Tips for Setting Up & Managing Your Business

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What does it take to get started?

- General knowledge of the ag industry
- Recognition of your business opportunity or advantage
- Market for your product and understanding of that market
- Technical knowledge of crop production practices and/or livestock production
- Financial resources to develop your operation
- Necessary business management skills
Business Structure

- Management Structure
- Financial Structure
- Legal Structure
Management Structure

- **Definition**
  - How decisions are made and who makes them
  - How responsibilities are allocated among individuals

- **Types of Management Structure**
  - Hierarchical, top-down
    - Decision making authority retained at the top
  - Decentralized
    - Shared decision making

- Importance of multi-generational enterprises
Financial Structure

- Definition
  - How ongoing business operations are financed
  - How income is distributed
- Issues
  - Opportunity for investment by new owners or others – Transfer/Succession
  - Sharing of business income
Legal Structure

O Definition
O Legal relationships between and among the current and future owners and between current or future owners and third parties, such as lenders and vendors

O Components
O Legal entities under which current and future owners operate the business
O Legal agreements governing the transfer of ownership, management, and control of farm business
Choosing a Legal Entity

- Factors to Consider
  - Management and Control
    - Is business to be run by single individual or will there be multiple owner/operators?
  - Owner Liability
    - How important is it to limit the personal liability of business owners for business debts and obligations to amount of investment in business?
Choosing a Legal Entity

- Factors to Consider
  - Tax Treatment
    - “Double taxation” – entity pays taxes on profits and owners pay taxes on any profits distributed to them
    - “Pass-through entity” – entity does not pay taxes on profits, instead tax obligation “passes through” entity to owners (“single taxation”)
Choosing a Legal Entity

- Transferability of Ownership Interests
  - How easy is it for owners to transfer interest in the business?
    - Affects ability to raise additional financial capital
    - Affects ability to control who owns and has say in operation of business
Choosing a Legal Entity

- Factors to Consider
  - Continuity
    - What happens if an owner dies or otherwise withdraws from the entity? Continue in existence or must a new entity be formed?
  - Start-up Costs and Burden
    - Legal, filing, and other fees
  - Administrative Costs and Burden
    - Formalities – annual meetings, etc.
    - Annual fees
Legal Entities

- Sole Proprietor
- General Partnership
- Limited Partnership
- Corporation
  - S-Corporation
- Limited Liability Company
Sole Proprietor

- No legal distinction between business and individual
- No limitation of liability
- Can operate as DBA
- No agreements or filings necessary
- Simplest, easiest to start
General Partnership

- Voluntary association of 2 or more individuals, partnerships, corporations
- Formed by oral or written agreement
- No filing requirements in TN
- Do not enter into lightly
  - All partners personally liable for debts/obligations
  - Any partner can legally obligate the partnership
Limited Partnership

- Similar to general
- Limited partner invests capital but does not have right to manage
- No unlimited liability – only up to the amount invested
- Limited liability but more filing documents
Corporation

- Distinct from owners
- Operations governed by state laws
- Shareholders
- Must pay taxes on profits
  - Except S-Corporation
Limited Liability Company

- Combines favorable attributes of partnerships & corporations
- Must file annual report
- Oral or written operating agreement
- Can be pass-through or taxed as corporation
Record-Keeping vs. Record Analysis

- Record-Keeping
  - Filing
  - Categorizing
  - Maintaining
- Record Analysis
  - Evaluating
    - Make informed decisions
What are your goals for the record keeping system?

- Keep what is needed for tax purposes
- Be prepared for the unexpected
- Plan ahead
- Communication
- Business analysis
  - Be able to accurately identify share of income and expenses
  - Determine costs of production per unit
  - Know where profit (and/or loss) centers are in the operation
Records for tax purposes

- Cash records
  - Farm income and expenses
  - Employee payroll
  - 1099’s
  - Asset sales and purchases
  - Keep most items 3-7 years
Tax records

- www.irs.gov
- Publication 225, Farmer’s Tax Guide
- Publication 552, Recordkeeping for Individuals
- Publication 583, Starting a Business and Keeping Records
Methods of Record Keeping

- Pen & Paper
- Spreadsheets
- Computer Programs
  - Quicken
  - QuickBooks
  - PCMars
- Pay for Service
What features do you require?

