



FARM COMMONS

Farmer's Guide to Limited Liability Companies (LLCs)

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Section 1: Limited Liability Company (LLC) Fundamentals

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AT A GLANCE CHART: LLC

	General Concept	Terminology
LLC Specific Terminology	Name:	“Farm Name, LLC”
	Owners / Investors are called:	“Members”
	Persons who make management decisions are called:	“Managers” (if manager-managed); “Members” (if member-managed)
	Creation Document is called:	“Articles of Organization”
	Organizing document is called:	“Operating Agreement”
	An owner’s investment is called:	“Capital Contribution”
	An ownership share is called:	“Percentage Interest”
	A payment of the company’s profits to the owners is called:	Distribution
	Is there personal liability?	Limited to a member’s capital contribution if LLC integrity is maintained.
	How many participants can you have?	1+ persons, can be other business entities or trusts; unless elect S corporation tax status.*
	Are annual meetings required?	Not required, unless elect S corporation tax status.*
	Are different member classes allowed?	Allowed, unless elect S corporation tax status.*
	Is an EIN necessary?	Required, unless you’re a single member LLC with no employees.
Who files the tax return?	Pass-through is default (members file and report LLC’s income on their tax returns); option to elect C corporation (entity files and reports LLC’s income on Form 1120) or S corporation federal tax status.*	
LLC with S Corporation Federal Tax Status	How many participants can you have?	Maximum 100 persons. Cannot be other business entities or trusts. All must be U.S. citizens.
	Are annual meetings required?	Required.
	Are different member classes allowed?	Not allowed.
	Is an EIN necessary?	Required.
	Who files the tax return?	Pass-through; but, entity must file informational Form 1120S with the IRS, distribute schedule K-1 to each member, and file all schedule K-1s with the IRS. Each member must report her share of business’ income on her individual tax return.

Introduction

This section provides an overview of the LLC entity. The purpose of this section is to offer farmers a basic understanding of what it means to run a farm operation as an LLC. The following section, *Going Deeper into LLCs*, gives you some tools that you can use to help you navigate the process of creating and operating an LLC. It includes a checklist for creating an LLC, two sample operating agreements, and a checklist for preparing an operating agreement. A fictitious story about three sisters who create Sun Sisters Farm, LLC is woven throughout this LLC chapter to help explain some of the more complex legal scenarios and give you a better sense of some scenarios you should consider when forming and operating an LLC.

LLC Origins

A limited liability company, or “LLC,” is a separate and distinct legal entity. This means that unlike a sole proprietorship or general partnership, the law recognizes an LLC as separate from the individual(s) that run it.

Increasing popularity of the LLC

The LLC business entity has been gaining popularity over the past thirty-five years. Wyoming was the first state to create the LLC option way back in 1977. All 50 states and the District of Columbia have now authorized the organization of LLCs by enacting a state LLC statute. It took a while for the LLC to be generally accepted, mainly because it was not clear how the IRS would decide to tax the entity: As a corporation? As a sole proprietorship? Something else entirely? The IRS clarified its rules for LLCs in the late 1990’s, allowing LLCs to elect the S corporation tax status. Ever since, the LLC has been gaining traction and is now one of the most popular entity choices for small businesses throughout the country.

“The LLC has been gaining traction and is now one of the most popular entity choices for small businesses throughout the country.”

The LLC was created to address a growing concern that individuals running sole proprietorships and general partnerships were personally exposed to liabilities related to their business. Before the LLC came about, becoming a corporation (either C corporation or S corporation) was the only option to protect the owner’s personal liabilities. Yet the corporate structure, as we will get into later, is quite inflexible and can have unfavorable tax consequences for small business owners. The solution was to create the hybrid structure: the LLC. The LLC entity carries the

same flexibility and tax status as a sole proprietorship or general partnership while providing the same level of protection from personal liabilities as the corporation.

LLCs are now considered very stable business entities. Many of the same legal standards that apply to corporations in court are being applied to LLCs. For example, a concept like “fiduciary duty” (which involves determining whether an LLC owner acted in good faith and should therefore be protected from liability) is being applied to LLC owners the same way it is applied to a director or officer of a corporation. This continuity of legal principles between the comparatively new LLC and the time-tested corporation leaves most legal professionals comfortable recommending LLCs to their clients.

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“The capital contribution amount reflects each member’s risk or stake in the business. No more, no less.”
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Basic Characteristics of the LLC

LLCs protect personal assets from business liabilities

One fundamental characteristic of the LLC entity is that it protects personal assets from business liabilities. For those who would like peace of mind in keeping the risks of their business separate from their personal assets, this is an advantage. The “members”—which is the LLC term for the business owners—are not at risk of losing personal assets if another person or business secures a court judgment against the member. The LLC members can, however, lose up to the amount they have invested in the company. The cash, property, and other resources members give to the LLC is their investment, or in LLC lingo, his or her “capital contribution.” Once a member transfers ownership of the cash or property, it is considered a contribution to the LLC. In effect, this capital contribution amount reflects each member’s risk or stake in the business. No more, no less.

We all know that, just like any small business, farm operations may not succeed. One season of unpredictable weather or out of control pests could lead to no profit or even a loss. If the farm doesn’t turn a profit and uses up capital in the process, the members won’t even get their capital contribution back. There’s nothing left. Taking it a step further, let’s say the business had taken out a loan to pay for some farm equipment and is no longer able to pay on its debt. It won’t be long before the creditors come knocking on the farm business’s door. However, given the LLC protects members from personal liability, the members do not have to worry so much that creditors will come knocking on their door and snatch up their lake house or their boat if the farm business starts going south. The creditor could still lay claim to any remaining farm LLC assets, but nothing more.

