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# Limited Liability Companies: A New Tool for Small Agribusinesses?

A new form of business organization, the limited liability company (LLC), has joined the partnership, sole proprietorship, and corporation. In 1988 the Internal Revenue Service ruled to allow a Wyoming LLC. Since that time many states have followed suit, and by 1996 forty-nine states plus the District of Columbia allowed this new organizational form. (Hawaii does not yet allow LLCs.) The limited liability company is a legal entity that combines the tax advantages of partnerships and the limited liability advantages of corporations. Table 1 compares the LLC with the S corporation and a partnership.

## Tax implications

The Internal Revenue Service usually treats LLCs as a partnership for tax purposes. However, if an LLC is "too like" a corporation, it will be taxed as such. Advantages of being taxed like a partnership include no double-taxation, and partnership tax forms take less time to complete, on average, than corporation forms. In addition, there may be payroll tax advantages. Stockholders in a corporation who work in the business must pay themselves a just wage, including social security, federal unemployment, and other applicable payroll taxes. Owners of a partnership who work in the business may take draws from the business, paying self-employment tax (a much shorter and easier process than payroll taxes), or to pay themselves a wage with income taxes withheld and reported by the business.

To be treated as a partnership, the IRS ruling states that an LLC must contain no more than two of the following four characteristics:

*LLCs are well suited for start-up businesses and for small, closely held businesses, like many family-owned agribusinesses that may benefit from ability to retain control over management as well as have limited liability protection for investors.*

1. limited liability
2. continuity of life
3. free transferability of interests
4. centralized management

Generally, an LLC will have the corporate characteristic of limited liability, meaning it can have only one of the other three characteristics if it is to maintain its partnership taxation status.

An LLC will lack continuity of life if it dissolves upon loss of one member. Also, if prearranged in the operating agreement, if a majority in interest of the remaining members consent to continue, the LLC will lack continuity of life but will not necessarily dissolve upon loss of one member.

Federal regulations state that an LLC will possess free transferability of interest only if "members owning substantially all of the interests" in the entity have an unrestricted right to transfer their interests (Moon). Some states

require LLCs to include consent of all members to transfer any single member's interest, thus prohibiting the characteristic of free transferability.

Centralized management will exist if management authority is delegated to any group not consisting of all members (CCH Incorporated). If an LLC chooses to have the corporate characteristic of centralized management, it can designate certain members to be member-managers in the operating agreement, as often happens with a large number of owners. The possibility of centralized management gives LLC owners flexibility that is not available in other business structures. The owners may all participate in management, similar to general partners, but maintain their liability protection. Or, the owners may choose a subgroup of owners to operate the firm, as with a limited partnership or corporation.

## Converting an existing business to an LLC

Existing corporations may not find it advantageous to convert to an LLC. A corporation is not permitted to transfer property to another entity without incurring tax liability (Miller). Gains (losses) are recognized upon conversion, based on the fair market value of the corporate property. In addition, if an investor's basis has increased upon conversion, another tax liability may be incurred.

Partnerships, generally, can convert to LLCs as a tax-free conversion (Miller). This is similar to a partnership converting into a limited partnership through an amendment to the partnership agreement. This law has been applied to conversions of general



Table 1. Comparison of a limited liability company, an S corporation, and a partnership

	LLC	S Corporation	Partnership
Federal tax treatment	Pass-through taxation. File partnership income tax forms.	Exempt from corporate income tax. File corporate income tax forms.	Pass-through taxation. File partnership income tax forms.
Payroll taxes for owners	Can either take draws from company's profits, or pay a salary and payroll taxes.	Required if participating in management.	Can either take draws from company's profits, or pay a salary and payroll taxes.
Number of shareholders	Minimum of 2 in most states; no maximum.	No minimum; maximum of 35.	Minimum of 2; maximum of 500 in most states.
Foreign shareholders	Allowed.	Not allowed.	Allowed.
Limited liability protection	All owners.	All stockholders.	Only limited partners.
Ability to make management decisions	All owners.	All stockholders if employed.	Only general partners.
Default rule on capital contributions	Proportionally based on investments, unless otherwise stated in the written operating agreement.	Proportionally based on investment, and/or as noted in articles of incorporation.	Equally distributed, unless otherwise stated in a written partnership agreement.
Certainty of laws	New form of business; differs from state to state.	Established, consistent laws.	Established, consistent laws.

and limited partnerships into LLCs qualifying as partnerships (Schorr).

### Implications for agribusiness

LLCs are well suited for start-up businesses and for small, closely held businesses, like many family-owned agribusinesses that may benefit from ability to retain control over management as well as have limited liability protection for investors. For example, a catfish producer recently opened a small catfish processing plant in Mississippi. This businessman wanted to provide processing facilities for his and other producers' fish. As with most agribusinesses, this owner wanted limited liability protection against legal actions brought because of worker injury, distribution of contaminated fish, and so forth. An S corporation could be

used to achieve the limited liability status. However, with only one stockholder, forming an LLC avoids the time and money needed to retain an attorney to create corporation documents. In addition, future professional fees for accountants may be reduced because LLCs may file partnership income tax returns rather than the longer and more complex corporate returns.

Because it is new, the LLC receives different treatment in different states. However, with the quick adoption of this form of business by most states, these differences will likely smooth out over time. Meanwhile, agribusiness managers should be aware of the advantages this form of organization brings with respect to liability, management structure, transferability, and taxes. ☐

### ■ For more information

CCH Incorporated. *A Guide to Limited Liability Companies*, 3rd ed. G. Robert, A. Mandarino, and M. Cashin, eds. Chicago, 1996.

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