

## Chapter 7: The Business of CSA

Most of us find ‘business’ considerations to be at the bottom of the list of things we need to do and know about. But a clear understanding of terms used in discussing farm business operations is important. The term “business structure” is used within the context of three broad categories: organizational structure, legal structure, and financial structure.

The first step may be simply getting your farm name registered with the County. Most banks will require the filing of Doing Business As (DBA) paperwork as a condition of opening a business account. This is neither a complex nor expensive job; ask at the County Building where your farm is located.

If you are bringing people onto the farm – whether at a CSA pickup, farm event, or farm stand, consider carrying extra liability insurance. Farm property insurance sometimes accommodates these activities. Ask your insurance agent.

### Organizational Structure (management)

Organizational structure (how decisions are made, and who is responsible for what) is an important long-term management issue that often does not receive the attention that it deserves. Stakeholders (family members, employees, and investors) need to know what their role is, what is expected, who makes decisions (now and in the future), who is responsible, and who is accountable. Surveys have shown that the most successful family businesses exhibit shared decision making.

### Business Organization (Legal Form)

The legal form of the business can have significant implications for tax management, estate planning, business transition planning, and other important business objectives. Therefore, ample attention should be given to this management choice, especially when making major changes in the farm business such as bringing in a new generation.

When the stakeholder team of a business, or potential business, is considering the choice of legal form, the primary issues are: 1) access to capital, 2) liability, 3) management flexibility and control, 4) continuity, 5) taxation, and 6) legal filing requirements and other costs.

### Sole proprietorship

- Most common form of business organization for farms and ranches.
- The business is limited to the life of the owner, and the individual is responsible for all debts and obligations.
- Legally, if you do not incorporate, form a partnership or a limited liability corporation (LLC), you are a sole proprietor and your business is a sole proprietorship.
- Income tax: the sole proprietorship does not file separately; a Schedule F (Profit and Loss from Farming) is filed with your 1040 and pay personal tax on the profit. Self Employment tax (Social Security and Medicare Tax) is also a factor.
- A husband and wife can be set up as sole proprietorship, though one spouse might be considered the official ‘owner.’

#### Advantages of the sole proprietorship

- Ease of startup, as there are few formalities to go through to get the business going, and low maintenance costs as there are few legal filing requirements.
- Decision making and management control are centralized with the owner - manager.
- An individual can conduct business in any state, with few reporting requirements.
- Profits are taxed at the owner’s personal rate, and business losses can typically be used to offset other income for taxation purposes.

#### Disadvantages

- Terminates with the death of the owner
- Investment capital is limited to that available to the sole owner, making it difficult to obtain long-term financing and limiting growth potential, particularly as the operator ages.

- Business growth is limited to the abilities, skills, and interests of the sole owner. This “life cycle” disadvantage results in the sole proprietorship being the least effective structure for maintaining the overall farming operation at peak efficiency when transferring the business across generations.

- Owner’s personal assets are subject to any business liabilities.

- Can be a hindrance to estate planning, however, if the farm operation will cease at the owner’s death, this may be the simplest structure to liquidate.

### General Partnership

In a general partnership, two or more persons contribute assets and share in management of the business. Partners are jointly responsible for debts and obligations of the business. Income distributions, responsibilities, etc. are typically spelled out in a partnership agreement. Partnerships must file for a Federal Employer’s ID number whether they have employees or not.

#### Advantages of a general partnership

- Ease of organization.
- Low initial cost of organization.
- The general partnership is a quasi-entity that can own assets, enter into contracts, etc.
- Resources are drawn from all partners, expanding the resource potential, and the management base relative to a sole proprietorship.
- Income is passed through for tax purposes, so profits are taxed

at the rates of the individual partners, and business losses are taken as personal tax deductions. Taxes are reported on Form 1065, “U.S. Partnership Return of Income” and each partner gets a Schedule K-1, “Partners Share of Income, Credits, Deductions, Etc.”

#### Disadvantages

- Liability is shared between partners; however, each partner is liable for all obligations against the partnership and may be held liable for obligations against another partner.
- Control and decision-making are shared, and legally each partner can act on behalf of the business. This aspect has some advantages; however, it does underscore the importance of choosing partners with care as it is difficult to get rid of a “bad” partner.
- No continuity of life beyond the partners. Depending on the details spelled out in the partnership agreement and associated buy-sell agreements the business may be forced into liquidation with the death of a partner. Due to these uncertainties, it may be difficult
- No way to accumulate earnings within the partnership that are tax deferred.

