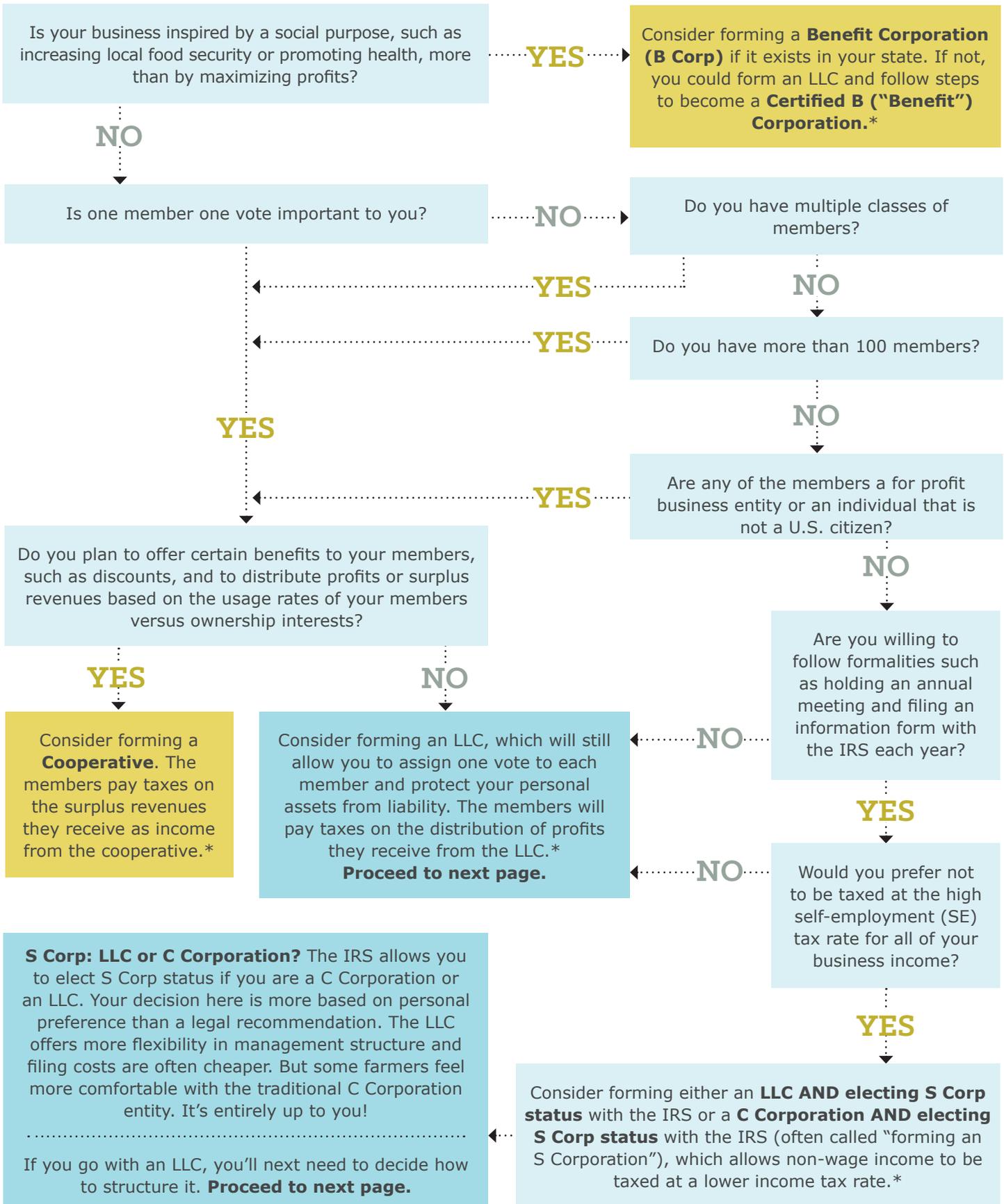
NO

Consider forming an **LLC AND electing S Corp status** with the IRS. An owner of an S Corp must designate a reasonable amount of income to wages and may designate the remainder to distributions, which are taxed at a lower dividend income tax rate.

Consider forming an **LLC**, which will still allow you to protect your personal assets from liability. You'll simply file individual tax returns as if you were a sole proprietorship.

You'll be recognized in your state as a **single member LLC**.*
Proceed to page 5.

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LLC: Member-Managed or Manager-Managed?

Now that you've decided on an LLC, you'll need to decide how to structure it. To do so, answer this: Will either you or other individual(s) of your choice make all the day-to-day decisions without having to check in with all the members of the LLC?

YES

Consider electing the **manager/ management LLC structure**, which allows the appointed manager(s) to run the day-to-day operations of the business. The members will vote on "big" decisions, as determined by your operating agreement or state statute (if you choose not to create an operating agreement).

NO

Consider the **member/management LLC structure**, which allows all members of the LLC to make decisions about how to run the business. This is generally the default in most states.

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