

## CHAPTER II: BUSINESS STRUCTURES

*Although the overwhelming majority of farms in Massachusetts are sole proprietorships, farmers can benefit from a discussion about how different business structures may accomplish their goals. Depending on which business structure farmers choose, farmers may be able to limit their liability, reduce their tax burden, transfer the business to the next generation more easily, and increase their ability to access larger markets through co-operative practices.*

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**OVERVIEW** This chapter is meant to assist attorneys advising farmers with the business formation of their farms. It provides an overview of the different types of business structures and evaluates them from the perspective of a small-scale farm business.

**1. Overview of Business Structures** This section introduces the attorney to some of the main issues facing farmers with regard to formalizing their businesses, including a discussion of how certain issues that farmers face are different from those faced by clients in other businesses.

**2. Prevalence of Farm Business Structures in Massachusetts and the United States** The section provides an overview of the prevalence of various farm business structures available in Massachusetts and the United States.

**3. Getting Context: Initial Questions to Ask the Farmer** This section highlights some questions an attorney should ask the farmer to understand the farmer's operation and to identify those issues that could be addressed by the choice of a particular business structure.

**4. Major Factors in Evaluating Different Business Structures** This section lists factors attorneys can use to evaluate the various business structures, including ease of formation and management, limiting liability, taxation, ease of transfer, life of entity, and ability to raise capital.

**5. Choosing a Business Structure** This section discusses the main business structures that farmers use, including sole proprietorships, partnerships, limited liability companies, corporations, and others. Each business structure is evaluated for its usefulness for farmers.

**OVERVIEW OF BUSINESS STRUCTURES** Attorneys often act as business advisors for their clients, counseling on and assisting in the formation of legal business structures that help those businesses thrive. Attorneys can play that same role with farmers. Farmers face similar issues to the attorney's more traditional business clients, including limiting liability and finding ways to facilitate business transfers. However, some farm issues differ from the attorney's traditional business clients' concerns.

For example, attorneys may be accustomed to working for clients whose income comes entirely from their business. In contrast, many farmers use non-farm income to financially support their farms and households. In the United States, a majority, 60.9%, of principal farm operators worked at least one day off the farm per year, and 39.9% of principal operators worked 200 days or more off the farm per year.<sup>1</sup> In

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<sup>1</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, U.S. DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_US/st99\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_US/st99_1_001_001.pdf).

Massachusetts, 50% of principal farm operators' primary occupation is not farming.<sup>2</sup> Even for those Massachusetts operators who reported their primary occupation as farming, 42% worked at least one day off-farm and 19.5% worked more than 200 days off-farm.<sup>3</sup>

Additionally, the economic profile of farmers in the Legal Food Hub (LFH) may not mirror the attorney's traditional clients. Nearly 85% of Massachusetts farms had gross annual sales of less than \$50,000.<sup>4</sup> Only 2.6% of Massachusetts farms grossed more than \$500,000.<sup>5</sup> LFH limits eligibility to farms with less than \$75,000 in gross annual sales, and annual household income below 400% of the federal poverty line. Therefore, the risks and costs of various business structures may have a different weight for LFH farmers.

Finally, certain farmers' personal assets may have more protection from business creditors than those of other clients. Farmers might have fewer purely personal assets since a farmer's personal assets, such vehicles and homes, may be used in the operation of the farm. To satisfy a farmer's creditors, a bankruptcy judge may avoid seizing those assets that the farmer needs in order to make a living. Furthermore, farmers have their own chapter of the bankruptcy code (Chapter 12, instead of Chapter 9 or Chapter 11), which provides farmers and their assets additional protection.<sup>6</sup>

Still, farmers have many reasons to formalize their business. First, formalized structures can help farmers transfer the farm to the next generation. For example, the business may be structured to allow multiple farm operators, which helps transfer knowledge and assets between generations. Also, if a farm has multiple

### **Risk Management on Farms**

Farmers have a variety of risk management tools to choose from, including certain formalized business structures. Commodity agricultural operations (those farms growing corn, soy, wheat, etc.) are eligible for an assortment of insurance options (often subsidized by the government), crop subsidies, and even disaster payments should the weather be especially bad in any given year. However, in Massachusetts, commodity crop operations are rare; less than 1% of farms report growing corn or wheat for grain. The majority of farms produce specialty crops (those growing fruits, vegetables, and nuts), and they largely do not have the same options available to them. There are some insurance programs for larger specialty crop operators; for the majority of smaller-scale specialty crop producers, however, government insurance, crop subsidies, and disaster payments are not tools they can use to manage their risk. Diversification of the farm operation (in terms of crops and market outlets) and smart business structure formation are important tools for these smaller-scale producers.

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<sup>2</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 69, 15 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_069\\_069.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_069_069.pdf).

<sup>3</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 69, 15 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_069\\_069.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_069_069.pdf).

<sup>4</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_001_001.pdf).

<sup>5</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_001_001.pdf).

<sup>6</sup> 11 U.S.C. § 1201 et seq. (2012).

operators, a formalized business structure can help order decision-making, compensation, and dissolution. Second, farmers may participate in a multi-farm endeavor and may wish to segregate various farms' assets. Third, farmers may use a variety of business structures to segregate assets within a single operation. For instance, farmers may be advised to hold land independently from the rest of their business. Additionally, farmers may engage in non-production activities, such as agri-tourism or processing, and may want to structure those higher-risk activities as separate businesses to limit tort liability.

## PREVALENCE OF FARM BUSINESS STRUCTURES IN MASSACHUSETTS

**AND THE UNITED STATES** Although the number of formally structured farms increased between 2007 and 2012, the vast majority (86.7%) of farms in the United States still operate as sole proprietorships.<sup>7</sup> Similarly, in Massachusetts 79.5% of farms operate as sole proprietorships.<sup>8</sup> Since 2002, the total number of farms using corporations, limited liability companies, or other structures (cooperative, estate, or trust) increased alongside a decline in the number of farms organized as partnerships.<sup>9</sup> Note, the 2012 Census of Agriculture categorized farms as individual, partnership, corporation, or other.<sup>10</sup> The charts below reflect those categories, though the Guide covers a wider range of structures.

**Figure 1. United States Farms by Legal Status<sup>11</sup>**

	2012	2007	2002
Total Number of Farms	2,109,303	2,204,792	2,128,982
Family or Individual (sole proprietorship)	1,828,946 (86.7%)	1,906,335 (86.5%)	1,909,598 (89.7%)
Partnership	137,987 (6.5%)	174,247 (7.9%)	129,593 (6.05%)
Corporations	106,746 (5.1%)	96,074 (4.3%)	73,752 (3.5%)
Other (co-operative, estate, or trust)	35,654 (1.7%)	28,136 (1.3%)	16,039 (0.75%)

<sup>7</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, U.S. DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_US/st99\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_US/st99_1_001_001.pdf).

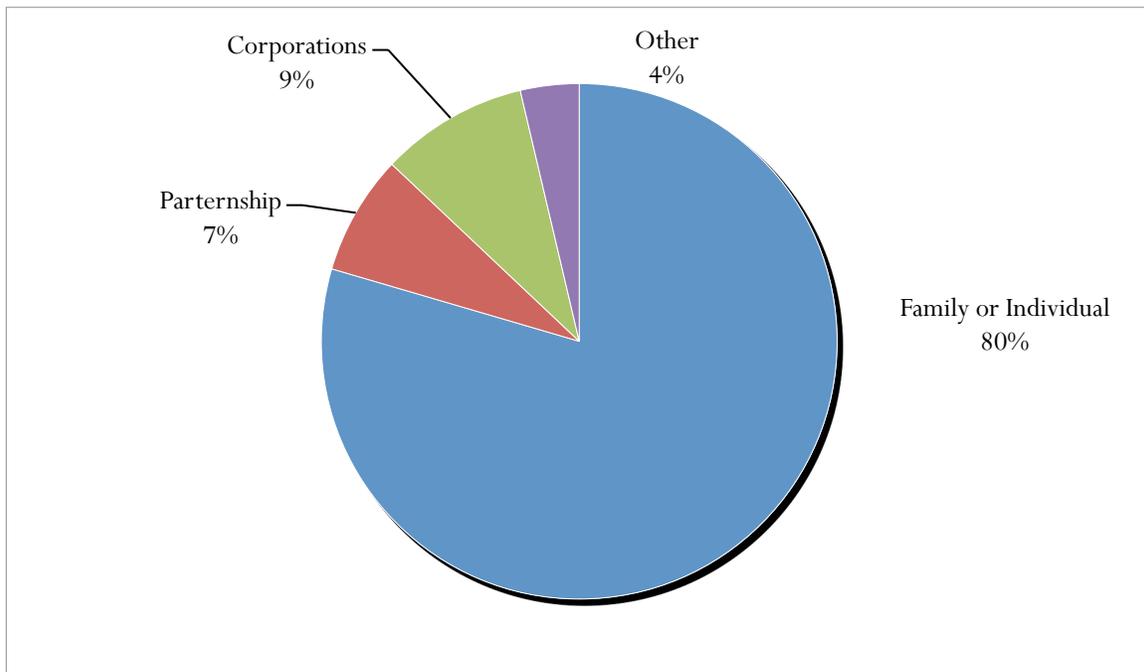
<sup>8</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_001_001.pdf).