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“The percentage interest is significant, as depending on how you decide to structure your LLC, the percentage interest breakdown may determine voting rights and who ultimately has control over the company.”
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Capital contributions and percentage interest of the members

The capital contribution of each member can be cash, land, equipment, services, etc. However, be sure to see an accountant or your attorney if services are involved as that can lead to tax implications. If the LLC has one member, then that member will own 100% of the company. If there are multiple members, the company determines ownership shares or “percentage interest” of each member. The total value of all the capital contributions given by the members divided by the amount of each member’s contribution reveals the individual member’s shares. The percentage interest is significant, as depending on how you decided to structure your LLC, the percentage interest breakdown may determine voting rights and who ultimately has control over the company. See the LLC Operating Agreement Checklist for more details on making capital contributions. See the *Story of Sun Sisters Farm, LLC* for an example.

Sun Sisters Farm, LLC story: capital contributions and percentage interest

Here at Farm Commons, we like to use stories to help illustrate confusing legal concepts. Throughout this section on LLCs, including the *Extensive Farm Operating Agreement for Sun Sisters Farm, LLC*, we’ll often be referring to our story of the Sun Sisters Farm, LLC.

Jema, Ingrid, and Marie are sisters that grew up with backyard gardens and an abundance of fresh fruits and vegetables. Each of them individually has always dreamed of starting a farm. Jema loves everything culinary and wants to cater to the local restaurants with fresh herbs and specialty items including heirloom vegetables, herbs, and edible flowers. Ingrid is all about supporting the local community and wants to start a CSA. Marie has a keen business sense and currently runs a successful marketing company. She actually owns a beautiful 10-acre farm that she purchased ten years ago with a dream of quitting her job and running a farm business. But it just hasn’t happened and she can’t do it herself. The property has a shed, a tiny two-bedroom farmhouse, and about a ½ acre fruit orchard. The rest of it is overgrown alfalfa.

The sisters meet up for Jema’s birthday and get to talking about their shared dream of starting a farm business. They decide to go in on it together! They decide to form an LLC to provide liability protection. They file their articles

of organization and name their entity “Sun Sisters Farm LLC.” They then start drafting their operating agreement, starting by discussing what their capital contributions will be. Marie decides she’ll grant the LLC the title to her farmland as her capital contribution, which is valued at \$45,000. Jema invests \$30,000 in cash as her capital contribution. Ingrid offers one year of her farm labor as her capital contribution, which is valued at \$25,000. Based on this, Sun Sisters Farm LLC will have a total of \$100,000 in capital. Marie has 45%, Jema has 30%, and Ingrid has 25% percentage interest in the company.

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“Two essential ways to protect the LLC members’ personal assets are to adequately capitalize the LLC and keep the LLC’s financial affairs separate from the members’ personal financial affairs.”
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With all that said, the LLC’s protection from personal liability is not absolute. Hence the name *limited* liability company. If the farm business does not follow certain standards, then the courts can reach around the LLC’s personal liability shield and allow creditors to access the individual members’ personal assets. Two essential ways to protect the members’ personal assets are to adequately capitalize the LLC and keep the LLC’s financial affairs separate from the members’ personal financial affairs. However, even if the LLC is properly maintained, some creditors may require members to personally guarantee farm debt. Also of note, the LLC’s liability protection is not a substitute for insurance. We’ll discuss each of these caveats on the LLC’s liability protection in more detail now.

Capitalize the farm operation LLC

Members may lose their personal liability protection if the company is undercapitalized. As a basic rule of thumb, a company is adequately capitalized if it can make due on its debts, or pay its monthly bills so to speak. Anything less would be undercapitalized. In other words, if you start incurring more debt than you can reasonably pay off based on estimated revenue, your LLC will be considered undercapitalized. As a result, the members may be personally liable to cover the business’ debt. The takeaway message is to be smart about how much debt you allow the LLC to take on. Good business planning and maintaining an accurate profit and loss statement are helpful ways to prevent undercapitalization of your company.

Sun Sisters Farm, LLC story: undercapitalization

For example, let’s say that the members of Sun Sisters Farm, LLC decide they want to buy a brand new tractor with all the bells and whistles. They find one for \$45,000. They’ve already blown all but \$10,000 of the LLC’s capital—\$30,000 in cash—on various tools, a storage shed, seeds, and soil

amendments. So, they decide to put all of their remaining \$10,000 down and take out a three-year loan for \$35,000 for the tractor using the farm property as collateral. The monthly payment plus interest works out to be \$1,000 per month for the three years.

One month later, Jema and Margo decide they really need a greenhouse. They convince Ingrid and Marie to consider the idea. Jema calls up a contractor that is well known for building custom greenhouses. He draws up an elaborate plan. They all love it. He estimates it will cost \$40,000, and offers them a flexible interest free payment plan for one year after which he'll begin charging 20% interest. They decide to go for it and sign a contract.

As you may have added up, the three sisters have created quite a bind for the LLC. The LLC now has no cash and at best they expect to make just \$15,000 in annual profits in the first two years. There's really no way the company will be able to make due on these debts without incurring even more with hefty interest rates. The LLC is hugely undercapitalized as a direct result of the members' collective poor judgment. If the LLC fails to make its payments in time, the lender for the tractor loan and contractor for the greenhouse could sue to collect on the debt. A court would most likely conclude that Jema, Ingrid, and Marie are each personally on the hook for the full amount. You can keep out of trouble by simply following good business judgment. In common sense terms, don't allow the LLC to bite off more than it can chew!

