



# LIMITED LIABILITY COMPANIES

## AGRICULTURAL APPLICATIONS

Module Name: Limited Liability Companies in Agriculture



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# CHARACTERISTICS OF LLC'S



- LIMITED LIABILITY
- OPERATIONAL FLEXIBILITY
- PARTNERSHIP TAXATION  
BENEFITS
- ESTATE PLANNING ADVANTAGES

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## WHAT IS A LIMITED LIABILITY COMPANY?



A LLC IS A “HYBRID” ENTITY

- LLC RECEIVES PARTNERSHIP TAX  
TREATMENT
- LLC MEMBERS’ LIABILITY IS SIMILAR  
TO CORPORATION SHAREHOLDERS

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# HOW DO YOU FORM AN LLC?



- FILE ARTICLES OF ORGANIZATION WITH THE SECRETARY OF STATE WHICH ARE SIMILAR TO A CORPORATION'S ARTICLES OF INCORPORATION.

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PREPARE AN OPERATING AGREEMENT, WHICH IS MUCH LIKE A PARTNERSHIP AGREEMENT OR BYLAWS OF A CORPORATION

1. CONTRIBUTIONS
2. MANAGEMENT
3. SHARING OF PROFITS AND LOSSES
4. DISTRIBUTIONS
5. TRANSFER OF MEMBER INTERESTS
6. DISSOLUTION

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# KANSAS CORPORATE FARMING RESTRICTIONS



**IN GENERAL, THE SAME CORPORATE  
FARMING RESTRICTIONS APPLY TO  
LLC'S AS APPLY TO CORPORATIONS.**

- 1. THE LLC MUST BE FOUNDED FOR THE PURPOSE OF FARMING AND OWNING LAND.**
- 2. THE LLC MUST HAVE NO MORE THAN 10 MEMBERS**
- 3. MEMBERS MUST BE NATURAL PERSONS OR PERMISSIBLE ENTITIES**
- 4. AT LEAST ONE MEMBER MUST RESIDE ON THE FARM OR CONDUCT THE FARMING ACTIVITY.**

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# LIMITED LIABILITY



**LLC STATUTES MAINTAIN THAT AN LLC IS A  
SEPARATE ENTITY**

- LLC PROPERTY IS OWNED BY THE LLC, NOT ITS MEMBERS**
- MEMBER'S CREDITOR'S WILL NOT HAVE THE RIGHT TO ATTACH LLC PROPERTY WITH RESPECT TO THE MEMBER'S DEBTS**
- LAWSUITS BY AND AGAINST LLCS WILL BE BROUGHT IN THE NAME OF THE LLC AND NOT IN THE NAME OF THE LLC MEMBERS**
- LLC MEMBER LIABILITY IS COMPARIBLE WITH THAT OF A SHAREHOLDER OF A CORPORATION**
- EACH MEMBER IS PERSONALLY LIABLE FOR HIS OWN ACTIONS, BUT NOT ACTIONS COMMITTED BY THE MEMBER IN HIS CAPACITY AS MANAGER OF THE LLC**
- MEMBERS OF AN LLC CANNOT BE HELD PERSONALLY LIABLE FOR THE LLC'S DEBTS AND OBLIGATIONS**

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# FARMING LIMITED LIABILITY IS MINIMAL



- FARMERS HAVE CLOSE TIES TO THE DAY TO DAY OPERATIONS OF THE LLC, THUS ARE LIKELY TO BE SUED AS INDIVIDUALS
- BANKS ARE GOING TO REQUIRE THE PERSONAL GUARANTEE OF INDIVIDUAL MEMBERS BEFORE ISSUING CREDIT

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## WHO MIGHT BENEFIT FROM LIMITED LIABILITY?



