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An Agricultural Law Research Publication

**A Snapshot of LLCs and Farming:**  
*How Farm Businesses have implemented the Limited Liability Company  
Structure in the Midwestern United States*

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In fall 2018, a family found a Christmas card from the 1950s depicting the family farm in all of its glory. A daughter found it among her mother’s bible, shortly after her mother’s funeral. At Thanksgiving, the aunts and uncles received a framed copy, and proudly showed the grandchildren, nieces, and nephews where in the picture their mother’s bushes had been and where their father kept the livestock. Many commented on remembering those simpler times. One of the simpler things about this story is that this family farm transitioned to the next generation without the use of a business entity. Today, that is becoming less and less common.

In the modern world, attorneys and accountants often encourage farm owners to organize their farm to reap a number of benefits of such organization. Depending upon the type of structure chosen, the benefits range from liability protection to tax benefits and from administrative ease to transitioning to the next generation. All fifty states allow the partnership, corporation, and Limited Liability Company (“LLC”) structures in some form.<sup>1</sup> Many states will use a uniform statute, while others prefer to modify how those businesses may be structured in their state.

This paper examines the history of the LLC, its common features among the states, and its usefulness for farming families and businesses. The title “Limited Liability Company” makes the liability protection feature evident; however, practitioners have found the LLC a worthwhile tool for creating a business transition plan that serves the interests and wishes of the owners well. The LLC has not eliminated headaches for farm businesses, but it has proved itself as a popular tool for a number of purposes.

## I. A Brief History of the Limited Liability Company

When compared to other business ownership structures, such as the corporation or sole proprietorship, the LLC remains a recent innovation in the law. Prior to 1977, the LLC did not exist in the United States.<sup>2</sup> Before the creation of the LLC, businesspeople often had to choose between the flexibility and favorable tax treatment of the partnership model or the limited liability offered by forming a corporation. States created hybrids such as S-corporations and limited partnerships that mixed some of the benefits of partnerships with corporations, but something was still missing for the Hamilton Brothers Oil Company.

The Hamilton Brothers Oil Company was a Denver based oil exploration company that operated a number of foreign business entities.<sup>3</sup> One of these businesses, organized under Panamanian law, qualified for partnership taxation, but also received corporate-style limited

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\* Evin Bachelor and Peggy Kirk Hall are licensed attorneys in Ohio. Both wish to thank Christopher Hogan, previous Law Fellow with OSU’s Agricultural & Resource Law Program, for his earlier research on this topic.

<sup>1</sup> See, “Partnership Act,” UNIFORM LAW COMMISSION (2019) <https://my.uniformlaws.org/committees/community-home?CommunityKey=52456941-7883-47a5-91b6-d2f086d0bb44> (all states but Louisiana adopted the Uniform Partnership Act of 1914, but most have adopted a revised uniform act); Mark Schroeder, *Louisiana’s New Partnership Provisions: A Review of the Changes and Some Continuing Problem Areas*, 42 La. L. Rev. 1429 (1982) (Louisiana has its own partnership law); Carol Goforth, *An Overview of Organizational and Ownership Options Available to Agricultural Enterprises*, THE NATIONAL AGRICULTURAL LAW CENTER (2002) [http://nationalaglawcenter.org/wp-content/uploads/assets/articles/goforth\\_ownership2.pdf](http://nationalaglawcenter.org/wp-content/uploads/assets/articles/goforth_ownership2.pdf).

<sup>2</sup> Susan Pace Hamill, “The Story of LLCs: Combining the Best Features of a Flawed Business Tax Structure,” *Business Tax Stories: An In-Depth Look at Ten Leading Developments in Corporate and Partnership Taxation* (2005) [https://www.law.ua.edu/misc/bio/hamill/Chapter%2010--Business%20Tax%20Stories%20\(Foundations\).pdf](https://www.law.ua.edu/misc/bio/hamill/Chapter%2010--Business%20Tax%20Stories%20(Foundations).pdf).

<sup>3</sup> *Id.*



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liability protection. Concerned about capital and participation requirements in foreign countries and that U.S. courts would not recognize the liability protections, the company explored other options. Instead of choosing an entity that did not do exactly what it wanted, the Hamilton Brothers Oil Company decided to pursue the legislative route. Frank Burke, Jr., an advisor to the Hamilton Brothers Oil Company, helped draft the first LLC law, and pushed the Alaska legislature to adopt it. After two failed attempts to pass the bill in 1975 and 1976, the focus shifted to Wyoming.

Wyoming took up the cause and passed the Wyoming Limited Liability Company Act on March 4, 1977.<sup>4</sup> The new Limited Liability Company structure promised the liability protections of a corporation with the tax treatment and flexibility of a partnership. However, the promise had to be reconciled with federal tax law. The Internal Revenue Service had to decide what to do with LLCs. Are they partnerships, corporations, or something else?

In the first few years after Wyoming's statute took effect, few businesses moved to adopt the structure because the IRS had not decided how it would treat LLCs for tax purposes.<sup>5</sup> The IRS issued a private letter ruling in 1980 indicating that LLCs created under Wyoming's law would receive partnership tax treatment. However, proposed regulations and a sense of hostility prevented much movement on adoption of LLC statutes by other states.<sup>6</sup> Then in 1988, the IRS issued Revenue Ruling 88-76, and confirmed that entities created under Wyoming's LLC law would receive partnership tax treatment despite having some corporate characteristics.<sup>7</sup> Between 1990 and 1996, the number of states with LLC statutes rose from two to fifty.

