

## CHAPTER II: BUSINESS STRUCTURES

*Although the overwhelming majority of farms in Maine are sole proprietorships, farmers can benefit from counseling discussions about which business structure may best meet their needs and goals. Depending on which business structure they choose, farmers may be able to limit their liability, reduce their tax burden, transfer the business to the next generation more easily, or increase their ability to access larger markets through cooperative practices.*

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**OVERVIEW** This chapter will assist attorneys advising farmers on the business formation of their farms by providing an overview of different types of business structures and evaluating 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 farmers face when forming their businesses. It also explains how certain issues farmers face are different from those faced by clients in other businesses.

**2. Prevalence of Farm Business Structures in Maine and the United States** This section provides an overview of the prevalence of various farm business structures in Maine 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 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 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 for farmers. Farmers face similar issues as an attorney's more traditional business clients, including raising cash, limiting liability, and finding ways to facilitate business transfers. However, some farm issues differ from traditional business clients' concerns.

For example, attorneys may be accustomed to working for clients whose income is entirely derived from their businesses. In contrast, many farmers use non-farm income to 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 Maine, 51% of

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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).

principal farm operators' primary occupation is not farming.<sup>2</sup> Even for those Maine operators who reported their primary occupations as farming, 62.5% worked at least one day off-farm and 37.5% worked more than 200 days off-farm.<sup>3</sup>

Additionally, the economic profile of farmers in the Legal Services Food Hub (Hub) may not mirror an attorney's traditional clients. Nearly 86% of Maine farms had gross annual sales of less than \$50,000.<sup>4</sup> Only 2.9% of Maine farms grossed more than \$500,000.<sup>5</sup> Therefore, the risks and costs of various business structures may have different weight for many Maine farmers.<sup>6</sup>

Finally, certain personal assets of farmers may have more protection from business creditors than those of other clients. Farmers might have fewer assets solely for personal use because a farmer's assets, such as vehicles and homes, may also 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 to make a living. Further, farmers have their own chapter of the bankruptcy code (Chapter 12, instead of Chapters 9 or 11), which provides farmers and their assets additional protection.<sup>7</sup>

### 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, many Maine farms—particularly those eligible for assistance through the Hub—produce specialty crops (i.e., 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. The newer Whole-Farm Revenue Protection insurance provides coverage under one policy against loss of revenue that the operator expects to earn or would obtain from commodities she produces during the insurance period. But for the majority of smaller-scale specialty crop producers, 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.

Still, farmers have many reasons to formalize their businesses. 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 (such as the owner and her adult children), which helps transfer knowledge and assets

<sup>2</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 69 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_069\\_069.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_069_069.pdf).

<sup>3</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 69 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_069\\_069.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_069_069.pdf).

<sup>4</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_001_001.pdf).

<sup>5</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_001_001.pdf).

<sup>6</sup> The Hub limits pro bono eligibility to farms with (a) annual revenue of at least \$5,000 in the prior tax year OR operations that started within the last three years; AND (b) net annual income of \$30,000 or less; AND (c) household income not exceeding 400% of the Federal Poverty Level. The 2015 Federal Poverty Level is \$11,770 for individuals and \$24,250 for a family of four.

<sup>7</sup> 11 U.S.C. § 1201 et seq. (2012).

between generations. Second, if a farm has multiple operators, a formalized business structure can help order decision-making, compensation, and dissolution. Third, farmers participating in multi-farm endeavors may wish to segregate various farms' assets. Fourth, 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 the business. Finally, farmers may engage in non-production activities, such as agritourism or processing, and may want to structure those higher-risk activities as separate businesses to limit tort and other potential liabilities.

## PREVALENCE OF FARM BUSINESS STRUCTURES IN MAINE AND THE UNITED STATES

The vast majority (86.7%) of farms in the United States operate as sole proprietorships.<sup>8</sup> Similarly, in Maine, 85% of farms operate as sole proprietorships.<sup>9</sup> Since 2002, the total number of farms using corporations, limited liability companies, or other structures (cooperative, estate, or trust) increased, while the number of farms organized as partnerships declined.<sup>10</sup> (The 2012 Census of Agriculture categorized farms as individual, partnership, corporation, or other.<sup>11</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>12</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 (cooperative, estate, or trust)	35,654 (1.7%)	28,136 (1.3%)	16,039 (0.75%)

<sup>8</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).

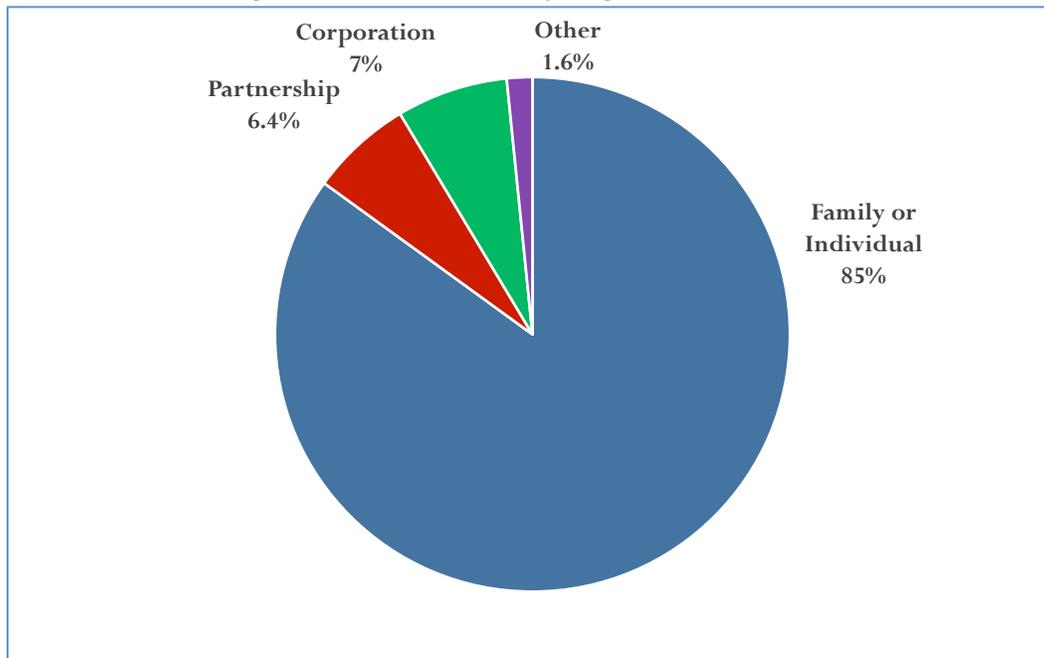
<sup>9</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_001_001.pdf).

<sup>10</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, MAINE STATE DATA TABLE 1 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st25\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st25_1_001_001.pdf).

<sup>11</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>12</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. Maine Farms by Legal Status in 2012<sup>13</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 its 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 the farmer like to expand her farm operation by selling to grocery stores or through a community supported 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 her operational priorities.