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“Members must be sure not to commingle funds, such as draw on business assets to pay for personal expenses.”
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Astute farmers might realize they could avoid losing any investment in the farm by not investing anything in it. You can't lose capital if you don't contribute it, right? The reasoning is sound, but a farmer following that logic may expose his or her personal assets to the business' liabilities. If the farm needs capital to reasonably function, the members need to provide it to protect themselves.

Keep the LLC's financial affairs separate from the members' financial affairs

Courts are also able to access personal assets if the members fail to keep the business separate from their personal affairs. This includes commingling funds such as drawing on business assets to pay for personal expenses or not keeping separate business and individual bank accounts. Farmers accustomed to paying for household groceries and their feed bill with the same checkbook might find it awkward to keep two different payment methods at hand. On the other hand, many farmers benefit from two different bank accounts. The practice can make it

easier to assess the finances of the household separately from that of the business. Of course, personal assets are available for personal liabilities. In other words, you cannot draw on the business assets to pay for your personal credit card debt, home mortgage, or car payments. By the same token, business assets are available to satisfy business liabilities. The take away here is to be sure to develop policies and systems for keeping your business and individual affairs separate, which includes at the minimum having separate bank accounts, credit cards, and accounting systems. And, most importantly, be sure you follow these policies and systems once you set them.

Handling business and personal accounts

Just as business assets are available for business liabilities, personal assets are available for personal liabilities. Keep separate business and individual bank accounts, credit cards, and accounting systems. Do not use the business' assets to pay your personal bills like credit card and rent payments.

“Forming an LLC is not a substitute for insurance.”

LLC members might be required to personally guarantee farm debt.

Let's not forget a few other factors that play out in the real world. First, creditors often require that individual owners of a business entity, here members of the LLC, personally guarantee obligations. Creditors know that if there's nothing left in the business entity there will be nothing left for them. What this means is that creditors may require the members to commit to loan payments as an individual, not just as a member of the LLC. As a result, personal assets will be on the line even though the member took on the obligation to benefit the business. Members have to negotiate whether and to what extent a personal guarantee is required with creditors on a case by case basis.

LLCs do not substitute for insurance or reduce the likelihood of business liabilities

Finally, forming an LLC, or any business entity for that matter, is not a substitute for insurance. Some farmers mistakenly believe creating an LLC reduces the likelihood of liability. The name “limited liability” is a little misleading, isn't it? Creating an LLC does nothing to change the landscape of a farm's potential liability. It only limits the assets available to satisfy that liability, should it materialize, to business assets. All the farm's assets are entirely available to anyone with a successful claim against a farm LLC. Good liability insurance provides the farm with a defense in court and a source of funds to pay out on a court claim if it is successful. Farm Commons

For more details on different farm insurance policies and the type of liability they cover, see Farm Common's print resource: *Managing the Sustainable Farm's Risks with Insurance: Navigating Common Options*, which is available on our website.

“LLCs allow wide latitude in determining who has voting rights or control when big decisions are made.”

strongly urges any farm business, no matter what business entity it adopts, to maintain adequate insurance coverage.

LLCs are flexible

The second key characteristic of an LLC is that it allows for a lot of flexibility. Farmers and business owners in general take advantage of flexibility in three main areas: (1) determining voting rights and control, (2) allocating profits and losses, and (3) upholding formalities.

LLCs allow wide latitude in determining who has voting rights or control when big decisions are made. For example, you can establish multiple classes of members and say that some have voting rights and others don't. You could also determine that voting rights are based on percentage interest in the company, so that if one member has 55% percentage interest she will carry a majority in every vote. Or, you could say that every member has one vote regardless of the percentage interest breakdown.

● LLC members have flexibility in deciding how to allocate profits and losses.

Generally, farmers and business owners will allocate profits and losses in direct proportion to ownership, or “percentage interest” in LLC-speak. If two farmers have equal percentage interests, they split the profit (or loss) down the middle. When it comes to LLC law, you have freedom to set this up pretty much however you want. But when it comes to tax law, anyone looking to allocate losses out of proportion to percentage interest should understand the potential tax effects of the decision. So, if you want a creative arrangement, be sure you check with your accountant or tax attorney for more information.

LLCs allow greater flexibility around formalities. Unlike corporations, state LLC statutes typically do not require LLC's to have elected members or hold annual meetings. Single member LLCs are especially attracted to this flexibility. There's no need to hold a meeting and vote yourself in as the President, Secretary, and Treasurer! With that said, Farm Commons highly recommends that farm operations that form an LLC still follow some level of formality including holding annual meetings, assigning clear responsibilities, documenting decisions in writing, and establishing policies and procedures to ensure regular and clear communication. These procedures serve as evidence that you are, in fact, maintaining your business in a legitimate way and will help prevent the court from reaching around the entity if allegations of improper play ever arise. In addition to these legal benefits, maintaining these formalities will help you maintain favorable

For more on determining voting rights, see the *Checklist: Preparing for Your Farm's LLC Operating Agreement* and check out the *Extensive Farm Operating Agreement for Sun Sisters Farm, LLC* and the *Brief Operating Agreement for Happy Couple Farm, LLC* in the following section of this chapter.

