

# **Agricultural Business Organizations: Basic Characteristics and Choices**

by Forrest A. Buhler, Staff Attorney  
Kansas Agricultural Mediation Service

## **I. Basic business structures for agricultural operations**

### **A. Sole or individual proprietorship**

### **B. Partnerships**

1. General partnership
2. Limited partnership
3. Limited liability partnership

### **C. Corporations**

1. Subchapter C, regular corporation
2. Subchapter S, closely held corporation

### **D. Limited Liability Company**

## **II. Definitions and characteristics of the basic business structures**

A. **Sole Proprietorship**. A business operated by an individual engaged alone in a trade or business with sole control over management of that business, and with unlimited personal liability for the debts of the business.

B. **Partnership**. (Kansas Revised Uniform Partnership Act, K.S.A. 56a-101 *et seq.*; Kansas Revised Uniform Limited Partnership Act, K.S.A. 56-1a101 *et seq.*)

1. **General Partnership**. "An association of two or more persons to carry on as co-owners a business for profit."<sup>1</sup> "A partnership is an entity distinct from its partners."<sup>2</sup>
  - i. "Person" in a partnership may include an individual, corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.<sup>3</sup>
  - ii. *Formalities*. Relations among the partners and between the partners and the partnership are governed by the partnership agreement.<sup>4</sup> The agreement may be written, oral or implied.<sup>5</sup> To the extent the partners do not have an agreement, the State of Kansas will impose the terms of the "Kansas Revised Uniform Partnership Act".<sup>6</sup> In addition to a formal agreement, a partnership may be created by law without individuals realizing it; such as, where persons share the profits and losses of a business,<sup>7</sup> or a "purported partner"--a person who holds themselves out as a partner and one on whom the law imposes responsibilities.<sup>8</sup>
  - iii. *Continuity*. Kansas law defines when a partnership is dissolved and its business must be wound up.<sup>9</sup> Examples of events causing dissolution of a partnership include:<sup>10</sup>
    - a. an event agreed to in the partnership agreement;<sup>11</sup>
    - b. an event that makes it unlawful for all of the business of the partnership to be continued;<sup>12</sup>

- c. a judicial determination that the economic purpose of the partnership is likely to be unreasonably frustrated or it is reasonably impractical to carry on the partnership business in conformance with the partnership agreement;<sup>13</sup>
  - d. in a partnership for a definite term or particular undertaking there is within 90 days of a dissociation of a partner by death of that partner, bankruptcy of that partner, or appointment of a guardian or conservator for that partner, it is the express will of at least one-half of the remaining partners to wind up the partnership business;<sup>14</sup>
  - e. However, after dissolution but before winding up the business, all of the partners may agree to waive the right to have the partnership wound up and the partnership terminated. This would mean that the partnership resumes carrying on its business as if the dissolution had never occurred. Otherwise, a partnership continues after dissolution only to wind up the business.<sup>15</sup>
- iv. *Liability.* Each partner is fully/ personally liable (jointly and severally liable) for all obligations of the partnership.<sup>16</sup> Kansas law now requires that a partnership creditor must first exhaust partnership assets before going after a partner's individual assets.<sup>17</sup> A partnership may sue and be sued in the name of the partnership as well as any or all of the partners.<sup>18</sup> Except as may otherwise be provided by Kansas law<sup>19</sup> persons who are not partners as to each other are not liable as partners to other persons.<sup>20</sup>
- v. *Management/ Control.* Each partner has an equal say in the management of the partnership unless the partnership agreement provides otherwise.<sup>21</sup> Any differences arising as to matters in the ordinary course of business of the partnership will be decided by a majority vote of the partners.<sup>22</sup> Each partner is an agent of the partnership and can bind the partnership for acts "apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership".<sup>23</sup> Acts not apparently in the ordinary course are not binding unless authorized by the other partners.<sup>24</sup> A new innovation allows partnerships and partners to voluntarily make a public record of certain important information about the partnership. The document with which this can be done is called a "statement"<sup>25</sup> and must be centrally filed with the office of the secretary of state, unless it is with respect to real estate, then a certified copy of the statement must be filed with the register of deeds where the land is located.<sup>26</sup> Examples of "statements" that may be filed include:<sup>27</sup>
- a. Partnership authority--authority or limitations of authority of partners;<sup>28</sup>
  - b. Denial--a partner or person may file a denial to a statement of status as a partner or that person's authority;<sup>29</sup>
  - c. Dissociation--the dissociated partner or partnership may state that the partner is dissociated and how authority is limited.<sup>30</sup>
  - d. Dissolution--the partnership is dissolved and winding up business.<sup>31</sup>
- vi. *Profit and loss distribution.* Each partner shall share equally in the profits and losses unless the partnership agreement provides otherwise.<sup>32</sup>
- vii. *Tax treatment.* The partnership must file a tax return, but is not a taxpaying entity.<sup>33</sup> Taxes are paid by individual partners.<sup>34</sup> Income, deductions, and credits pass through to the individual partners.