In 1997, the IRS implemented "check-the-box" regulations, which signaled wider acceptance of LLCs by the federal government.<sup>8</sup> Today, "check-the-box" regulations allow LLCs to choose how to be treated for federal tax purposes. The classification of LLCs as a corporation, partnership, or disregarded entity is important because of how federal tax law treats owners and managers under each class. Using IRS Form 8832, LLCs may choose whether to self-classify as a corporation, partnership, or disregarded entity separate from its owner.<sup>9</sup> Entities in existence before the 1997 regulations generally may continue their preexisting classification without filing Form 8832. All other entities must file a Form 8832 to select their classification, or else the IRS will classify the entity under the IRS's default rules. By default, the IRS classifies LLCs as pass-through, with single-member LLCs treated as sole-proprietorships and multi-member LLCs as partnerships. Since many LLCs prefer pass-through taxation, the default rule may be satisfactory, thereby making filing Form 8832 unnecessary.

With widespread acceptance by state legislatures, and clarity from the federal government for tax purposes, American businesses were ready to try out and start using the LLC structure. Farms and agribusinesses were no exception. As explained more in depth below, it took only a matter of years for farms and agribusinesses to adopt the LLC structure in relatively large numbers

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<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> Larry Ribstein, *LLCs: Is the Future Here?*, ABA Business Law Section Newsletter, vol. 13, no. 2 (Nov. 2003) <https://www.americanbar.org/content/dam/aba/publications/blt/2003/11/lc-is-the-future-here-200311.pdf>.

<sup>7</sup> Susan Pace Hamill, "The Story of LLCs: Combining the Best Features of a Flawed Business Tax Structure".

<sup>8</sup> See 26 C.F.R. §§ 301.7701-1 to .7701-3.

<sup>9</sup> See "About Form 8832, Entity Classification Election," U.S. DEPARTMENT OF THE TREASURY: INTERNAL REVENUE SERVICE, <https://www.irs.gov/forms-pubs/about-form-8832>.



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when compared to the more traditional corporate structure. Before examining the adoption of LLCs in agriculture, the basics of the LLC structure itself merit a closer look.

## II. LLC Statutes and Characteristics in the Midwestern United States

States have taken a number of different approaches in designing their LLC statutes, such that the specific requirements for LLCs will vary depending upon the home state of the business. While a uniform statute addressing LLCs exists, only a handful of states have adopted it. Nonetheless, LLC statutes across the nation possess a number of common characteristics. For purposes of simplicity, and given that it often serves as a legal microcosm for agriculture, the statutes examined here will be from the Midwestern United States.<sup>10</sup>

Whether or not a state has adopted the Uniform Limited Liability Company Act (“ULLCA”) stands out as one of the major differences among Midwestern states. The National Conference of Commissioners on Uniform State Laws first drafted the ULLCA in 1996, revised it in 2006, and amended it in 2011 and 2013.<sup>11</sup> One of the main purposes of a uniform law, and one of the missions of the conference that develops uniform laws, is to “reduce the need for individuals and businesses to deal with different laws when they move and do business in different states.”<sup>12</sup> As of January 2019, 20 states have adopted the ULLCA, and at least one other state has introduced implementing legislation.<sup>13</sup>

Midwestern States and the ULLCA	
Have Adopted the ULLCA <sup>14</sup>	Have Not Adopted the ULLCA
Iowa	Indiana
Illinois	Kansas
Minnesota	Michigan
Nebraska	Missouri
North Dakota	Ohio
South Dakota	Wisconsin

Each Midwestern state has statutory provisions that explain the requirements for forming LLCs in their state, along with explaining certain things that an operating agreement can and

<sup>10</sup> For the purposes of this paper, the “Midwest” refers to those states considered to be the “Midwest” by the U.S. Census Bureau. “Census Regions and Divisions of the United States,” U.S. DEPARTMENT OF COMMERCE: CENSUS BUREAU, [https://www2.census.gov/geo/pdfs/maps-data/maps/reference/us\\_regdiv.pdf](https://www2.census.gov/geo/pdfs/maps-data/maps/reference/us_regdiv.pdf).

<sup>11</sup> “Limited Liability Company Act, Revised,” NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (2019) <https://my.uniformlaws.org/committees/community-home?CommunityKey=bbea059c-6853-4f45-b69b-7ca2e49cf740>.

<sup>12</sup> “Uniform Limited Liability Company Act (2006)”, NATIONAL CONFERENCE OF COMMISSIONERS OF UNIFORM STATE LAWS, at 2 (Dec. 9, 2014) <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=59420093-1faf-c04e-5649-8a70f657a1c1&forceDialog=0>.

<sup>13</sup> “Limited Liability Company Act, Revised,” NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (2019).

<sup>14</sup> “Limited Liability Company Act, Revised,” NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (2019) <https://my.uniformlaws.org/committees/community-home?CommunityKey=bbea059c-6853-4f45-b69b-7ca2e49cf740>.



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cannot contain. These two documents serve as the most important documents for an LLC. Without any Articles of Incorporation, an LLC does not exist. Without an operating agreement, an LLC does not reach its full potential as a business structured to the needs of the operation. Farms and agribusinesses are no exception.

### A. LLC Formation

LLC formation in the eyes of a state requires very little information or effort, and generally involves a brief form document. In order to receive the benefits of the LLC structure, a business must file documents with the secretary of state in the state where the business wishes to register. This action provides notice to the state and to others that this business is holding itself out as a separate legal entity.