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

- **Ownership and/or 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>13</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 1 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_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 Farm Stands:** Does the farmer have, or hope to have, a roadside market or farm stand? Is the roadside market or farm stand 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, or food safety standards and practices?
- **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?
- **Agritourism and Other Forms of On-Farm Recreation:** Does the farmer engage in, or want to engage in, agritourism 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 onto the farmer's land to engage in agricultural activities?
- **Permits, Licenses, and Certifications:** What permits, licenses, or certifications, if any, does the farm operation have or require?
- **Insurance:** What kind of insurance policy, if any, does the farmer hold? Do any insurance policies 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?
- **Financing:** How does the farmer fund the farm? Has the farmer 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>14</sup> This section will familiarize the attorney with some factors that might motivate farmers to choose one business structure over another.

**Percentage of Farms Operated as Sole Proprietorships**

Maine: 84.8%

Nationally: 86.7%

Source: 2012 Census of Agriculture

The attorney must be very careful to determine who the client is (e.g., the farmer? a partner? the partnership? a corporation? an investor? a limited partner?) and then must be very clear in all further dealings in order to avoid conflicts of interest. This is a common problem that can have tragic consequences. If in doubt, an attorney should ask for help from more experienced

lawyers or from the Maine Overseers of the Bar. This guide assumes that the client is the farmer, but that may not be the case.

**Maine Statutes**

Maine Uniform Partnership Act, 31 M.R.S.A. §1001 et seq.

Maine Uniform Limited Partnership Act, 31 M.R.S.A. §1301 et seq.

Maine Limited Liability Partnership Act, 31 M.R.S.A. §801 et seq.

Maine Limited Liability Company Act, 31 M.R.S.A. § 1501 et seq.

Maine Business Corporation Act, 13-C M.R.S.A. §101 et seq.

Maine Nonprofit Corporation Act, 13-B M.R.S.A. §101 et seq.

Cooperatives 13 M.R.S.A. §§ 1501 et seq.

First, attorneys and the client should consider the **ease of formation and management** of the organization. Farming can be very time intensive, especially for diversified and small-scale operations common in Maine. 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.

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>15</sup> In contrast, “double-taxation” entities, mostly C-corporations, must pay taxes on the business’s profits, and

<sup>14</sup> See, e.g. *Natural Events and Disasters*, U.S. ENVTL. PROTECTION AGENCY, <http://www.epa.gov/oecaagct/tned.html> (last visited Feb. 16, 2015).

<sup>15</sup> See ANNETTE M. HIGBY ET AL., *A LEGAL GUIDE TO THE BUSINESS OF FARMING IN VERMONT* (Univ. of VT. Extension ed. 2006), available at <http://www.uvm.edu/farmtransfer/LegalGuide.pdf>.

then any profits distributed to owners are taxed as personal income.<sup>16</sup> But there are also benefits to a C-corporation that may justify using it. This calls for bringing in a good tax advisor/CPA/tax lawyer to run the various numbers and figure out which format actually makes the best sense.

Third, 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 any business, there are many ways a farmer can incur liability: an employee or visitor could be injured on the farm; pollution or hazardous materials could run off the farm; the farmer could default on a loan; 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 to minimize the risk. Other risk management tools, such as insurance, may address the farmer's potential liabilities more cheaply.

Fourth, attorneys should 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 a 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 better facilitate investment. If the farmer hopes to have non-operators financially support the farm, she might consider a business structure that allows for outside investment without turning over control.

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 advise 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 primary business structures available under Maine law.

**Sole Proprietorships** A sole proprietorship is the most common form of business ownership. 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

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<sup>16</sup> See ANNETTE M. HIGBY ET AL., A LEGAL GUIDE TO THE BUSINESS OF FARMING IN VERMONT (Univ. of VT. Extension ed. 2006), available at <http://www.uvm.edu/farmtransfer/LegalGuide.pdf>.

liabilities.<sup>17</sup> Most Maine farms (84.8%) are sole proprietorships.<sup>18</sup> Forming a sole proprietorship does not require any legal filing.

If a farmer operates a sole proprietorship, she does not need to register her business with the State. However, there may be state, city, or town permits or licenses that are required to operate her business.<sup>19</sup> Even if the farmer wishes to avoid formal organization, an attorney should still advise her client to choose a name for the business and register the farm business name with the Maine 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> This is a useful practice but not a legal requirement; there is no provision under Maine law that requires farmers to file trade names for sole proprietorships at the state level. Local filing, however, is mandatory. If a farmer decides to operate as a sole proprietor under a trade name, she will be required by Maine law to file with the municipal clerk where her business is located.<sup>22</sup>

#### 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>23</sup> In Maine, one can establish a sole proprietorship without filing any legal documents, and there are no yearly filings or fee requirements.<sup>24</sup> The formality 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 farming rather than business formalities.
- **Taxation:** The owner of a sole proprietorship is taxed on a personal level for all income and expenses from the business.<sup>25</sup> Because Hub farmers must make less than 400% of the Federal Poverty Level, their tax rates will likely be low.

#### Cons for Farmers:

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<sup>17</sup> *Sole Proprietorship*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/sole-proprietorship-0> (last visited Apr. 22, 2015).

<sup>18</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA TABLE 1, 7 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_001\\_001.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_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.

<sup>19</sup> *Starting a Business*, MAINE.GOV, <http://www.maine.gov/portal/business/starting.html> (last visited Apr. 22, 2015).

<sup>20</sup> ME. SECRETARY OF STATE, [www.maine.gov/sos](http://www.maine.gov/sos).

<sup>21</sup> *How to Name a Business*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/how-name-business> (last visited Apr. 17, 2015).

<sup>22</sup> 31 M.R.S §§ 1-2 (2014); *see also Marks & Trade Names*, MAINE.GOV, <http://www.maine.gov/sos/cec/corp/trademarks.html> (last visited Apr. 22, 2015).

<sup>23</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>24</sup> *Frequently Asked Questions*, ME. SMALL BUS. DEV. CTR., <http://www.mainesbdc.org/index.cfm/spKey/faqs.html> (last visited Apr. 22, 2015).

<sup>25</sup> *Frequently Asked Questions*, ME. SMALL BUS. DEV. CTR., <http://www.mainesbdc.org/index.cfm/spKey/faqs.html> (last visited Apr. 22, 2015).

- **Limiting Liability:** A sole proprietorship 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>26</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, as previously noted. Though this may appear to benefit the farmer, it can limit creditors’ willingness to loan capital.
- **Life of Entity:** A sole proprietorship terminates when the owner passes away or sells the business assets.<sup>27</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.
- **Outside Investment:** Sole proprietorships do not allow the business owner to raise capital by selling equity interests in the business.<sup>28</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>29</sup> However, 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 transaction costs.

