An Introduction to Farming Business Structures

Choosing the right company structure is an important decision for any farm owner and there are three main options for any business: sole trader, partnership, and limited company. All of these options come with their own benefits and drawbacks, so finding the right one is essential and a very individual process.

This article will help you obtain a better understanding of the three main business structures in the context of agriculture.

Sole Trader

As the simplest of the three business structures, a sole trader farm has one owner and the business and the owner themselves are essentially one and the same. According to a Defra sample of 750 farms, 52% of farms are sole traders.

The Popular Choice

This structure's popularity is largely due to low administrative costs and not much legal formality, which means it's much easier to set up and run than other business structures. However, the main drawback of being a sole trader is that there is unlimited liability. This means the owner is personally responsible for all of the debts and liabilities of the farm.

Essentially, being a sole trader is like being self-employed because you are solely responsible for the success of your farm. Your business income is reported on a Self Assessment tax return for HMRC when you are a sole trader.

When a farm structured as a sole trader is sold, the business does not transfer to a new owner. Instead, to be able to transfer assets, a new entity from the new owner is needed (sole trader or otherwise). The debts are also not transferred because the previous sole trader is personally responsible for them.

Partnership

A general partnership operates in a similar way to a sole trader – with unlimited liability, little administrative costs, and not as much legal formality as a limited company. The roles and responsibilities of each partner will be outlined in a legal partnership agreement, which determines how profits, losses, and liabilities are shared. The partnership agreement can also detail the contributions of each partner, which could be land or labour, for example. According to a Defra survey, around 39% of farms are structured as partnerships.

The premise, for many farm partnerships, is based around 'safety in numbers'. Two or more people are required to set up a partnership, which means resources, knowledge/experience, and finances can be pooled together for a stronger business. Liabilities and debts are also shared between partners, as a ratio equal to their share.

The Drawbacks

In certain circumstances, this 'safety in numbers' approach can be a risk for the partners of a farm partnership because of its unlimited, personal liability – despite pre-determined responsibility. For example, one partner may become responsible for all debts/liabilities if the other partner(s) does not have the means to pay their share.

The partners are personally responsible for business debts and liabilities, which also means that no income tax is paid as an entity and that each partner pays individual tax. Based upon their individual earnings from the earnings of the farm, each partner should complete a Self Assessment tax return for HMRC.

The LLP

Limited Liability Partnerships (LLP) have become more popular recently, and aim to combine the benefits of a partnership with the protection of a limited company. An LLP allows for limited liability, which means the partners are not personally liable for debts the business can't pay and their liability is limited to the amount of money they invested. LLPs are taxed in the same way as general partnerships, and partners still hold capital in the business, with accounts prepared each year.

Limited Company

When set up as a limited company, a farm is a separate legal entity from the (one or more) owners, who are known as 'members'. Members and shareholders are both protected from liability, whereas the limited company is responsible in its own right for all dealings.

Shareholders are people who own 'shares' in a limited company. They own a portion of the company and are paid dividends (being a percentage of the profits) which are proportional to the number of shares they own. They are also commonly referred to as 'members'.

A limited company enters into contracts, etc. with the company name and the staff are employed by the company, for example.

Each member of the limited company owns a share of the company, and shareholders determine how the profits are distributed via dividends.

A dividend is a payment made to shareholders when a limited company makes a profit. They are distributed to shareholders, again, in direct proportion to the amount (or percentage) of shares they own in the limited company.

In most limited companies, a board of directors is elected and these directors carries out the day-to-day operation of the farm (you can read more about this in our director's duties blog). These directors are legally responsible according to the Companies Act 2006, although they are not personally responsible for debts unless they breach the rules of this agreement.

Each year, a limited company is required to file an annual return, which sets out who the directors and shareholders are. They also need to file an annual account with Companies House as part of the public record.

Taxes for a Limited Company

A company tax return is completed by the company, whereas shareholders complete a Self-Assessment tax return based upon their personal income and dividends. Employees of limited companies are subject to income tax and national insurance through the PAYE system.

Around 8% of farms are companies, according to Defra's survey of 750 farms. This number is low, likely, because of the high administrative costs and a large amount of legal work required to set up and maintain a limited company.

On the other hand, the benefit of limited liability and, in some cases, tax benefits, can sometimes make the additional admin, accounting, and reporting worthwhile.

Making the Right Call

Choosing the right business structure for your farm will depend upon a lot of things, and these are likely to change over time. It's not uncommon for an agricultural business to begin as a sole trader, and then develop into a partnership, for example.

Understanding the basics of the three main business structures will help you make the right decision for your farm. There are plenty of other decisions to make, however, such as the flexibility of partnerships and how this can be benefited from with succession planning.

The best course of action is to speak with an accountant and solicitor with expertise in the field. This will help you explore your options and decide what is best for your farm, and the future of your business.

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