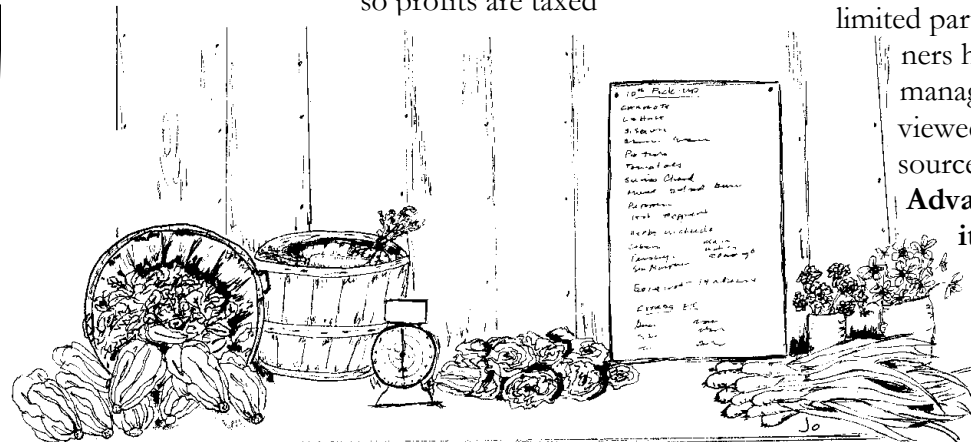
### Limited Partnership

A more formal class of partnerships (requiring formal partnership agreements and other documents meeting the requirements of the state where formed) include limited partnerships and family limited partnerships. The limited partnership is a formal agreement between one or more general partners and one or more

limited partners. Limited partners have no voice in management and are viewed primarily as a source of capital.

#### Advantages of a limited partnership

- Limited liability: each limited partner is liable for debts only up to the



amount of his or her investment in the company.

- Flexibility: Limited partner interests can be sold at any time to raise capital, although once sold, there are limits on the ability to trade those interests.
- The life of the company is not tied to any one partner's mortality, so there is the possibility of "continuity of life."
- Profits are "passed through" to investors, so income is taxed at individual rates.

#### **Disadvantages**

- Complexity and cost of formation and the advanced accounting and reporting requirements imposed by state regulations.
- There must be at least one general partner who is fully liable for partnership obligations.

The family limited partnership is a special form of limited partnership provided for by statutes in most states. The principle objective of a family limited partnership is to carry on a closely held business where management and control are important. The advantages and disadvantages are similar to those of a limited partnership, however, there are restrictions regarding who can participate as partners.

### **Corporation**

The corporation is the most complex business structure that would typically be considered by an agricultural business. The corporation is a separate legal entity comprised of shareholders, directors, and officers. It is considered a separate taxable entity; however, it may be taxed under subchapter C or subchapter S.

The C Corporation reports income and expenses on a corporate tax return and is taxed at corporate rates. Profits are taxed before dividends are paid. Dividends are also taxed to shareholders, who report them as income resulting in the "double taxation" of profits.

The S corporation is taxed in much the same way as a partnership. Profits are taxed at the shareholder's individual rate.

Either type of corporation can enter into contracts, own property, and act as a separate legal entity.

#### **Advantages of Incorporation**

- A primary advantage of the corporate organizational form is that no shareholder, officer, or director can be held liable for debts of the corporation unless a law was breached.
- Interests in the business can be readily sold by transfer or sale of shares of stock. obtaining capital and compensating resource owners, and facilitates estate planning.
- Depending on whether the corporation is formed as a subchapter S, or a subchapter C, various levels of flexibility in tax planning are available.
- The entity can exist into perpetuity as long as regulations are met, and there are some advantages in the availability of pension plans, medical plans, and other benefit plans relative to other forms of business organization.

#### **Wordy**

The Lord's Prayer contains 56 words. Lincoln's Gettysburg Address has 268 words. The Declaration of Independence is 1,322 words long. Federal regulations governing the sale of cabbages are 26,011 words long.

#### **Disadvantages**

- Initial startup cost, and ongoing administrative requirements.
- Fairly extensive articles of incorporation are required.
- Documentation is required in each state of business.
- Extensive record keeping and filing of reports is required on an

ongoing basis.

- Management control is vested in the board of directors and officers, so minority shareholders may feel left out.
- Under the subchapter C structure there is the possibility of double taxation of profits.
- Difficult to use business losses to offset profits from other endeavors.
- The corporate entity can be the most difficult and costly to dissolve, making business exit difficult if circumstances change.

### **Limited Liability Company (LLC)**

A limited liability company is a business entity that combines the limited liability of a corporation, with the flexible management options of a general partnership.

#### **Advantages**

- Limited liability of the various parties involved.
- Relatively flexible management options and partnership tax status.
- Ownership and voting rights can be divided in “unconventional” ways relative to corporations.

#### **Disadvantages**

- Complicated and expensive to form.
- They are subject to complex accounting and reporting requirements.
- Ownership interests are not as liquid as shares of stock in a corporation and are much more

difficult to transfer making it a less attractive choice if estate planning is an imminent concern.

#### **The Non Profit Corporation**

CSA growers sometimes express an interest in forming a nonprofit corporation. After all, none of are making a *big* profit, right? But of course that is not what it means to be a non-prof.

Others believe that their educational or social justice efforts make them eligible for this status. And in some cases they are right. To form a non profit corporation at the state level is relatively simple and inexpensive, and often will not require the services of a lawyer or accountant.

IRS standards for non-profit incorporation as a 501 c3 tax exempt organization, with all of the tax benefits that accrue, are very specific and strict. The accounting and tax implications need to be considered carefully as well.

Several books are available to help you decide if your situation might meet the requirements — and whether you want to take on the responsibilities involved. One that I have found to be useful is *How to Form a Nonprofit Corporation* by Anthony Mancuso.

#### **References**

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