### Gentleman’s Agreements

Sometimes farmers enter into “gentleman’s agreements” with neighbors or relatives to share 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 to see if the farmer has unintentionally formed a partnership. It is important to explain to the farmer that any unwritten agreements pertaining to land ownership (leases over one year or fee ownership) are likely unenforceable due to the statute of frauds. So, any agreement pertaining to land should be reduced to writing, and most such agreements will need to be recorded in the Registry of Deeds.

**Partnerships** A partnership is an association of two or more persons to carry on as co-owners of a business for profit.<sup>30</sup> A partner’s contribution may consist of money, property, labor, credit, and/or skill. In return for his or her contribution to the business, each partner shares in the profits and losses of the business.<sup>31</sup> About 6.4% of farms in Maine are organized as partnerships.<sup>32</sup> Of the 525 farms that identify as

<sup>26</sup> STEPHEN C. ALBERTY, 1 ADVISING SMALL BUSINESSES § 3:2 (2014).

<sup>27</sup> HARRY J. HAYNSWORTH, SELECTING THE FORM OF A SMALL BUSINESS ENTITY 3 (1985).

<sup>28</sup> *Sole Proprietorship*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/sole-proprietorship-0> (last visited Feb. 16, 2015).

<sup>29</sup> *Transfer Ownership*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/transfer-ownership> (last visited Feb. 16, 2015).

<sup>30</sup> 31 M.R.S. § 1001(6) (2013).

<sup>31</sup> *Partnership*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/partnership> (last visited Apr. 25, 2015).

<sup>32</sup> U.S. DEP’T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 67 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_067\\_067.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_067_067.pdf).

partnerships, 312 (59.4%) are registered under Maine law as limited partnerships and limited liability partnerships.<sup>33</sup>

### ***The General Partnership***

A general partnership is an association of two or more persons to carry on, as co-owners, a for-profit business. All partners share equally in control of the business and liability. A general partnership is the default business structure for two or more persons who operate a business and share profits. The Uniform Partnership Act governs partnerships in Maine,<sup>34</sup> and the partnership is governed by its partnership agreement.<sup>35</sup> In Maine, there are no formation or filing requirements, and the partnership is governed by its partnership agreement with the partnership statute supplying the default rules for the relationship between the partners when there is no agreement on a specific term.<sup>36</sup> Because of the informality of some arrangements, farmers may be unknowingly operating as a partnership and doing so without having negotiated a comprehensive partnership agreement.



#### **Percentage of Farms Operated as Partnerships**

Maine: 6.4%  
Nationally: 6.5%

Source: 2012 Census of Agriculture

Farmers operating as a general partnership should draft a partnership agreement.<sup>37</sup> They can set forth the specific terms that they want governing the partnership. There are some terms of a partnership that may not be varied by the agreement.<sup>38</sup> A partnership statement should be filed with the secretary of state.<sup>39</sup> The agreement should contain, at a minimum, the following:

- 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 extent of each partner's authority to incur debt or 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.

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<sup>33</sup> U.S. DEP'T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 67 (2014), *available at* [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_067\\_067.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_067_067.pdf); 31 M.R.S. §§ 801-876, 1001-1105, 1301-1461 (2013).

<sup>34</sup> 31 M.R.S. § 1001 et seq. (2013).

<sup>35</sup> 31 M.R.S. § 1003(1) (2013).

<sup>36</sup> 31 M.R.S. § 1003 (2013).

<sup>37</sup> STEPHEN C. ALBERTY, 1 ADVISING SMALL BUSINESSES § 5:7 (2014).

<sup>38</sup> 31 M.R.S. § 1003(2) (2013).

<sup>39</sup> 31 M.R.S. § 1005 (2013).

In addition to addressing the distribution of profits, when drawing up a partnership agreement, the attorney should focus attention on 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. It would also be advisable for the attorney to address some of the finer details, such as the process for a partner to withdraw from the partnership and the process to dissolve the partnership.

If no partnership agreement is written, an agreement may still be inferred by a judge from the words, conduct, customs, and practices of the partners. If agreement on a specific term is neither explicit nor inferable, Maine's Uniform Partnership Act will supply the terms for the operation of the partnership and the relations of the partners. However, ownership of the land will be controlled by the recorded deeds. Additionally, without a comprehensive written partnership agreement, it will be more difficult to wind down and terminate the partnership.

#### Pros for Farmers:

- **Ease of Formation and Management:** If there are two farmers operating one farm, any form of agreement to jointly operate the farm for profit will create 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 unless the partners elect to have partnership income separately taxed.<sup>40</sup> Partners pay income tax on any profits earned by the partnership, while the partnership itself is not taxed.<sup>41</sup> However, partnerships may elect not to distribute excess cash to the partners and instead reinvest those profits in the business.
- **Raising Capital:** General partnerships allow for outside investments because there is no limit on the number of partners. Outside individuals can invest and become a general partner.<sup>42</sup> Note: this may require modifying the partnership agreement.
- **Life of Entity:** Partnerships can set explicit conditions for their dissolution, and partners can agree to dissolve the entity at any time. (Note, however, that absent a written partnership agreement addressing dissolution, the partners may disassociate at any time, leaving the remaining partner with an economic burden to buy-out the departing partner.<sup>43</sup>)

#### Cons for Farmers:

- **Liability:** General partnerships expose partners to both upside and downside risk. In other words, partners share in all business profits and losses, and are also exposed individually to liability for

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<sup>40</sup> *Bulletin # 3009: How to Organize Your Business*, UMAINE COOP. EXTENSION PUBL'N, <http://umaine.edu/publications/3009e/> (last updated 2008); BERNSTEIN SHUR, *DOING BUSINESS IN MAINE* (Lex Mundi 2010), available at [http://www.lexmundi.com/lexmundi/Guides\\_To\\_Doing\\_Business.asp](http://www.lexmundi.com/lexmundi/Guides_To_Doing_Business.asp).

<sup>41</sup> *Bulletin # 3009: How to Organize Your Business*, UMAINE COOP. EXTENSION PUBL'N, <http://umaine.edu/publications/3009e/> (last updated 2008).

<sup>42</sup> *Bulletin # 3009: How to Organize Your Business*, UMAINE COOP. EXTENSION PUBL'N, <http://umaine.edu/publications/3009e/> (last updated 2008).

<sup>43</sup> 31 M.R.S. §§ 1061, 1071 (2013).

business losses. All general partners are jointly and severally liable for all business obligations.<sup>44</sup> Creditors, and others, may sue any or all partners and recover from their personal assets.<sup>45</sup>

- **Ease of Transfer:** In Maine, a partnership generally continues after dissolution, but only for purposes of closing the business.<sup>46</sup> Absent a provision in the partnership agreement to the contrary, or without the consent of the other partners, partners can grant an assignee of the partner's partnership interest their share of profits only, not the right to participate in the management and conduct of the partnership.<sup>47</sup> Therefore, if the farmer plans to transfer control of the farm to relatives or another party, the farmer should either ensure that the partnership agreement clearly provides for transfer of control or choose a different business structure.
- **Raising Capital:** Joint and several liability of general partners may deter outside investment because all investors who become partners will be exposed to the business's risks.<sup>48</sup> Or a farmer may not wish to use general partnerships to raise funds when outside investors/partners would gain the right to influence farm management.
- **Partner Relationships:** While partnerships can provide many benefits, going into business with other individuals can complicate relationships, and disagreement among partners may consume resources, cause unnecessary stress, and adversely impact the business. Seeking out new partners also can be costly and uncertain.

