

The state of Iowa allows for several different forms of business. The choice of a business entity affects liability, taxation, capitalization, decision making, agricultural government payments, gifting, or transfer options. Such a decision requires much thought and advice from professionals such as attorneys and accountants when deciding on which business structure is appropriate. This publication is not intended to provide legal advice but to familiarize you with some of the terms and concepts. A table is provided at the end of this publication to compare the various options available.

The business structures allowed in Iowa include:

- Sole Proprietorship
- General Partnership (Iowa Code chapter 486A)
- Limited Partnership [Domestic or Foreign] (Iowa Code chapter 488)
- Limited Liability Partnership [Domestic or Foreign] (Iowa Code chapter 486A)
- For Profit Corporation [Domestic or Foreign] (Iowa Code chapter 490)
- Nonprofit Corporation [Domestic or Foreign] (Iowa Code chapter 504)
- Professional Corporation [Domestic or Foreign] (Iowa Code chapter 496C)
- Limited Liability Company [Domestic or Foreign]

“For Profit Corporations” are further divided into C corporations and S corporations. In addition, there are provisions for different types of cooperatives.

Liability

Individual liability for debts and torts varies based on the business structure. Often preference will be given to a business structure that limits the individual’s financial liability to the equity contributed and shields the other personal assets from possible business exposure.

Taxes

Another factor is the way that the business will be taxed. Some entities allow for the pass through of tax liability. Others may be subject to double taxation but will have more favorable tax rates, tax deductions, fringe benefits, or possible “minority shareholder discounts” for estate planning. Advice from a tax attorney is critical to understanding the implications.

Capitalization

Equity in a business can be raised from personal contributions, borrowing, or including other investors. Each business structure has unique issues relating to how this can be done. Keep in mind that a lender may still want personal guarantees on loans to provide additional collateral on borrowed capital.

Decision Making

The business structure can also impact the amount of decision making and control that other investors have. Certain classes of shareholders may or may not have voting rights. Some may have buy-sell agreements or other restrictions on transfer of shares or units. The structure also impacts the complexity of the organization, record keeping, tax reporting, and related costs.

Agricultural Program Payments

In the past, USDA farm program payments have been a substantial part of farm profits. Eligibility and payment limits can be impacted by the type of business structure. The USDA rules have changed over time and continue to be a moving target. Currently the programs look at payments at the business level and at the individual level.

Gifts or Transferring Ownership

Often we want to transfer wealth to the next generation by gifting, commonly using the annual gift tax exclusion. We may or may not want to give the income from assets that are transferred or control of the business. For estate tax planning, we may also want to qualify for “minority shareholder discounts” on the shares of assets given away as well as those that are retained in the estate.

Business Name

After a decision is made as to the type of business entity the next step may be to select a name. The Iowa secretary of state maintains a database of names that have been used by Iowa-based companies. You can search the list online to see if your proposed name is already taken or is so similar to others that it might cause confusion. Search the [database](http://sos.iowa.gov/) at <http://sos.iowa.gov/>.

Also, make sure you don’t infringe on someone else’s [trademark](http://www.uspto.gov/trademarks/index.jsp) by checking <http://www.uspto.gov/trademarks/index.jsp>.

Business Entities

Sole Proprietor (SP)

The simplest and most common form of business entity is the sole proprietorship. This provides you with a great deal of control. All you need to do is start doing business. A business license, sales tax permit, purchase

insurance, or registered name may be useful, but is not required in this situation. Record-keeping requirements may be less. The assets may be transferred easier and financing may be simpler.

A major disadvantage is that personal assets are not protected from creditors of the business. These businesses tend to have limited life if the owner dies. All income is taxable and subject to self-employment taxes subject to limits.

General Partnership (GP)

A partnership is a legal entity created by two or more people wanting to operate a business together. Partners transfer money or property to the entity in exchange for a partnership interest. They are very easy to set up. They can be set up formally (written operating agreement) or informally. The name of the partnership should be registered. One caution is that people may unintentionally set up a partnership by holding themselves out to the public as a partnership; for example, by selling grain in the names of two people. A crop-share landlord is not in a partnership necessarily but you may want to reinforce that by stating it in the lease.