2. **Limited Partnership**. (L.P.) "A partnership formed by two or more persons under the laws of the state of Kansas and having one or more general partners and one or more limited partners."<sup>35</sup>

i. The major difference between this type of partnership and a regular partnership is that this type has a "limited partner(s)" who has limited personal liability for the debts and obligations of the partnership.

*Liability.* The limited partner's personal liability for the debts and obligations of the partnership is limited to the extent of his investment in the limited partnership and is not liable for the obligations of the limited partnership.<sup>36</sup> As in a regular partnership, the "general partner" is fully and personally liable for the debts and obligations of the partnership.<sup>37</sup>

ii. *Management/ Control.* In order to protect his limited liability a limited partner must be careful how he participates in the business of the limited partnership. He must not also be a general partner, and he must not "participate in the control of the business". Kansas law defines what "participate in the control of the business" is not.<sup>38</sup>

iii. *Formalities.* To create a limited partnership, certain formalities must be met under Kansas law. Among the requirements is that a certificate of limited partnership must be filed with the Kansas Secretary of State as well as an annual report.<sup>39</sup> A limited partnership agreement is required.

iv. *Continuity.* A limited partnership is dissolved by the happening of an event specified in the written partnership agreement, the written consent of all partners, and judicial decree.<sup>40</sup> Unless otherwise provided by the written partnership agreement, the cessation of a person as a general partner shall not cause dissolution and the limited partnership shall be continued unless certain actions are taken within 90 days to do so.<sup>41</sup>

v. *Profit and loss distribution.* By agreement of the parties.

vi. *Tax Treatment.* A limited partnership may be taxed as a regular partnership would be, or as a corporation depending on how it is structured, and depending on certain elections under the Internal Revenue Service regulations that may be made by the limited partnership.<sup>42</sup> In general, an unincorporated domestic organization, like a limited partnership, with two or more owners receives a default classification as a partnership. Any unincorporated organization may elect out of its default status and elect to be classified as a corporation for tax purposes.<sup>43</sup>

3. **Limited Liability Partnership**. (L.L.P.) A general partnership formed pursuant to an agreement governed by Kansas laws and registered with the Kansas Secretary of State in accordance with Kansas law.<sup>44</sup>

i. The main difference between this type of partnership and a general partnership is that a partner in a registered limited liability partnership is not personally liable for debts and obligations of the partnership arising out of the negligence or wrongful acts committed in the course of the partnership business by another partner.<sup>45</sup>

C. **Corporation**. A separate legal entity created under the laws of a particular state and operated by stockholders (owners of the corporation), a board of directors (policy makers for the corporation), and officers and employees responsible for the day-to-day management of the corporation.

## 1. Important characteristics common to all corporations.

- i. *Formalities.* Articles of Incorporation, containing certain information required by statute<sup>46</sup>, must be filed with the Secretary of State.<sup>47</sup> By-laws must then be drafted to govern the rights of stockholders, directors officers and employees in operating the business.<sup>48</sup> Corporations, including agricultural corporations that farm 10 or more acres, must submit an annual report to the Secretary of State.<sup>49</sup> Failure to comply with these formalities can result in criminal sanctions and dissolution.<sup>50</sup>
- ii. *Management/ Control/Ownership.* Stock is issued representing a shareholders ownership interest in the corporation (a stockholder does not "own" an interest in specific assets of the corporation) and the stockholders voting power within the corporation. Stock is purchased with money, property or services to the corporation, and can also be obtained by gift. Stockholders select the board of directors who manage the business through officers selected by the directors. Stockholders, directors, and officers may all be the same people or one person.
- iii. *Transferability of stock.* Stock can be freely transferred without affecting the underlying operation and assets owned by the corporation.
- iv. *Continuity.* As long as the formalities involved in maintaining a corporation are complied with, the corporation will continue in existence and will not be dissolved in the event of the death of a stockholder, director or officer, nor will a transfer of stock affect continuity. The corporation will basically remain in existence as long as the stockholders want it to continue.
- v. *Liability.* A stockholder is not personally liable for the debts and obligations of the corporation. The stockholder's liability is usually limited to the amount of the investment in the corporation. In order to maintain this limited liability the corporation must be adequately capitalized, properly incorporated under state law, and comply with all the formalities required by state law. Stockholders may personally obligate themselves if they co-sign or guarantee a promissory note in their own name and not as an authorized representative of the corporation.
- vi. *Tax Treatment.* The Internal Revenue Service looks at four factors in determining if a business organization should be treated as a corporation for tax purposes. If an organization has three or four of the following characteristics, it will be taxed as a corporation, and if it only has two or less it will be taxed as a partnership:
  - a. Is there a centralized management?
  - b. Is there continuity of life for the business?
  - c. Is there limited liability?
  - d. Is there free transferability of interest?