For more details on when and how businesses allocate profits and losses, see the *Extensive Operating Agreement for Sun Sisters Farm, LLC* in the following section of this chapter.

relations with your members and make better business decisions, which will all help lead to a thriving farm business.

Ultimately, the flexibility that an LLC provides is often why farm operations prefer this business entity structure over a corporation. As we'll see later, a corporation requires a more rigid structure and strict formalities.

Forming an LLC

Now that we've provided some basic background and characteristics, we can dive into the process of creating an LLC. This includes filing the articles of organization and creating your operating agreement.

Choosing a name

Before you start the steps in creating an LLC, decide on a name for your farm operation. Choosing a name is a very important step. The name helps create an identity for your business, your product, and your entire food-shed. But, it's also a legal consideration. Most states prohibit two businesses from registering the same business name in that state. In addition, if you choose the same name as another business already in operation, that business may demand that you stop using their name. Indeed, that business could have exclusive rights and protection to use the name under trademark law. If this problem comes up after your operation has been around a few years, changing your name will likely confuse customers. And it's sad to lose the name you've grown to love!

Avoid potential legal problems by choosing a name that isn't already in use. First, check state and federal databases of trademarks and trade names. Generally, the state's Secretary of State office will maintain a database of business names or "trade names," which will likely be searchable online. The United States Patent and Trademark Office (USPTO) has a searchable online database for registered federal trademarks. A basic Internet search will point you in the direction of these databases. Although a farm should not automatically assume that federally registered names are unavailable, consider it a red flag. Be sure you get more information and even consult a trademark attorney before choosing a name already registered in the federal database. Finally, you may want to check if your preferred website address is available and even register that domain name. You can do a basic Internet search for existing businesses with the same name. You can register your preferred domain name on websites like GoDaddy or DreamHost.

For more detailed information on each of the steps required for creating an LLC, see the *Checklist: Creating an LLC* in the following section of this chapter.

“Avoid potential legal problems by choosing a name that isn't already in use.”

Also of note, most state LLC statutes require that the name of an LLC include the words “limited liability company” or the abbreviation “LLC” and not have the terms “Corporation” or “Inc.”

Who can create an LLC?

A basic question you may have is who can be a member of an LLC? Again, the LLC is quite flexible in this regard. An LLC can be created by a single person or multiple people. There are no restrictions on how many people may participate. Also of note, another business entity such as a nonprofit, another LLC, a trust, or a corporation could be a member of an LLC.

What about Married Couples?

Married couples that live in specific states may choose to form their LLC with one member—the married couple as a single unit. This option is available to couples in states that adopt “community property” systems. The nature of community property is way beyond the scope of this guide! To summarize, some married couples may want to form a single-member LLC for tax reasons. Married couples in community property states should talk with their accountant or tax preparer about the best option for their specific situation.

For more information on specific issues related to married couple LLCs, see the *Brief Operating Agreement for Happy Couple Farm, LLC* in the following section of this chapter.

Preparing and filing articles of organization

The first step in formally creating an LLC is filing the “articles of organization.” This is done at the state level, usually through the state’s Secretary of State Office.

Many states provide a form that can be easily downloaded or even filed online. Other states simply list the information required, in which case you can create your own document that includes this information. An Internet search for “file an LLC and [your state’s name]” should bring up a form and more information. Each state charges different fees, which vary between \$25 to \$1000. Once your articles of organization and fee are filed and processed, you’ll get a confirmation from the filing agency that your LLC is now recognized as an official business entity in your state.

Annual Fee: Note that most states also require an annual fee. It’s a good idea to find out upfront whether your state charges an annual fee and, if so, how much. The amount of the fee may be a factor in your decision on whether to form an LLC.

Key terms for LLC articles of organization: registered agent and member-managed or manager-managed

Filing your articles of organization is typically a simple and non-technical process. However, there are a few terms you may not be familiar with. First, is the “registered agent.” This is basically the person that will receive “service

For more information on member-managed or manager-managed, see the *Checklist: Preparing for Your Farm's LLC Operating Agreement* in the following section of this chapter.

of process,” which is an official notice that the LLC is being sued. It does not in any way mean this individual is liable or responsible for the outcome. It simply means that the agent is required to pass on the notice to the other members of the LLC so that the LLC is officially on notice. Some businesses select an LLC member to be the agent. Others choose to work with one of the many independent businesses that provide agent of process services for a fee. Second, the articles of organization will generally require you to specify whether your LLC will be “member-managed” or “manager managed.” Which one is your farm? It depends on who you determine has the authority to make day-to-day management decisions for the business (i.e. decisions related to managing employees, making small purchases, marketing, and handling customer relations). If you want all members to make to day-to-day decisions, you should designate member-managed. If you want only specific people to make those decisions, the farm may be manager-managed.

Preparing an operating agreement

An operating agreement outlines how the LLC is to operate or run its business. The document usually is not filed with any government office—it is for the business’ own use. As mentioned earlier, a lot of states do not require an LLC to create an operating agreement. However, even if it is not required in your state, Farm Commons strongly recommends that every LLC create an operating agreement. An operating agreement is a great choice for three reasons: (1) it helps safeguard the personal liability protection LLCs provide for individual members, (2) it lets your farm operation to take advantage of the flexibility aspects of the LLC, and (3) it allows you to set more favorable ground rules in your relations with third parties. In addition, some lenders will require an operating agreement before making a loan to the farm.