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

The limited liability partnership (LLP) is a general partnership that has adopted limited liability status.<sup>49</sup> The LLP limits the personal liability of all the entity's partners, which minimizes the risks to partners' personal assets.<sup>50</sup> To form an LLP, a farmer must choose a name and register it with the secretary of state,<sup>51</sup> and also must register<sup>52</sup> and file a Certificate of Limited Liability Partnership with the Secretary of State.<sup>53</sup> A registered limited liability partnership must maintain a registered agent in the state.<sup>54</sup>

#### Pros for Farmers:

- **Taxation:** Like all partnerships, limited liability partnerships may receive "pass-through" tax treatment.<sup>55</sup> Partners pay income tax on any profits earned by the limited liability partnership,

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<sup>44</sup> 31 M.R.S. § 1034(1) (2013).

<sup>45</sup> 31 M.R.S. § 1035 (2013).

<sup>46</sup> 31 M.R.S. § 1082 (2013) ("At any time after the dissolution of a partnership and before the winding up of its business is completed, all of the partners, including any dissociating partner other than a wrongfully dissociating partner, may waive the right to have the partnership's business wound up and the partnership terminated.")

<sup>47</sup> 31 M.R.S. §§ 1063(2)(A), 1087 (2013).

<sup>48</sup> See ANNETTE M. HIGBY ET AL., A LEGAL GUIDE TO THE BUSINESS OF FARMING IN VERMONT (Univ. of VT. Extension ed. 2006), available at <http://www.uvm.edu/farmtransfer/LegalGuide.pdf>.

<sup>49</sup> 31 M.R.S. § 821 (2013).

<sup>50</sup> 31 M.R.S. § 822 (2013).

<sup>51</sup> 31 M.R.S. § 803-A (2013).

<sup>52</sup> 31 M.R.S. § 821 (2013).

<sup>53</sup> 31 M.R.S. § 822 (2013).

<sup>54</sup> 31 M.R.S. § 807-A (2013).

<sup>55</sup> 18-125 C.M.R. 806, § 2 (2006).

while the partnership itself is not taxed.<sup>56</sup> However, partnerships may elect not to distribute excess cash to the partners and instead reinvest those profits in the business.

- **Limited Liability:** All of the partners are protected from the LLP's liabilities, except in the case of a partner's own negligence.<sup>57</sup> This protection extends to all partners, even those involved in farm management.
- **Raising Capital:** LLPs may accept investments from outside investors. Because an LLP is a general partnership with limited liability status, all persons jointly carrying on a business for profit will be considered partners. In an LLP, partnership status carries with it power over the management of the partnership business. The LLP could be attractive to investors interested in farm management and who 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 more formal steps and fees required to form and maintain an LLP. These requirements may deter a farmer from choosing to form an LLP.
- **Partner Relationships:** While partnerships can provide many benefits, going into business with other individuals can complicate relationships, and disagreement among partners may consume resources, cause unnecessary stress, and adversely impact the business. Seeking out new partners also can be costly and uncertain.
- **Ease of Transfer:** LLPs can face similar transfer difficulties to the general partnership.

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

The limited partnership (LP) is similar to the general partnership in that there must be at least two owners but differs because the partners do not have equal obligation.<sup>58</sup> Under an LP, some partners are deemed "limited partners" who invest and are entitled to profits but do not have all of the rights or obligations of "general partners."<sup>59</sup> The general partners control business management and operations and remain liable for all business obligations.<sup>60</sup> The limited partners, on the other hand, enjoy a limitation on liability and have limited duties.<sup>61</sup> An LP must file a Certificate of Limited Partnership with the secretary of state.<sup>62</sup> Farmers in an LP should draft a partnership agreement addressing at least the issues discussed above regarding a general partnership.

#### Pros for Farmers:

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<sup>56</sup> *Bulletin # 3009: How to Organize Your Business*, UMAINE COOP. EXTENSION PUBL'N, <http://umaine.edu/publications/3009e/> (last updated 2008).

<sup>57</sup> *Starting Your Own Company: Know the Basics*, LINNELL, CHOATE, & WEBBER, LLP, <http://lcwlaw.com/2012/03/starting-your-own-company-know-the-basics/> (last visited Apr. 22, 2015).

<sup>58</sup> 31 M.R.S. § 1302(11) (2013).

<sup>59</sup> 31 M.R.S. §§ 1342-43 (2013).

<sup>60</sup> 31 M.R.S. § 1354 (2013).

<sup>61</sup> 31 M.R.S. § 1345 (2013).

<sup>62</sup> 31 M.R.S. § 1321(1) (2013).

- **Taxation:** Like a sole proprietorship, partnerships receive “pass-through” tax treatment.<sup>63</sup> Partners pay income tax on any profits earned by the limited partnership, while the LP itself is not taxed.<sup>64</sup> Alternatively, partners can elect to have the LP taxed as an entity with separate taxation on profits distributed to partners (i.e, double taxation). Partnerships may elect not to 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 and so can encourage investors.<sup>65</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. It may also be useful in distributing interests in the farm to children or other family members without subjecting them to potential liability for the obligations of the LP.
- **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>66</sup> Additionally, individual partnership interests may be transferred if all partners consent to the transfer or the partnership agreement so provides.<sup>67</sup> (Note, however, that without any partnership agreement, transfers can be complicated.)
- **Life of Entity:** Farmers can have substantial control over the LP’s end by including termination conditions in the partnership agreement.<sup>68</sup>
- **Raising Capital:** Unlike general partnerships, investors can provide capital without incurring any liability by becoming limited partners.<sup>69</sup> This is good for investors who do not wish to manage the farm and want limited liability.

#### Cons for Farmers:

- **Liability:** General partners in an LP remain personally liable for any and all actions the partnership takes.<sup>70</sup> The LP can elect in its Certificate of Limited Partnership to be a limited liability limited partnership (LLLLP).<sup>71</sup> This election will free a general partner from any personal liability for an obligation of the LLLP arising “in contract, tort or otherwise.”<sup>72</sup>

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<sup>63</sup> BERNSTEIN SHUR, DOING BUSINESS IN MAINE (Lex Mundi 2010), *available at* [http://www.lexmundi.com/lexmundi/Guides\\_To\\_Doing\\_Business.asp](http://www.lexmundi.com/lexmundi/Guides_To_Doing_Business.asp).