A business's "Articles of Organization" create the separate legal entity, and contains similar information as the "Articles of Incorporation" for a corporation's filing or a "Certificate of Limited Partnership."<sup>15</sup> Every state requires the articles of organization to include the name of the LLC with LLC in the name as well as the name and address of a registered agent in the state.<sup>16</sup> Many states will require other information such as an address for the LLC's principal office, a general purpose statement, and signatures.<sup>17</sup> As an example, Ohio requires LLC articles of organization to be signed, name the LLC, provide a period of duration, and include any other provisions from the operating agreement "that the members elect to set out in the articles for the regulation of the affairs of the company."<sup>18</sup>

Depending upon the state, the articles of organization take effect and the LLC legally exists upon filing or upon confirmation of receipt by the appropriate state official.<sup>19</sup> Farmers and agribusinesses looking for more information on the requirements in their state should consult their secretary of state's website, or contact an attorney in their state.

### B. The LLC's Heart: the Operating Agreement

While the articles of organization create the legal entity, the operating agreement serves as a governing document containing rules for members and managers about how to operate the LLC. More specifically, in states like Iowa that have adopted the Revised Uniform Limited Liability Company Act, an operating agreement governs:

- a. Relations among the members as members and between members and the limited liability company.

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<sup>15</sup> For a thorough overview of business organizations, see Carol R. Goforth, "Part II: An Overview of Organizational and Ownership Options Available to Agricultural Enterprises," *An Agricultural Law Research Article*, THE NATIONAL AGRICULTURAL LAW CENTER (July 2002) [http://nationalaglawcenter.org/wp-content/uploads/assets/articles/goforth\\_ownership2.pdf](http://nationalaglawcenter.org/wp-content/uploads/assets/articles/goforth_ownership2.pdf).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> Ohio Revised Code § 1705.04(A).

<sup>19</sup> Carol R. Goforth, "Part II: An Overview of Organizational and Ownership Options Available to Agricultural Enterprises," *An Agricultural Law Research Article*, THE NATIONAL AGRICULTURAL LAW CENTER, 3-4 (July 2002).

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- b. The rights and duties under [the Iowa LLC chapter] of a person in the capacity of manager.
- c. The activities of the company and the conduct of those activities.
- d. The means and conditions for amending the operating agreement.<sup>20</sup>

These provisions mean that the operating agreement may spell out capital contributions, management rules, voting power, allocation of profits and losses, how to make changes to the operating agreement, whether and how membership interests may be transferred, how to leave the LLC, and how to end the LLC.<sup>21</sup> Further, the operating agreement may alter traditional fiduciary duties and provide for indemnification for breaches of certain duties, but states generally do not allow for the complete elimination of fiduciary duties.<sup>22</sup>

In order to enforce the operating agreement against a member, states may require that the members sign the document; however, a state may presume or deem that a member has assented to the operating agreement by mere fact of being a member.<sup>23</sup> States without a uniform law in particular may modify these requirements. For instance, Indiana defines an operating agreement as “any written or oral agreement of the members as to the affairs of a limit liability company and the conduct that is binding upon all the members.”<sup>24</sup> While the definition states that the operating agreement may have written or oral components, many of the default rules in Indiana’s law will overrule oral provisions that are not reduced to writing.<sup>25</sup>

What are default rules? Default rules are laws that serve as gap fillers where an operating agreement either does not exist or does not speak to a specific issue. Some default rules pull from the common law of corporations, but many state legislatures have reduced these default provisions to statutory law. At estate and business transition workshops, attendees will often hear the presenter joke that a person without a will or trust and an LLC without an operating agreement essentially allow their state legislators decide how their estate or business affairs get handled. The joke is funny, but also true. Unless members understand the default rules and wish for them to apply, practitioners will strongly recommend having a thorough operating agreement in place so that the LLC operates as the members want, rather than how the state capitol wants. Not all default rules are bad, but LLCs will want to understand what the default rules mean and choose whether or not to adopt them, rather than assume that the default rules are sufficient for the LLC.

For farms and agribusinesses, the unique nature of agriculture can make an operating agreement all the more important to have. While a farm LLC is normal in that the members have entered into a business relationship, the centrality of family and passing along LLC assets to the next generation makes farm LLCs somewhat unique. For example, issues regarding voting may represent an important piece of the operating agreement that a farm or agribusiness will want to spell out. Will all members have an equal vote? Will voting weight be based upon a per capita basis? Should the older generation have more voting authority? Should a specified group of

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<sup>20</sup> Revised Uniform Limited Liability Company Act, Iowa Code § 489.110(1).

<sup>21</sup> Carol R. Goforth, “Part II: An Overview of Organizational and Ownership Options Available to Agricultural Enterprises,” *An Agricultural Law Research Article*, THE NATIONAL AGRICULTURAL LAW CENTER, 4-13 (July 2002).

<sup>22</sup> Revised Uniform Limited Liability Company Act, Iowa Code § 489.110 (3), (7).

<sup>23</sup> Revised Uniform Limited Liability Company Act, Iowa Code § 489.111.

<sup>24</sup> Indiana Code § 23-18-1-16.

<sup>25</sup> *See, e.g.*, Indiana Code § 23-18-3-1(1)(a).



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members, such as spouses brought into the family only by marriage, have limited voting rights? States like Ohio allow LLCs to make choices on voting via the operating agreement.<sup>26</sup>

An LLC may draft the operating agreement on its own, but the use of an attorney is advised. Operating agreements modify the default rules of a state, and attorneys know these rules. In addition to providing legal analysis regarding the default rules, an attorney can also craft the operating agreement with succession planning, member rights, and creditor rights in mind.

