



# Veiling the Farm

A Look at Entity Formations in Tennessee, and are Any of them Right for Me?

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**DISCLAIMER!**

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LEGAL

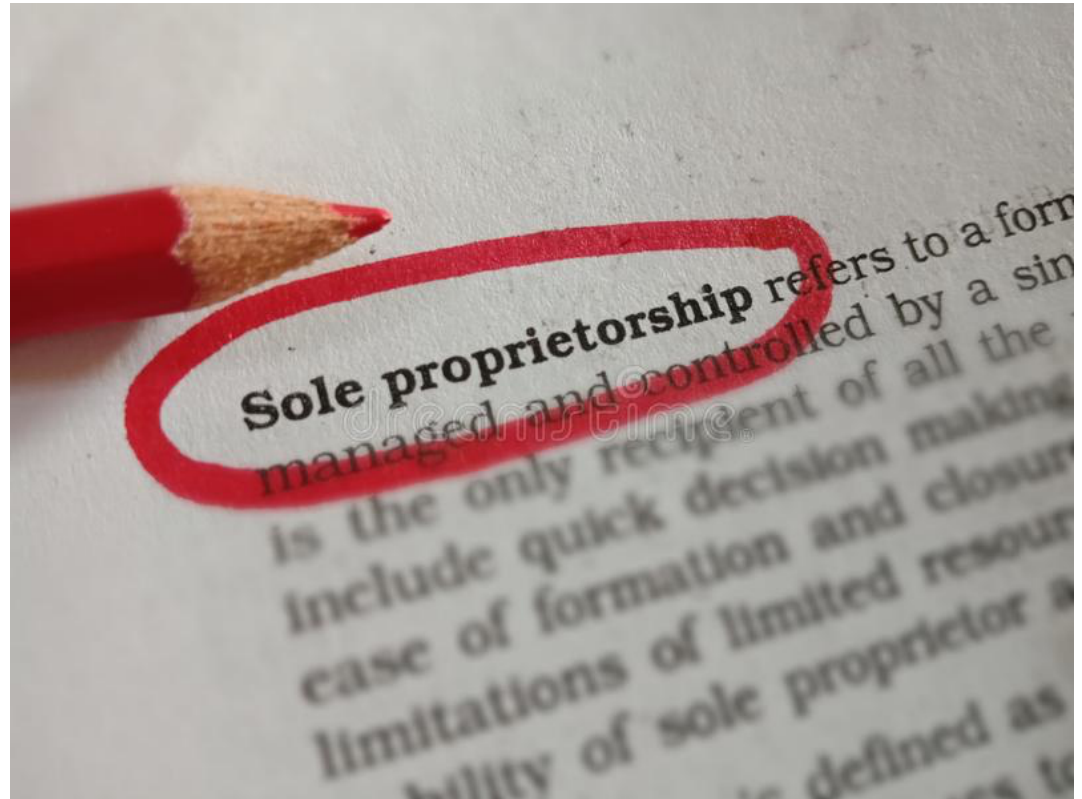


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## Where it begins AGENCY

- Agency (PRINCIPAL → AGENT)
  - Who do you want to be able to represent your business?
  - Who can bind your business?
  - Who Controls? (\*Key Question)
- Three Forms:
  - Actual Authority
    - Express
    - Implied
  - Apparent Authority
    - Inherent Agency power

What are you if  
you don't form  
an entity?



## Base elements:

### Sole Proprietorship

- One person doing business with or without employees in their name or through a fictitious name.
  - Exception for Married Couples in regards to taxes.

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## Advantages of Sole Proprietorship

- Easy to set up – you want a business, you get one.
- Control – 100%
- No entity taxation (Double taxation – Big “C”)
- Minimal costs (perhaps business license or other handling or licensing requirements)
- Few formalities (separate bank account, bylaws, operating agreement, etc . . .)



## Disadvantages of Sole Proprietorship

- No cap on personal liability
- Agent liability and/or Respondeat Superior
- Difficult to get outside financing
- Personal credit rating may be impacted
- All of it falls on you!





Who's it good  
for?