First, the operating agreement helps set the ground rules for how the members will manage and operate the company. When members operate the business in line with the written provisions of the operating agreement a court is more likely to find that the members have earned the LLC’s protection for personal assets. Also, when a written operating agreement is in place, which explicitly requires things like maintaining separate bank accounts and accounting records, the members generally take these fundamental requirements of the business more seriously. This helps prevent the commingling of funds and other careless acts that could give a court grounds to reach around the LLC and grab hold of the individual member’s personal assets.

“The operating agreement helps set the ground rules for how the members will manage and operate the company.”

Second, if you don't have a thorough operating agreement the detailed provisions in your state's LLC statute will step in as the default rules if a dispute arises between the members or with a third party. Your state's default rules may not be preferable or suitable for your farm operations. In other words, creating a thorough operating agreement gives the farm operation the opportunity to write its own rules. By writing an operating agreement, farmers and business owners can take advantage of the flexible aspects of the LLC entity that we discussed above.

Third, the operating agreement clarifies and governs relations with third parties. It may not seem to matter much if there are just a few members who all have a close working relationship. They could agree on each decision related to how the LLC will operate in various conversations and that may be good enough. However, if it's not written down in an operating agreement, it won't govern anyone else who wasn't a part of that discussion. For example, let's say one LLC member dies and bequeaths her membership to her daughter. If the prior agreements between the mother and other LLC members are written into an operating agreement, the daughter would have to follow the rules set forth in the operating agreement as well.

To reiterate, the LLC business entity provides business owners or members a lot of flexibility on how they want to structure their operation. When thinking about your operating agreement, use your imagination and really think about what would be ideal given the interests and objectives of your farm operation. One way of thinking about an operating agreement is to imagine all the contingencies or worse case scenarios and then figure out how you'd want each scenario to be handled. The *Checklist: Preparing for Your Farm's LLC Operating Agreement*, which is in the following section of this chapter, provides a helpful guide in walking you through some of the questions to think about such scenarios. Issues that you can address in your operating agreement include: How are big decisions like whether to buy a major asset or sell the farm operation? How are profits and losses allocated and who decides? What happens if a member dies? What happens if a member wants to leave? Can members be expelled from the business, and, if so, how and under what condition? And so much more.

It can be an uncomfortable and challenging process to think about such bad scenarios. However, talking through these issues now will undoubtedly ease the process if and when such things happen. It helps all the members get on the same page and develop a sense of shared understanding and predictability. In this way, thinking through worse case scenarios upfront actually helps prevent miscommunication and misunderstandings that may lead to such crises.

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“One way of thinking about an operating agreement is to imagine all the contingencies of worse case scenarios and then figure out how you'd want each scenario to be handled.”
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Step-by-step process for preparing an operating agreement

1. Review the questions in the *Checklist: Preparing for Your Farm's LLC Operating Agreement* and think through various contingencies or worst-case scenarios.
2. Openly discuss the questions and contingencies with your LLC members.
3. Agree on and outline an approach that's best for your farm operation.
4. Start drafting your operating agreement yourself using the *Extensive Operating Agreement for Sun Sisters Farm, LLC* or the *Brief Operating Agreement for Happy Couple Farms, LLC* as a guide or give your outline to your attorney to draft most efficiently.
5. Have your attorney review your operating agreement before finalizing it.
6. Have all your members thoroughly review and sign your operating agreement to officially adopt it as the governing document.

For more detailed steps on how to create your own operating agreement including various issues that can be addressed see the *Checklist: Preparing for Your Farm's LLC Operating Agreement*. For sample provisions with detailed explanations and stories see the *Extensive Operating Agreement for Sun Sisters Farm, LLC* in the following section of this chapter. If you are a farm operation run by a married couple, see the *Brief Operating Agreement for Happy Couple Farms, LLC*, which provides sample provisions with detailed explanations and stories that are more applicable to this scenario.

The operating agreement samples provided in this LLC section provide sample provisions with detailed explanations and stories to help guide you further along the process. Keep in mind that your operating agreement must comply with certain baseline requirements set forth in your state's LLC statute. Given these statutes vary from state to state, Farm Commons highly recommends that you work with an attorney to help you through the process. You can save costs by working through the *step-by-step process* above. If you decide to draft the operating agreement yourself, you should have an attorney review it. This will help assure that all of the provisions are in line with your state's statute and that none of the provisions contradict each other, which is sometimes hard to spot. Internal contradictions result in confusion which can lead to disputes. This would defeat the purpose of having an operating agreement.

Implementing Good Business Practices for Your LLC

Now that you've formed your LLC (by filing the articles of organization) and have established the governing rules (by finalizing and officially adopting your operating agreement), you must follow through by acting like you have a separate business. This means upholding good business practices by keeping your business affairs separate from your personal affairs, abiding by the provisions of your operating agreement, filing applicable annual maintenance fees with the state, and filing your taxes.

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“If the LLC upholds good business practices, each member’s liability extends only to the value of his or her capital contribution.”
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Keep your business and personal financial affairs separate

It is essential that you maintain a clear and distinct level of separateness between the LLC’s business affairs and each your members’ personal affairs. Primarily, this means maintaining separate bank accounts and accounting records. This also includes not paying your personal debts or bills with the business assets. Of course, members can pay for legitimate expenses related to the LLC with their personal funds as long as they account for and properly record these expenses and record them as business expenses. Be sure to keep all the receipts in case of an audit. The member can either write these “business expenses” off on her individual tax return, or she can request to be reimbursed directly by the LLC. If the LLC reimburses the expense, then she cannot also write it off. That would be a sure way of abusing the integrity and separateness of the business entity!