<sup>9</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE U.S. DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_US/st99\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_US/st99_1_001_001.pdf); U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_001_001.pdf).

<sup>10</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, U.S. DATA TABLE 67 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_US/st99\\_1\\_067\\_067.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_US/st99_1_067_067.pdf)

<sup>11</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, U.S. DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_US/st99\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_US/st99_1_001_001.pdf).

**Figure 2. Massachusetts Farms by Legal Status in 2012<sup>12</sup>**



**GETTING CONTEXT: INITIAL QUESTIONS TO ASK THE FARMER** The attorney's first task when serving farmers will often be to identify the most useful business structures. To provide informed advice, an attorney must understand the current business operation, including goals, challenges, and liabilities. Farmers' priorities may vary, for instance: Is the farmer's goal to limit the farm's potential liability? Does the farmer want to reduce taxes? Or, would they like to expand the farm operation by selling to grocery stores or through a community support agriculture (CSA) operation? The attorney's questions and farmer's answers can serve two purposes. First, they increase the attorney's understanding. Second, they help the farmer identify and organize their operational priorities.

Attorneys should ask farmers questions about the following topics. Note these questions do not always directly relate to structure formation; however, they provide an opportunity for attorneys to learn about the farm's risks and opportunities, which will help inform the attorney's guidance.

- **Ownership and Management:** Who will be participating in the management of the farm operation? Who owns the farm business? Who might gain or lose farm ownership in the future?
- **Land:** Who owns the land? Are there any mortgages or liens on the land? Does anyone lease the land? What are the terms of the leases and mortgages? Does the farmer hope to purchase land in the future? Are there any easements or other preservation restrictions on the land?

<sup>12</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_001_001.pdf).

- **Employees:** Does the farmer have any employees? How many? Are the employees family members of the farmer? Does the farmer consider any of the people working on the farm to be interns, volunteers, or independent contractors?
- **Collaborative Practices:** Does the farmer collaborate with other farmers? For example, does the farmer store other farmers' produce on her farm? Does the farmer share equipment with other farmers?
- **Roadside Markets and Farmstands:** Does the farmer have, or hope to have, a roadside market or farmstand? Is the roadside market or farmstand located on property owned or controlled by the farmer? Is the farmer selling any goods he or she did not produce?
- **Wholesale Markets:** Does the farmer sell, or hope to sell, to wholesalers?
- **Value-Added Products:** Will the farmer sell products other than raw agricultural commodities (i.e., will she process them in some way)?
- **Farmers' Markets:** Does the farmer sell, or want to sell, at a farmers' market? What requirements does the farmers' market set? For instance, does the farmers' market require particular insurance?
- **Community Supported Agriculture:** Does the farmer have, or want to have, a CSA? If so, will members of the CSA pick up their shares on the farm, or off the farm? Will the CSA members ever come on the farm for a tour, for a gathering, and/or to do work around the farm?
- **Direct Sales to Restaurants and other Institutions:** Does the farmer sell, or want to sell, directly to restaurants or other institutions? Does the restaurant or institution require a certain level of insurance? Does the restaurant or institution request or require compliance with food safety standards? Does the farmer do any processing (minimal or otherwise) to the product she sells to the restaurant or institution?
- **Agri-Tourism and Other Forms of On-Farm Recreation:** Does the farmer engage in, or want to engage in, agri-tourism activities or other forms of on-farm recreation?
- **Pick-Your-Own:** Does the farmer have, or want to have, a pick-your-own operation; i.e., does the public come on to the farmer's land to engage in agricultural activities?
- **Permits:** What permits, if any, does the farm operation require? For example, a farmer's permits might include a commercial fishing permit,<sup>13</sup> or a milk dealer's license.<sup>14</sup>
- **Insurance:** What kind of insurance policy, if any, does the farmer hold? Does the insurance policy explicitly cover or exclude any activities that the farmer conducts (e.g., if the farmer allows members of the public to enter the farm)?
- **Other Professionals:** Does the farmer consult with any other business professionals, such as an accountant or tax preparer?

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<sup>13</sup> *Commercial Fishing Permit*, MASS. EXEC. OFFICE OF ENERGY & ENVTL. AFFAIRS, <http://www.mass.gov/eea/data/license/fish-game/marine-fisheries/commercial-fishing-permit.html> (last visited Jun. 19, 2014).

<sup>14</sup> *Milk Dealers License*, MASS. EXEC. OFFICE OF ENERGY & ENVTL. AFFAIRS, <http://www.mass.gov/eea/data/license/agricultural-resources/milk-dealers-license.html> (last visited Jun. 19, 2014).

- **Financing:** How does the farmer fund the farm? Have they received any grants or loans? Is the farmer interested in modifying or finding additional grants or loans?

## MAJOR FACTORS IN EVALUATING DIFFERENT BUSINESS STRUCTURES

Once the attorney has an idea of the goals and needs of the farmer, the attorney will be better able to assist the farmer in choosing the best business structure for the operation. When helping farmers decide which structure to choose, it is important to protect the farmer and her assets from unpredictable emergencies and unforeseen hardships.<sup>15</sup> The following section will familiarize the attorney with some factors that might motivate farmers to choose one business structure over another. This section assumes a basic understanding of the various business formation options.

Attorneys should advise farmers to consider the **ease of formation and management**. Farming can be very time intensive, especially for diversified and small-scale operations typical in Massachusetts. Additionally, farmers have different preferences for management and administration. Some farmers may have flexible schedules or business training and therefore lower administration costs. In other cases, management costs may make formation and upkeep of a formal business structure too expensive. Some business structures require fewer state and federal filings; others require organizational documents, registration, and on-going recordkeeping. The attorney and farmer should discuss administrative requirements, and highlight which requirements are on-going as opposed to one-time.

**Massachusetts General Laws**  
Partnerships: Ch. 108A  
Limited Liability Partnerships: Ch. 108A  
Limited Partnerships: Ch. 109  
Limited Liability Companies: Ch. 156C  
Business Corporations: Ch. 156, 156B, 156D  
“B” Corporations: Ch. 156E  
Co-operatives: Ch. 157  
Worker Co-operatives: Ch. 157A

Second, the attorney must consider how the entity will be **taxed**. Businesses can create or limit tax liability. A “pass-through” entity, such as a partnership or S-corporation, is not itself subject to taxation; instead, the entity’s owners are taxed on their share of the business income.<sup>16</sup> In contrast, “double-taxation” entities, mostly C-corporations, must pay taxes on the business’s profits, and then any profits distributed to owners are taxed as personal income.<sup>17</sup> Because farmers in the LFH must have gross sales of less than \$75,000, the formality costs may outweigh the corporate benefits.

Additionally, attorneys should help the farmer consider how to **limit liability**. Certain business structures limit the liability of some or all of the business’s owners, while others provide no protection. As with other businesses, there are many ways a farmer can incur liability; for example, the farmer could default on a

<sup>15</sup> See, e.g. *Natural Events and Disasters*, U.S. ENVTL. PROTECTION AGENCY, <http://www.epa.gov/oecaagct/tned.html> (last visited Jun. 17, 2014).

<sup>16</sup> Annette M. Higby, *A Legal Guide to the Business of Farming in Vermont*, UNIVERSITY OF VERMONT EXTENSION (2006), available at <http://www.uvm.edu/farmtransfer/LegalGuide.pdf>.