1. OFF-FARM MEMBERS NOT INVOLVED IN DAY TO DAY ACTIVITY'
2. RETIRED FAMILY MEMBERS NO LONGER INVOLVED IN DAILY ACTIVITY
3. BUSINESSES WITH SEPARATE OPERATING UNITS AND DIVIDED MANAGEMENT RESPONSIBILITES
4. MEMBERS WHO HAVE SUBSTANTIAL NET WORTH OUTSIDE THE LLC
5. IT IS GENERALLY NOT ADVISABLE TO PUT ALL ASSETS INTO AN LLC IF LIMITED LIABILITY IS A CONCERN
6. THIS SEPARATE ENTITY TRAIT IS THE PRIMARY ADVANTAGE OF AN LLC OVER A GENERAL PARTNERSHIP

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# OPERATIONAL FLEXIBILITY



## MANAGEMENT BY ONE MEMBER OR ALL MEMBERS

### FLEXIBILITY IN MAKING ALLOCATIONS OF PROFIT AND DISTRIBUTIONS

- AN LLC CAN TREAT DIFFERENT CLASSES OF MEMBERS DIFFERENTLY, WHICH IS AN ADVANTAGE OVER A SUB-S CORP, WHICH CAN HAVE ONLY ONE CLASS OF STOCK FOR DISTRIBUTION PURPOSES.
- A FAMILY FARMING OPERATION COULD SET UP LIMITED NON-MANAGING MEMBERS (OFF-FARM HEIRS) WHO RECEIVE A GUARANTEED RATE OF RETURN ON THEIR INVESTMENT, WHILE THE ON-FARM HEIRS COULD BE THE MANAGING MEMBERS WHO RECEIVE A GUARANTEED PAYMENT FOR LABOR AND A DIVISION OF THE PROFITS.

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# PARTNERSHIP TAXATION BENEFITS



## IRS DEFAULT RULES

1. 2 OR MORE MEMBER LLC'S ARE TAXED AS A PARTNERSHIP
2. A ONE MEMBER LLC IS TAXED AS A SOLE PROPRIETORSHIP
3. A SPECIAL FILING MUST BE MADE TO ELECT CORPORATION STATUS (FORM 8832)

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# IRC SECTION 754 ELECTION



**THIS ELECTION ALLOWS A PARTNERSHIP TO ADJUST THE “INSIDE” BASIS OF PARTNERSHIP ASSETS WHEN A PARTNERSHIP UNIT IS PURCHASED OR ACQUIRED THROUGH THE ESTATE(STEP-UP BASIS).**

- **FARM MACHINERY IS SET UP ON A NEW DEPRECIATION SCHEDULE FOR THE NEW OWNER BASED ON THE TRANSFER VALUE.**
- **BREEDING LIVESTOCK IS SET UP ON A NEW DEPRECIATION SCHEDULE FOR THE NEW OWNER BASED ON THE TRANSFER VALUE.**
- **RAISED GRAIN AND LIVESTOCK GETS A BASIS EQUAL TO ITS TRANSFER VALUE.**
- **THE BASIS IN LAND AND BUILDINGS IS ADJUSTED TO THE TRANSFER VALUE FOR THAT UNIT.**

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# LIQUIDATION OR REORGANIZATION



**A PRO-RATA DISTRIBUTION OF ASSETS AND LIABILITIES TO EACH MEMBER COULD BE DONE AS A TAX-FREE TRANSACTION.**

**IF ALL ASSETS WERE SOLD, ONLY ONE LAYER OF TAX WOULD BE DUE, SINCE THE LLC IS A PASS THROUGH ENTITY AND PAYS NO TAX ITSELF.**

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# LIABILITIES INCLUDED IN MEMBER TAX BASIS CALCULATION



TO DETERMINE THE AMOUNT OF A DEDUCTIBLE LOSS FROM AN LLC, MEMBERS CAN ADD THEIR SHARE OF LLC LIABILITIES TO THEIR CAPITAL ACCOUNT.

SUB-S SHAREHOLDERS MUST MAKE A DIRECT LOAN TO THE CORPORATION TO ADD TO THEIR BASIS.

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# SELF-EMPLOYMENT TAX ISSUES



PROPOSED IRS REGULATIONS TREAT MEMBERS AS GENERAL PARTNERS (SUBJECT TO SE TAX) IF SUCH MEMBER:

1. HAS PERSONAL LIABILITY FOR DEBTS OR LOANS OF THE ENTITY
2. CAN CONTRACT ON BEHALF OF THE ENTITY
3. PARTICIPATES IN THE BUSINESS FOR MORE THAN 500 HOURS PER YEAR

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# LLC TAX DISADVANTAGES



## **LACK OF TAX-FREE FRINGE BENEFITS TO MEMBERS**

1. IRC SECT 119 HOUSING FOR THE CONVENIENCE OF EMPLOYER
2. MEDICAL REIMBURSEMENT PLAN
3. HEALTH INSURANCE
4. 50,000 TERM LIFE INSURANCE

IF AN LLC IS CLASSIFIED AS A FARMING SYNDICATE, IT WILL BE INELIGIBLE TO USE CASH ACCOUNTING FOR TAX PURPOSES.

