

Corporations

A **corporation** is a separate legal entity incorporated under state law that keeps the business distinctly separate from the owners. Stockholders are generally not liable for any debts of a corporation. Creating a corporation is more complicated and more costly than creating a partnership. You must draft and file articles of incorporation and register in accordance with state laws, draft corporate by-laws, hold a board of directors meeting and issue stock.

Corporate management is also more complicated than managing partnerships. Farm corporations may decide to create a very large or a limited board of directors, but generally shareholders owning over 50 percent of the company stock retain managerial power. Minority shareholders generally have little, if any, managerial input.

Transferring corporate stock by sale or gift is relatively easy. On-farm successors can also earn shares of the corporation as compensation. If sales of stock involve capital gains there will be income tax consequences. Also, gifts of stock must fall below \$12,000 per person to remain within the gift tax exclusion. Corporate stock may also be transferred easily by will. Corporate by-laws can be written to deny transfer of stock to persons outside the family.

C Corporation

The distinctive difference between a **Sub Chapter C Corporation** and a **Sub Chapter S Corporation** is the way gains and losses are reported and taxed. A C Corporation is a separate taxpayer. Owners must file one tax return on behalf of the corporation in addition to their individual returns. Profits are only distributed to the shareholders as dividends or salaries. Profits distributed as dividends are taxed as income on the corporate level and again as income to the shareholders in the form of stock dividend. Terminating a C Corporation also has major tax disadvantages. Gains from liquidation will also be taxable both on the corporate and share holder levels. If land is included in the corporation, the tax liability may be disastrous. Stock can be held as common or preferred and distribution between the two classes is flexible.

S Corporation

Gains and losses in **S Corporations** flow through to the individual shareholders. The corporation does not file its own return because profits and losses are reported on shareholder returns. S Corporations are limited to one class of stock and not over thirty-five shareholders. Terminating an S Corporation can also be difficult; however, only the shareholders will be taxed.

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