## 2. Subchapter "C" Corporation, a regular corporation.

- i. *Tax Treatment.* A Subchapter C is taxed as a separate legal entity, and has its own income tax rates.<sup>51</sup> It takes its own deductions and credits; however, payment of dividends to stockholders is not deductible expense.
- ii. *Profit and loss.* Income is distributed to stockholders as a dividend according to their stock holdings. A dividend is taxable income to the stockholder. To avoid paying a dividend a corporation may reinvest profits

back into the corporation, or reasonable wages may be paid to a stockholder who is also an employee of the corporation.

### 3. **Subchapter "S" Corporation, a closely held corporation.**

- i. *Tax Treatment.* A Subchapter S is normally taxed as a partnership where income, deductions and credits are passed through to the stockholders. The corporation itself does not pay taxes. Stockholders pay at their own personal tax rates.
- ii. *Restrictions imposed to qualify as a Subchapter S.* A Subchapter S corporation does not lose the main corporate characteristics listed above. However, there are certain restrictions required by the Tax Code to qualify as a Subchapter S making it a "closely held corporation":<sup>52</sup>
  - a. It must have only one class of stock.
  - b. The number of stockholders is limited to 100.
  - c. The stockholders must be individuals, and may not be owned by a partnership, another corporation, or certain trusts.
  - d. All stockholder must consent to the classification as a Subchapter S.

### 4. **Restrictions on Agricultural Corporations.**

- i. *Prohibitions.* Kansas law prohibits any corporation, trust, limited liability company, limited partnership or corporate partnership, from either directly or indirectly, owning, acquiring, or otherwise obtaining or leasing any agricultural land in Kansas.<sup>53</sup>
- ii. *Exceptions.* Kansas law allows certain business organizations to own, acquire, obtain or lease agricultural land in Kansas. In order to fall within these exceptions the business must qualify as either a "...family farm corporation, authorized farm corporation, limited liability agricultural company, family farm limited liability agricultural company, limited agricultural partnership, family trust, authorized trust or testamentary trust..."<sup>54</sup> all specifically defined by statute.<sup>55</sup> The criteria for these businesses usually include restrictions on the number of persons involved, that they be natural persons, that they be related as a family, and that a certain percentage be actively engaged in the operation or live on the land. Other exceptions are set out in the statute.<sup>56</sup>
- iii. *Example.* A "family farm corporation" must meet the following criteria:<sup>57</sup>
  - a. A corporation founded for the purpose of farming and owning ag land;
  - b. The majority of the voting stock is held by, and a majority of the stockholders are, persons related to each other within the third degree of relationship, by blood or adoption, or the spouses or the stepchildren of any such persons; all of the stockholders must be natural persons; one must live on farm.

D. **Limited Liability Company (LLC).** A separate legal entity created under the laws of a particular state. It is owned, operated and managed by its "members". It is a business entity that combines the tax and management characteristics of a general partnership with the limited liability of a corporation.

1. *Formalities.* Articles of Organization, containing certain information required by statute,<sup>58</sup> must be filed with the Kansas Secretary of State before it can begin operating.<sup>59</sup> In Kansas an LLC must have at least one member.<sup>60</sup> An

"operating agreement" may be adopted by the LLC for purposes of regulating and managing the affairs of the LLC.<sup>61</sup> The "operating agreement" of an LLC is similar to the by-laws of a corporation or the partnership agreement of a limited partnership.<sup>62</sup> Although an "operating agreement" is not required by Kansas law, the agreement is essential to the running of the business since the articles of organization are not required to set out the details of doing so. Failure to comply with the formalities necessary to create and maintain a LLC can result in penalties and dissolution of the LLC.<sup>63</sup>

2. *Management/ Control.* Members manage the LLC as set forth in the Articles of Organization or the operating agreement. Every member holding an interest in profits shall be entitled to vote, unless otherwise provided in the operating agreement.<sup>64</sup> Each member in a member managed LLC has the authority to bind the LLC, unless the articles of organization vest management in one or more "managers" then no member acting solely in the capacity as a member is an agent of the LLC.<sup>65</sup> The Articles of Organization may provide that management of the LLC be vested in a manager or managers chosen by the members. The manager(s) is an agent of the LLC for the purpose of its business and affairs with ability to bind the LLC to any deal in the "usual way of business or affairs".<sup>66</sup>
3. *Transferability of member's interest.* Unless otherwise provided in the operating agreement, a member's interest, in whole or in part, may be transferred.<sup>67</sup> The person to whom the member's interest is transferred is not entitled to become a "member" or exercise any management or other rights or powers except as provided in the operating agreement and upon the approval of all other members of the LLC except the member transferring the interest.<sup>68</sup>
4. *Continuity.* As long as the formalities involved in maintaining a LLC are complied with, the LLC will continue in existence unless certain events occur, including: expiration of period fixed in the operating agreement for duration of the LLC (if no time is specified then the LLC shall have perpetual existence); and the written agreement of all members.<sup>69</sup> Unless otherwise provided in the operating agreement, the death, retirement, expulsion, bankruptcy or dissolution of a member will not cause dissolution unless within 90 days following the occurrence of such an event, all remaining members agree in writing to dissolve the LLC.<sup>70</sup>
5. *Liability.* Neither members nor managers of an LLC are personally liable for the debts of the LLC.<sup>71</sup> Members may personally obligate themselves if they co-sign or guarantee a promissory note in their own name and not as an authorized representative of the LLC.<sup>72</sup>
6. *Profit and loss distribution.* Distributions of cash, other assets, profits and losses of an LLC shall be allocated to the members as provided in the operating agreement. If no provision is made, then cash, other assets, profits and losses shall be allocated among the members and among classes or groups of members on the basis of the agreed value of the contributions made by each member to the extent they have been received by the LLC and have not been returned.<sup>73</sup>
7. *Tax treatment.* A LLC may be taxed as a regular partnership would be, or as a corporation depending on how it is structured and depending on certain elections under the Internal Revenue Service regulations that may be made