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# ESTATE PLANNING ADVANTAGES



THE LLC COULD BE A GOOD ENTITY FOR HOLDING LAND FOR THE PURPOSE OF MAINTAINING ELIGIBILITY FOR SPECIAL USE VALUATION OR THE FAMILY OWNED BUSINESS DEDUCTION.

THE LLC IS A GOOD ENTITY FOR NON-FARM HEIRS TO HOLD OWNERSHIP INTERESTS.

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# OTHER FACTORS



FOR FSA/ASCS PAYMENT LIMITATION PURPOSES, AN LLC IS CONSIDERED TO BE IDENTICAL TO A CORPORATION, THUS IT QUALIFIES AS ONLY ONE PERSON.

CREATING ANY TYPE OF BUSINESS ENTITY IS VERY COMPLICATED AND REQUIRES INPUT FROM MANY SOURCES. LEGAL, ACCOUNTING AND FINANCIAL COUNSEL IS VERY IMPORTANT TO UTILIZE WHEN MAKING A DECISION TO CREATE ANY TYPE OF BUSINESS ENTITY.

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# LLC CASE STUDY #1



JOE FARMER IS 55 YEARS OLD AND HAS ESTABLISHED A SUCCESSFUL 500 SOW FARROW TO FINISH HOG OPERATION AND FARMS 2000 ACRES OF TILLABLE LAND. HIS SONS, JASON AND JARROD, ARE 32 AND 30 YEARS OF AGE, RESPECTIVELY, AND HAVE WORKED AS SALARIED EMPLOYEES FOR JOE FOR THE PAST 3 YEARS. JOE'S SONS HAVE BEEN PUSHING FOR AN EQUITY POSITION AND MORE MANAGEMENT RESPONSIBILITIES IN THE FARMING OPERATION. JOE AND HIS WIFE WOULD LIKE TO SLOW DOWN THEIR WORKING PACE A LITTLE, BUT WANT TO STAY INVOLVED IN THE OPERATION. THEY ALSO WANT TO BE SURE TO TREAT THEIR TWO DAUGHTERS WHO LIVE OFF THE FARM EQUITABLY. JOE IS CONSIDERING AN ENTITY TO HOLD ALL OR A PART OF HIS FARMING ASSETS. WOULD AN LLC BE A GOOD CHOICE?

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# LLC CASE STUDY #1 BALANCE SHEET



	FMV	COST BASIS
CORN	92500	0
MILO	105000	0
BEANS	63750	0
MARKET HOGS	270000	0
RAISED SOWS	75000	0
FARM EQUIP	400000	125000
BUILDINGS	350000	200000
LAND	1200000	550000
TOTAL ASSETS	2552750	875000

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# LLC CASE STUDY #1 DEFERRED TAX LIABILITY



A HUGE DEFERRED TAX LIABILITY WOULD OCCUR IF ALL THE FARMING ASSETS WERE TRANSFERRED TO A C CORPORATION. THE FAIR MARKET VALUE OF 2,552,750 LESS THE TAX BASIS OF 875,000 WOULD RESULT IN A POTENTIAL TAXABLE GAIN OF \$1,677,750 IF THE CORPORATION WOULD BE LIQUIDATED. AT AN ESTIMATED 34% FEDERAL TAX RATE AND 7% STATE TAX RATE, 41% OF THE GAIN OR \$ 687,877 OF TAX WOULD BE DUE BY THE CORP, PLUS JOE AND HIS WIFE WOULD OWE CAPITAL GAINS ON THE ASSET DISTRIBUTION IF THE LIQUIDATION TOOK PLACE DURING THEIR LIFETIME(BEFORE STEP UP IN BASIS TO THEIR STOCK).