<sup>17</sup> Annette M. Higby, *A Legal Guide to the Business of Farming in Vermont*, UNIVERSITY OF VERMONT EXTENSION (2006), available at <http://www.uvm.edu/farmtransfer/LegalGuide.pdf>.

loan; an employee or visitor could be injured on the farm; or, a business partner could incur a debt tied to the farm business. The attorney should identify potential liabilities and assess whether to suggest a limited liability business structure. Other risk-management tools, such as insurance, may address the farmer's potential liabilities more cheaply. (See "Risk Management" text box).

Attorneys should also consider **ease of transfer** when discussing the business structure options with the farmer. Farmers may wish to keep the farm within the family or maintain ownership until much later in life; others may decide to transfer sooner, or to persons outside of the family. Customizable business structures can smooth complicated transfers and carry out a farmer's unique wishes.

Similarly, the **life of the entity** is an important factor to consider when selecting a business structure. The attorney and farmer should discuss whether the farm business will terminate once she retires, or whether the farm operation will continue beyond this farmer's term. Chapter IV of this Guide has more detail about farm transitions.

Finally, the attorney should help assess the importance of **outside investment**. Certain business structures facilitate investment, while others do not. If the farmer hopes to have non-operators financially support the farm, she might consider a business structure that allows for outside investment. For example, if the farm operates as a non-profit, it may attract funding because their investors may be able to deduct contributions to the farm from their taxable income.

After considering these many factors with the farmer, the attorney will have a better understanding of the farmer's needs and will only then be able to assist the farmer in choosing a business structure.

**CHOOSING A BUSINESS STRUCTURE** A farmer may choose from many structures when formalizing her business operation. This section discusses the main business structures available in Massachusetts that farmers would most likely utilize.

**Sole Proprietorships** A sole proprietorship is the simplest and most common business structure. It is an unincorporated business owned and run by one individual with no distinction between the business and the owner. The owner is entitled to all profits and is responsible for all the business's debts, losses, and liabilities.<sup>18</sup> Most Massachusetts farms, 79.5%, are sole proprietorships;<sup>19</sup> perhaps because sole proprietorships are the default business structure and do not

**Percentage of Farms Operated as Sole Proprietorships**

Massachusetts: 79.5%

Nationally: 86.7%

Source: 2012 Census of Agriculture

<sup>18</sup> *Sole Proprietorship*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/sole-proprietorship-0> (last visited Jun. 17, 2014).

<sup>19</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_001_001.pdf). The 2012 U.S. Census of Agriculture categorizes the "family or individual" designation as sole proprietorship, and excludes partnerships and corporations.

require any legal filings.

If the farmer wishes to avoid formal organization, attorneys should still advise their clients to choose a name for the business and register the farm business name with the Massachusetts Secretary of State.<sup>20</sup> This allows the farmer to ensure that the name is not already being used by another business and that other businesses cannot use the farm's name in the future.<sup>21</sup> Note, that if the farmer uses a business name other than their own, they must file a Doing Business As (DBA) certificate.

#### Pros for Farmers:

- **Ease of Formation and Management:** Any person who starts a farming business without organizing or filing will be considered a sole proprietor.<sup>22</sup> There are few legal filings the farmer must complete to begin operations, and there are no yearly filings or fee requirements.<sup>23</sup> The administration of a sole proprietorship requires very little time or effort from the farmer. Farmers may find this appealing because it allows them to focus on the activity of farming rather than business formalities.
- **Taxation:** The owner of a sole proprietorship reports the income from the business on her individual tax filings.<sup>24</sup> Because LFH farmers must make less than 400% of the federal poverty level, their tax rate will likely be low.

#### Cons for Farmers:

- **Limiting Liability:** A sole proprietorships is not distinct from its owner, so this business structure does not limit the owner's liability. Generally, a creditor of the business can force the owner to sell personal assets in order to pay the debts and obligations of the business.<sup>25</sup> However, because the farmer's personal assets and the farm assets may be the same, those shared-use assets may be unavailable to satisfy creditors during bankruptcy proceedings.
- **Life of Entity:** A sole proprietorship terminates when the owner passes away or sells the business assets.<sup>26</sup> Therefore, sole proprietorships may be undesirable for a farmer who wishes to keep the farm business intact after she passes away, especially if the farmer has multiple heirs or complex succession needs.

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<sup>20</sup> MASSACHUSETTS SECRETARY OF STATE, <http://www.sec.state.ma.us/>.

<sup>21</sup> *How to Name a Business*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/how-name-business> (last visited Jun. 17, 2014).

<sup>22</sup> LARRY D. SODERQUIST ET AL., *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES, MATERIALS, PROBLEMS* 39 (6th ed. 2005) (“[T]he legal identity of the sole proprietorship and its owner are one and the same...”).

<sup>23</sup> *Sole Proprietorships*, MASS. DEP'T OF REVENUE, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/sole-proprietorships.html> (last visited Jun. 17, 2014).

<sup>24</sup> *Sole Proprietorships*, MASS. DEP'T OF REVENUE, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/sole-proprietorships.html> (last visited Jun. 17, 2014).

<sup>25</sup> 1 *Advising Small Businesses* § 3:2 (2014).

<sup>26</sup> Harry J. Haynsworth, *Selecting the Form of a Small Business Entity* 3 (1985).

- **Outside Investment:** Sole proprietorships do not allow the business owner to raise capital by selling equity interests in the business.<sup>27</sup> Therefore, if the farmer is interested in obtaining outside investments, a sole proprietorship may not be the best option.
- **Ease of Transfer:** Because sole proprietors have total control over their farming operation, they will have full rights to transfer assets to another party.<sup>28</sup> However, a sole proprietorship, cannot, by definition, have more than one owner, a farm can only retain the sole proprietorship form if it is transferred to a single person. Additionally, because a sole proprietorship has no legal identity separate from its owner, it cannot be transferred as a business. Instead, each part of the farm business, such as land, structures, and equipment, must be conveyed. Transferring the business in this manner may increase the transaction costs, and limits the farmer’s ability to use creative methods of transfer, such as sharing between owner and successor.

**Partnerships** A partnership is a single business owned by two or more people. A partner’s contribution may consist of money, property, labor, and/or skill. In return for their contribution to the business, each partner shares in the profits and losses of the business.<sup>29</sup> About 7.5% of farms in Massachusetts are organized as partnerships.<sup>30</sup> Of the 563 farms that identify as partnerships, 388 (68.9%) are registered under Massachusetts law as limited partnerships and limited liability partnerships.<sup>31</sup>



***The General Partnership***

A general partnership is an association of two or more persons who combine their resources—money, labor, skills, and/or property—to conduct business for profit, expecting to share both profits and losses.<sup>32</sup> Because of the informality of some arrangements, farmers may be unknowingly operating as a partnership and doing so without having any formal paperwork, such as a partnership agreement.<sup>33</sup>

It is wise for farmers operating as a general partnership to write a partnership agreement.<sup>34</sup> The agreement should contain, at a minimum, the following:

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<sup>27</sup> *Sole Proprietorship*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/sole-proprietorship-0> (last visited Apr. 23, 2014).  
<sup>28</sup> *Transfer Ownership*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/transfer-ownership> (last visited Apr. 23, 2014).  
<sup>29</sup> *Partnership*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/partnership> (last visited Jun. 19, 2014).  
<sup>30</sup> U.S. DEP’T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 67 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_067\\_067.pdf/](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_067_067.pdf/).  
<sup>31</sup> U.S. DEP’T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 67 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_067\\_067.pdf/](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_067_067.pdf/); MASS. GEN. LAWS ch. 108A, §§ 6, 45 (2014); MASS. GEN. LAWS ch. 109 (2014).  
<sup>32</sup> MASS. GEN. LAWS ch. 108A § 6 (2014).  
<sup>33</sup> MASS. GEN. LAWS ch. 108A, § 7 (2014).  
<sup>34</sup> 1 Advising Small Businesses § 5:7 (2014).

- each partner’s ownership interest;
- how profits and losses are shared;
- any obligation to contribute additional capital;
- how management and control is shared among the partners and how decisions are made;
- the ability to incur debt or other liabilities for the partnership;
- restrictions on transferring partnership interests;
- how to accept new partners and how current partners can withdraw from the partnership; and,
- how and under what circumstances the partnership will terminate.