by the LLC.<sup>74</sup> In general, an unincorporated domestic organization, like an LLC, with two or more owners receives a default classification as a partnership. Any unincorporated organization may elect out of its default status and elect to be classified as a corporation for tax purposes.<sup>75</sup>

### III. Basic advantages and disadvantages of the different types of agricultural business organizations

#### A. Sole or individual proprietorship

##### 1. Advantages of a sole proprietorship.

- i. *Simple to create, maintain and terminate.* In contrast to other business structures, creating and maintaining a sole proprietorship does not require special filings or reports to government agencies, nor are there any formalities required to terminate. The individual simply starts doing business and stops. Thus there is very little cost involved in setting up or terminating this type of business structure.
- ii. *Individual management and control.* The sole proprietor does not have to report or be accountable to directors, stockholders, members, managers, or partners. The individual makes all of the decisions.
- iii. *Profits and losses.* The sole proprietor does not share profits or losses with anyone else.
- iv. *Exempt property.* The sole proprietor is allowed to claim a limited amount of property as "exempt" under Kansas law. This property cannot be attached and sold through legal process to pay a debt or obligation to a creditor. These exemptions are not available to other business organizations. Examples of exempt property in Kansas include but are not limited to the following:<sup>76</sup>
  - a. Homestead consisting of a home on 160 acres of farming land or a home on one acre within the limits of an incorporated city;<sup>77</sup>
  - b. Household goods and furnishings reasonably necessary at the person's principal residence for one year;<sup>78</sup>
  - c. One means of conveyance, not to exceed \$20,000 in value, used for transportation to a from employment;<sup>79</sup>
  - d. Tools, equipment, breeding stock and other things used in carrying on a person's trade or business not to exceed an aggregate value of \$7,500;<sup>80</sup>
  - e. Certain pension and retirement money and plans;<sup>81</sup>
  - f. Certain annuity, disability, and death benefits; certain life insurance policies; public assistance and unemployment benefits;<sup>82</sup>
  - g. Certain amount of wage earnings (25% of disposable earnings).

##### 2. Disadvantages of a sole proprietorship.

- i. *Unlimited personal liability.* The sole proprietor is personally liable for all debts and obligations of the business. All non-exempt assets, both business and personal, of the sole proprietor are subject to being attached and sold in the event a judgment is taken against the debtor.
- ii. *Lack of continuity.* A sole proprietorship terminates on the death of the proprietor, often causing liquidation or partition of a farming operation into

less workable units, especially if some of the heirs are not active in the farming operation.

- iii. *Limited transferability.* It is difficult for the sole proprietor to transfer assets to heirs and still maintain the ability produce enough to provide a reasonable security of income and capital for retirement. Parceling out the assets themselves can put a strain on the productivity of the business.
- iv. *Limited capital.* The sole proprietor is limited to the capital he has or can borrow. Protection for outside investors is limited and not attractive.
- v. *Tax treatment.* Income is taxed at the proprietor's own tax bracket, and there are fewer income tax planning advantages that what a corporation can offer.

## B. General Partnerships.

### 1. Advantages of a general partnership.

- i. *Simple to create and maintain.* There are no special formalities required to form and maintain a partnership. There is more required than for a sole proprietorship, but significantly less than a corporation or LLC.
- ii. *Transferability.* It is easier to transfer an interest in a partnership without having to transfer specific assets as you would with a sole proprietorship.
- iii. *Tax treatment.* The partnership is not a separate tax paying entity. Income, deductions and credits pass through the partnership to the individual partners who report the same on their individual returns. The double taxation issue associated with corporations is avoided.

