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Choice of Entity for Agricultural Businesses

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Over the past few years, the list or menu of types of legal entities which can be used to operate an agricultural based business in Florida has increased significantly. There are many reasons, both tax and non-tax, which need to be considered when selecting which entity type should be used for a particular business and for particular owners. This article will provide a basic overview of these available options and the business reasons for each. Our goal is to encourage the reader to carefully consider the type of entity used to operate his or her business.

Types of Entities

There are four (4) primary classifications of business entities in Florida: (i) sole proprietorships, (ii) partnerships, (iii) limited liability companies (LLC), and (iv) corporations. In addition, there are four (4) types of partnerships available in Florida and they are: (i) general partnerships (GP), (ii) limited partnerships (LP), (iii) limited liability partnerships (LLP), and (iv) limited liability limited partnerships (LLLP). Other than the sole proprietorship and general partnership, each entity type offers some degree of liability protection for its owners and each has slightly different tax consequences. While a detailed discussion of the liability protection and tax consequences of operating out of each type of entity is beyond the scope of this article, following is a summary of the primary tax and non-tax considerations that should be considered when evaluating the type of entity to be used to operate a business.

Non-Tax Considerations

There are many non-tax factors to consider when selecting a business entity. Some of the primary considerations include the following: the degree of limited liability for the owners and the business; providing centralized management; establishing the management's rights, restrictions, and powers to act; continuity of life of the business; restrictions on the ability to transfer ownership interests; cost to form and maintain; and the ability to facilitate owners' estate planning goals.

Sole proprietorships and GPs are not required to register with the State in order to operate as a business. However, if a sole proprietorship or GP use a name different than the name of its

owners, then the business must register the fictitious name (or in the case of a GP, register the partnership). All of the other entity types require filing formation documents and annual reports with the State of Florida. The formation fees and annual reporting fees for each entity type vary.

Income Tax Considerations

Business entity types can be broadly classified into two categories, pass-through entities and taxable entities, and there are significant tax differences among the various types of pass-through entities and between pass-through entities and taxable entities. To further muddy the water, each of the entities, if eligible, can elect to be taxed as an “S” corporation, which is a type of pass-through entity.

Pass-through entities, which include all types of partnerships, LLCs and “S” corporations, do not generally pay income tax. The owners of the pass-through entity will pay income tax on their proportionate share of the income of the entity or pass through losses and deductions to the owners. On the other hand, taxable entities, which include corporations (other than S corporations) pay federal and state income tax at the entity level and, in addition, the owners of taxable entities pay income tax on the dividends they receive and losses or deductions are only available to the entity. This double-tax system, plus the Florida income tax on corporations, results in most corporations electing to be taxed as an “S” corporation.

Finally, the tax incentives available to a particular entity type must be considered, as certain benefits are attributable to only certain types of entities. For example, the ability to average farm income over 3 years under Section 1301 of the Internal Revenue Code is not available to the owners of a corporation unless the corporation elects to be taxed as an “S” corporation.

Conclusion

The decision in choosing an entity type to operate an agricultural business is very important. Is your business structure right for you? There are many factors to consider and one factor may be more important to some businesses than to others. Before starting a business, or if you have a business that has been operating for a period of time, you should consult with a qualified business and tax attorney to make sure that you select or operate an entity type that is appropriate for your goals and objections.

About the Authors

Michael D. Minton and Bradley R. Gould are Tax and Succession Planning Attorneys with Dean, Mead, Minton & Zwemer, a law firm that provides comprehensive legal representation to agribusiness clients throughout Florida.