Another key requirement for keeping the business affairs separate is to properly allocate assets to the LLC. Any land, equipment, or other asset that is contributed to the LLC as a member’s capital contribution needs to be formally transferred over. Officially allocating assets in this way helps make absolutely clear who owns what. It also clarifies the extent of each member’s liability if the farm operation turns sour. Recall that if the LLC upholds good business practices, each member’s liability extends only to the value of his or her capital contribution. If the lines aren’t clear, the courts can reach around and grab more.

Sun Sisters Farm, LLC story: allocation of assets

Let’s go back to our Sun Sisters Farm, LLC story as an example. Recall that Marie offered her farmland as her capital contribution. To properly allocate this asset, she needs to transfer the title of the farm to the LLC so that the land is in the LLC’s name. If a member prefers to keep the land in her personal ownerships and instead decides to lease the land to the LLC, a written lease needs to be formalized to evidence this arrangement between the member and the LLC.

Follow your operating agreement

Be sure to follow what your operating agreement says. Legally speaking, this is a contract that all the members are now bound by. You should make copies, or make it available in electronic form, so that every member has it and can refer to it as needed. Following the rules and procedures your operating agreement sets gives the business legitimacy in court. It also helps facilitate good relations among the members, as everyone will be on the same page.

For example, if your operating agreement requires an annual meeting, then you need to have one. You should take minutes to record what happened. The minutes don't have to be elaborate, just enough for the members to recall what was discussed and decided. If you decide to make changes to your operating agreement, you'll need to follow the procedure it sets for making amendments. Your operating amendment could require unanimous, a super-majority (i.e. two-thirds of members), or just majority consent for an amendment depending on how you set it up. If you properly agree to an amendment, get it in writing and have all the members sign it.

If the business starts turning a profit, the members can agree to take a draw on the profits—or “distribution.” The distribution is generally associated with the member's ownership share—or “percentage interest” in the company. This reflects each of the member's potential upside.

You'll need to follow your operating agreement's rules about how distributions are made.

It's a good idea to keep your operating agreement, as well as all meeting minutes and any amendments in one binder so that it is readily available. This also helps prove the legitimacy of your LLC by showing you are taking the separate entity seriously. Whenever you have a doubt about what's required for making a decision, or how to deal with a specific scenario when it arises, refer to your operating agreement for guidance.

“Most states require an annual fee to continue to operate as an LLC. Be sure you pay this fee each year, on time.”

Pay your state's annual LLC maintenance fees

This is simple, but it's amazing how many LLCs fail to follow up. Most states require an annual fee to continue to operate as an LLC. Be sure you pay this fee each year, on time. Otherwise, you could incur late fees. Or, at worse, your LLC could be administratively dissolved. You would then have to start the whole process over again, which no farmer has time to do.

Designate your tax status

Recall that the LLC entity arose through state specific LLC statutes. When states started creating the LLC, the IRS decided not to designate a new LLC category for taxation. Instead, the IRS provides a lot of flexibility and lets the LLC entity chose from among existing business tax options. You can choose to be taxed as a sole proprietorship, a general partnership, a C corporation or an S corporation. While

this guide is not intended to provide tax advice, we will provide a brief overview to help with basic understanding as you work with your accountant or tax attorney to decide what designation is best for your LLC.

This guide is not intended to be relied upon as tax advice. Farm Commons strongly advises any farm operation that decides to form an LLC to consult with an accountant or tax attorney before determining the preferred tax election.

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“By default, the LLC has flow-through taxation. Each member will be required to report the LLC income on his or her personal tax returns.”
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By default, if an LLC has one member (“owner”) it will be taxed a sole proprietorship. Similarly, if it has two or more members it will be taxed as a partnership unless you elect otherwise. When taxed as a sole proprietorship or partnership, income and deductions related to the business will flow through to the individual members of the LLC. Such flow-through taxation is often preferred over a corporation because there will be no federal income tax on the company itself. Each member will be required to report the LLC income on his or her personal tax returns.

Does your LLC need an Employment Identification Number (EIN)?

An EIN is the identification number that the IRS uses to identify the tax accounts of employers and certain other business entities. Not all LLCs need an EIN. Again, this is because the IRS does not formally recognize LLCs as a separate entity for tax purposes, and instead allows LLCs to choose how they wish to be taxed. LLCs can select to be taxed as corporations (both C corporations and S corporations as we’ll discuss in the upcoming chapters on C corporations and S corporations), general partnerships, or sole proprietorships if there is only one member. LLCs choosing to be taxed as corporations or general partnerships need an EIN. Single-member LLCs need an EIN only if they have employees or if they choose a corporation tax treatment. Otherwise, a single member LLC will handle all of the LLC’s tax issues by filing an individual tax return using his or her social security number. So basically, you’ll need an EIN unless you are a single member LLC that has no employees. You can get an EIN immediately by applying online through the IRS website. If you prefer, you download the Form SS-4 on the IRS website and fax your completed form to the service center for your state, and they will respond with a return fax in about one week. Some banks will refuse to issue bank accounts without

For more on C corporations see chapter 3 (part 2, chapter 3 of the *Farmer’s Guide to Choosing a Business Entity*).

an EIN, even if the IRS does not require the business to have one. In those cases, it can be easier to simply get the EIN than to argue with the bank about the necessity of the EIN.