- Self-financed start-ups
- Low volume businesses that do not interact with the public much or have limited exposure for debts
- Pay your taxes! But you will see this structure more frequently with under-the-table transactions

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## Tips if you want to be a Sole Proprietor:

- **Optimize commercial general liability insurance tailored to your business activities – don't cheap out!**
- **Comply with tax, registration and bonding requirements**
- **Keep clearly defined books and records related to the business itself to avoid audit quagmire and allow for efficient tax preparation (remember, you are reporting income)**
- **File a “fictitious name” or “DBA” if required or advisable**
- **Get an Employer Identification Number (EIN)**
- **Know state and local laws that may help you (e.g. Agritourism Notice – T.C.A § 43-39-103 (2014))**
- **Sam's Club card, credit cards (you are a business!)**

## T.C.A. § 43-39-103 - Warning notice (2014)

- **(a) (1)** Every agritourism professional shall post and maintain a sign that contains the warning notice specified in subsection (b). The sign shall be placed in a clearly visible location at the entrance to the agritourism location and at the site of the agritourism activity. The warning notice shall consist of a sign in black letters, with each letter to be a minimum of one inch (1") in height.
- **(2)** Every written contract entered into by an agritourism professional for the providing of professional services, instruction or the rental of equipment to a participant for purposes of engaging in or participating in an agritourism activity, whether or not the contract involves agritourism activities on or off the site of the agritourism activity, shall contain in clearly readable print the warning notice specified in subsection (b).
- **(b)** The signs and contracts described in subsection (a) shall contain the following language or substantially similar language:
- **WARNING**
- Under Tennessee law, there is no liability for an injury to or death of a participant in an agritourism activity conducted at this agritourism location or by this agritourism professional if such injury or death results from the inherent risks of the agritourism activity.
- Inherent risks of agritourism activities include, among others, risks of injury inherent to land, equipment, and animals, as well as the potential for you to act in a negligent manner that may contribute to your injury or death. You are assuming the risk of participating in this agritourism activity.
- **(c)** Failure to comply with this section shall prevent an agritourism professional from invoking the privileges of immunity provided by this chapter.

What if you don't  
form an entity,  
but have a co-  
owner?



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Base elements:

Partnership

- An association of two or more persons to carry on as co-owners a business for profit (Revised Uniform Partnership Act § 101 (1994)
  - Exception on “Association” – Partnership by Estoppel
- Control is different than agency as the partners control together
- “Capital Contributions” convert to “Capital Accounts” for each partner



## Advantages of a Partnership

- **Fiduciary relationship between partners**
- **Shared resource contributions (e.g., cash vs “know-how”)**
- **Access to potential additional benefits, such as farm programs, New Market Tax Credits, etc.**
- **Continuity of the business (with 2 or more partners)**

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## Disadvantages of a Partnership

- Still joint and several liability
- Doesn't stop at the partnership itself from an accounting perspective
- Breakdown in trust (partner can sign on your behalf)
- Partnership by Estoppel

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Who's it good  
for?

- Small businesses
- Strategic business partners
- Those needing access to resources that they wouldn't naturally otherwise have (cash, know-how, IP)
- In some instances, familial relationships – IRS marriage exemption



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## Tips for a Partnership

- Have a partnership agreement
- Have a clearly defined exit strategy incorporated into your partnership agreement
- Hire an accountant (partnership accounting)
- Have clearly defined roles
- Keep separate books for the entity
- Joint venture – partnership limited in time and/or scope, with a specific purpose (Define to avoid continued liability)

# Legal Entity Formations





# Legal Entity Formations

- Created by State Statute
- Require filing with the Secretary of State
  - Main reason is notice of limited liability to the public
- Separate Entity from Owner(s)



## Reasons for entity formation

- **Limited Liability (Protect Business Owners)**
- **Taxes (ask your CPA!)**
- **Insurance recommendations**
- **Ability to create equity for investors**
- **Perhaps professional image**
- **Others . . .**

# Limited Liability Company



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Base elements:

Of  
Limited Liability  
Companies

- Can be formed with at least one person as a member
- File articles of organization with Secretary of State includes name (may need to reserve name), mailing address, the name and address of the registered agent, the number of members (if at least more than 6), and the period of duration if not perpetual
- Member-managed, Manager-managed, or Director – managed (Different duties of obligation)
  - Need statement in Operating Agreement and/or Articles to be Manager-Managed or Director-Managed
  - Director-managed requires a President of the Board

# Advantages

- Liability limited to capital and equity contribution (protects your personal assets)
  - Voluntary liability and sales tax exemptions.
- Perpetual existence
- Ease of Formation
- Flexibility – more reliant on Operating Agreements
- Flow-through taxes – no company tax (\*can be elected)
- Additional ability to obtain financing
- Ability to bring in equity partners (other “members”)
- Harder to Dissolve and Terminate – requires filing

## Disadvantages

- Many times financiers will seek additional personal guarantees from members
- Formation costs and ongoing registration fees
- Registered agent requirements
- Requires independent books, records and bank accounts
- Difficult to use interest as a pledge for personal financing (similar to closely held corporations)
- Reliance on the legal entity in the face of piercing the company veil
- Must file with the state prior to termination



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## Who's it good for?