### 2. Disadvantages of a general partnership.

- i. *Unlimited personal liability.* Each partner is jointly and severally liable for all partnership debt, meaning that if the partnership fails to pay a debt, each partner may be held liable for the full payment of the debt. Each partner is personally liable for all debts of the partnership meaning that a partner's personal non-exempt assets, as well as the business assets, may be subjected to payment of the partnership debt.
- ii. *Management and control.* Management of the partnership is more difficult because partners must be consulted and decisions jointly made. A formal partnership agreement is recommended to eliminate some of these concerns, and to make the business run more smoothly. Potential partners should make sure that their personalities, goals, management styles and work habits are compatible. There will also be a loss of management and control when transferring the partnership to an heir.
- iii. *Tax considerations.* Partners should always seek competent tax advice before creating, changing or dissolving the partnership.

## C. Limited Partnerships <sup>83</sup>

### 1. Advantages of a limited partnership.

- i. *Capital source.* It provides a new source of capital from private investors willing to share in the profits as opposed to lender financing. Thus interest expense is decreased, and profits and losses are spread over more individuals.

- ii. *Limited liability for the limited partner.* A limited partner is only liable to the extent of his investment. A limited partner's personal assets are protected from attempts by creditors to collect the debts and obligations of the limited partnership.
- iii. *Transferability of assets.* To some degree this business structure will allow a partner to transfer an interest in the partnership to another without losing control of the business. An interest in the partnership may be transferred without having to transfer or liquidate specific assets.
- iv. *Tax treatment and considerations.* These are similar to a general partnership, although there may be some differences for the limited partner that are beyond the scope of this outline.

## 2. Disadvantages of a limited partnership.

- i. *Complexity.* It is a much more complex business arrangement than a sole proprietorship or a general partnership. A written limited partnership agreement is necessary. Limited partners will demand more strict accountability in the form of reports and information since they cannot be involved in the day-to-day management of the partnership.
- ii. *Formalities.* State law requires several formalities to create and maintain a limited partnership that are not required for a sole proprietorship or a general partnership. The costs to create and maintain a limited partnership are obviously more as well.
- iii. *Control and management.* Although the limited partner cannot be involved in the day-to-day running of the partnership, the general partner still loses some control because the limited partner may pull his investment out of the partnership if it is not profitable and thus may be able to exercise indirectly some control over what directions the business may take.
- iv. *Unlimited personal liability of the general partner.* The general partner is personally liable for all debts and obligations of the business.
- v. *Continuity.* The limited partnership will terminate upon the occurrence of events set out in the agreement making necessary to reconstitute the business. If a general partner withdraws then all of the remaining partners may agree in writing to continue the business. Thus continuity is not assured as it would be in a corporation.

## D. Limited Liability Partnership.

### 1. Advantages of a limited liability partnership.

- i. The advantages are the same as a general partnership except that there is one major difference that is an advantage to each of the general partners over a general partnership form of business. A partner in a registered limited liability partnership is not personally liable for debts and obligations of the partnership arising out of the negligence or wrongful acts committed in the course of the partnership business by another partner. This is especially helpful if a partner is concerned about the lack of control he has over the actions or conduct of another partner.

### 2. Disadvantages of a limited liability partnership.

- i. The disadvantages are the same as a general partnership except that there are some more formalities required by state law to create and maintain this type of organization.

## E. Corporations.

### 1. Advantages of a corporation.

- i. *Limited liability.* Stockholders are not personally liable for the debts and obligations of the corporation. However, many times stockholders will be required by a lender to co-sign a promissory note or a personal guarantee obligating themselves personally to that particular debt. In addition, if all of a stockholder's property is transferred into a corporation then he may lose it all as well.
- ii. *Continuity.* The existence of a corporation and the continuity of the operation are not affected by the death of a stockholder nor by the transfer of stock in the corporation. This continuity aids in long-range planning and avoids problems of business interruption in the event of the death of a stockholder.
- iii. *Transferability of assets.* Shares of stock provide a simple and convenient way to make lifetime and death transfers. Stock can be transferred without having to transfer specific assets and without affecting the underlying operation. It is thus an aid to estate planning.
- iv. *Control/Management.* By maintaining a majority of the shares of stock, one can maintain control of the corporation. There may also be different classes of stock that will allow a person to have some interest in the corporation but not be allowed to vote in managing the corporation. Thus, parents may be able to transfer an interest in the corporation to other family members who they do not want to participate in the management of the corporation.
- v. *Tax Treatment.* A corporation can deduct certain expenses from income that an individual cannot. Whether or not this may be advantageous to your situation needs to be carefully considered before using it as a basis for incorporation.
- vi. *Economic Efficiency.* Incorporation can provide a structure for growth and expansion of the business. It will give the business more avenues for capital sources rather than relying on lender financing

### 2. Disadvantages of a corporation.

- i. *Complexity.* It is a much more complex business arrangement than a sole proprietorship or a partnership.
- ii. *Formalities.* State law requires several formalities to create and maintain a corporation that are not required for a sole proprietorship, a general partnership, a limited partnership or even an LLC. The costs to create and maintain a corporation are significantly more as well. If the formalities are not complied with, the corporation may be dissolved and lose the limited liability to its stockholders.
- iii. *Taxes--Dissolution or liquidation.* Although there are no tax consequences for a stockholder to transfer assets into the corporation, there will be significant consequences when the corporation dissolves, liquidates or reorganizes, especially when assets will or have appreciated in value.