If no partnership agreement is written, then equal ownership and liability will be assumed.<sup>35</sup> Additionally, without a partnership agreement it will be difficult to wind down and terminate the partnership effectively.

When drawing up a partnership agreement, it is important to note that farms in the LFH network are unlikely to have high profit margins. This means that while it is important to decide how to divide profits, the attorney should focus more attention on the other sections of the partnership agreement, such as the contributions of each partner to the partnership, the division of responsibility for potential risks, the authority of the partners to act on behalf of the partnership, the division of management duties, and the resolution process for disputes.

### Gentleman’s Agreements

Sometimes farmers enter into “gentleman’s agreements” with neighbors or relatives to share in the profits from crops or to share some of the labor. Make sure to talk with the farmer about any gentleman’s agreements the farmer may have made to see if the farmer has unintentionally formed a partnership.

#### Pros for Farmers:

- **Ease of Formation and Management:** If there are two farmers operating one farm, chances are high that they are a general partnership. The ease of formation and maintenance of the business structure can be a positive for farmers.
- **Taxation:** Like a sole proprietorship, partnerships receive “pass-through” tax treatment.<sup>36</sup>
- **Raising Capital:** General partnerships allow for outside investments, because there is no limit on the number of partners. Outside individuals can simply invest and become a partner.<sup>37</sup> Note: this may require modifying the partnership agreement.

<sup>35</sup> MASS. GEN. LAWS ch. 108A § 6 (2014).

<sup>36</sup> *Partnerships*, MASS. DEP’T OF REVENUE, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/partnerships.html> (last visited Jun. 17, 2014).

<sup>37</sup> FOLEY HOAG LLP, *DOING BUSINESS IN MASSACHUSETTS 5* (Lex Mundi 2011), available at [www.lexmundi.com/Document.asp?DocID=3607](http://www.lexmundi.com/Document.asp?DocID=3607).

### Cons for Farmers:

- **Limited Liability:** General partnerships expose partners to both upside and downside risk. In other words, partners share in all business profits, but are also exposed individually to liability for business losses. All general partners are jointly and severally liable for all business obligations.<sup>38</sup> Creditors, and others, may sue any or all partners and recover from their personal assets.<sup>39</sup>
- **Ease of Transfer:** In Massachusetts, partnerships do not automatically terminate when a partner exits.<sup>40</sup> Absent a provision in the partnership agreement to the contrary, or without the consent of the other partners, partners can only grant an assignee their share of profits, and not the right to control or inspect the partnership.<sup>41</sup> Therefore, if the farmer plans on transferring control of the farm to relatives or another party, the farmer either should ensure that the partnership agreement clearly provides for transfer of control or should choose a different business structure.
- **Life of Entity:** Partnerships can set explicit conditions for their dissolution, and partners can agree to dissolve the entity at any time.
- **Raising Capital:** Joint and several liability may deter outside investment, because all investors will be exposed to the business's risks.<sup>42</sup> Additionally, farmers may not wish to use general partnerships to raise funds, because outside investors would gain the right to influence farm management.

### ***The Limited Partnership***

The limited partnership (LP) is similar to the general partnership in that there must be at least two owners.<sup>43</sup> In an LP, at least one of the owners must be a “general” partner and while the others may be “limited” partners.<sup>44</sup> The general partners control business management and operation and remain liable for all business obligations.<sup>45</sup> The limited partners, on the other hand, enjoy a limitation on liability but may not participate in the management or operation of the LP.<sup>46</sup> An LP must file a certificate of limited partnership with the state.<sup>47</sup> As with a general partnership, farmers in an LP should also draft a partnership agreement addressing the issues discussed above.

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<sup>38</sup> MASS. GEN. LAWS ch. 108A, § 15 (2014).

<sup>39</sup> MASS. GEN. LAWS ch. 108A, § 28 (2014).

<sup>40</sup> “A conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership.” MASS. GEN. LAWS ch. 108A, § 27 (2014).

<sup>41</sup> “[I]t merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled.” MASS. GEN. LAWS ch. 108A, § 27 (2014).

<sup>42</sup> See Annette M. Higby, *A Legal Guide to the Business of Farming in Vermont*, UNIVERSITY OF VERMONT EXTENSION (2006), available at <http://www.uvm.edu/farmtransfer/LegalGuide.pdf>.

<sup>43</sup> MASS. GEN. LAWS ch. 109, § 1 (2014).

<sup>44</sup> MASS. GEN. LAWS ch. 109, § 1 (2014).

<sup>45</sup> MASS. GEN. LAWS ch. 109, § 24 (2014).

<sup>46</sup> MASS. GEN. LAWS ch. 109, § 19 (2014).

<sup>47</sup> MASS. GEN. LAWS ch. 109, § 8 (2014).

### Pros for Farmers:

- **Taxation:** Partners pay income tax on any profits received from the limited partnership.<sup>48</sup> However, partnerships may elect to not distribute excess cash to the partners and instead reinvest those profits in the business.
- **Limited Liability:** LPs protect limited partners' personal assets from business liabilities, but prohibit them from managing the day-to-day business operations.<sup>49</sup> This could be a benefit for a farmer who wants multiple investors, but wants to retain management and control over the farm for herself.
- **Ease of Transfer:** Unless otherwise provided in the partnership agreement, an LP can be consolidated or merged with another business entity as long as all general and limited partners approve.<sup>50</sup> Additionally, individual partnership interests may be transferred subject to limitations in the partnership agreement.<sup>51</sup>
- **Life of Entity:** Farmers can have substantial control over the LP's end by including termination conditions in the partnership agreement.<sup>52</sup>
- **Raising Capital:** Unlike general partnerships, investors can provide capital without incurring any liability by becoming limited partners.<sup>53</sup> This is good for investors who do not wish to manage the farm and want limited liability.

### Cons for Farmers:

- **Limited Liability:** General partners remain personally liable for any and all actions the partnership takes.<sup>54</sup>

### ***The Limited Liability Partnership***

The limited liability partnership (LLP) limits the personal liabilities of the entity's partners, which minimizes the risks to partners' personal assets.<sup>55</sup> To form an LLP, the partnership must file documents with the state and pay an initial fee.<sup>56</sup> LLPs must also file annual reports and pay an annual fee.<sup>57</sup>

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<sup>48</sup> *Partnerships*, MASS. DEP'T OF REVENUE, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/partnerships.html> (last visited Jun. 17, 2014).

<sup>49</sup> MASS. GEN. LAWS ch. 109, § 19 (2014).

<sup>50</sup> MASS. GEN. LAWS ch. 109, § 16A (2014).

<sup>51</sup> MASS. GEN. LAWS ch. 109, § 40 (2014).

<sup>52</sup> MASS. GEN. LAWS ch. 109, § 44 (2014).

<sup>53</sup> MASS. GEN. LAWS ch. 109, § 19 (2014).

<sup>54</sup> MASS. GEN. LAWS ch. 109, § 24 (2014).

<sup>55</sup> MASS. GEN. LAWS ch. 108A, §15 (2014).

<sup>56</sup> MASS. GEN. LAWS ch. 108A, § 45 (2014).

<sup>57</sup> MASS. GEN. LAWS ch. 108A, § 45 (2014).

### Pros for Farmers:

- **Taxation:** An LLP with at least two members will be treated as either a partnership or corporation for Massachusetts income tax purposes, depending on the entity's federal treatment.<sup>58</sup> Partners report income from the LLP on their personal income taxes.
- **Limited Liability:** All of the partners are protected from the LLP's liabilities, except in the case of a partner's own negligence.<sup>59</sup> This protection extends to all partners, even those involved in farm management.
- **Raising Capital:** LLPs are able to accept investments from outside investors. As in a general partnership, any persons carrying on a business and sharing in the profits and losses will be considered partners. Thus, upon investment, the investor becomes a partner. In an LLP, the investor becomes a partner with authority over the management of the farm. The LLP could be attractive to investors who are interested in farm management and want limited liability.
- **Life of Entity:** Partnerships can set explicit conditions for their dissolution, and partners can agree to dissolve the entity at any time.

### Cons for Farmers:

- **Ease of Formation and Management:** There are several formal steps and fees required to form and maintain an LLP.<sup>60</sup> These requirements may deter a farmer from choosing to form an LLP.