One limitation of the partnership is that all partners are able to conduct business in the name of the partnership thus binding them to contracts and financial obligations. One option to limit a partner’s exposure is to become a “limited partner,” which would limit your financial exposure to the amount invested. This requires a written agreement and filing with the secretary of state.

If all of the partners agree, an incoming partner may purchase or be given a partnership interest. A person or entity could

also be given interests as compensation for labor or management given to the partnership.

Partnerships have specific rules about how they are dissolved, but usually can easily be dissolved. They automatically dissolve if one of the general partners dies, withdraws, goes bankrupt, or has legal disability, often resulting in unintended tax consequences for the other partners. Buy-sell agreements can provide requirements for the dissolving of a partnership.

Partnerships are taxed as “pass through entities.” The partnership gets its own tax identification number and files tax returns. The partnership’s earnings, capital gains, or losses flow through to the individual and are taxed at the individual’s rate. Individuals are responsible for self-employment taxes. Your basis in the partnership totals the amount of money you brought in plus the basis in property that you transferred in plus the share of the partnership liabilities you assumed.

The advantages of a partnership are that they are easy to set up and the income is taxed the same as a sole proprietor. The disadvantages are your assets are subject to creditors, partners can bind you to contracts, and they may have to be dissolved to separate interests.

Limited Liability Partnership (LLP)

Another way to limit liability is to become designated as a limited liability partnership. A limited partnership has one or more general partners and one or more limited partners. A person becomes a limited partner either by the consent of all the partners, as a result of a conversion or merger, or as provided in the partnership agreement. Limited partners don’t participate in management. If you do, you may be considered a general partner with the associated liability issues.

A limited partner cannot bind the partnership. An obligation of the limited partnership is not an obligation of the limited partner, even if the limited partner is involved in management or control. A limited partner doesn’t have a fiduciary responsibility to the partnership. All general partners are liable jointly and severally for all obligations of the limited partnership unless otherwise agreed to by the claimant or provided by law.

Limited partnerships are taxed the same way as general partnerships.

Family Limited Partnerships (FLP)

Family limited partnerships are restricted to family members. The parents generally set up the partnership. Then, over time, they transfer shares of the partnership to the children or grandchildren. Often parents are using the annual gift exclusion (\$15,000 in 2019) to make these tax-free transfers. The management may be kept with the general partners so a large percentage of the partnership could be gifted away with the parents still maintaining control. The income tax liability for profits goes with the ownership interest so you want to watch the income tax liability and the income distribution together.

The restrictions on the ownership of the FLP may make it difficult for someone wanting to sell out since family members are the only ones eligible to buy. If the partnership has to be dissolved, there will probably be some significant income tax issues to deal with. One of the reasons for using a FLP is to reduce the value of the assets for estate tax purposes. This may result in the partnership’s assets being reduced by 25 percent or more for valuations.

“C” Corporation

The traditional corporation is the “C corp”. It has investors called stockholders and they are only at risk for the amount they have invested in the company. The stockholders elect a board of directors that hires the management. In small family corporations, stockholders, board members, and officers are often the same people. Minority shareholders may have very little decision making in the operation of the corporation. The stockholders have one vote for every share of stock they own.

The corporation can generally continue indefinitely. Small, closely held corporations need to maintain records of annual meetings and elections and file annual or biannual reports as required if they want to maintain their status. The corporation, at start-up, files “Articles of Incorporation.” Corporations require more recordkeeping than other types of business entities.

The corporation is taxed as a separate entity. The corporation pays taxes on its profits and then, when it pays out profits to the shareholders in the form of dividends, the shareholders may pay taxes on the profits again. In the past, corporations had lower tax brackets and greater deductibility of fringe benefits. C corps may have a fiscal tax year different than the calendar year.

Traditionally, C corps were viewed as a way to pass ownership onto the next generation by gifting, selling, transferring for compensation, or by inheriting shares of stock. That is why you may find land owned by the corporation. At death the shares of stock get an adjustment in basis, but the underlying assets don’t, which can result in significant tax liability issues if the corporation is liquidated. It is possible to convert a C corp to an S corp.

“S” Corporation

The “S corp,” which is a special form of the C corp, is also referred to as “Subchapter S,” referring back to provisions in the federal tax code. The S corp has limited liability like the C corp, but it is taxed like a partnership. The income and the deductions flow through to the individual tax payers, who may be able to utilize potential tax losses in the start-up phase. S corps must use a calendar year for tax purposes.