Competent tax advice should be obtained on these issues before incorporating and after considering the specific needs of your business.<sup>84</sup>

- iv. *Taxes--Double taxation on dividends.* Since a dividend is not a deductible expense from a corporation's income, the corporation pays tax on that income. The dividend is also income for a stockholder and thus the money is actually taxed twice.
  - a. A Subchapter S corporation may avoid this problem since income, deductions and credits are passed through to the stockholders--the corporation itself does not pay taxes on income. However, the restrictions placed on the Subchapter S need to be considered in determining whether the tax advantages outweigh other factors.
- v. *Loss of limited liability.* If a corporation is not adequately funded it may be considered a sham, and stockholders could lose their limited liability. Also if personal funds and assets are not kept separate from the business funds and assets, such that the corporation's separate identity is not honored, the stockholders could again lose their limited liability.

#### F. Limited Liability Company.

##### 1. Advantages of a limited liability company.

- i. *Limited liability for members and managers.* All members and managers of an LLC have limited liability. Just like stockholders of a corporation their liability is limited to their agreed capital contributions (investment). This limited liability exists regardless of the extent to which they participate in management of the LLC's business, in contrast to a limited partnership in which limited liability is contingent on the limited partner not participating in management of the partnership.
- ii. *Tax treatment.* The major advantage for using the LLC, as opposed to a corporation, for a business structure will be for businesses desiring partnership tax treatment combined with limited liability. An S corporation generally, but not always, offers this same advantage. However, an S corporation is subject to many restrictions on ownership. An LLC may offer other tax advantages that an S corporation cannot offer (i.e. in an LLC, appreciated property may be distributed to members without triggering a gain at the LLC level, whereas a corporation would not be able to avoid that gain).<sup>85</sup> The double taxation issue that regular C corporations have to deal with would not be an issue in an LLC since it can be treated like a partnership for income tax purposes. A limited partnership can offer the same tax advantages as an LLC, but it cannot offer limited liability to general partners.

##### 2. Disadvantages of a limited liability company.

- i. *Continuity.* In comparison to a corporation, the LLC does not have the same certainty of continuity and continued existence upon death, bankruptcy or withdrawal of one of the members. The "articles of organization" of the LLC must provide for such continuity, otherwise it will be up to the unanimous consent of the remaining members.
- ii. *Formalities/Complexity.* State law requires several formalities to create and maintain a LLC that are not required for a sole proprietorship or a general partnership. The costs to create and maintain a LLC are

significantly more as well. If the formalities are not complied with the LLC may be dissolved and lose the limited liability to its members.

- iii. *Transferability*. Transferring an interest in the LLC is more difficult than a corporation in that the members must approve the transfer in order for the new member to have the right to participate and have a say in management of the LLC.
- iv. *Control/Management*. Like a partnership, members of an LLC have an equal say in management of the LLC. Careful drafting of the operating agreement and the articles of organization can eliminate some of these concerns; however, potential members, or managers, of the LLC should make sure that their personalities, goals, management styles and work habits are compatible.

**IV. Conclusion.** The issue of how a business should be structured is very complex. Great care and thought should be taken in choosing which structure is best for your operation. Even greater care should be exercised in drafting the relevant agreements, by-laws and other documents constituting your business structure. A thorough financial, legal and tax analysis by competent professionals is essential for making any decision on how to organize your business. Each situation is different and laws are constantly changing. There are many, many exceptions to the general rules discussed above and how they are applied to specific factual situations. The above outline is for general reference purposes only and is not intended as a detailed checklist for making your choice of a business entity. However, it is intended to give you enough information to ask informed questions of the professionals you consult with in choosing and creating a business structure.

**\*\*NOTE TO READER\*\***

**The above outline is designed for general informational use only. In no way is this outline intended to substitute for legal or tax counsel. It is absolutely essential that you obtain the services of an experienced attorney and tax counsel prior to forming a business entity for specific advice about your particular situation. Future changes in laws cannot be predicted, and statements made in this publication are based solely on the laws in force on the date of writing, August 1, 2001.**

**BIBLIOGRAPHY AND REFERENCES**

**All Types of Businesses Generally**

- ◇ Sam Brownback and James Wadley, Kansas Agricultural Law (Second Edition), 1994.
- ◇ Neil Harl, Agricultural Law, (1989)
- ◇ Neil Harl, Farm Estate & Business Planning, (12th Edition), 1994.
- ◇ J.W. Looney, Agricultural Law: A Lawyer's Guide to Representing Farm Clients, 1990.
- ◇ Roger McEowen and James Wadley, Kansas Ag Law Update, A Cumulative Supplement to Kansas Agricultural Law, 2nd Edition.