**Limited Liability Companies** A limited liability company (LLC) is a hybrid type of legal structure that provides the limited liability features of a corporation and operational flexibility of a partnership.<sup>61</sup> LLCs are popular business structures among farmers because they do not require as many formal requirements as certain other business entities and are very flexible.<sup>62</sup> By default LLCs are owned by members; members also act as managers of the LLC.<sup>63</sup> The operating agreement may establish one or more managers, in which case some members may not have a role in managing the LLC.<sup>64</sup>

#### Percentage of Farms Operated as Limited Liability Companies

Massachusetts: 6.1%

Nationally: 4.8%

Source: 2012 Census of Agriculture

<sup>58</sup> *Limited Liability Companies and Limited Liability Partnerships*, MASS. DEP'T OF REVENUE, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/limited-liability-companies-and-limited.html> (last visited June 19, 2014).

<sup>59</sup> *Limited Liability Companies and Limited Liability Partnerships*, MASS. DEP'T OF REVENUE, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/limited-liability-companies-and-limited.html> (last visited June 19, 2014).

<sup>60</sup> MASS. GEN. LAWS ch. 108A, § 45 (2014).

<sup>61</sup> *Limited Liability Company*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/limited-liability-company-llc> (last visited Jun. 14, 2014).

<sup>62</sup> 1 *Advising Small Businesses* § 7:1 (2014).

<sup>63</sup> MASS. GEN. LAWS ch. 156C, § 2 (2014).

<sup>64</sup> MASS. GEN. LAWS ch. 156C, § 24 (2014).

## Pros for Farmers:

- **Ease of Formation and Management:** Although there are some steps a farmer must take to maintain an LLC, they are less onerous than other business structure filing requirements, notably those for corporations. To form an LLC, the farmer must file a certificate of organization with the state.<sup>65</sup> The farmer should also create an operating agreement, which details how the LLC is to be governed and provides other organizational detail.<sup>66</sup>
- **Taxation:** LLCs may elect pass-through or double taxation. This customization allows members to select an optimal tax treatment. However, for those LLCs with a single member, the member must account for all profits and losses on his or her individual income taxes.<sup>67</sup> For LLCs with multiple members, the profits and losses are generally allocated based on proportional ownership, but may be allocated differently.<sup>68</sup>
- **Limited Liability:** Provided that the separateness and formalities of the LLC are respected, LLCs provide a limitation on liability for all members with respect to the debts and liabilities of the LLC.<sup>69</sup> This can be attractive to farmers who want to be able to exercise control over the management of the farm as well as protect themselves from liability.
- **Ease of Transfer:** LLCs allow for the transfer of interests in the LLC to other parties, including the assignment of a member or manager's interests to another party, unless otherwise provided in the operating agreement.<sup>70</sup> LLCs are good for farmers who want to transfer the farm business between generations or between owners, because LLCs allow for flexible operating agreements to accommodate various transfer situations.
- **Raising Capital:** LLCs are a good type of business entity if the farmer is interested in obtaining outside investments since there can be a number of different classes of members or managers.<sup>71</sup> By using an LLC rather than a corporation, a farm business can more flexibly structure investor relationships.<sup>72</sup>
- **Other:**
  - **Multiple Business Ventures:** LLCs are good for farmers forming a multi-farm CSA because it allows multiple partners to share farm management and limit their liability. Similarly, an LLC may be a good option for farmers who have different business ventures and want to keep them separate. For example, if the farmer hosts a fall festival that includes hayrides, the farmer may want to use an LLC for the agricultural operation and a separate LLC for the festival operation.

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<sup>65</sup> MASS. GEN. LAWS ch. 156C, §12 (2014).

<sup>66</sup> 1 Advising Small Businesses § 7:15 (2014).

<sup>67</sup> 1 Advising Small Businesses § 7:5 (2014).

<sup>68</sup> 1 Advising Small Businesses § 7:35 (2014)

<sup>69</sup> 1 Advising Small Businesses § 7:15 (2014).

<sup>70</sup> MASS. GEN. LAWS ch. 156C, § 439 (2014).

<sup>71</sup> FOLEY HOAG LLP, DOING BUSINESS IN MASSACHUSETTS 8 (Lex Mundi 2011), *available at* [www.lexmundi.com/Document.asp?DocID=3607](http://www.lexmundi.com/Document.asp?DocID=3607).

<sup>72</sup> FOLEY HOAG LLP, DOING BUSINESS IN MASSACHUSETTS 8 (Lex Mundi 2011), *available at* [www.lexmundi.com/Document.asp?DocID=3607](http://www.lexmundi.com/Document.asp?DocID=3607).

- **Higher-Risk Activities:** Farms that engage in higher-risk activities, such as fermenters, value-added operations, and agri-tourism, can separate LLCs for those operations to protect the rest of their operation.
- **Weighted Voting:** LLCs may be customized for farmers who want to use the “one member, one vote” co-operative principle, while encouraging investments from members and managers. However, this does not make the LLC a formal co-operative, which are described more below. LLCs allow farmers to assign weight to votes differently on various topics, for example, using “one member, one vote” for operational decisions, and votes weighted by investment for any land sale.

Cons for Farmers:

- **Life of Entity:** Termination of an LLC can sometimes be difficult depending on the language contained in the operating agreement.<sup>73</sup> Therefore, the LLC operating agreement should specify a time or an event that will trigger dissolution.<sup>74</sup>
- **Other:**
  - **Fees:** Flat fees may be problematic for LFH farmers with low gross income.
  - **Paperwork:** An LLC is also not a good option for farmers who prefer not to bear any paperwork or reporting burdens. One downside to the flexibility of the LLC is that the operating agreement tends to be more complex than the organizational documentation for a corporation.
  - **Personal Guarantee:** Some creditors may require farmers to personally guarantee their debts, regardless of the structure of their business, nullifying protection from liability.

**Percentage of Farms Operated as Corporations**

Massachusetts: 9.3%  
Nationally: 5%

Source: 2012 Census of Agriculture

**Corporations** A corporation is an independent legal entity owned by shareholders. This means that the corporation itself, not the shareholders that own it, is legally responsible for the actions of the business and debts it incurs.<sup>75</sup> There are 719 farms in Massachusetts that identify as corporations.<sup>76</sup> Of those corporate farms, 578 identify as being family held (over 98% of which have ten or less stockholders).<sup>77</sup> Nearly all of the farms that are not family-held corporate farms also have ten or fewer

<sup>73</sup> MASS. GEN. LAWS ch. 156C, § 43 (2014).

<sup>74</sup> MASS. GEN. LAWS ch. 156C, § 43 (2014).

<sup>75</sup> *S-Corporation*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/s-corporation> (last visited Jun. 19, 2014).

<sup>76</sup> U.S. DEP’T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 67 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_067\\_067.pdf/](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_067_067.pdf/).

<sup>77</sup> U.S. DEP’T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 67 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_067\\_067.pdf/](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_067_067.pdf/).

stockholders.<sup>78</sup> In Massachusetts, a farm can organize as a C-corporation, an S-corporation, or a B-corporation. This section only provides a very basic overview of S- and C-corporations, because participating attorneys are likely familiar with corporate law and LFH farmers are unlikely to form as a corporation.

### ***S- and C-Corporations***

The S-corporation is more commonly used among farmers in the Midwest.<sup>79</sup> Farmers used S-corporations to limit liability and transfer the farm between generations before LLCs were available.<sup>80</sup> S-corporations are used by farmers more often than C-corporations, perhaps because of their pass-through tax status.

To form a corporation in Massachusetts the farm must prepare and file Articles of Organization.<sup>81</sup> Then the shareholders must elect to become an S- or C-corporation.<sup>82</sup> In Massachusetts, all S-corporations must pay an initial filing fee and annual fee and, as of the publication of this guide, a minimum of \$456 in corporate tax, regardless of the business' profitability.<sup>83</sup> Additionally, in an S-corporation all shareholders must be natural persons and citizens of the United States.<sup>84</sup>

#### Pros for Farmers:

- **Limited Liability:** Shareholders are protected from the liabilities and debts of the corporation, so long as the corporation maintains business formalities such as periodic meetings of the board of directors and careful recordkeeping.<sup>85</sup>
- **Ease of Transfer:** Corporations can be transferred to other owners if the Articles of Organization and bylaws allow.<sup>86</sup>
- **Life of Entity:** Corporations can survive beyond the life of the shareholders; a corporation is terminated by shareholder vote or judicial action.<sup>87</sup>
- **Raising Capital:** Corporations are useful tools for raising funds because they may receive outside investment in exchange for equity or debt.