- Any size business if significant interest in protecting personal assets
- Individuals or groups that operate multiple businesses (can limit the liability from crossing other entities under the same umbrella)
- Estate planning (can keep it out of probate) – alternative to trusts

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## Tips for a Limited Liability Company

- Have a clearly defined operating agreement tailored to the complexities of your business (not just Legal Zoom or other template)
- Keep the accounting completely separate
- Maintain a lawyer knowledgeable about your business activities as you are unable to represent yourself since it is a separate entity
- Where possible, ward off personal guarantees
- Recognize the difference between voting and revenue percentages interest

Corporation



## Base elements:

### Of Corporations

- One person required
- File Articles of Incorporation or Charter (TN) with Secretary of State
  - Mandatory rules v. default rules
- Bylaws
- Board of Directors managed
- Shareholder owned
- Base rule – 1 share= 1 vote

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# Advantages

- **Limited Liability on your personal assets**
- **Perpetual Existence**
- **Easier access to capital**
- **Flexibility in equity structuring**
- **Professional appearance**
- **Still may maintain control while selling stock**
- **Separate Credit Rating**
- **Closely-Held Corporations can use Shareholder Agreement instead of Board of Directors**

# Disadvantages

- Formality – Keeping Business Records, Meetings; Shareholder meetings
- Double Taxation
- Registration and renewals – Cost!
- Chance of Piercing the Corporate Veil – still rare.
- Possible Application of Securities Laws – State and Federal (You should know by the time you get here though)

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Who's it good  
for?

- Any business that is seeking to shield personal assets of shareholders.
- Those businesses look for more advanced financing (Venture Capital)
- Desire to go Public, International or Both!

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## Tips for Corporations

- More in your Bylaws, less in your Charter
- Odd number of Directors
- Stagger Board elections if possible
- Leave room to grow if possible – additional classes; authorized, but not issued stocks (“Treasury Stocks” under Delaware Law)
- Determine need for debt (bonds or loans) versus issuing equity (shares)
- Indemnification clauses for Directors and Officers





## Other Legal Entities (For- Profit)

- **Limited Partnership (LP)**
- **Limited Liability Partnership (LLP)**
- **Professional Corporation (PC)**
- **Professional Limited Liability Company (PLLC)**

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## Other Entity Formations found in Agriculture

# Cooperative

- Owned and Operated for the benefit of those supplying and using the the association
  - The returns that its members receive on their individual financial investments into the co-op are limited
  - It is financed mostly by its members and those who use the co-op
  - It distributes net margins to its members in proportion to their use of the co-op
  - Governed by State and Federal Antitrust Laws
- 
- \*Overview of Cooperatives. (2020) The National Agricultural Law Center. Retrieved on October 12, 2020 from <https://nationalaglawcenter.org/overview/cooperatives/>

Marketing Cooperative  
Association a/k/a LCA's  
T.C.A. § 43-16-104,  
et. al.

▪ PURPOSE

- (1) Agriculture is characterized by individual production in contrast to the group or factory system that characterizes other forms of industrial production;
- (2) The ordinary form of corporate organization permits industrial groups to combine for the purpose of group production and the ensuing group marketing and that the public has an interest in permitting farmers to bring their industry to the high degree of efficiency and merchandising skill evidenced in the manufacturing industries;
- (3) The public interest urgently needs to prevent the migration from the farm to the city in order to keep up farm production and to preserve the agricultural supply of the nation; and
- (4) The public interest demands that the farmer be encouraged to attain a superior and more direct system of marketing in the substitution of merchandising for the blind, unscientific, and speculative selling of crops; and
- (5) That for this purpose, the farmers should secure special guidance and instructive data from the college of agricultural sciences and natural resources, University of Tennessee.