- Inexpensive
- Flexible
- Easy to use
- Able to “grow” with the business
- Allows for both farm and family records
- Comprehensive (or at least meets many needs)
Questions records can answer

- Are my costs of production too high?
- What kind of risk management strategies should I be using?
- Am I making more on crops or livestock?
- Should I buy or raise hay? Heifers?, etc.
- What is my break-even price?
Using Records

- Historical analysis – Financial performance
- Current assessment – Financial position
- Forward planning
- Whole Farm/Enterprise
Measurements

- Liquidity (current ratio = current assets/current liabilities)
  - Low stress >2
  - High stress <1

- Solvency (debt/asset ratio = total farm liabilities/total farm assets)
  - Low stress <40%
  - High stress >70%
Measurements

- **Profitability**
  - Net Farm Income = Revenue - expenses +/- gains/losses

- **Efficiency and Repayment Capacity**
  - Interest Expense Ratio = Total farm interest/Gross farm revenues
    - Low stress <10%
    - High stress >20%
Control Family Living Expenses

- Often only estimated.....most likely significantly underestimated
- Plan for changes that may impact operation
- Create a budget
- Cash flow plans do not work when you
  - Leave things out
  - Overcomplicate your plan
  - Don’t actually do it
  - Don’t actually live it
Manageable Debt Load

- Utilize the “good times” to reduce outstanding debt
  - AFTER YOU PAID YOUR TAXES
- Farmers are land rich and cash poor
- Make smart purchase and pre-buy decisions
Business Plan

- Document that summarizes the operational and financial objectives of a business and contains the detailed plans and budgets showing how the objectives are to be realized
Why do I need one?

- Think through financial details of projects
- Operational guide
- Requirement from lender
- Reflects how well you can plan, organize, implement and market
Goals

- Short-term
- Intermediate
- Long-term
- Write it down
- Commit to it
Business Planning Bottom Line

- Farm businesses that developed business plan were 2 times more profitable.
- Producers who communicate were 21% more profitable.
- Producers who separated business and family issues were 63% larger and had 22% higher net income.

Source: Business Planning Lite, Dr. David Kohl, Virginia Tech
Where Do I Start?

- Establish a team
- Seek information from qualified and reputable sources
- Pay for professionalism
- Put together a business plan
Tax Update

- New Marginal Tax Rates & Brackets
  - Corporate rate = 21%
- New Standard Deduction
- No Personal Exemption
- Increased Child Tax Credit
- New uses for 529 Plan
- Interest Deduction Lower Limit ($1M to $750K)
- SALT Deduction Limit
Tax Update

- Bonus depreciation increased
  - $1M
  - New & Used
- Sec 179 increased to $1M
- Regular depreciation
  - Life of asset reduced for new equipment
  - Tax Method change
- NOL can offset only 80% of taxable income
- NOL carrybacks are generally prohibited
  - Farm carryback 2 years
Tax Update

- Estate Tax Exemption
  - $5.49 to $11.2
- Charitable Donation limit increased to 60% of income
- Medical Expense threshold reduced from 10% of AGI to 7.5%
- Obamacare penalty revoked in 2019
  - Penalty can still be assessed in 2018
Tax Update

- Other eliminations
  - Casualty & theft losses eliminated (except federally declared disaster)
  - Unreimbursed employee expenses
  - Tax preparation expenses
  - Alimony payments
  - Moving expenses
  - Employer-subsidized parking & transportation reimbursement
“The greatest crop you will ever raise is your children.”
~ Dr. David Kohl
Thank You!