Getting Your Business in Order

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Outline

- Setting up the correct business structure for your farm
- Importance of business records of your farm
  - Methods of maintaining good records
- Understand the financial condition of your farm
  - Ways to improve it and preserve it
- Knowing your farm’s true assets
- Transferring a farm to the next generation
Choosing the Right Business Structure

• Ownership structure of the farm
  – Establishes the management team
  – Helps to define who has responsibilities regarding farm debts and business liabilities
  – Sets up parameters for transferring business ownership and control of the farm
Business Structure

• Things to keep in mind:
  – Management of the Farm
    • Will the business be managed by one person or by a team of people?
    • Do you intend the business to continue on after your death?
  – Liability of the Farm
    • Are you involved in a business where you might find yourself and personal assets placed at risk?
    • Do you need to limit the personal liability of the owners from the debts and obligations of the business?
Business Structure

• Things to keep in mind:
  – Taxation of profits
    • Double taxation occurs under certain business structures. The business is taxed on profits and the owners of the business are also taxed on the profits they receive from the business.
    • Pass through entities allow for business to pass on profits to the owners without being taxed. The taxation of profits occurs at the owners personal income tax bracket since the earnings are directly passed along to the owners.
Business Structure

• Most commons business structures:
  – Sole proprietorship
  – Partnerships
    • General
    • Limited
  – Corporation
    • S-corporation
  – Limited liability company

• The choice of structure plays a large role in transferring ownership interests and control of the farm!
Business Structure

• Sole Proprietorship
  – The owner and the business are one
  – Inseparable liability and responsibility for operations of the farm
  – When the owner passes, the business ceases. Unless you have specified a successor and transferred business assets and liabilities.
  – No operation agreements or filings with the state
  – Easiest business structure by far, but has the most exposure.
Business Structure

• Partnerships
  – General partnership: association of two or more persons to carry on a business as co-owners for a profit.
    • A “person in a partnership” can be another partnership or corporation.
  – Can be formed by either an oral or written agreement; formal and informal
  – Does not require any filing with the State of TN
  – All partners are held liable for the debts of the partnership
    • Any single partner can legally obligate the partnership. You have to trust your partners completely or do not enter into a partnership.
Business Structure

• Partnerships
  – Limited: much like a general partnership; however, limited partners invest capital into the business but do not have any management rights.
  – Unlike a general partnership, there is no unlimited liability.
    • Limited liability to the amount of contributed capital.
    • Limited partners do not have management control
Corporations

• Corporations operate as an entity that is distinct from its owners. It operates an individual as it can take on debts, sue others, be sued, and enter into contracts.

• Operations of the corporations are governed by state laws.
  – Shareholders own the corporation
  – Board of directors govern the corporation
  – Managers run the corporation
Corporations

- Profits in corporations are taxed
  - Corporate profits are subject to “double taxation” with profits being taxed when earned by the corporation and also taxed when distributed to the shareholders as dividends.
  - Corporations can elect to be Subchapter S corporations (S-corporations), which are pass-through entities that do not pay taxes on corporate profits.
Limited Liability Companies

• A hybrid of proprietorships/partnerships and corporations.
• It has the advantage of limited liability without double taxation of profits if set up correctly.
  – Can be taxed like a corporation if set up as a corporation instead of a partnership
  – Liability is limited to what member contribute to the entity
  – Operating agreement specifies the management of the LLC
Why worry so much about entity structure?

- If you have other existing businesses, you may want to separate things to protect other assets.
- Desire to limit personal risk from the business.
  - Business structure can help with that.
- Transfer of business from one generation to the next can be partially taken care of with the correct business structure.
- Written business agreements, such as operating agreements, can mitigate disputes between business partners.
Why is recordkeeping so important?

• In managing a farm, there may be no greater task than keeping up with the records of the business.

• Records have to be kept for:
  – Production
  – Financial
  – Taxes
  – Personnel
  – Lists goes on and on.
Why is recordkeeping so important?

• Managers need to be aware of the difference between recordkeeping and record analysis.
• Recordkeeping is just a menial task.
  – Collection and entering data
• Analyzing your records to make good management decisions is invaluable.
  – Evaluating and improving performance
• Huge difference between the two!
How do I keep better records?

• Paper and pen – still works even in 2019…
• Electronically – spreadsheets, bookkeeping software, etc.
  – Common examples:
    • Excel – huge help in tracking income, expenses, and overall business performance.
    • Quicken – an excellent tool for tracking income and expenses for your farm that can generate reports very easily for your tax preparer.
    • QuickBooks – another excellent software that is good at tracking all aspects of your businesses.
      – Preferred by many accountants since you can share files seamlessly with them.
        » Possibly overwhelming for some folks. If you do not use payroll or use invoices, you may consider Quicken.
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What do you want to get out of your recordkeeping?

- Information to complete taxes
- Help prepare for sudden changes in the business
- Planning for changes such as expansions or contractions
  - Good and the bad will happen
- Easily communicate your operation’s performance with lenders, accountants, and other advisers.
- Business analysis
  - Determine break even levels, what is making/losing money, and know what to change.
What do you need your recordkeeping to be able to do?

• Be inexpensive
• Be flexible
• Skills required to use – that depends on you
• Track both farm and non-farm income and expenses
  – In most poultry operations, you must be able to look at both.
• Can it still be used as the business grows?
What do I use my records for?

- Determine if some costs are too high
- Determine if revenues are enough to cover expenses, pay debt obligations, and pay yourself.
- Does the poultry operation pay its own way?
- Am I making payments for the poultry barns from other enterprises or vice versa?
- Can I handle a shortfall in any of my enterprises?
What do I need to use records for?

• Look at how the farm’s performance has trended over the past few years.
• Analyze the farm’s current financial situation.
• Plan for future changes that you want to make.
• Better yet: Complete a whole farm cash flow to see how the entire operation is performing to include all farm and non-farm income, expenses, debt obligations, and any potential taxes.
• Make annual decisions such as extra debt payments, what do regarding equipment purchases, depreciation, etc.
What should you be aiming for?

• Lenders look at three main financial criteria.
  – Cash flow ratios
    • Example: Repayment capacity ratios and debt coverage
      – Varies by lender, but higher than 1.25x on a DCR is acceptable
  – Liquidity ratios
    • Example: Current ratio (current assets / current liabilities)
      – Higher the ratio above 1.00 the better as it indicates less financial stress
      – Lower than 1.00 means that you are in short on cash regarding upcoming operating expenses and debt payments
  – Solvency ratios
    • Example: Debt to asset ratio; Less than 30% is strong and higher than 70% signifies financial weakness
Managing Your Debt

- Poultry houses aren’t cheep.
  - Pun intended grammar ninjas.
- Very solid advise is to pay off the houses early if cash flow allows.
  - Not only builds equity in the event of a needed refinance for any major changes to the barns, but helps you pay less over the life of the loan.
- Farmers tend to be very dirt rich and cash poor.
Develop a Business Plan

• Include financial information of your farm
• It helps you in operating your farm, which is the most important benefit.
  – Also required by your lender!
• Demonstrates how good a manager you are and want to be.
What should be in my plan?

- Production and financial records
- Goals for the near futures and long term
- Budgets for the poultry operation
- Budgets for other enterprises
- Whole farm cash flow
- Assistance is available to you FREE of charge from the UT Extension Farm MANAGE program!
Question/Comments

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