Some restrictions on the S corp are that it is limited to 100 shareholders, may not have a corporate shareholder, and may not have more than one type of stock. There are filing requirements as well.

Many of today’s S corps started out as C corps, but were converted to S corps. The IRS states that if more than 25 percent of an S corporation’s gross receipts consists of passive income for three consecutive years when the corporation has accumulated earnings and profits, the S corporation will automatically lose its subchapter S status. Cash rent from farmland would be “passive income.”

Limited Liability Company (LLC)

The most recent form of business is the limited liability company. It is a simpler form of business than a corporation, retains the limitation of liability, while still providing the option of having pass through taxation by making an “election.”

The formation of an LLC is similar to a corporation but the owners are called “members.” The ownership is in units instead of shares, and the directors are called managers. Iowa does allow a single-member LLC, but LLCs are not recognized everywhere.

If it is a single-member LLC, it is a disregarded member for income tax purposes.

Management of an LLC can be very flexible depending upon what the Certificate of Organization and the Operating Agreement require. Distribution of profits is also flexible. The IRS may not allow as great a discount for minority shareholder interests due to the flexibility in transferring business interests.

Other Considerations

The type of business structure may impact USDA Farm Service Agency (FSA) programs as well as other government programs. Rules change over time; to find out the current implications, visit the local FSA office to understand liability issues beyond what the entity may provide and reasons that you may still have liability issues.

When putting together a business structure think about how the business will deal with gifts, transfers, sales, buy-sell agreements, financial stress, death, termination, or transfer to the next generation.

There are other business arrangements such as labor sharing agreements, machinery sharing agreements, livestock production contracts, and strategic alliances that may be useful.

Seek competent professional advice before forming an entity.

Additional Resources

Ag Decision Maker

[Transition and Estate Planning](http://www.extension.iastate.edu/agdm/wdbusiness.html) - www.extension.iastate.edu/agdm/wdbusiness.html

[Business Arrangements](http://www.extension.iastate.edu/agdm/wholefarm/html/c4-40.html) - www.extension.iastate.edu/agdm/wholefarm/html/c4-40.html

[Farm Business Choices](http://www.extension.iastate.edu/agdm/wholefarm/html/c4-41.html) - www.extension.iastate.edu/agdm/wholefarm/html/c4-41.html

[Partnerships](http://www.extension.iastate.edu/agdm/wholefarm/html/c4-46.html) - www.extension.iastate.edu/agdm/wholefarm/html/c4-46.html

[Corporations](http://www.extension.iastate.edu/agdm/wholefarm/html/c4-47.html) - www.extension.iastate.edu/agdm/wholefarm/html/c4-47.html

[Center for Ag Law and Taxation](http://www.calt.iastate.edu) - www.calt.iastate.edu

[Iowa State Bar Association](http://www.iowabar.org/) - www.iowabar.org/

[Iowa Code](http://www.legis.iowa.gov/law/statutory) - www.legis.iowa.gov/law/statutory

Ch. 486A Uniform Partnership Act

Ch. 488 Uniform Limited Partnership Act

Ch. 489 Revised Uniform Limited Liability Company Act

Ch. 490 Business Corporations

Ch. 497 Cooperative Association

Ch. 498 Nonprofit Cooperative Association

Ch. 499 Cooperative Association

[Iowa Secretary of State](https://sos.iowa.gov/) - https://sos.iowa.gov/
First Floor, Lucas Building, 321 E. 12th St.
Des Moines, IA 50319
(515) 281-5204

IRS Taxpayer Assistance Center
210 Walnut St., Des Moines, IA 50309
(515) 564-6618

[Tax Information for Businesses](http://www.irs.gov/businesses) - www.irs.gov/businesses

[Forms and Publications](http://www.irs.gov/forms-instructions) - www.irs.gov/forms-instructions

[Taxpayer Services](http://www.iowa.gov/tax/business/business.html) -

www.iowa.gov/tax/business/business.html
Iowa Department of Revenue
P.O. Box 10457, Des Moines, IA 50306-0457
(515) 281-3114 or (800) 367-3388

