CPA weighs alternatives in farm structure

BY CURT HARLER

HARRISBURG — The decision to form a partnership or corporation has implications on tax returns for that farm for years to come.

Even if taxes are not the sole consideration, the fate of future generations on the farm may be determined by how wisely the farm owner of today provides for the farming generations of the future.

Steven M. Hoffman, a certified public accountant and manager of the Harrisburg office of Peat, Marwick, Mitchell and Company, says there are pros and cons to each of the three typical farm structures· individual ownership, partnership, and incorporation.

As an individual, a farmer can be sole owner of the farm business and its assets As a result, that individual is taxed on the total income from his operation.

This could be subject to some extremely high rates, Hoffman said. Individual tax rates are graduated and go as high as 70 percent.

Only the net amount of income after taxes is available for reinvestment in the farm or to meet individual expenses.

The primary advantage of the individual ownership of a farm business is simplicity in paying only one tax the first time around.

Partnership is not a separate taxable entity, but the earnings of the partners pass through to the individuals along with the credits and deductions.

The assets of the business are jointly owned by the partners and, again, only one tax is paid. Losses can also be passed through.

One of the major advantages of a family partnership is the profits from a farm operation can be spread among the members of the partnership rather than being all bunched in the parents' tax return, Hoffman said.

This avoids the need to pay tax at the highest tax rates.

But, he cautioned, a partnership can not be formed just to spread income. It has to have some sort of economic reality, and the partners have to own a share in the partnership.

The disadvantages to a partnership include unlimited liability, the same as with an individually owned operation.

Normally, upon the death of one partner, the partnership disolves. And a further disadvantage may be that the fiscal year has to be the same as that of the general partners, he said.

The third form available is the corporation.

A corporate farm's assets are owned by the corporation and the individual owns shares of stock.

In essence, the individual has no direct ownership, but the ownership is represented by the share of stock he owns in the corporation.

It is possible to have a corporation with an individual owning the one and only share of stock.

A corporation is regarded as a separate taxable entity for federal tax purposes. So the individual, theoretically, is not responsible for paying the tax of the corporation, he said.

The individual generally is not liable for the debts of the corporation, either.

The maximum corporate tax rate is 46 percent of taxable income over $100,000, so there is a rate differential between corporate and personal taxation that could favor the corporate farm.

Salaries paid to the owner and shareholders can be deductions for the corporation.

The corporation has good continuity — if one member of the corporation dies, it does not spell the end to the corporation.

If a partner dies, a partnership has to be dissolved.

There is flexibility in compensation, too.

Corporate ownership is more readily adaptable to a gift-giving program. It is easier, for estate planning purposes, to give away a few shares of stock than it would be to break off a section of land or a physical part of the farm operation.

Also, a corporation can adopt a different fiscal tax year than that for the owners

There is one tax election to be made for a corporation called Subchapter S which allows that corporation to be taxed similarly to a partnership.

That is, the income or loss is passed through to the owners.

Also, the sale of stock in a corporation is generally viewed as a capital gain. And 60 percent of a capital gain is excluded from tax, whereas all of a normal gain is taxed

Sale of an individually owned farm or a farm partnership generally results in ordinary income

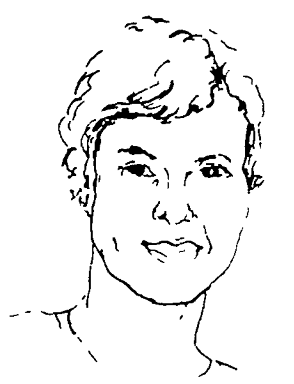
The primary disadvantage of a corporation is double taxation. The corporation pays tax. And if the individuals want to participate in the earnings of the corporation, and they can't be paid out as salary, then the corporation has to pay a dividend.

Dividends are not deductable by corporations and taxes have to be paid by individuals on dividends received.

Among other disadvantages Hoffman pointed our are the added complexity of a corporation's tax returns and the need for a bit more record keeping.

But there is more to consider than just tax advantages when deciding whether or not to form a partnership or corporation.

Business and personal goals must be reviewed, then based on that, a farmer can decide on what form of operation to have, Hoffman concluded



On being a farm wife - And other hazards

Joyce Bupp

Over the course of the past several years, we've been honored with the receipt of literally hundreds of pieces of postal correspondence. Tempering the discovery that we are so desirable to the signers of these letters is the reality that most of the stuff can be described at best as "junk mail."

With last week's shipment of goodies came an invitation from the prestigious George Washington University in the nation's capitol. On the gold-colored flyer was a registration form and invitation to the owner-operator to pursue a continuing engineering education in a three-day, $485 advanced course titled: "Analysis of variance for data having unequal numbers of observations in the subclasses"

While the various individuals with this operation have accumulated many years of assorted engineering-type experience, none of it comes with a B.S. degree. We include what could loosely be labeled an agriculture engineer, a mechanical engineer, a couple of volunteeer top-notch general fix-it engineers and, of course, a domestic engineer.

Nevertheless, pursuing this advanced study might help us all better understand the engineering principal of unequal numbers that confront and confound us daily.

For instance, there's the case of the 40 by 30 inch calf which manages to escape regularly through the 14 by 12 inch head-hole in the welded steel front of the calf pen stall. Would that be what you call a variance of data of unequal numbers?

Or, what about the contrary cow that persistently wedges her 24 by 12 inch head under the 3 inch clearance beneath the pasture fence, even though the grass is just as green on the inside?

Other problems of unequal numbers could also stand some analysis. Like how can a 1/30th acre of an unfarmable rock pile produce three acres worth of weeds?

And what engineering data supports the unequal numbers of the 88 square inches of shoe sole that regularly tracks 197 square inches of yucky mud on my kitchen floor?

Unfortunately, my analysis of the data brings me to the observation that this advanced course is offered in early June, when all the unequal numbers of subclasses on this farm will be involved in wrapping up the first session of haymaking.

Confidentially, I'd be happy to settle for knowing what in the world the title of the course means.