**Partnerships**

- ◇ "Revised Uniform Partnership Act", Kansas Statutes Annotated K.S.A. 56a-101 *et seq.*
- ◇ "Kansas Revised Uniform Limited Partnership Act", K.S.A. 56-1a101 to 56-1a609.

- ◇ Don Pretzer, "Partnerships as a Farm Business Arrangement", Kansas State University Cooperative Extension Publication C-590 (1978).
- ◇ John R. Wine, Jr., "Kansas Revised Uniform Limited Partnership Act", Volume 53 of the Journal of the Kansas Bar Association (J.K.B.A.) at page 204, (1984).
- ◇ Edwin W. Hecker, Jr., "The Kansas Revised Uniform Partnership Act", 68 J.K.B.A. No. 9 16, (1999)

### Corporations

- ◇ "Agricultural Corporations", K.S.A. 17-5901 to 17-5908.
- ◇ "Kansas General Corporation Code", K.S.A. 17-6001 to 17-7515.
- ◇ Neil E. Harl and John C. O'Byrne, "The Farm Corporation: What it is, How it works, How it is taxed", North Central Regional Extension Publication No. 11.198 (Revised 1992)
- ◇ Roger McEowen, "Planning for the Tax Effects of Liquidating and Reorganizing the Farm and Ranch Corporation", 68 North Dakota Law Review 467-507. (1992)
- ◇ Eric Melgren, "No Mere Yeoman: Incorporating the Family Farm--Considerations and Consequences", 24 Washburn Law Journal 546-573. (1985)

### Limited Liability Companies

- ◇ "The Kansas Revised Limited Liability Company Act", K.S.A. 17-7663 to 17-76,142.
- ◇ Edwin W. Heckler, Jr., "The Kansas Revised Limited Liability Company Act", 69 J.K.B.A. No. 10, 16 (2000).
- ◇ Curtis J. Braukmann, "Limited Liability Companies", 39 Kansas Law Review 967, (1991).
- ◇ Edwin W. Heckler, Jr., "Limited Liability Companies in Kansas", 63 J.K.B.A. No. 2, ('94).
- ◇ Alson R. Martin, "The Kansas Limited Liability Company Act--Business and Tax Considerations", 59 J.K.B.A. No. 9, 17 (1990).

### Footnotes

- 
- <sup>1</sup> K.S.A. 56a-101(f), and 56a-202(a)
  - <sup>2</sup> K.S.A. 56a-201(a)
  - <sup>3</sup> K.S.A. 56a-101(j)
  - <sup>4</sup> K.S.A. 56a-103(a)
  - <sup>5</sup> K.S.A. 56a-101(g); Partnership agreement could be written, oral, or implied pursuant to Kan. Stat. Ann. § 56a-101(g). Therefore, under Kansas law, it was clear that a partnership between debtor and investors in the livestock raising venture existed, even if no formal partnership agreement was ever created. *Bucl v. Hampton (In re Hampton)*, 2008 Bankr. LEXIS 1943 (Bankr. D. Kan. June 27 2008), affirmed by 407 B.R. 443, 2009 Bankr. LEXIS 3327 (B.A.P. 10th Cir. 2009).
  - <sup>6</sup> K.S.A. 56a-103(a)
  - <sup>7</sup> K.S.A. 56a-202(a) and (c)(3)
  - <sup>8</sup> K.S.A. 56a-308(a)-(b)
  - <sup>9</sup> K.S.A. 56a-801

- 
- <sup>10</sup> This outline is not a complete list. See K.S.A. 56a-801 for other examples.
- <sup>11</sup> K.S.A. 56a-801(c)
- <sup>12</sup> K.S.A. 56a-801(d)
- <sup>13</sup> K.S.A. 56a-801(e)
- <sup>14</sup> K.S.A. 56a-801(b); For other examples of what causes dissociation of a partner see K.S.A. 56a-601-2.
- <sup>15</sup> K.S.A. 56a-802
- <sup>16</sup> K.S.A. 56a-306
- <sup>17</sup> K.S.A. 56a-307(c)-(d)
- <sup>18</sup> K.S.A. 56a-307(a)-(b)
- <sup>19</sup> K.S.A. 56a-308(a)-(b) discusses the liability of persons who by words or conduct purport to be a partner or consents to being represented by another as a partner.
- <sup>20</sup> K.S.A. 56a-308(e)
- <sup>21</sup> K.S.A. 56a-401(f)
- <sup>22</sup> K.S.A. 56a-401(j)
- <sup>23</sup> K.S.A. 56a-301(a)
- <sup>24</sup> K.S.A. 56a-301(b)
- <sup>25</sup> K.S.A. 56a-101(m). See K.S.A. 56a-105(c)(1) for the formalities and signatures required.
- <sup>26</sup> K.S.A. 56a-105(a)-(i)
- <sup>27</sup> Other statements not mentioned include: a) statement of merger K.S.A. 56a-907; b) statement of qualification K.S.A. 56a-1001; c) statement of foreign qualification K.S.A. 56a-1102; d) amendment or cancellation of any statement.K.S.A. 56a-101(m).
- <sup>28</sup> K.S.A. 56a-303
- <sup>29</sup> K.S.A. 56a-304
- <sup>30</sup> K.S.A. 56a-704
- <sup>31</sup> K.S.A. 56a-805
- <sup>32</sup> K.S.A. 56a-401(b)
- <sup>33</sup> I.R.C. 701
- <sup>34</sup> I.R.C. 702

