Advantages of Incorporating Your Livestock Business

John Alan Cohan

Frequently the question is presented concerning the advantages that may or may not be available for a cattle ranch reorganizing its business structure into a corporate entity. While almost all of the larger cattle operations are operated under a corporate entity, many medium or smaller scale ranches still operate either as a sole proprietorship or as a partnership. This article will discuss the issues to consider in deciding whether incorporating your business may be a prudent alternative.

It is important for one considering doing business as a corporation to evaluate the various responsibilities of operating this form of business. There are certain record-keeping requirements and ongoing maintenance factors, such as minutes, periodic elections of officers, decisions concerning how much stock should be issued and to whom, structuring of the bylaws, protection of the corporate name and fictitious business names used in conjunction with the corporation, and other issues. Almost always, it is necessary to obtain legal assistance in the creation and ongoing maintenance of a corporation.

One chief advantage of operating as a corporation is that the tax rate on corporate profits (especially if the profits are below $50,000) is lower than the rate applicable to individuals, and this permits business profits to be sheltered from the higher individual tax rates. Another advantage is that the corporation can pay "reasonable" salaries to any shareholders who actively participate in the management of the business. Salaries paid by the corporation can be paid to family members who are shareholders, and are tax deductible by the corporation. Another benefit available in the corporate form is that shares of stock can be sold (assuming compliance with securities laws) as a means of raising revenue for the corporation. Quite often a family will create a corporation because the free transferability of stock is an important estate planning device. A senior member of the family, for example, can periodically give corporate stock to other relatives, and thereby reduce his taxable estate.

Further tax-saving benefits can be realized if an existing cattle business, operating as a proprietorship, transfers its assets to a newly formed corporation. A much lower tax bill will be realized by the corporation upon the sale of cattle than would be the case if the cattle were sold by the proprietorship that previously owned the assets.

Under the 1986 Tax Reform Act, the cash method of accounting is still available for a corporation involved in the cattle business if it is a family corporation and has less than $1,000,000 in gross receipts.

Another major feature of being organized as a corporation is that shareholders have no personal liability for business losses, debts, obligations, or acts of negligence, and parties must pursue their remedies solely against the assets of the corporation.

Under the tax laws, a corporation itself is a taxpaying entity, which must pay taxes based on its profits. When distributions are made by the corporation to shareholders, the distributions are usually treated as dividends and taxed as ordinary income. If the corporation has no earnings, but instead has sustained losses, any distribution would instead be treated as a return of capital, which is not taxed, but reduces the basis of the shareholders' stock.

It is sometimes desirable to make distributions of property, such as cattle or breeding rights, instead of cash distributions. Distributions of this kind are nevertheless treated as taxable dividends based on the fair market value of the property or intangible item transferred to the shareholder.

Frequently people will transfer cattle and other assets to create the corporate entity, and receive stock in exchange. This is normally a tax-free transaction as long as the person or persons making the transfer of property have control of the corporation by owning at least 80% of the total voting power and stock in the corporation.

It may be desirable to designate the family-owned corporation as a "Subchapter S" corporation. An "S" corporation is a regular corporation except that, for tax purposes, the income is "passed through" to the shareholders. The corporation itself does not pay income tax. An "S" corporation is similar to a partnership, where profits and losses are allocated among the partners in accordance with their agreement.

A corporation, once established, can also engage in several different kinds of business activities under the same auspices, with each activity having the same types of protection and benefits of the corporate form of doing business.

Finally, it is usually desirable to prepare a shareholders' agreement and/or a voting trust agreement once the corporation is created to insure that the intended business objectives of the corporation will be carried out and that possible disputes or deadlocks in decision-making can be avoided. A voting trust agreement, for example, requires that certain shareholders delegate their voting rights to a third party who exercises the rights on behalf of the shareholder. A shareholders' agreement can cover many issues, but basically it provides for a uniform understanding among the shareholders as to the future course of business intended to be take by the corporation.

This article has highlighted the main points to consider in deciding whether to incorporate your particular business. For additional information or assistance, readers may feel free to contact the author.

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