An LLC can be taxed as a corporation by filling out the IRS form 8832, “Entity Classification Election,” and electing corporation tax status. Once you do this, the default is that you will be taxed as a C corporation. Basically, the LLC will be taxed separately from the owners and profit remaining in the LLC at the end of its tax year will be taxed at corporate tax rates. This may be an option to consider if certain LLC members prefer privacy, and do not want to report their business income on their individual tax returns. Also, with corporation tax status you can choose a fiscal year rather than a calendar year. For example, you can designate that your tax year ends on March 31 and begins on April 1. This might be preferable for farm operations that want to pay taxes more in tune with your particular farm operation season.

Another option is to be taxed as an S corporation. After choosing the corporation election on the 8832 form, the LLC would then need to file the IRS tax form 2553 “Election by a Small Business Corporation.” The S corporation handles self-employment taxes slightly differently. Basically, in addition to a “reasonable” salary that can be paid to the member(s) or owner(s) of the farm operation, the members can also receive income in the form of “distributions.” Distributions are taxed at a lower rate and are free from self-employment taxes including social security and Medicare taxation. This can equate to about 15% savings in federal taxes. Distributions can of course only be made if there are sufficient profits in your farm operation. Otherwise, your company will be considered undercapitalized. Recall that if this happens, the members may be personally liable to cover the business’s debt. A couple other point of clarification. First, while you will be designated as an S corporation for federal tax purposes, your entity is still considered an LLC in the eyes of your state. Second, to be an S corporation, you have to follow additional formalities including holding annual meetings and filing an annual form, Form 1120S, with the IRS. This is the informational tax document used to report the income, losses, and dividends of S corporation shareholders (i.e. members if you are an LLC with S corporation tax status).

For more on S corporations see chapter 4 (part 2, chapter 4 of the *Farmer’s Guide to Choosing A Business Entity*).

“An LLC can choose to be taxed as an S corporation, which handles self-employment taxes slightly differently.”

Deciding on salaries of members

Farmers may be motivated to keep their salary as low as possible so that the remainder is taxed at a lower rate. If you designate the LLC as an S corporation for tax status, keep in mind that the IRS does not look fondly

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 “If you designate the LLC as an S corporation for tax status, keep in mind that the IRS does not look fondly on artificially low salaries as a way to take advantage of the added tax benefits.”
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on artificially low salaries and can reclassify dividends as salary. The IRS will look at many different factors in determining what a reasonable salary should be. Anything above that could be reclassified and taxed as dividends. Factors the IRS will consider include the following:

- training and experience,
- duties and responsibilities,
- time and effort devoted to the business,
- dividend history,
- payments to non-shareholder employees,
- timing and manner of paying bonuses to key people,
- what comparable businesses pay for similar services, compensation agreements, and
- the use of a formula to determine compensation.

This begs the question, what is a reasonable salary for a farmer? Where do we draw the line? According to the Bureau of Labor Statistics, in 2014, the average annual income for supervisors of farms and farmworkers is \$47,540. If you own and run your own farm operation, which includes supervisory duties, the IRS may consider this as the baseline. Let’s say a member of an LLC with net annual income of \$50,000 tried to claim that just \$20,000 of that was a reasonable salary in hopes of getting a tax break on the remaining \$30,000. You might have an uphill battle convincing the IRS that a farmer of similar skill and responsibilities could only reasonably expect \$20,000.

Tax designation choices for an LLC

- Do nothing. The default will apply, which is a sole proprietorship (single member LLC) or general partnership (two or more members).
- File IRS form 8832, “Entity Classification Election” and elect corporation. You will be taxed as a C corporation.
- File IRS form 8832, “Entity Classification Election” and elect corporation and then file IRS tax form 2553 “Election by a Small Business Corporation.” You will be taxed as an S corporation.

Note that this is simply for federal tax status. You will still be considered an LLC in the eyes of your state!

“Working with a tax expert will help guarantee you’re doing everything properly; it could also end up saving you money by finding ways to minimize your tax burden.”

Fulfill your tax obligations

Once you decide on your tax designation and file the appropriate forms, you’ll then need to be sure the entity and each of its members fulfills the annual tax obligations. This includes distributing forms, filing forms, and, of course, paying taxes when due. The following provides a basic breakdown of what’s required based on the tax status you choose for your farm operation LLC. Again, Farm Commons strongly recommends that you seek guidance from your accountant or tax attorney come tax season. Tax law is very particular. Working with a tax expert will help guarantee you’re doing everything properly; it could also end up saving you money by finding ways to minimize your tax burden.

If you choose the default status and are taxed as a sole proprietorship or general partnership then the LLC itself does not have to file a separate annual income tax return. Rather, each member will report income from the LLC on their individual tax returns (i.e. Form 1040, Schedule C, E, or F). If the LLC has more than one member, and is thus taxed as a general partnership, it will need to distribute Form 1065 to each member. This is purely an informational form that provides each member the necessary profit and loss information of the LLC to report on his or her individual tax return. Each member must include the Form 1065 when filing his or her tax return.

If you elect to be taxed as a C corporation, the LLC will have to file Form 1120, the U.S. Corporation Income Tax Return, and pay its own taxes. In addition, the members of the LLC will each have to individually report and pay taxes on any LLC income they receive (e.g. salary and distribution of profits).