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<sup>78</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MASSACHUSETTS STATE DATA TABLE 67 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Massachusetts/st25\\_1\\_067\\_067.pdf/](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Massachusetts/st25_1_067_067.pdf/).

<sup>79</sup> Phone Interview with Rachel Armstrong, Executive Director, Farm Commons, May 27, 2014 (on file with author).

<sup>80</sup> Phone Interview with Rachel Armstrong, Executive Director, Farm Commons, May 27, 2014 (on file with author).

<sup>81</sup> *S-Corporation*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/s-corporation> (last visited Jun. 19, 2014)

<sup>82</sup> 26 U.S.C. § 1362 (2012).

<sup>83</sup> *S Corporations*, MASS DEP'T. OF REVENUE, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/corporations/s-corporations.html> (last visited Jun. 17, 2014).

<sup>84</sup> 26 U.S.C. § 1361 (2012).

<sup>85</sup> *S-Corporation*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/s-corporation> (last visited Jun. 19, 2014).

<sup>86</sup> MASS. GEN. LAWS ch. 156D, § 6.27 (2014).

<sup>87</sup> 26 U.S.C. § 1362(d) (2012).

### Cons for Farmers:

- **Ease of Formation and Management:** There are numerous formalities required to form a corporation. For example, the S-corporation must have a board of directors,<sup>88</sup> hold at least one annual shareholder meeting,<sup>89</sup> and keep a distinct business bank account.<sup>90</sup> Other restrictions apply to corporations, including detailed recordkeeping requirements. These corporate formalities may differ from the farmer's current practices, and the costs of compliance will differ based on the farmer's needs, preferences, and business administration skills.
- **Taxation:** In Massachusetts, as of the publication of this guide, S-corporations owe a minimum of \$456 in corporate taxes each year regardless of their profitability, which may be too high a fee for farmers participating in the LFH.<sup>91</sup>

### ***The B-Corporation***

Benefit corporations, or B-corporations, combine elements of for-profit and non-profit corporations. They have the public benefit focus of a non-profit, but are permitted to distribute profits to shareholders. B-corporations are relatively new to Massachusetts; corporations were able to elect benefit corporation status beginning in December 2012.<sup>92</sup>

Unlike S- and C- corporations B-corporations are not required to focus solely on maximizing profits. Instead, a B-corporation may pursue general or specific public benefits.<sup>93</sup> In Massachusetts, a “general public benefit” materially and positively impacts society and the environment.<sup>94</sup> This standard takes the corporate actions as a whole and uses a neutral, third-party standard to evaluate the business and operations of a benefit corporation.<sup>95</sup> A “specific public benefit” includes any particular benefit on society or the environment including:

- providing low-income or underserved individuals and communities with beneficial products or services;
- promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
- promoting the preservation and conservation of the environment; and,
- improving human health.<sup>96</sup>

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<sup>88</sup> MASS. GEN. LAWS ch. 156, § 21 (2014).

<sup>89</sup> MASS. GEN. LAWS ch. 156, § 7.01 (2014).

<sup>90</sup> *Corporation Basics*, NOLO.COM, <http://www.nolo.com/legal-encyclopedia/corporation-basics-29867.html>.

<sup>91</sup> *S Corporations*, MASS. DEP'T OF REVENUE, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/corporations/s-corporations.html> (last visited Apr. 25, 2014).

<sup>92</sup> Sharon C. Lincoln & Adrienne M. Ellman, *Benefit Corporations Have Arrived in Massachusetts*, BOSTON BAR ASSOCIATION, Jan. 11, 2013, available at <http://www.bostonbar.org/sections/business-transactions/business-transactions-newsletter/2013/01/11/benefit-corporations-have-arrived-in-massachusetts>.

<sup>93</sup> MASS. GEN. LAWS ch. 156E, § 9 (2014).

<sup>94</sup> MASS. GEN. LAWS ch. 156E, § 9 (2014).

<sup>95</sup> MASS. GEN. LAWS ch. 156E, § 2 (2014).

<sup>96</sup> MASS. GEN. LAWS ch. 156E, § 2 (2014).

When making a decision for the B-corporation, the directors of a B-corporation must consider the decision's effect on

- shareholders;
- employees and workforce;
- customers and clients;
- society and the local community;
- the local, regional, and global environment;
- the short- and long-term interests of the B-corporation; and,
- the B-corporation's general or specific public benefit purpose.<sup>97</sup>

B-corporations are subject to the Massachusetts laws governing traditional corporations.<sup>98</sup> In addition to an annual report, B-corporations must pay a \$75 fee<sup>99</sup> and file an annual benefit report that assesses the B-corporation's public benefit accomplishments.<sup>100</sup>

This business structure may be appealing to certain farmers who wish to ensure long-term accountability for a social or environmental mission. For example, Cabot Creamery Cooperative in Vermont operates as a B-corporation.<sup>101</sup> Twelve-hundred farmers own Cabot, and almost half are located in low-income communities.<sup>102</sup> They fill over half of their open positions through internal promotions, and offer health, wellness, and counseling services to their employees.<sup>103</sup> Finally, Cabot sets specific energy reduction targets and studies the life cycle impacts of well over half of its products.<sup>104</sup> Cabot is not the only B-corporation farm; Epiphany Farms Enterprise Inc. (EFE) in Bloomington, Illinois also operates as a B-corporation.<sup>105</sup> EFE uses harvested rainwater to irrigate crops, donates to charity, and purchases many supplies from local businesses.<sup>106</sup> Although there are not yet any B-corporation farms in Massachusetts, this is an option that attorneys may want to discuss with the farmer.

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<sup>97</sup> MASS. GEN. LAWS ch. 156E, § 10 (2014).

<sup>98</sup> MASS. GEN. LAWS ch. 156A (2014); MASS. GEN. LAWS ch. 156D (2014).

<sup>99</sup> Massachusetts Secretary of State, Memorandum: New Legislation, Massachusetts General Laws Chapter 156E, Effective December 1, 2012, <http://www.sec.state.ma.us/cor/corpdf/Notice%20regarding%20Benefit%20Corporations.pdf>.

<sup>100</sup> MASS. GEN. LAWS ch. 156E, § 15 (2014).

<sup>101</sup> *Cabot Creamery Cooperative*, CERTIFIED B CORPORATION, <http://www.bcorporation.net/community/cabot-creamery-cooperative>.

<sup>102</sup> *Cabot Creamery Cooperative*, CERTIFIED B CORPORATION, <http://www.bcorporation.net/community/cabot-creamery-cooperative>.

<sup>103</sup> *Cabot Creamery Cooperative*, CERTIFIED B CORPORATION, <http://www.bcorporation.net/community/cabot-creamery-cooperative>.

<sup>104</sup> *Cabot Creamery Cooperative*, CERTIFIED B CORPORATION, <http://www.bcorporation.net/community/cabot-creamery-cooperative>.

<sup>105</sup> *Epiphany Farms Enterprise Inc.*, CERTIFIED B CORPORATION, <http://www.bcorporation.net/community/epiphany-farms-enterprise-inc>.

<sup>106</sup> *Epiphany Farms Enterprise Inc.*, CERTIFIED B CORPORATION, <http://www.bcorporation.net/community/epiphany-farms-enterprise-inc>.

### Pros for Farmers:

- **Taxation:** B-corporations are organized as corporations, and are taxed as such. B-corporations can elect to be taxed as S-corporations to receive the pass-through benefits of S-corporations.
- **Limited Liability:** Shareholders are protected from liability in a B-corporation as they would be in a traditional corporation.
- **Ease of Transfer:** Management and ownership of the B-corporation is easily transferred, as with traditional corporations.
- **Life of Entity:** A B-corporation can survive beyond the life of the shareholders; a B-corporation is terminated by shareholder vote or judicial action.
- **Raising Capital:** B-corporations are subject to the same laws as traditional corporations, and so may receive similar kinds of outside investment.
- **Other:** B-corporation status helps farmers raise capital while maintaining environmental or social purposes. Additionally B-corporations may provide a marketing benefit as the distinction creates credibility for consumers.