<sup>64</sup> *Bulletin # 3009: How to Organize Your Business*, UMAINE COOP. EXTENSION PUBL’N, <http://umaine.edu/publications/3009e/> (last updated 2008).

<sup>65</sup> 31 M.R.S. § 1343 (2013) (explaining that a limited partner is not liable for partnership obligations “even if the limited partner participates in the management and control of the limited partnership”). The risk is that a limited partner could be so involved with the operation that the court would re-characterize the limited partner as a general partner.

<sup>66</sup> 31 M.R.S. §§ 1431-43 (2013).

<sup>67</sup> 31 M.R.S. §§ 1381-1384 (2013).

<sup>68</sup> 31 M.R.S. § 1373 (2013).

<sup>69</sup> BERNSTEIN SHUR, DOING BUSINESS IN MAINE (Lex Mundi 2010), *available at* [http://www.lexmundi.com/lexmundi/Guides\\_To\\_Doing\\_Business.asp](http://www.lexmundi.com/lexmundi/Guides_To_Doing_Business.asp).

<sup>70</sup> 31 M.R.S. § 1354 (2013).

<sup>71</sup> 31 M.R.S. § 1321 (2013).

<sup>72</sup> 31 M.R.S. § 1354(3) (2013).

- **Partner Relationships:** While partnerships can provide many benefits, going into business with other individuals can complicate relationships, and disagreement among partners may consume resources, cause unnecessary stress, and adversely impact the business. Seeking out new partners also can be costly and uncertain.

**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>73</sup> LLCs are popular business structures among farmers because LLCs do not demand as many formal requirements as certain other business entities and are very flexible.<sup>74</sup> By default, LLCs are owned by members; members may also act as managers of the LLC.<sup>75</sup> In Maine, the law requires that the LLC have a company agreement, and within the agreement, members are able to determine how they want the company to operate and the roles of its members.<sup>76</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>77</sup>



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 formation with the secretary of state.<sup>78</sup> The farmer must also create an operating agreement, which details how the LLC is to be governed and provides other organizational details.<sup>79</sup>
- **Taxation:** LLCs may elect “pass-through” or “double” taxation. As with partnerships, 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 (pass-through).<sup>80</sup> For LLCs with multiple members, the profits and losses are generally allocated based on proportional ownership but may be allocated differently in the partnership agreement.<sup>81</sup>

<sup>73</sup> *Limited Liability Company*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/limited-liability-company-llc> (last visited Feb. 26, 2015).

<sup>74</sup> STEPHEN C. ALBERTY, 1 ADVISING SMALL BUSINESSES § 7:1 (2014).

<sup>75</sup> 31 M.R.S. § 1523 (2013).

<sup>76</sup> 31 M.R.S. § 1521 (2013); *Starting Your Own Company: Know the Basics*, LINNELL, CHOATE, & WEBBER, LLP, <http://lcwlaw.com/2012/03/starting-your-own-company-know-the-basics/> (last visited Apr. 22, 2015).

<sup>77</sup> 31 M.R.S. § 1524 (2013).

<sup>78</sup> 31 M.R.S. § 1531 (2013).

<sup>79</sup> 31 M.R.S. § 1521 (2013).

<sup>80</sup> STEPHEN C. ALBERTY, 1 ADVISING SMALL BUSINESSES § 7:5 (2014).

<sup>81</sup> STEPHEN C. ALBERTY, 1 ADVISING SMALL BUSINESSES § 7:35 (2014).

- **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>82</sup> This can be attractive to farmers who want to be able to exercise control over the management of the farm and protect themselves from personal liability.
- **Ease of Transfer:** LLCs allow for the controlled transfer of interests in the LLC to other parties, including the assignment of a member's interests to another party, as expressly provided in the operating agreement.<sup>83</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 because there can be several different classes of members or managers.<sup>84</sup> By using an LLC rather than a corporation, a farm business can more flexibly structure investor relationships.<sup>85</sup>
- **Other:**
  - **Multiple Business Ventures:** An LLC is good for farmers forming a multi-farm CSA because it allows multiple members to share CSA 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 or other such events, the farmer may want to use an LLC for the agricultural operation and a separate LLC for the festival operation, protecting the assets of the farming venture from the potential liabilities of the festival operation.
  - **Higher-Risk Activities:** Farms that engage in higher-risk activities, such as fermenters, value-added operations, and agritourism, can create separate LLCs for those operations to protect the rest of the operation.
  - **Weighted Voting:** LLCs allow farmers to assign different weight to votes on different topics. For example, a farmer can use "one member, one vote" for operational decisions, or votes weighted by amount of investment for land sale. She can creatively allocate power by use of categories, classes, or voting rights. A lawyer advising a farmer should consult an expert if the farmer wishes to go this route.

#### Cons for Farmers:

- **Other:**
  - **Fees:** Annual state filing fees may be problematic for farmers with low gross income, but the filing fee for an LLC should not be prohibitive.

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<sup>82</sup> STEPHEN C. ALBERTY, 1 ADVISING SMALL BUSINESSES § 7:15 (2014).

<sup>83</sup> 31 M.R.S. § 1571 (2013).

<sup>84</sup> *Starting Your Own Company: Know the Basics*, LINNELL, CHOATE, & WEBBER, LLP, <http://lcwlaw.com/2012/03/starting-your-own-company-know-the-basics/> (last visited Apr. 22, 2015).

<sup>85</sup> *Starting Your Own Company: Know the Basics*, LINNELL, CHOATE, & WEBBER, LLP, <http://lcwlaw.com/2012/03/starting-your-own-company-know-the-basics/> (last visited Apr. 22, 2015).

- **Paperwork:** An LLC is also not a good option for farmers who prefer not to bear paperwork or reporting burdens.
- **Personal Guarantee:** Some creditors may require farmers to personally guarantee their debts, regardless of the structure of their business, nullifying the usual protection from liability provided by the LLC structure (though this may also be true for other limited liability entities).

### *The Low-Profit Limited Liability Company (L3C)*

The L3C is a relatively new legal form that combines aspects of a nonprofit and an LLC. There has not been much use of this form of structure as of the date the writing of this guide. Maine enacted L3C legislation effective July 1, 2011.<sup>86</sup> The L3C is essentially an LLC that has a primary public interest mission while, unlike a nonprofit organization, retaining an ability to generate and to distribute limited profits to its members. In Maine, a business may qualify as an L3C only if “no significant purpose of the company is the production of income or the appreciation of property.”<sup>87</sup>

The filing fees and process are the same as for an LLC, except that the organization must specify its mission and that it intends to be an L3C. One of the major driving forces behind the creation of L3Cs was to help socially minded organizations raise funds,<sup>88</sup> but it is not yet clear that it will work well enough to be worth the restrictions. L3Cs are meant to attract “Program Related Investments” (PRIs). A PRI is a loan, investment, or other financial backing from a charitable foundation, except it must be made primarily to further the foundation’s social mission, with profit being only a secondary goal. Because L3Cs have a social mission written into their bylaws, the hope was that private foundations would more readily support them through PRIs. Thus far, foundations do not seem to be making many PRIs to L3Cs. A lawyer should consult with an expert in L3Cs if her client wishes to explore this option.