Importantly, LLCs can and should modify an operating agreement over time as economic, family, and other important considerations change.

### **C. Titling and Acquiring Assets for the LLC**

The LLC exists upon proper filing of the required documents, but the LLC has little functionality without assets. In other words, LLC members and managers must take steps to capitalize and give life to the LLC beyond the articles of organization and operating agreement. In addition to requiring members to pay a buy-in price, assets themselves may be transferred to the LLC. Ways to transfer assets to the LLC include:

- Writing a bill of sale of certain assets
- Opening a bank account in the LLC's name
- For real property, executing a deed to the LLC
- For titled personal property, transferring title to the LLC

By taking these steps, the LLC obtains legal ownership of the transferred property, and may dispose of the assets as allowed under the operating agreement. Further, LLCs may purchase additional assets, apply for loans, and sell assets that it owns.

## **III. Benefits of LLCs**

The LLC structure offers a number of benefits, some of which are unique to LLCs. From providing a high level of liability protection to an option for pass-through taxation, and from a highly customizable business structure to a useful estate and business transition tool, LLCs are an attractive solution to a number of problems facing farms and agribusinesses. When choosing whether to form an LLC, and when drafting an operating agreement, a farm or agribusiness should discuss each of these features with its attorney and tax professional, as well as with all of the LLC's members and managers, to ensure that the LLC suits the farm and the family, rather than the other way around.

### **A. Liability Protection, with Some Limitations**

Limiting liability serves an important role in LLCs, as any observer can tell given the prominence of "limited liability" in the name. In effect, the LLC members separate their house from their office. If they engage in a business activity through the LLC and the LLC fails, the LLC's creditors will generally only have access to the LLC's assets, and not the personal assets of

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<sup>26</sup> See Ohio Revised Code § 1705.26.



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the members or managers. Thus, the main financial risk that members face is losing their investment in the business. The limit on liability extends to lawsuits based in tort, contract, and otherwise that relate to the business of the LLC.

The limits on liability are not absolute. Three exceptions in particular can undermine how well an LLC protects its members or managers from liability. First, the limited liability does not extend to willful misconduct or knowing criminal violations.<sup>27</sup> For example, Minnesota, which adopted the Revised Uniform Limited Liability Company Act, restricts LLCs from adopting an operating agreement that would limit a member or manager's liability for breaches of certain fiduciary duties, intentional harm to the company or a member, or intentional violations of criminal law.<sup>28</sup> A member or manager who commits these acts will face personal liability for those acts.

Second, the common law doctrine of "piercing the corporate veil" still applies to LLCs.<sup>29</sup> As previously mentioned, limiting an investor's liability to their investment represents a cornerstone of corporate law in the United States. However, courts have from time to time encountered cases where limiting liability does not serve the public interest or general fairness. When this happens, a court may "pierce the corporate veil" and hold the shareholders or officers of a corporation personally liable for a corporation's debts or obligations. In deciding whether to do this, courts will examine factors such as whether the corporation is undercapitalized, whether it lacks separate records, whether finances have been comingled, whether the corporation was formed for an illegal or fraudulent purpose, whether corporate formalities were followed, and whether the corporation is a mere sham.<sup>30</sup>

For example, an Iowa court of appeals in 2018 allowed a plaintiff to collect directly from the owner of a corporation after that owner failed to maintain the existence of a separate legal entity.<sup>31</sup> In that case, the defendant owned and operated a biosolids management company, but breached a contract with a client by refusing to perform. The court found that the owner comingled corporate and personal assets and accounts, failed to keep records, and had no bylaws or meeting records. The court indicated that violating one of the factors alone, such as failure to follow corporate formalities, did not doom the corporate veil; however, when the facts call multiple factors into question, the aggregate effect may result in loss of protection.

While that case involved a corporation, developing case law suggests that courts will apply this doctrine to LLCs. Another Iowa case noted that in "exceptional circumstances," and using the factors mentioned above, Iowa courts may "pierce the veil of a limited liability company and hold members or managers individually liable."<sup>32</sup> Iowa is not alone. In one Ohio case, the LLC's owners argued that piercing the veil only applies to corporations; however, the court of appeals cited cases from five different appellate districts in Ohio that applied the doctrine to LLCs, without

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<sup>27</sup> Jesse Richardson, Jr. and L. Leon Geyer, *Ten Limitations to Ponder on Farm Limited Liability Companies*, 4 DRAKE J. AG. L. 197, 198 (1999) (citing Carol J. Miller et al., *Limited Liability Companies Before and After the January 1997 IRS "Check-the-Box" Regulations: Choice of Entity and Taxation Considerations*, 25 N. KY. L. REV. 585, 593 (1998)).

<sup>28</sup> Minn. Stat. § 332C.0110 subd. 7.

<sup>29</sup> Shayna Borakove, *Estate Planning, Business Continuation, Transition and Succession for Farmers*, 26 SAN JOAQUIN AG. L. REV. 1, 12 (2016-2017).

<sup>30</sup> *Woodruff Construction, LLC v. Clark*, No. 17-1422 (Iowa Ct. App. Aug. 15, 2018).

<sup>31</sup> *Id.*; Kristine A. Tidgren, "Corporate Veil Pierced Where Owner was Sloppy with Finances," IOWA STATE UNIVERSITY CENTER FOR AGRICULTURAL LAW AND TAXATION (Aug. 30, 2018) <https://www.calt.iastate.edu/blogpost/corporate-veil-pierced-where-owner-was-sloppy-finances>.