Relative Advantages and Disadvantages of Various Business Forms

Issue	Sole Proprietorship	C Corporation	General / Limited Liability Partnership	Limited Partnership	Limited Liability Company	S Corporation
Nature of Entity	Legal person same as the owner	Legal person separate from shareholder-owners	Aggregate of two or more persons	Aggregate of two or more persons	Aggregate of two or more persons	Legal person separate from shareholder-owners
Life of Business	Fixed term; ends when owner dies	Perpetual or fixed term of years	Agreed term; terminates at death of partner; LLP must register annually	Agreed term; terminates at death of partner	Agreed term; terminates at death of partner	Perpetual or fixed term of years
Management Decision	Sole proprietor	Elected directors and officers selected by directors	Usually agreement of partners	Usually general partner	Usually manager is elected	Elected directors and officers selected by directors
Formation of Entity	Very simple	Relatively simple	Relatively complex; LLP must register	Relatively complex	Relatively simple	Relatively simple
Flexibility in Capitalization	N/A	Very flexible	Very flexible	Very flexible	Very flexible	Somewhat inflexible
Limited Liability	None	Yes	No; LLP partner exempt from co-partner's torts	No for G.P./Yes for L.P.	Yes	Yes
Flexibility in Conducting Business Affairs	Inflexible	Flexible	Flexible	Relatively flexible	Relatively flexible	Somewhat inflexible
Flexibility in Taxable Year	None	Yes	No	No	No	Little
Allocation of Income, Losses, Deductions, and Credits	N/A	Somewhat inflexible	Very flexible	Very flexible	Very flexible	Generally inflexible
Tax Effects Upon Liquidation	No double tax	Difficult to avoid double tax	No double tax	No double tax	No double tax	Generally no double tax (Section 1374)
Convertibility to Another Entity Tax-Free	Yes	Some restrictions	Yes	Yes	Yes	Some restrictions

Relative Advantages and Disadvantages of Various Business Forms, continued

Issue	Sole Proprietorship	C Corporation	General / Limited Liability Partnership	Limited Partnership	Limited Liability Company	S Corporation
Line of Business	Very flexible	Few restrictions	Flexible; LLP some restrictions	Very flexible	Few restrictions	Few restrictions
Self-employment Income from Entity	Yes	No	Yes	Yes - GP No - LP	Usually; See Proposed Regs§ 1.140-2(a)-18	To extent of salary and bonus
Effect of Passive Loss Limitation Rules	N/A	Applies at corp. level/generally avoidable for larger corps.	Partners may or may not materially participate	Ltd. partners deemed not to materially participate	Members may or may not materially participate	Shareholders may or may not materially participate
Availability of Entity Losses to Owners	N/A	No	Flow through of losses to owners	Flow through of losses to owners	Flow through of losses to owners	Flow through of losses to owners
Fringe Benefits	Limited compared to C Corp	Widest available	Limited compared to C Corp	Limited compared to C Corp	Limited compared to C Corp	Limited compared to C Corp
Estate Planning Opportunities	Fair	Very good	Good	Very good	Very good	Fair
Accumulated Earnings and PHC Tax	N/A	Section 531 and Section 541 applicable	No	No	No	No
State Taxes	Same as individual	Generally uniform and deductible	Generally uniform	Generally uniform	States vary	States vary
Dividend Received Deduction	N/A	Allowed	Not allowed	Not allowed	Not allowed	Not allowed
Effect of Bus. Liabilities on Owner's Basis	Full effect	No effect	Proportionate share	Limited partners share in nonrecourse	Proportionate share	Only share-holder's own loans
Alternative Minimum Tax	Subject to AMT	Subject to corporate AMT	Preference items flow to each partner	Preference items flow to each member	Preference items flow to each member	Preference items flow to each share-holder
Method of Accounting	Cash method	Depends on size and ownership	Generally may use cash method	Generally may use cash method	Generally may use cash method unless farming syndicate	Generally may use cash method

Source: *Principles of Ag Law*, Roger A. McEowen, Neil E. Harl

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United States
Department of
Agriculture

National Institute
of Food and
Agriculture



This material is based upon work supported by USDA/NIFA under Award Number 2010-49200-06200.

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Prepared by Kelvin Leibold
farm and business management specialist
kleibold@iastate.edu, 641-648-4850

www.extension.iastate.edu/agdm
store.extension.iastate.edu