An L3C can also raise money in all of the traditional ways, such as attracting investors or taking out loans. Note that, unlike donations to a nonprofit, donations to an L3C are not tax deductible. Because they have a social mission, some investors may be scared away, but the tradeoff is that this mission may attract socially minded investors and make the L3C more appealing for new funding sources, such as crowdfunding.

#### Pros for Farmers:

- **Limited Liability:** L3Cs enjoy the same limited liability as LLCs.
- **Raising Capital:** L3Cs can raise capital like for-profit companies but may also have access to funding sources traditionally associated with nonprofits (at least in theory).
- **Other:** Farmers can run a business with the potential to garner outside investment while prioritizing a social mission (if desired) above maximizing profitability.

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<sup>86</sup> 31 M.R.S. § 1611 (2013).

<sup>87</sup> 31 M.R.S. § 1611(2) (2013).

<sup>88</sup> 31 M.R.S. § 1611 (2013) (expressly references Section 170(c)(2)(B) of the Internal Revenue Code of 1986 in identifying whether a business furthers “charitable or educational purposes” so as to qualify as an L3C).

### Cons for Farmers:

- **Taxation:** L3Cs are not eligible for tax-exempt treatment because they do not have to satisfy the strict income-limitations imposed on nonprofit corporations.<sup>89</sup>
- **Purpose and Oversight:** Because L3Cs must “significantly further the accomplishment of one or more charitable or educational purposes,” and cannot have a significant purpose to produce income, they may not fit with the farmer’s personal profit mission. As a very new entity, it is unclear how much oversight of this mission-fit may be imposed by the Internal Revenue Service (IRS) or state regulators.

**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>90</sup> There are 582 farms in Maine that identify as corporations.<sup>91</sup> Of those corporate farms, 503 identify as being family held (over 98% of which have 10 or fewer stockholders).<sup>92</sup> Nearly all of the farms that are not family-held corporate farms also have 10 or fewer stockholders.<sup>93</sup> For purposes of federal income tax treatment, a farm can organize as a C-corporation or as a Subchapter S-corporation. A corporation may be closely held, which means that a limited number of people are shareholders, often family members. Smaller businesses, such as those likely to participate in the Hub, often elect S-corporation status with the IRS because of its tax advantages, i.e., the availability of pass-through taxation. If a corporation is larger and desires more flexibility in structuring its classes of shares, or plans to make a public offering of shares, it will likely prefer C-corporation status, which taxes the corporation as a separate entity. This section provides a basic overview of both forms.



#### **Percentage of Farms Operated as Corporations**

Maine: 7.1%  
Nationally: 5%

Source: 2012 Census of Agriculture



### ***C-Corporations***

A corporation’s designation as “C” or “S” is determined in the company’s dealings with the IRS. To form any kind of corporation in Maine you must prepare and file Articles of Incorporation.<sup>94</sup> These Articles of Incorporation include the name of the corporation; the number of shares the corporation is permitted to issue; the clerk of the corporation (who primarily handles the administrative

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<sup>89</sup> 31 M.R.S. § 1611(1) (2013); see generally *Maine Low-Profit Limited Liability Companies (L3C)*, LAWFORCHANGE.COM, <http://www.lawforchange.org/NewsBot.asp?MODE=VIEW&ID=2577> (last visited Apr. 22, 2015).

<sup>90</sup> 13-C M.R.S. § 623 (2013).

<sup>91</sup> U.S. DEP’T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 67 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_067\\_067.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_067_067.pdf).

<sup>92</sup> U.S. DEP’T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 67(2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_067\\_067.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_067_067.pdf).

<sup>93</sup> U.S. DEP’T OF AGRIC., 2012 CENSUS OF AGRICULTURE, MAINE STATE DATA, TABLE 67 (2014), available at [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_State\\_Level/Maine/st23\\_1\\_067\\_067.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_State_Level/Maine/st23_1_067_067.pdf).

<sup>94</sup> 13-C M.R.S. §§ 201-07 (2013).

functions of the corporation); and the incorporators, the people forming the corporation.<sup>95</sup> The corporation also needs bylaws,<sup>96</sup> directors,<sup>97</sup> officers,<sup>98</sup> and a good record keeping system.<sup>99</sup> The corporation also needs to file annual reports with the secretary of state.<sup>100</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>101</sup>
- **Ease of Transfer:** Stockholders can sell their stock to a willing buyer unless prohibited by the stockholder rules of the corporation itself.<sup>102</sup> The entire corporation can be merged with other corporations. This is quite complex and an expert attorney must be engaged.<sup>103</sup>
- **Life of Entity:** Corporations can survive beyond the life of the shareholders—the stock passes to heirs or devisees. Dissolving a corporation in Maine can be accomplished in various ways.<sup>104</sup>
- **Raising Capital:** Corporations are useful tools for raising funds because of their ability to sell equity (shares) in the corporation, which is often easier and more familiar than selling partnership interests or LLC interests. A C-corporation may offer different classes of shares, providing greater financing flexibility.

#### Cons for Farmers:

- **Ease of Formation and Management:** There are numerous formalities required to form a corporation. For example, the corporation must have a board of directors,<sup>105</sup> hold at least one annual shareholder meeting,<sup>106</sup> and keep a distinct business bank account.<sup>107</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. Under the law, a corporation is a separate and legally distinct "person."

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<sup>95</sup> 13-C M.R.S. § 202 (2013).

<sup>96</sup> 13-C M.R.S. § 206 (2013).

<sup>97</sup> 13 C-M.R.S. § 801 (2013).

<sup>98</sup> 13-C M.R.S. § 841 (2013).

<sup>99</sup> 13-C M.R.S. §§ 1601-23 (2013).

<sup>100</sup> 13-C M.R.S. § 1621 (2013).

<sup>101</sup> 13-C M.R.S. § 623 (2013).

<sup>102</sup> 13-C M.R.S. § 628 (2013).

<sup>103</sup> 13-C M.R.S. §§ 1201-02 (2013).

<sup>104</sup> 13-C M.R.S. §§ 1401-1440 (2013); *Bulletin # 3009: How to Organize Your Business*, UMAINE COOP. EXTENSION PUBL'N, <http://umaine.edu/publications/3009e/> (last updated 2008).

<sup>105</sup> 13-C M.R.S. §§ 743, 801 (2013).

<sup>106</sup> 13-C M.R.S. § 701 (2013).

<sup>107</sup> *Corporation Basics*, NOLO.COM, <http://www.nolo.com/legal-encyclopedia/corporation-basics-29867.html> (last visited Apr. 22, 2015).