<sup>32</sup> *CCS, Inc. v. K&M Enterprises, L.L.C.*, No. 3-033/12-1213 (Iowa Ct. App. Feb. 27, 2013).



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the Ohio Supreme Court striking those decisions.<sup>33</sup> Despite this, the Ohio General Assembly does instruct courts not to pierce the veil of LLCs for failure of officers to observe corporate formalities, which could seriously harm officers of a corporation if violated.<sup>34</sup>

Some states have gone so far as enacting legislation allowing courts to pierce the veil of LLCs. Minnesota, which adopted the Revised Uniform Limited Liability Company Act, included a provision in its law that states:

**Piercing the veil.** Except as relates to the failure of a limited liability company to observe any formalities relating exclusively to the management of its internal affairs the case law that states the conditions and circumstances under which the corporate veil of a corporation may be pierced under Minnesota law also applies to limited liability companies.<sup>35</sup>

Similarly, Wisconsin explicitly states that its LLC law does not “preclude a court from ignoring the [LLC] entity under principles of common law [...] that are similar to those applicable to business corporations and shareholders.”<sup>36</sup> Both of these statutes show the legislative intent to treat LLCs similar to corporations when a question arises as whether LLCs have a separate legal existence from their owners.

Just as a state legislature may apply the piercing the veil doctrine to LLCs by statute, states may stop courts from doing so if they wish. For instance, state legislators in West Virginia introduced Senate Bill 258 early in the 2019 legislative session.<sup>37</sup> The bill would prevent the application of this common law doctrine, and thereby prevent the imposition of “personal liability on a member or manager of a limited liability company.” A law like this would make LLC membership a more attractive means to shielding personal assets from business creditors. At this time, no state has passed a law expressly forbidding courts from piercing the veil of an LLC.<sup>38</sup>

Third, if a member or manager of the LLC owes a debt to a creditor, that creditor may have the right to recover against the member or manager’s interest in the LLC. This is the opposite of the description in the introductory paragraph where a creditor of the LLC cannot reach the personal assets of a member or manager to satisfy a debt of the LLC. Here, where a member or manager has a personal debt to a creditor, and the creditor receives a judgment against the member or manager, the creditor may seek a charging order against the member or manager’s interest in the LLC. The charging order may give the creditor the first right to any distribution made by the LLC to the member or manager. Generally this will not give the creditor decision-making authority in the LLC, but that could depend upon the language of the operating agreement and the applicable state law. Some states will allow a creditor to foreclose on the member or manager’s interest, which could lead to the creditor becoming a member of the LLC.

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<sup>33</sup> *Premier Therapy, L.L.C. v. Childs*, 2016-Ohio-7934, ¶¶ 63-65, 75 N.E.3d 692, 711-12 (7th Dist. Ct. App.).

<sup>34</sup> Ohio Revised Code § 1705.48.

<sup>35</sup> Minnesota Stat. § 322C.0304 (subd. 3).

<sup>36</sup> Wisconsin Stat. § 183.0304(2).

<sup>37</sup> S.B. 258, 84TH WEST VIRGINIA LEGISLATURE (2019) [http://www.wvlegislature.gov/Bill\\_Status/bills\\_history.cfm?year=2019&sessiontype=RS&input=258](http://www.wvlegislature.gov/Bill_Status/bills_history.cfm?year=2019&sessiontype=RS&input=258).

<sup>38</sup> Jake Zuckerman, “Critics says WV Senate bill would breed shell LLCs, protect owners,” CHARLESTON GAZETTE-MAIL (Jan. 26, 2019) [https://www.wvgazette.com/news/legislative\\_session/critics-says-wv-senate-bill-would-breed-shell-llcs-protect/article\\_71214015-af05-50da-92d6-ada8305dc7f9.html](https://www.wvgazette.com/news/legislative_session/critics-says-wv-senate-bill-would-breed-shell-llcs-protect/article_71214015-af05-50da-92d6-ada8305dc7f9.html).



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What does all of this mean for farms and agribusinesses? Creating one or more LLCs to own and operate the farm business allows farms and agribusinesses to shield different aspects of the operation from debts and liabilities of another part of the operation. If a farmer puts his or her land and equipment into an LLC, debts used to purchase those assets, or debts that use those assets as collateral, can only be collected against those assets, and not the farmer's home or personal assets. A farmer may take the additional step of setting up multiple LLCs to further shield different assets from liability risks. However, with each LLC, the farmer must maintain separate records, bank accounts, and follow the formalities listed in the operating agreement. Each LLC must remain a separate legal entity in order for the business configuration to work as intended. When used correctly, creating an LLC to shield various assets from the liabilities of other assets presents a potentially significant benefit that farmers may wish to consider.

## B. Pass Through Taxation

LLC members may select whether to have the Internal Revenue Service tax the entity itself at the corporate rate, or to have the members taxed on the profits and losses directly.<sup>39</sup> This stems from the IRS's 1997 "check-the-box" regulations, which give LLC members the option to select how to classify the entity for tax purposes using IRS Form 8832.<sup>40</sup> Taxing the members directly instead of the entity is known as "pass through taxation" because the IRS does not tax the profits and losses of the business at the entity level, but rather allows them to "pass through" the entity and be assessed as part of the personal income taxes of the members.<sup>41</sup> Without pass through taxation, the IRS would tax the entity at the corporate rate, and then any profits or losses received by the members or owners would be taxable at the personal rate. This results in two layers of taxation.