A LLC WOULD AVOID THE SECOND LAYER OF TAX, AND COULD ALSO AVOID THE FIRST IF THE LLC INTEREST HAD GONE THROUGH AN ESTATE TO RECEIVE A STEP UP IN BASIS.

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# LLC CASE STUDY #1 PURCHASE OF EQUITY INTERESTS



PURCHASE OF EQUITY INTERESTS BY THE SONS WOULD RESULT IN NO TAX BENEFIT TO THEM IF THEY BUY C CORP OR SUB-S CORP STOCK. IN A LLC, THE SECTION 754 ELECTION COULD BE MADE TO ADJUST THE INSIDE BASIS OF THE LLC ASSETS AND ALLOCATE THIS ADJUSTMENT TO THE PURCHASING MEMBER. IF JOE AND HIS WIFE BEQUEATH UNITS IN THE LLC TO THE OFF-FARM SISTERS, THE BROTHERS WOULD BE ABLE TO PURCHASE THE LLC UNITS FROM THEIR SISTERS WITH "BEFORE TAX" DOLLARS. THIS WOULD BE A DEFINITE ADVANTAGE OF AN LLC OVER A CORPORATION.

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## LLC CASE STUDY #1 PURCHASE OF EQUITY INTERESTS



- LLC COULD ESTABLISH IN ITS OPERATING AGREEMENT THAT ANY MEMBER WANTING TO SELL THEIR SHARES MUST OFFER THEM BACK TO THE LLC OR OTHER MEMBERS ON A 5 OR 10 YEAR CONTRACT WITH FAVORABLE INTEREST RATES.
- THIS COULD BE A POSSIBLE WAY TO EQUITABLY TREAT OFF-FARM HEIRS WHO WANT THE CASH, WITHOUT FORCING THE ON-FARM HEIRS TO HAVE TO BORROW A LOT OF FUNDS FROM OUTSIDE CREDITORS.
- ANOTHER POSSIBILITY IS ONLY ALLOWING A PERCENTAGE OF EACH MEMBER'S UNITS TO BE SOLD IN A GIVEN YEAR, WITH A NEW VALUATION ESTABLISHED EACH YEAR, SO THAT ON-FARM HEIRS WONT BE FORCED TO BUY OUT NON-FARM HEIRS AT A PEAK IN THE CATTLE, HOG OR LAND CYCLE.

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# LLC CASE STUDY #1 INCOME FLEXIBILITY



FLEXIBILITY IN DIVIDING PROFITS AND LOSSES WOULD BE AVAILABLE TO A LLC. FOR EXAMPLE, JOE FARMER COULD TAKE A GUARANTEED PAYMENT OF 5% ON HIS EQUITY WHEN HE RETIRED, WITH ALL ADDITIONAL INCOME ACCRUING TO HIS SONS. THIS TYPE OF ALLOCATION COULD POSSIBLY WORK WELL WITH INCOME ALLOCATION TO THE OFF-FARM HEIRS.

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# LLC CASE STUDY #1 DISSOLVING THE FARM



THE LLC WOULD LEAVE MANY MORE OPTIONS OPEN FOR DISSOLVING THE FARMING OPERATION AS COMPARED TO A CORPORATION.

A PRO-RATA DISTRIBUTION OF ASSETS AND LIABILITIES COULD TAKE PLACE ON A TAX-FREE BASIS FROM A LLC. IF JASON AND JARROD DECIDED TO SPLIT INTO TWO OPERATION ENTITIES IN 20 YEARS, IT COULD BE DONE IN A TAX-FREE DISTRIBUTION.

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# LLC SUMMARY



- LLCs CAN BE VERY ADVANTAGEOUS IN ESTABLISHING AN ENTITY FOR MOVING THE FARM BUSINESS WITH A LARGE AMOUNT OF ASSETS FROM ONE GENERATION TO THE NEXT.
- LIMITED LIABILITY TO OFF-FARM HEIRS.
- OPERATIONAL FLEXIBILITY AND ABILITY TO ALLOCATE INCOME DIFFERENTLY TO DIFFERENT CLASSES OF MEMBERS.
- PARTNERSHIP TAX TREATMENT AND INSIDE BASIS STEP-UP THROUGH AN ESTATE.
- ESTATE PLANNING FLEXIBILITY.

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