

# RIGHTRISK™

## RIGHTRISK NEWS

### Structuring Farm Ownership for Liability Protection

#### DATES TO REMEMBER

**Noninsured Crop Disaster Assistance Program (NAP)**  
 Deadline for springseeded forage and all other crops  
 - April 1, 2019

**Spring crop acreage reporting deadline**  
 - July 15

**Dairy Producers Previously Enrolled in LGM Program Now Eligible for 2018 Margin Protection Program**

For more information see:  
<http://www.rma.usda.gov>  
<http://www.fsa.usda.gov>



The end of the twentieth century saw an explosion in the number and type of business organizations utilized by farmers and ranchers across the United States. An overview of some of the more important benefits and consequences of these various business entities was offered in last month's *RightRisk News*. We focus on one of the most important benefits in this article: the protection from legal liability for actions performed on behalf of the business.

Asset protection is an important aspect of farming and ranching. Employing one or more types of business entities to operate the business has become a common way to limit the exposure of assets to liability claims. For example, there may be one or more entities for ownership of the land and other assets and a separate entity for operating the business. Not only may multiple business structures provide asset protection, they can also be useful in estate and succession planning. There is a wide spectrum of liability exposure across the different forms of business organization.

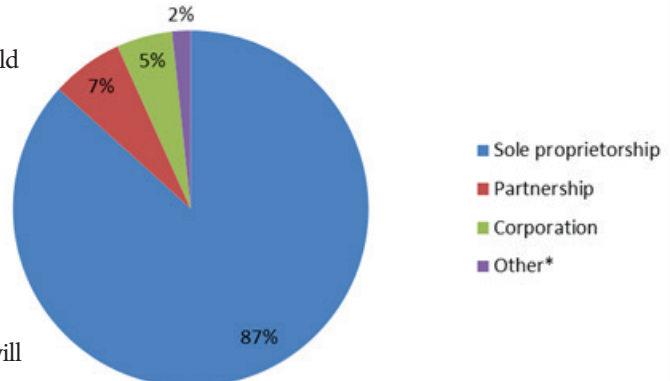
Sole proprietorships are usually viewed as the form of business ownership providing the least liability protection. This is true where the sole proprietor is personally liable for all of the business obligations and there is no limit to this liability. A husband and wife operating a family farm as a sole proprietorship expose all of their assets, including personal assets, to liability risk. For example, farm debt liability extends to personal assets that may have nothing to do with the farm. This is important because, according to the 2012 U.S. Census of Agriculture, 87 percent of farms in the United States operate as a sole proprietorship (Figure 1).

A strong argument can be made that partnerships are worse in terms of the liability protection they offer than sole proprietorships. Partnerships are formed when two or more people begin doing business together. The partnership may file paperwork with the Secretary of State in the state in which it is operating but it is not required for the partnership to exist. A husband and wife running a farm or ranch business must file the appropriate paperwork in order to be recognized as a partnership. Otherwise, they are treated as a sole proprietorship and all their assets are lumped together as if owned by one person.

Partnerships offer a number of liability issues to consider. There is no protection for the personal assets of owners from liability claims against the business like sole proprietorships. However, partnerships involve what is called joint and several liability. This means that all partners are responsible for the actions of any partner. This would include misrepresentation of information to the Farm Service Agency (FSA) or a financial institution that would be classified as fraudulent behavior.

Partnerships also include a default level of joint authority which implies that each partner is considered an agent of the partnership and can bind the partnership into legal agreements. This is a compelling reason for partnerships, including family farm partnerships, to formally file a partnership agreement with the state. The scope of business activities for the partnership can be clearly defined in the agreement, as well as how much authority each partner will have to conduct business on behalf of the partnership. The discussions

Figure 1. Farms by Legal Status, 2012 U.S. Census of Agriculture.



\*The "other" category includes cooperatives, estates, trusts, etc.

How Much Risk is Right for You?



required to complete a good partnership agreement can be a valuable tool in limiting liability exposure for the people involved and a proactive step in mitigating any future misunderstandings.

Limited partnerships can be used to attract investors into the farm business as limited partners, without adding exposure to liability claims. Each limited partnership must have at least one general partner with no liability protection. Limited partnerships tend to be complicated to set up and run. Generally, farm owners seeking liability protection are better served by setting up a limited liability company.

Limited liability companies (LLCs) are a relatively new form of business entity. They first appeared in 1977 with the passage of Wyoming legislation. An LLC is formed by filing articles of organization with the secretary of state and paying the appropriate filing fee. Owners of an LLC are referred to as “members.” The liability of an individual member extends only to his or her contributions to the LLC and the extent to which he or she has personally guaranteed any financial obligations of the LLC.

Members can participate in the management of the LLC without forfeiting their limited personal liability protection. However, members must be careful not to pierce this “veil of protection” by treating the LLC as an extension of their personal affairs. Therefore, separate bank accounts for the LLC and personal business and adequately funding the LLC accounts are a must. Creating a formal written operating agreement can also spell out specific member duties including writing checks, requesting credit, signing contracts, etc. further limiting the liability exposure of member owners to potential business activities.

Corporations are a step up in liability protection, when compared to an LLC. A corporation is its own entity, separate from its owners (shareholders). A corporation shields its owners from personal liability for all business activities, debts, and obligations. Each owner is at risk only to the level of his or her investment in the corporation and the extent to which he or she has personally guaranteed any financial obligations.

Articles of incorporation must be filed with the secretary of state to form a corporation. However, there is more to creating and running a corporation than simply filing articles of incorporation. A corporation requires the issuance of stock to formally divide up ownership, a board of directors, by-laws to govern operations, and annual meetings of the shareholders and directors. Liability protection for owners of a corporation is much more established and has undergone much higher tests in the courts than have LLCs. However, as with an LLC, owners must be diligent not to pierce the “veil of protection” by operating the corporation as an extension of their personal affairs.

It is becoming more common for farms and ranches to be owned and operated using more than one business entity with protection of assets from liability claims as the primary objective. For example, a business entity may be formed exclusively for operating the farm business (an operating company). Assets used in the business (land, buildings, equipment, etc.) may be owned personally or by one or more additional business entities. The operating company leases the assets from the respective owners and uses them in the day-to-day operation of the business. Lease payments are a business expense for the operating company and income for the owner(s) of the asset. The assets are not owned by the operating company and, therefore, are not exposed to liability claims made against the operating company related to its business activities.

The option of creating and managing business entities is an important tool when it comes to implementing a farm or ranch business strategy. Competent legal counsel should be obtained to ensure that liability protection goals are being achieved with the business entity or entities selected.



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