Higher corporate tax rates encouraged businesspeople to seek pass through taxation to reduce the overall taxation on a given dollar earned by a business and distributed to owners. Agriculture was no different. Prior to the 2017 tax reform, when the top federal statutory tax rate on corporations sat at 35%, the average effective tax rate that American businesses paid was 22%.<sup>42</sup> When examined at the industry level, agricultural corporations paid an average effective tax rate of 25%.<sup>43</sup> Under the Tax Cut and Jobs Act, the corporate tax rate has dropped to a flat 21%, resulting in an anticipated overall corporate tax reduction.<sup>44</sup> Even though the rate has

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<sup>39</sup> The default tax classification of LLCs by the IRS treats a single member LLC as a sole proprietorship and a multi-member LLC as a partnership, thus LLCs primarily will use Form 8832 to elect for tax classification as a corporation. Consult a tax professional for more information. "Publication 3402 (06/2016), Taxation of Limited Liability Companies," U.S. DEPARTMENT OF THE TREASURY (June 2016) <https://www.irs.gov/publications/p3402>.

<sup>40</sup> 26 C.F.R. §§ 301.7701-1 to .7701-3; "About Form 8832, Entity Classification Election," U.S. DEPARTMENT OF THE TREASURY: INTERNAL REVENUE SERVICE.

<sup>41</sup> Caron Beesley, "6 Things You Need to Know About Your Tax Responsibilities as an LLC," U.S. SMALL BUSINESS ADMINISTRATION (published Nov. 13, 2012, updated Dec. 29, 2017) <https://www.sba.gov/blogs/6-things-you-need-know-about-your-tax-responsibilities-llc>.

<sup>42</sup> "Average Effective Federal Corporate Tax Rates," U.S. DEPARTMENT OF THE TREASURY: OFFICE OF TAX ANALYSIS (Apr. 1, 2016) <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/Average-Effective-Tax-Rates-2016.pdf>.

<sup>43</sup> *Id.*

<sup>44</sup> "Publication 5318: Tax Year 2018," U.S. DEPARTMENT OF THE TREASURY (Nov. 2018) <https://www.irs.gov/pub/irs-pdf/p5318.pdf>.



dropped, Congress still provides incentives for entities with pass through taxation, namely the qualified business income deduction, but this provision will expire if not reauthorized in 2025.<sup>45</sup>

What does all of this mean for farms and agribusinesses? By using pass through taxation, farms and agribusinesses face only one round of taxation, and have one less tax return to worry about. The best option for a farm or agribusiness depends upon that operation's situation, and no one-size-fits all recommendation applies to every operation. While LLCs commonly choose to stay with pass through taxation, LLCs must consult with their tax professionals to determine the best option for a farm or agribusiness.

### C. Flexible Entity Structure

State laws allow persons to create and operate LLCs in a highly customizable fashion.<sup>46</sup> Not only are LLCs relatively easy to form, but their applications provide owners with great flexibility to meet the needs of the farm or agribusiness. For instance, LLCs may have one or more members.<sup>47</sup> In contrast, a partnership requires the involvement of two or more persons, meaning that a partnership of two that loses a member cannot survive. LLCs have the flexibility to go back and forth between having a single member or multiple members without necessarily having to wind up the LLC.<sup>48</sup> While corporations have a similar feature, in that individual persons may form a corporation, corporations cannot obtain the partnership features that LLCs offer, such as pass through taxation.<sup>49</sup> However, single-member LLCs may not afford as much limited liability protection as when there are multiple members, so those wishing to form a single-member LLC will want to consult an attorney to discuss the relevant state law. One solution would involve naming both spouses as members, or creating different classes of members in the operating agreement with different voting powers so as to avoid only having one member.

Another feature of flexibility involves the creation of multiple LLCs. Attorneys may advise clients to set up multiple LLCs to shield different assets. For example, a married couple with 150 acres of land, two livestock barns, and a farm stand may want to consider forming multiple LLCs to shield different parts of the operation. Each of these farm components entails very different liabilities, and some are high risk. Depending upon the state's farm stand and cottage food laws, selling food to consumers may pose a high liability risk if the food turns out to be contaminated. On a cautionary note, even if all the LLCs have the same members, the members must treat each LLC as a separate entity, with separate bank accounts, records, etc. Further, the LLCs will want to have written contractual relationships with the other LLCs. Doing so makes it more difficult for a court to determine that the multiple LLCs had no legal separation from one another such that a claimant can access the assets of all.

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<sup>45</sup> "JCX-1-18: List of Expiring Federal Tax Provisions, 2016-2027," UNITED STATES CONGRESS JOINT COMMITTEE ON TAXATION (Jan. 9, 2018) <https://www.jct.gov/publications.html?func=startdown&id=5057>; *see* "Tax Cuts and Jobs Act, Provision 11011 Section 199A – Qualified Business Income Deduction FAQs," U.S. DEPARTMENT OF THE TREASURY (Nov. 5, 2018) <https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-provision-11011-section-199a-qualified-business-income-deduction-faqs>.

<sup>46</sup> Refer to the above section titled "LLC Statutes and Characteristics in the Midwestern United States" for more information about forming the LLC, drafting an operating agreement, and capitalizing the LLC.

<sup>47</sup> *See, e.g.*, Ohio Revised Code § 1705.04(A) ("One or more persons [...] may form a limited liability company").