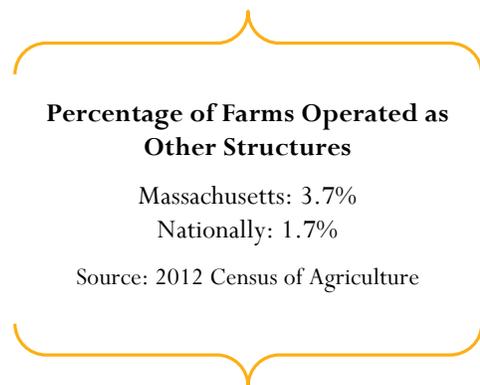
### Cons for Farmers:

- **Ease of Formation and Management:** As with other corporate structures, this structure may impose too high costs on the farmer. There are numerous filings and administrative requirements associated with B-corporation status. An existing corporation may elect to become a B-corporation by amending the corporation's Articles of Organization.<sup>107</sup> In addition to the requirements for traditional corporations, B-corporations must file an annual benefit report, with a \$75 fee, and must select a "benefit director" to prepare an annual shareholders report focused on the B-corporation's progress on its public benefit purpose.<sup>108</sup>

**Other Types of Business Structures** Farms may also seek non-profit or co-operative status. Each of these is described below.

#### ***Non-Profits***

Some farmers may consider pursuing non-profit status. Non-profit status can provide some major benefits to farmers, including tax-exemption and the ability to receive charitable donations. However, it may be difficult for farmers to qualify as a non-profit. To qualify as a non-profit, the farm's primary purpose must be educational or charitable.<sup>109</sup> The Internal Revenue Service (IRS) requires that organizing documents, such as Articles of Incorporation, articulate the organization's exempt purpose and



<sup>107</sup> MASS. GEN. LAWS ch. 156E, § 5 (2014).

<sup>108</sup> MASS. GEN. LAWS ch. 156E, § 11 (2014).

<sup>109</sup> 26 C.F.R. § 1.501(C)(3)-1(C)(1) (2014).

permanently dedicate the organization's assets to the exempt purpose.<sup>110</sup> The organization must petition the IRS and, as of Jan. 3, 2010, pay an \$850 fee for 501(c)(3) status.<sup>111</sup>

The Food Project is an example of a non-profit farm that operates in Boston. The mission of The Food Project is

...to create a thoughtful and productive community of youth and adults from diverse backgrounds who work together to build a sustainable food system. Our community produces healthy food for residents of the city and suburbs, provides youth leadership opportunities, and inspires and supports others to create change in their own communities.<sup>112</sup>

The Food Project has over forty acres of farmland in greater Boston and on the North Shore; they donate their produce to hunger relief organizations and sell their produce at farmers markets and through a CSA.<sup>113</sup> Although The Food Project grows and sells produce, their mission is educational; they work with teenagers and other volunteers to teach them about farming and the food system.<sup>114</sup> Because The Food Project produces food primarily to educate and end hunger, rather than to provide shareholders with profits, non-profit status makes sense. However, non-profit status is not appropriate for farms organized to produce profits.

#### Pros for Farmers:

- **Taxation:** All non-profits must file IRS Form 990, but are not usually required to pay federal income tax.<sup>115</sup> Officers must still pay personal income tax on their salaries, and the business must pay taxes on profits from non-exempt activities.<sup>116</sup>
- **Raising Capital:** Non-profits are permitted to receive tax-deductible charitable donations.<sup>117</sup> Further, operating under 501(c)(3) status allows a non-profit to apply for grants or receive funding from foundations or other grant-making institutions, as well as state and federal funding.<sup>118</sup>
- **Life of Entity:** Non-profit status will continue as long as organization pursues exempt purposes and follows formal reporting requirements, or until it formally notifies the IRS.

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<sup>110</sup> Form 1023, INTERNAL REVENUE SERVICE, available at <http://www.irs.gov/pub/irs-pdf/f1023.pdf>.

<sup>111</sup> Form 1023, INTERNAL REVENUE SERVICE, available at <http://www.irs.gov/pub/irs-pdf/f1023.pdf> (note: the fee is only \$400 if the organization's gross receipts did not exceed \$10,000 over the past four years).

<sup>112</sup> *Mission and Vision*, THE FOOD PROJECT, <http://thefoodproject.org/mission-and-vision>.

<sup>113</sup> *Our Farms*, THE FOOD PROJECT, <http://thefoodproject.org/our-farms>.

<sup>114</sup> *What We Do*, THE FOOD PROJECT, <http://thefoodproject.org/what-we-do>.

<sup>115</sup> INTERNAL REVENUE SERVICE, APPLYING FOR 501(C)(3) TAX-EXEMPT STATUS 2 (n.d.), available at <http://www.irs.gov/pub/irs-pdf/p4220.pdf>.

<sup>116</sup> 26 U.S.C. § 511(2012).

<sup>117</sup> INTERNAL REVENUE SERVICE, APPLYING FOR 501(C)(3) TAX-EXEMPT STATUS 2 (n.d.), available at <http://www.irs.gov/pub/irs-pdf/p4220.pdf>.

<sup>118</sup> INTERNAL REVENUE SERVICE, APPLYING FOR 501(C)(3) TAX-EXEMPT STATUS 2 (n.d.), available at <http://www.irs.gov/pub/irs-pdf/p4220.pdf>.

- **Ease of Transfer:** Once the non-profit is formed, it can be easily transferred from one operator to another. The farmer could be the executive director, or could be on staff as the farm manager.

Cons for Farmers:

- **Ease of Formation and Management:** There are a number of requirements to form and maintain a non-profit. The farmer must prove to the IRS that the farm operation satisfies the criteria for a 501(c)(3), must refrain from certain prohibited activities (particularly political or lobbying activities, and operating for the benefit of private interests), and must comply with recordkeeping, annual filing, and other disclosure requirements.<sup>119</sup>
- **Limit on Profit:** If a farmer wants to operate as a non-profit, the farm cannot be operated for the benefit of private interests (such as the founder or shareholders); instead, all profits and assets must be permanently dedicated to the exempt purposes and mission of the organization.<sup>120</sup>

**Co-operatives**

Co-operatives are an increasingly popular form of business structure among farmers and food producers in the local and regional food economy. Unlike a corporation, co-operatives must further members' goals and meet their needs.<sup>121</sup> These needs and goals depend on the type of member; in the agricultural sector, members can be producers, purchasers, or workers. A producer co-operative might use the co-operative to market and distribute the members' produce. For example, co-operation might help small farmers that want to sell to larger institutions, but cannot meet the demand alone. Similarly, dairy co-operatives help farmers share otherwise prohibitively expensive equipment, marketing, and distribution costs. This kind of purchasing co-operative allows farmers to purchase supplies or equipment together, which can lead to bulk discounts or useful sharing. In a worker co-operative, employees own and govern the business together, This might be a good option for a farmer that wants to give her employees an incentive to stay working on that particular farm, retaining their skills and experience over time. Producer and purchasing co-operatives are similar to one another in formation and structure. Worker co-operatives operate under a distinct set of laws. For this reason, the rest of the section is divided into two subparts addressing the two categories of co-operatives.

“[The] three primary operational characteristics of a co-operative [are]: **user ownership, user control, and proportional distribution** of surplus based on a member’s use of the enterprise.”

Source: New England Farmers Union, *Growing A Food System for the Future: A Manual for Co-operative Enterprise Development 2* (2014).

<sup>119</sup> INTERNAL REVENUE SERVICE, APPLYING FOR 501(C)(3) TAX-EXEMPT STATUS (n.d.), available at <http://www.irs.gov/pub/irs-pdf/p4220.pdf>.

<sup>120</sup> INTERNAL REVENUE SERVICE, APPLYING FOR 501(C)(3) TAX-EXEMPT STATUS 3 (n.d.), available at <http://www.irs.gov/pub/irs-pdf/p4220.pdf>.

<sup>121</sup> NEW ENGLAND FARMERS UNION, *GROWING A FOOD SYSTEM FOR THE FUTURE: A MANUAL FOR CO-OPERATIVE ENTERPRISE DEVELOPMENT 1* (2014), available at [http://www.newenglandfarmersunion.org/pdfs\\_docs/NEFU\\_Co-opManualFINALweb.pdf](http://www.newenglandfarmersunion.org/pdfs_docs/NEFU_Co-opManualFINALweb.pdf).