- **Taxation:** C-corporations are subject to federal and state corporate income tax, so income earned by a C-corporation is subject to double taxation.<sup>108</sup>

### ***S-Corporations***

Farmers used S-corporations to limit liability and transfer the farm between generations before LLCs were available.<sup>109</sup> Farmers use S-corporations more often than C-corporations. In Maine, a corporation becomes an S-corporation only when, with the consent of all shareholders, it seeks special tax treatment by filing with the IRS.<sup>110</sup> In an S-corporation, all shareholders must be natural persons, citizens, or resident aliens of the United States; there may not be more than 100 stockholders and not more than one class of stock.<sup>111</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>112</sup>
- **Ease of Transfer:** With the restrictions mentioned above concerning S-corporation stockholders, stock can be transferred to others owners if not prohibited by the Articles or bylaws.<sup>113</sup> (However, this is not necessarily an easy or straightforward task.)
- **Life of Entity:** Corporations can survive beyond the life of the shareholders. A corporation is dissolved by shareholder vote or judicial action.<sup>114</sup> Dissolving a corporation in Maine is complex—a farmer should consult an expert for assistance.
- **Taxation:** An S-corporation is taxed similarly to a partnership, where the income and losses are passed through to the shareholders based on their ownership interests.<sup>115</sup>

#### Cons for Farmers:

- **Ease of Formation and Management:** Similar to the C-corporation, there are numerous formalities required to form a corporation.
- **Raising Capital:** The S-corporation's ability to raise capital may be closer to that of a partnership or sole proprietorship. S-corporations are limited to one class of stock and 100 shareholders, who must be U.S. citizens or resident aliens.

### ***The Nonprofit Corporation***

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<sup>108</sup> See generally *Maine For-Profit Corporations: Using For-Profit Corporations to Pursue Social Objectives*, LAWFORCHANGE.COM, <http://www.lawforchange.org/NewsBot.asp?MODE=VIEW&ID=2573> (last visited Apr. 22, 2015).

<sup>109</sup> Phone Interview with Rachel Armstrong, Executive Director, Farm Commons, May 27, 2014 (on file with author).

<sup>110</sup> *Forming Your Business in Maine*, MAXFILINGS.COM, <https://maine.maxfilings.com/KC-differences-between-c-corporations-s-corporations.php> (last visited Apr. 22, 2015).

<sup>111</sup> 26 U.S.C. § 1361 (2012).

<sup>112</sup> *S-Corporation*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/content/s-corporation> (last visited Apr. 22, 2015).

<sup>113</sup> 13-C M.R.S. §§ 1201-02 (2013).

<sup>114</sup> 13-C M.R.S. §§ 1401 et seq. (2013).

<sup>115</sup> See generally *Maine For-Profit Corporations: Using For-Profit Corporations to Pursue Social Objectives*, LAWFORCHANGE.COM, <http://www.lawforchange.org/NewsBot.asp?MODE=VIEW&ID=2573> (last visited Apr. 22, 2015).

In Maine, a nonprofit corporation is managed by a board of directors. Instead of shareholders, the nonprofit corporation may have members who choose to participate in corporate matters. Nonprofit corporations are not organized to earn profits, so no part of the income may be distributed to its members, directors, or officers. A nonprofit corporation is formed under the Maine Nonprofit Corporation Act.<sup>116</sup> It can be a mutual benefit corporation or public benefit corporation. Be aware that there may be little reason to form a nonprofit unless the operation is also going to obtain 501(c)(3) status. In order to achieve federal tax-exempt status, a farm would need to be a public benefit corporation.

In Maine, a public benefit corporation may be: (1) designated as a public benefit corporation by statute; (2) tax exempt under section 501(c)(3) of the Internal Revenue Code; (3) organized for a public or charitable purpose and required to distribute assets to a similar tax exempt organization upon dissolution; or (4) established as a public benefit corporation.<sup>117</sup> An existing corporation may elect to become a nonprofit corporation by amending the corporation's Articles of Organization.<sup>118</sup> Nonprofit corporations must maintain complete and accurate records and books evidencing the proceedings of its members and directors, file an annual report with the secretary of state, and pay an annual filing fee.<sup>119</sup>

The simplest way to think of a nonprofit tax-exempt organization is that the control is separate from the benefit (you can have one or the other, but not both), and those with control cannot profit. Where profit is not the goal, this business structure may be appealing to certain farmers who wish to ensure long-term accountability for a social or environmental mission.

#### Pros for Farmers:

- **Taxation:** A 501(c)(3) nonprofit corporation is exempt from federal income taxes and is also exempt from paying Maine corporation taxes.
- **Limited Liability:** The members of a nonprofit corporation, if any, are generally not personally liable for the corporation's debts and liabilities.
- **Ease of Transfer:** Any two or more nonprofit corporations in Maine may merge or consolidate by adopting a plan of merger or consolidation contingent upon approval by the entities' members or directors, and filing articles of merger with the state.
- **Life of Entity:** A nonprofit corporation can survive beyond the life of the members; a nonprofit corporation is terminated by member vote or judicial action.

#### Cons for Farmers:

- **Ease of Formation and Management:** As with other corporate structures, this structure may impose high costs on the farmer. There are numerous filings and administrative requirements associated with nonprofit corporation status.

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<sup>116</sup> 13-B M.R.S. §§ 101 et seq. (2013).

<sup>117</sup> 13-B M.R.S. § 1406 (2014); *see generally* *How to Tell Whether Your Nonprofit Corporation is a Public Benefit Corporation or a Mutual Benefit Corporation*, MAINE.GOV, <http://www.maine.gov/sos/cec/corp/determining.html> (last visited Apr. 23, 2015).

<sup>118</sup> 13-B M.R.S. § 403 (2014); *see* 13-C M.R.S. §§ 931-32 (2013).

<sup>119</sup> 13-B M.R.S. §§ 715, 1301 (2013).

- **Raising Capital:** Although nonprofit corporations are not prohibited from raising money, the directors of a nonprofit are obligated to focus primary attention on the promotion of the social mission of the corporation rather than the production of income. However, nonprofits do have access to grants that might otherwise be unavailable to for-profit businesses.

There are times when a nonprofit tax-exempt corporation may make good sense, but an expert should be consulted before going too far down the road. Forming and maintaining nonprofit status can be very technical and prone to pitfalls.

### *Cooperatives*

Cooperatives are an increasingly popular form of business structure among farmers and food producers in the local and regional food economy. Unlike a corporation, cooperatives must further members' goals and meet their needs.<sup>120</sup>

These needs and goals depend on the type of members; in the agricultural sector, members can be producers, purchasers, or workers. A producer cooperative might use the cooperative to market and distribute the members' products. For example, a cooperative might help small farmers who want to sell to larger institutions but cannot meet the demand alone. Similarly, dairy cooperatives help farmers share otherwise prohibitively expensive equipment, marketing, and distribution costs. This kind of purchasing cooperative allows farmers to purchase supplies or equipment together, which can lead to bulk discounts or useful sharing. In a worker cooperative, employees own and govern the business together. This might be a good option for a farmer who wants to give her employees an incentive to stay working on that particular farm, retaining their skills and experience over time. Producer and purchasing cooperatives are similar to one another in formation and structure. Worker cooperatives 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 cooperatives.