<sup>48</sup> *See, e.g.*, Ohio Revised Code § 1776.01(M) (defining partnership as "an association of two or more persons").

<sup>49</sup> *See, e.g.*, Ohio Revised Code § 1701.04(A) ("Any person, singly or jointly with others, [...] may form a corporation").



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States also do not require the same level of documentation formalities for LLCs that they require for corporations. For example, Missouri requires corporations to hold annual shareholders meetings, and corporations must make records of board of directors meetings available to the shareholders.<sup>50</sup> While LLC members must have access to and a right to inspect business records, the annual meeting and minute requirements do not burden LLCs.

What does all of this mean for farms and agribusinesses? The flexibility afforded by the LLC structure allows for a highly customized business plan that helps attain the goals of the farm or agribusiness. In other words, it gives farms and agribusinesses options to suit their needs.

#### **D. Estate and Business Transition Planning to Pass on the Family Farm**

One of the lesser known, but potentially most useful, tools that farming businesses may utilize the LLC structure for is its business transition planning use. When a farmer tells his or her attorney about his or her goal to keep the farm within the family, attorneys increasingly have come to recommend the LLC structure. Farm assets and land not held within an organized business entity may leave the family because of death, divorce, creditors, or partition; however, LLCs can mitigate these risks.

Operating agreements may contain provisions that restrict the transfer of an ownership interest, thereby protecting the land and assets of the LLC. While an operating agreement cannot ban sales or transfers of ownership, the operating agreement may include rights of first refusal and other buy-out provisions. A right of first refusal alone would allow the members who do not wish for another member's interest to be transferred to purchase that member's interest at the offer price given by the third party. However, given the current value of land and equipment, families often find the market price prohibitive. A more detailed operating agreement may contain buy-out provisions that provide the members wishing to keep the farm with the right to purchase another member's share at a discount rate and over a period of years. By reducing the sticker price that a continuing member must pay, and giving him or her more time to pay, the burden of buying out another member's share is greatly reduced.

In addition to restricting the transfer of ownership, the operating agreement may impose restrictions on membership. The introduction of new members can dilute voting power for existing members, and this presents a problem for closely-held family businesses. Fortunately, farms and agribusinesses may include provisions in the operating agreement that limit certain rights to family members. As explained above as the third limitation to limited liability, sometimes a creditor gains rights to a member's share of distributions. However, the family may structure the operating agreement to limit the rights of a creditor so that the creditor cannot vote, force distributions, or make management decisions.

Beyond providing protection from those seeking to get out of the LLC and those trying to get into the LLC, the LLC structure offers a helpful business transition tool. The use of a business entity allows a family to transition equity ownership. While other business entities may help with this, the LLC provides a level of privacy and administrative ease when compared to a corporation because of the reporting and recordkeeping requirements imposed on corporations. Families can use this feature while the older generation is still active in the business, which would allow for a period of transition for both equity and management. Or families can write the equity transition

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<sup>50</sup> Revised Statutes of Missouri §§ 351.215, 351.225.



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into the operating agreement, and the transition can take effect upon the passing of the older generation.

What does this mean for farms and agribusinesses? While attorneys often espouse the benefits of limited liability and pass through taxation, for those with the goal of keeping the farm in the family, the LLC has proven highly useful toward that end. Most parents want to give their children a “fair share” inheritance, but recognize the distinction between the needs of children who wish to stay on the farm and those who do not. Simply stated, farms and agribusinesses are expensive to buy. In particular, land is expensive, making buying a farm at market value extremely difficult, if not impossible for most young farmers.

The LLC allows farms and agribusinesses the ability to give family members in succeeding generations who wish to continue farming a means to do so by reducing up front capital costs. Depending upon the plan put in place, the on-farm heir may benefit from discounted valuation, long-term payment plans, long-term leases of the farmland, and more. These do not mean that off-farm heirs will not receive a fair share. Rather, it often means that off-farm heirs will receive more liquid assets such as cash or rights to land rental income.

Just because the distribution of assets will not look equal in terms of dollar value does not mean that the plan is not fair. Forcing a child to give up farming because he or she cannot afford to buy out his or her siblings’ shares in the farm at market value raises a fairness question of its own. Ultimately, what is fair depends upon the family. The LLC structure can create an estate and business transition plan to fit the family’s personal definition of fairness.

#### IV. The Adoption of the LLC Structure in Agriculture

Farms and agribusinesses have quickly adopted the LLC structure over the past few years. The USDA’s Census of Agriculture has for a time asked questions about the ownership of a farm, namely whether a farm is owned by a family or individual, partnership, corporation, or some other form such as a cooperative or trust.<sup>51</sup> By 2012, the USDA included “Limited Liability Corporation” among the list of entities that a respondent could select from.<sup>52</sup> The USDA’s census reported that 101,372 farms used the “Limited Liability Corporation” structure, with just shy of 86 million acres under LLC ownership.<sup>53</sup> By comparison, 106,716 farms used the corporation structure, with over 131 million acres under the ownership of a corporation. The numbers for corporations represented an increase since 2007, when 96,074 farms reported using the corporation structure, with over 125 million acres under the ownership of a corporation.<sup>54</sup> The comparison suggests that practitioners have pushed their clients toward the newer LLC structure, although the older corporate structure remains very common. Unfortunately the lack of data on LLC use from

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<sup>51</sup> See, e.g., “Table 58. Summary by Size of Farm,” *2007 Census of Agriculture – United States Data*, USDA NATIONAL AGRICULTURAL STATISTICS SERVICE, at 80 (2007) [https://www.nass.usda.gov/Publications/AgCensus/2007/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_US/usv1.pdf](https://www.nass.usda.gov/Publications/AgCensus/2007/Full_Report/Volume_1,_Chapter_1_US/usv1.pdf).