Note that although some of the benefits of co-operatives can be achieved through other business structures, such as LLCs or non-profits, co-operatives are unique structures. If a client calls her organization a co-operative, it must follow the co-operative statute, or risk a \$10 daily fine.<sup>122</sup> As interest in co-operatives has grown, there is more focus on protecting the term “co-operative” and ensuring that only co-operatives organized as such use the name.<sup>123</sup>

### Producer or Purchasing Co-operatives

Under Massachusetts law, co-operatives are organized under traditional state corporation laws.<sup>124</sup> Seven or more members are required to form an agricultural co-operative.<sup>125</sup> All of these members must be Massachusetts residents.<sup>126</sup> Generally, co-operative members purchase common stock to raise capital.<sup>127</sup> However, Massachusetts does not require agricultural co-operatives to have capital stock.<sup>128</sup>

In order to be an agricultural co-operative, the organization must file Articles of Organization with the Massachusetts Secretary of State and pay a filing fee.<sup>129</sup> Within six months of filing, a co-operative must have its first meeting and must select a board of directors.<sup>130</sup> The agricultural co-operative’s by-laws must specify how voting will occur, and usually co-operatives give each member one vote.<sup>131</sup> However, in Massachusetts, voting power may be allocated based on the amount of land leased or used by the members for production for the co-operative, or by the proportion of product produced by each member in the preceding year.<sup>132</sup>

The co-operative must distribute earnings and profits to its members at least once a year.<sup>133</sup> However, in Massachusetts, a co-operative must reserve 10% of profits until the reserve fund equals 30% of the issued and outstanding capital stock.<sup>134</sup>

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<sup>122</sup> MASS. GEN. LAWS ch. 157, § 8 (2014).

<sup>123</sup> Email from Erbin Crowell, Executive Director, Neighboring Food Co-op Association (June 9, 2014) (on file with author).

<sup>124</sup> MASS. GEN. LAWS ch. 157, § 1 (2014) (indicating co-operatives are organized under Chapter 156B of the Massachusetts General Laws).

<sup>125</sup> MASS. GEN. LAWS ch. 157, § 3 (2014).

<sup>126</sup> MASS. GEN. LAWS ch. 157, § 3 (2014).

<sup>127</sup> MASS. GEN. LAWS ch. 157, § 4 (2014).

<sup>128</sup> “Agricultural and horticultural association engaged in any branch of agriculture, horticulture, viticulture, forestry, dairying, the raising of livestock or poultry and any other farming activity or business, if instituted for the mutual benefit of their members and formed for the purpose of doing business without profit to the association itself may be incorporated without capital stock.” MASS. GEN. LAWS ch. 157, § 10 (2014).

<sup>129</sup> MASS. GEN. LAWS ch. 157, §§ 7, 9 (2014).

<sup>130</sup> MASS. GEN. LAWS ch. 157, § 12 (2014).

<sup>131</sup> MASS. GEN. LAWS ch. 157, § 2 (2014); NEW ENGLAND FARMERS UNION, GROWING A FOOD SYSTEM FOR THE FUTURE: A MANUAL FOR CO-OPERATIVE ENTERPRISE DEVELOPMENT 1 (2014), *available at* [http://www.newenglandfarmersunion.org/pdfs\\_docs/NEFU\\_Co-opManualFINALweb.pdf](http://www.newenglandfarmersunion.org/pdfs_docs/NEFU_Co-opManualFINALweb.pdf).

<sup>132</sup> MASS. GEN. LAWS ch. 157, § 13 (2014).

<sup>133</sup> MASS. GEN. LAWS ch. 157, §§ 2, 6 (2014).

<sup>134</sup> MASS. GEN. LAWS ch. 157, §§ 2, 6 (2014).

### Pros for Farmers:

- **Control of Own Operation:** Farmers that are members of producer or purchaser co-operatives retain ownership over their own operations while also being members of the co-operative. In fact, most agricultural co-operatives are made up of sole proprietorships.<sup>135</sup>
- **Access to Services and Reduced Risk:** Co-operatives allow members to access business services without assuming all the risks and expenses themselves. For example, a dairy-processing co-operative allows members to spread the costs of expensive cheese making equipment.
- **Increased Competition:** By pooling their resources and production, farmers benefit from economies of scale while retaining their small size and local control.

### Worker-Co-operatives

Like the producer and purchasing co-operatives, worker co-operatives are organized under state corporation law.<sup>136</sup> A separate chapter of the Massachusetts General Laws sets out specific requirements for worker co-operatives.<sup>137</sup> In a worker co-operative, all members must be employed by the co-operative.<sup>138</sup> Each member must own exactly one voting share, called a membership share.<sup>139</sup> Chapter 157A gives workers significant authority; for example, only workers can vote to amend or repeal the co-operative's by-laws.<sup>140</sup> Any earnings from the worker-co-operative are distributed according to the amount of work each individual contributed to the co-operative.<sup>141</sup> Worker-co-operatives may only merge with other worker-co-operatives.<sup>142</sup>

### Pros for Farmers:

- **Limited Liability:** Because worker-co-operatives are organized under Massachusetts corporate laws, the members are protected from liability as they would under a traditional corporate structure.
- **Shared Ownership:** Farmers that want to operate a business collaboratively with other farmers could benefit from a worker-co-operative. Worker-co-operatives allow farmers to share ownership and control over a business, as well as share the operation's risks.
- **Ease of Transfer:** A worker-co-operative's Articles of Organization or by-laws determine the process for accepting and terminating members.<sup>143</sup> Depending on how these documents are worded, worker-co-operatives can make it easy or difficult for changes in membership. Transitioning to a worker-co-operative could be used to give ownership to employees over time.

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<sup>135</sup> Phone Interview with Erbin Crowell, Executive Director, Neighboring Food Co-op Association (June 9, 2014) (on file with author).

<sup>136</sup> MASS. GEN. LAWS ch. 157A, § 3 (2014).

<sup>137</sup> MASS. GEN. LAWS ch. 157A (2014).

<sup>138</sup> MASS. GEN. LAWS ch. 157A, § 6(a) (2014).

<sup>139</sup> MASS. GEN. LAWS ch. 157A, § 6(b) – (c) (2014).

<sup>140</sup> MASS. GEN. LAWS ch. 157A, § 7 (2014).

<sup>141</sup> MASS. GEN. LAWS ch. 157A, § 8 (2014).

<sup>142</sup> MASS. GEN. LAWS ch. 157A, § 11 (2014).

<sup>143</sup> MASS. GEN. LAWS ch. 157A, § 6(a) (2014).

### Cons for Farmers:

- **Control of Own Operation:** Because workers in a worker-co-operative are also the owners of the business, a worker-co-operative might not be ideal for farmers that want to retain sole ownership and control.

**CONCLUSION** An attorney can offer a farmer considerable business advice. However, the most meaningful information will come from the farmers. By utilizing the initial questions and highlighting the important factors to consider, attorneys can effectively work with farmers to accomplish their goals, including protecting their families and assets; creating thoughtful plans of action in case of unfortunate events; and building their businesses consistent with financial, social, environmental, and familial goals. In this way, attorneys can help farmers continue to steward the land and grow the local economy.

## **RESOURCES**

### **New Entry Sustainable Farming Project**

A guide to farming in Massachusetts for entrepreneurs.

[http://nesfp.org/sites/default/files/resources/an\\_entrepreneurs\\_guide\\_to\\_farming\\_ma\\_0.pdf](http://nesfp.org/sites/default/files/resources/an_entrepreneurs_guide_to_farming_ma_0.pdf)

### **Farm Commons**

Resources for farmers and attorneys to identify legal issues and sustainable farm law.

<http://farmcommons.org/>

### **Sustainable Agriculture and Research Education Program**

Guide to developing a business plan for farms and rural businesses.

<http://www.sare.org/Learning-Center/Books/Building-a-Sustainable-Business>

### **New England Farmers Union**

*Growing A Food System for the Future: A Manual for Co-operative Enterprise Development*

[http://www.newenglandfarmersunion.org/pdfs\\_docs/NEFU\\_Co-opManualFINALweb.pdf](http://www.newenglandfarmersunion.org/pdfs_docs/NEFU_Co-opManualFINALweb.pdf).