Marketing Cooperative  
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T.C.A. § 43-16-104,  
et. al.

- Eleven (11) or more persons, a majority of whom are residents of this state, engaged in the production of agricultural products, may form a nonprofit, cooperative association, with or without capital stock (preferred and common stock – must be specified in articles of incorporation).
- A member can also be a lessee/tenant of land used in production, and landlord/lessor if rent is received in any part from the crop raised on the leased premises. (This qualifies as “persons engaged in the production of the agricultural products.”)
- An association may be organized to engage in any activity:
  - (1) In connection with the marketing or selling of the agricultural products of its members, or with the harvesting, preserving, drying, processing, canning, packing, grading, storing, handling, shipping or utilization of such products, or the manufacturing or marketing of the by-products of such products;
  - (2) In connection with the manufacturing, selling, or supplying to its members of machinery, equipment, or supplies;
  - (3) In the financing of the above enumerated activities; or
  - (4) In any one (1) or more of the activities specified in this section.
- Should Cooperate with Univ. of TN College of Agricultural Sciences and Natural Resources for survey of marketing conditions of proposed commodities being handled under the organization.
- Must be at least five (5) directors.

Marketing Cooperative  
Association a/k/a LCA's  
T.C.A. § 43-16-104,  
et. al.

- (cont.)
- Board of Directors can be divided into districts throughout the state.
- One or more directors can be appointed by any public official or commission or by other directors. (Cannot be more than 1/5<sup>th</sup> the total board).
- No director, during that director's term of office, shall be a party to a contract for profit with the association differing in any way from the business relations accorded regular members or holders of common stock of the association or others, or differing from terms generally current in that district. The bylaws may provide that no director shall occupy any position in the association, except the president and secretary, on regular salary or substantially full-time pay.
- The association and its members may make and execute marketing contracts, requiring the members to sell, for any period of time, not over ten (10) years, all or any specified part of their agricultural products or specified commodities exclusively to or through the association, or any facilities to be created by the association.
- If they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for recorded and statutory liens, to the association upon delivery. The contract may provide, among other things, that the association may sell or resell the products delivered by its members, with or without taking title thereto, and pay over to its members the resale price, after deducting all necessary selling, overhead, and other costs and expenses, including interest or dividends on stock, not exceeding eight percent (8%) per annum, and reserves for retiring the stock, if any; and other proper reserves; and/or any other deductions

Marketing Cooperative  
Association a/k/a LCA's  
T.C.A. § 43-16-104,  
et. al.

- (Tax provisions from the statute) – Non-profit association
- Each association organized under this chapter shall pay an annual fee of ten dollars (\$10.00) only, in lieu of all franchise, license, corporation or other privilege taxes, or taxes or charges upon reserves held by it for members; provided, that if any association organized under this chapter sells to persons other than its own members any product or merchandise other than unmanufactured tobacco, livestock, poultry products, dairy products or any other farm products, such association shall be liable for any privilege tax with respect to such transactions or method of doing business imposed under the laws of Tennessee, other than franchise and excise taxes and corporation filing fees or charges upon reserves held by it for members.
- All corporations organized as subsidiaries and controlled by any agricultural cooperative association formed in accordance with the laws of this state shall not be considered corporations organized for profit and doing business in Tennessee, or subject to any privilege tax levied by any law as a tax for the privilege of doing business for profit in Tennessee, it being the legislative intent to exempt by this section all such subsidiary corporations controlled by agricultural cooperative associations, where any and all profits earned by such subsidiary corporations are paid over to or expended for the benefit of the agricultural cooperative associations, with the result that the activities carried on by the corporations eventually promote and benefit the agricultural interests of this state.

Marketing Cooperative  
Association a/k/a LCA's  
T.C.A. § 43-16-104,  
et. al.

## THE BIG ONE

- No association organized under this chapter and complying with the terms of this chapter shall be deemed to be a conspiracy or a combination in restraint of trade or an illegal monopoly, or an attempt to lessen competition or to fix prices arbitrarily; nor shall the marketing contracts and agreements between the association and its members or any agreements authorized in this chapter be considered illegal as such or in unlawful restraint of trade or as part of a conspiracy or combination to accomplish an improper or illegal purpose.



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# The Story of Aussie Dave

Real Life Application

Permission granted



David Hedt - G'day Mate!



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Questions?