<sup>52</sup> “Table 64. Summary by Size of Farm,” *2012 Census of Agriculture – United States Data*, USDA NATIONAL AGRICULTURAL STATISTICS SERVICE, at 82 (2012) [https://www.nass.usda.gov/Publications/AgCensus/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_US/usv1.pdf](https://www.nass.usda.gov/Publications/AgCensus/2012/Full_Report/Volume_1,_Chapter_1_US/usv1.pdf).

<sup>53</sup> *Id.*

<sup>54</sup> “Table 58. Summary by Size of Farm,” *2007 Census of Agriculture – United States Data*, USDA NATIONAL AGRICULTURAL STATISTICS SERVICE, at 80 (2007).



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2007 makes it difficult to precisely assess whether LLC adoption increased by the same rate or total number of farms when compared to corporations.

Outright ownership of the farm as a family or individual remains the dominant means of ownership, but the numbers show a drastic decline. The USDA’s 2012 census reported 1,828,946 farms did not have an organized entity, with over 550 million acres of farmland without limited liability protections.<sup>55</sup> Nonetheless, when compared to 2007, there exists an evident decrease in the number of farms owned as unorganized sole proprietorships or partnerships. Further, the number of farms existing as partnerships marked a stark decrease as well. The USDA’s 2012 census reports a loss of 110,000 farms under the family, individual, and partnership categories. The USDA’s next census will assist in determining whether the decrease represents a decline in the total number of American farms, or a shift toward organizing the farm under a legal entity.

The USDA’s 2012 census data shows quick adoption of the LLC structure by farms and agribusinesses when compared to the corporate structure. Once released, the USDA’s next census will show whether a trend toward LLCs exists; however, it will not be able to take into account changes made to the tax code in 2017. Those effects will have to wait for the next USDA census. The chart below lists the data previously referenced from 2007 and 2012.

U.S. Farms by Entity Type			
	2012 USDA Census of Agriculture <sup>56</sup>	2007 USDA Census of Agriculture <sup>57</sup>	Five Year Change
“Limited Liability Corporation” (LLC)	<i>Farms:</i> 101,372 <i>Acres:</i> 85,976,552	(no data)	(no data)
Corporation	<i>Farms:</i> 106,716 <i>Acres:</i> 131,272,892	<i>Farms:</i> 96,074 <i>Acres:</i> 125,319,810	<i>Farms:</i> + 10,642 <i>Acres:</i> + 5,953,082
Family or Individual	<i>Farms:</i> 1,828,946 <i>Acres:</i> 562,433,686	<i>Farms:</i> 1,906,335 <i>Acres:</i> 574,150,050	<i>Farms:</i> - 77,389 <i>Acres:</i> - 11,716,364
Partnership	<i>Farms:</i> 137,987 <i>Acres:</i> 156,076,785	<i>Farms:</i> 174,247 <i>Acres:</i> 161,416,999	<i>Farms:</i> - 36,260 <i>Acres:</i> - 5,340,214
Other (cooperative, estate, trust, institution)	<i>Farms:</i> 35,654 <i>Acres:</i> 64,744,294	<i>Farms:</i> 28,136 <i>Acres:</i> 61,208,981	<i>Farms:</i> + 7,518 <i>Acres:</i> + 3,535,313

## V. The Future of the Farming LLC

The usefulness of an LLC as an estate and business transition tool represents one of the more important evolutions of agricultural law in the past few years. Lawyers and business people often talk about the limited liability and pass through taxation options of LLCs, but for farming families, the LLC has become a way to keep the farm in the family. Farms and agribusinesses that utilize the LLC structure certainly benefit from the limited liability protections and tax options,

<sup>55</sup> “Table 64. Summary by Size of Farm,” *2012 Census of Agriculture – United States Data*, USDA NATIONAL AGRICULTURAL STATISTICS SERVICE, at 82 (2012).

<sup>56</sup> “Table 64. Summary by Size of Farm,” *2012 Census of Agriculture – United States Data*, USDA NATIONAL AGRICULTURAL STATISTICS SERVICE, at 82 (2012).

<sup>57</sup> “Table 58. Summary by Size of Farm,” *2007 Census of Agriculture – United States Data*, USDA NATIONAL AGRICULTURAL STATISTICS SERVICE, at 80 (2007).



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but the personal nature of the agriculture industry makes the estate and business transition planning potential just as important of a feature for many families.

Because of this, farms and agribusinesses appear destined to continue adopting the LLC structure. In the grand scheme of legal history, LLCs remain a new innovation. Yet enough time has passed for state legislatures, courts, and the Internal Revenue Service to provide sufficient clarity and certainty for LLC members and managers to know what to expect as they adopt the LLC structure.

While most states have not adopted a uniform law, all state LLC statutes possess similar principles, such as the centrality of the operating agreement. When forming an LLC, the members will want to take a close look at the laws of their state to understand the requirements of creating and operating an LLC, along with what default rules apply. By knowing the default rules, LLCs can choose to follow the default rules, or create a highly customized business entity that suits the needs of the farm or agribusiness. The LLC cannot cure all of a farm's troubles, but it can help mitigate liability risks, provide tax options, reduce administrative and paperwork burdens relative to a corporation, and keep the family farm in the family.



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