- 
- 35 K.S.A. 56-1a101
- 36 K.S.A. 56-1a203
- 37 K.S.A. 56-1a253
- 38 K.S.A. 56-1a203
- 39 K.S.A. 56-1a151 and 1a606
- 40 K.S.A. 56-1a451(a)
- 41 K.S.A. 56-1a451(b)
- 42 Treas. Reg. Section 301.7701-3(a)
- 43 Treas. Reg. Section 301.7701-3(b)
- 44 K.S.A. 56a-101(e); 56a-1001, which requires filing of a "statement of qualification"
- 45 K.S.A. 56a-306(c)
- 46 K.S.A. 17-6002
- 47 K.S.A. 17-6003
- 48 K.S.A. 17-6009
- 49 K.S.A. 17-7503(b); 17-5902
- 50 K.S.A. 17-7510
- 51 I.R.C. Section 11
- 52 I.R.C. Section 1361
- 53 K.S.A. 17-5904
- 54 K.S.A. 17-5904
- 55 K.S.A. 17-5903(d), (j), (k), (m), (n), (o), (u), (w)
- 56 K.S.A. 17-5904 (i.e. corporations involved in feedlots, poultry confinement facilities, rabbit confinement facilities, as well as dairy production facilities and swine production facilities voted favorably by a county resolution.)
- 57 K.S.A. 17-5903(j)
- 58 K.S.A. 17-7673(a)
- 59 K.S.A. 17-7673(b)
- 60 K.S.A. 17-7663(f)

---

<sup>61</sup> K.S.A. 17-7613 which required an operating agreement was repealed effective January 1, 2000. K.S.A. 17-7663(g) covers what may be included in an "operating agreement".

<sup>62</sup> K.S.A. 17-7663(g)

<sup>63</sup> K.S.A. 17-76,139(d)

<sup>64</sup> K.S.A. 17-7687(e)

<sup>65</sup> K.S.A. 17-7693

<sup>66</sup> K.S.A. 17-7693(b)

<sup>67</sup> K.S.A. 17-76,112(a)

<sup>68</sup> K.S.A. 17-76,112(a)-(b)

<sup>69</sup> K.S.A. 17-76,116(a)

<sup>70</sup> K.S.A. 17-76,116(b)

<sup>71</sup> K.S.A. 17-7688(a)

<sup>72</sup> K.S.A. 17-7688(b)

<sup>73</sup> K.S.A. 17-76,101 and K.S.A. 17-76,102

<sup>74</sup> Treas. Reg. Section 301.7701-3

<sup>75</sup> Treas. Reg. Section 301.7701-3

<sup>76</sup> K.S.A. 60-2301 to 2314 contains an extensive list of all the Kansas exemptions. The exemptions available in other states will be different.

<sup>77</sup> K.S.A. 60-2301. In 2011 the statute was amended by adding a reference to K.S.A. 12-534a which provides: “

12-524a. Homestead rights; continuation after annexation; limitation. When land located outside a city is annexed by such city under K.S.A. 12-521 and 12-521a, and amendments thereto, any homestead rights attributable to such land prior to such annexation shall continue after annexation until such land is sold after annexation.

<sup>78</sup> K.S.A. 60-2304(a)

<sup>79</sup> K.S.A. 60-2304(c)

<sup>80</sup> K.S.A. 60-2304(e)

<sup>81</sup> K.S.A. 60-2308 and 2313(a)(1)

<sup>82</sup> K.S.A. 60-2313

<sup>83</sup> The main source for this section is from the book Kansas Agricultural Law, by Brownback and Wadley, specifically "Chapter 6 Farm Business Organization" at pages 119-121.

---

<sup>84</sup> For a detailed analysis of these issues as they apply to farm corporations see "Planning for the Tax Effects of Liquidating and Reorganizing the Farm and Ranch Corporation" by Roger A. McEowen, 68 North Dakota Law Review 467.

<sup>85</sup> For a detailed list of the tax advantages of an LLC over other business forms see "The Kansas Limited Liability Company Act--Business and Tax Considerations" by Alson Martin, 59 Journal of the Kansas Bar Association 17. Also see Kansas Agricultural Law , cited above, at pages 145-148.