“[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 ENG. FARMERS UNION, GROWING A FOOD SYSTEM FOR THE FUTURE: A MANUAL FOR CO-OPERATIVE ENTERPRISE DEVELOPMENT 2 (2014).

(Note that although some of the benefits of cooperatives can be achieved through other business structures, such as LLCs or nonprofits, cooperatives are unique structures. If a client calls her organization a cooperative, it must follow the cooperative statute.<sup>121</sup> As interest in cooperatives has grown, there is more focus on protecting the term “cooperative” and ensuring that only cooperatives organized as such use the name.<sup>122</sup>)

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<sup>120</sup> See 13 M.R.S. § 1501 (2013); see also NEW ENG. 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>121</sup> See 13 M.R.S. §§ 1776, 1976 (2013).

<sup>122</sup> Email from Erbin Crowell, Executive Director, Neighboring Food Co-op Association to the author (June 9, 2014) (on file with author).

### Producer or Purchasing Cooperatives

Under Maine law, agricultural cooperatives are organized under their own statutory sections, and articles of incorporation must be prepared and filed with the secretary of state.<sup>123</sup> The general corporation law is also applicable to cooperatives.<sup>124</sup> Five or more adults, engaged in agriculture as “bona fide producers of agricultural products,” or two or more associations of such producers are requirements to forming an agricultural cooperative.<sup>125</sup> Generally, cooperative members (the term “member” includes any agricultural producer, either corporate or individual, with whom the association shall do business, either directly or through a member cooperative association, amounting to at least \$100 during any fiscal year, and may, by the bylaws, include “employees”) purchase common stock to raise capital.<sup>126</sup> Cooperatives may also borrow or issue preferred stock. However, Maine does not require agricultural cooperatives to have capital stock.<sup>127</sup>

The business of the association must be managed by a board of no fewer than three directors.<sup>128</sup> The members of the cooperative may adopt bylaws, which must be adopted by a majority of the members.<sup>129</sup> The agricultural cooperative’s bylaws must specify how voting will occur, and usually cooperatives give each member one vote, though voting can be allocated in other ways in the articles of incorporation, such as being based on patronage.<sup>130</sup> “Patronage” refers to “the amount of work performed as a member of an employee cooperative, measured in accordance with the articles of incorporation or bylaws.”<sup>131</sup>

The bylaws may determine the timeframe for which the association may distribute earnings and profits to its members.<sup>132</sup> However, in Maine, dividends in excess of 8% of the actual cash value of the consideration received by the association may not be paid on common or preferred stock or membership capital; but dividends may be cumulative.<sup>133</sup>

### Pros for Farmers:

- **Control of Own Operation:** Farmers that are members of producer or purchaser cooperatives retain ownership over their own operations while also being members of the cooperative. In fact, most agricultural cooperatives are made up of sole proprietorships.<sup>134</sup>

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<sup>123</sup> See 13 M.R.S. §§ 1171, 1823-24 (2013).

<sup>124</sup> 13 M.R.S. § 1782 (2013).

<sup>125</sup> 13 M.R.S. § 1821 (2013).

<sup>126</sup> 13 M.R.S. § 1911 (2013).

<sup>127</sup> 13 M.R.S. § 1821 (2013) (“Five or more adult persons . . . or 2 or more associations of such producers, may form an association with or without capital stock.”).

<sup>128</sup> 13 M.R.S. § 1871 (2013).

<sup>129</sup> 13 M.R.S. § 1826 (2013).

<sup>130</sup> 13 M.R.S. § 1826 (2013).

<sup>131</sup> 13 M.R.S. § 1972 (2013).

<sup>132</sup> 13 M.R.S. § 1912 (2013).

<sup>133</sup> 13 M.R.S. § 1912 (2013).

<sup>134</sup> Phone Interview with Erbin Crowell, Executive Director, Neighboring Food Co-op Association (June 9, 2014) (on file with author).

- **Access to Services and Reduced Risk:** Cooperatives allow members to access business services without assuming all the risks and expenses themselves. For example, a dairy-processing cooperative might allow members to spread the costs of expensive cheese-making equipment.
- **Increased Competitiveness:** By pooling their resources and production, farmers benefit from economies of scale while retaining their small size and local control.

#### Cons for Farmers:

- **Coordination Challenges:** Coordination challenges and potential collective action problems could be substantial.

#### Worker Cooperatives

Like the producer and purchasing cooperatives, worker cooperatives are organized under state corporation law.<sup>135</sup> A separate chapter of the Maine Revised Statutes sets out specific requirements for worker cooperatives.<sup>136</sup> In a worker cooperative, all members must be employed by the cooperative.<sup>137</sup> Each member must own exactly one voting share, called a membership share.<sup>138</sup> The Employee Cooperative Corporations Act gives workers significant authority. For example, only workers can vote to amend or repeal the cooperative's bylaws.<sup>139</sup> Any earnings from the worker cooperative are distributed according to the amount of work each individual contributed to the cooperative.<sup>140</sup> Worker cooperatives may merge only with other worker cooperatives.<sup>141</sup>

#### Pros for Farmers:

- **Limited Liability:** Because worker cooperatives are organized under Maine corporate laws, the members are protected from liability as they would be under a traditional corporate structure.
- **Shared Ownership:** Farmers that want to operate a business collaboratively with other farmers could benefit from a worker cooperative. Worker cooperatives allow farmers to share ownership and control over a business, as well as share the operation's risks.
- **Ease of Transfer:** A worker cooperative's Articles of Organization or by-laws determine the process for accepting and terminating members.<sup>142</sup> Depending on how these documents are worded, worker cooperatives can make it easy or difficult for changes in membership. Transitioning to a worker cooperative could be used to give ownership to employees overtime.

#### Cons for Farmers:

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<sup>135</sup> 13 M.R.S. § 1973 (2013) (“employee cooperative corporations are governed by Title 13-C, the Maine Business Corporation Act”).

<sup>136</sup> 13 M.R.S. § 1971 et seq. (2013).

<sup>137</sup> 13 M.R.S. § 1977 (2013).

<sup>138</sup> 13 M.R.S. § 1978(3) (2013).

<sup>139</sup> 13 M.R.S. § 1979 (2013).

<sup>140</sup> 13 M.R.S. § 1980 (2013).

<sup>141</sup> 13 M.R.S. § 1984 (2013).

<sup>142</sup> 13 M.R.S. § 1977 (2013).

- **Control of Own Operation:** Because workers in a worker cooperative are also the owners of the business, a worker cooperative 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 reviewing the initial questions with their clients 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 local economies.

## RESOURCES

### **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)