Double taxation of LLC with C corporation tax status

In effect, the farm operation LLC members pay double taxes. First, the entity pays and then the individual members pay. This double taxation dilemma is why business owners often prefer the LLC structure, as it provides the option to be taxed as a pass-through entity (i.e. sole proprietorship, general partnership, or S corporation). It would be a very unique circumstance for a farm operation LLC to choose to be taxed as a C corporation. Be sure to confirm with your tax attorney or accountant on whether this would be the ideal option for you.

If your LLC elects to be taxed as an S corporation, you'll have to file the annual Form 1120S with the IRS. This is an informational tax document used to report the income, losses, and dividends of S corporation shareholders (i.e. members of an LLC with S corporation tax status). The entity itself will not have to pay taxes, as it passes through to the individual members. In addition, an LLC that elects S corporation status will have to provide each of the LLC's members with a schedule K-1. The schedule K-1 is similar to a W-2, the end of the year wage statement that employees receive from their employers. The schedule K-1 shows the self-employment income each of the members receives from the company. The LLC must also submit a copy of schedule K-1 to the IRS for each member. This allows the IRS to be sure that each member is properly reporting any self-employment income he or she receives from an LLC that's being taxed as an S corporation.

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 "The business and all members need to keep good records of the business' financial affairs."
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Tax forms that an LLC must file and distribute based on tax status

- **LLC with sole proprietorship tax status (default for single member LLC):** Nothing. The individual member reports LLC income and profit or loss allocations on his or her individual tax return (or Form 1040, Schedule C, E, or F).
- **LLC with general partnership tax status (default for multi member LLC):** Distribute Form 1065 to each member. Each member reports LLC income and profit or loss allocations on his or her individual tax return and must include the Form 1065.
- **LLC with C corporation status:** File Form 1120, the U.S. Corporation Income Tax Return, with the IRS and pay taxes as a corporation. Each member will report and pay taxes on any income (i.e. salary and distribution of profits) he or she received by the entity on his or her individual income tax return.
- **LLC with S corporation tax status:** File Form 1120S with the IRS, which is purely informational. Distribute schedule K-1 to each member and file schedule K-1 for each member with the IRS. Each member reports LLC income and profit or loss allocations on his or her individual tax return.

Maintain accurate accounting records

Finally, the business and all members need to keep good records of the business' financial affairs, including all receipts of business expenses in case of an audit. It's also advisable that you use a reliable accounting system such as Quickbooks or hire an accountant to handle your accounting and taxes for you.



FARM COMMONS

Section 2: Going Deeper into LLCs

DISCLAIMER: This guide does not provide legal advice or establish an attorney client relationship between the reader and author. Always consult an attorney regarding your specific situation.

How to Use these Resources

With an initial decision in hand to form an LLC, farmers need to know exactly what it takes to form one. How does a person set up the LLC? What documents need to be filed and with who? What should be included in the operating agreement? This section is filled with hands-on tools to help guide you through the process of creating and maintaining an LLC as well as preparing your farm LLC's operating agreement.

The **Checklist: Creating an LLC** sketches the basic process a farmer follows to form and organize an LLC. It is designed to help farmers understand the big picture as they comply with the laws and outfit their farm for success. It's best to start with the checklist to get a sense of what will be required.

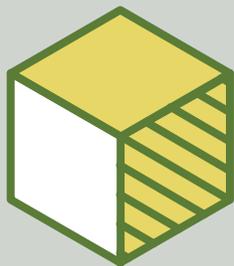
The sample **Brief Operating Agreement for Happy Couple Farm, LLC** includes the foundational provisions that are particularly important for a married couple LLC. It presumes that the couple's communication and working relationship are relatively good. It also assumes that if the couple divorces, marital or family law may dictate the division of assets to a certain extent, aside from what an operating agreement might require. So the provisions are not as elaborate as some operating agreements. If you think that you will eventually take on new business partners outside your family, you may want to take a look at the sample **Extensive Operating Agreement for Sun Sisters Farm, LLC**. This extensive agreement provides more elaborate provisions to handle various scenarios that may arise in an LLC with members of diverse backgrounds and interests who may come and go. These sample operating agreements serve as examples of the ways a farm operation may want to handle certain situations should they arise. The annotations provide even more ideas.

Rather than simply adopting someone else's operating agreement, including any of the sample agreements in this section, it's best to take the time to think through the various issues and craft an agreement that is best for your particular farm operation. The **Checklist: Preparing Your Farm's LLC Operating Agreement** will guide you through that process. It's filled with questions to illicit the best result that is specific to your situation. You can either take your answers to an attorney who will then be able to efficiently draft up your operating agreement, or you can take a crack at drafting it yourself using the sample agreements as a guide. Either way, Farm Commons advises that you have an attorney familiar with the laws in your state to look it over before it is finalized. This will ensure that they comply

“Rather than simply adopting someone else's operating agreement, it's best to take the time to think through various issues and craft an agreement that is best for your particular farm operation.”

with your state's corporation statute and that there are no conflicting provisions within the bylaws, which would only lead to confusion down the road.

Finally, while LLCs are generally not required to hold annual meetings, it is a good practice to do so anyway. Annual member meetings offer an opportunity for the members to get together and review the financials and strategize for the upcoming year. They help foster open communication and engagement from the membership. If you do hold annual member meetings, it's best to keep minutes to evidence what happened should a dispute or issue arise. In addition, if your LLC chooses to elect S corporation tax status, the IRS will require you to hold annual member meetings and take minutes. The sample **Annual Member Meeting Minutes with Annotations** included in this section illustrate how straightforward it is to take minutes. You can use these to guide you through the process should you decide or be required to hold annual member meetings.



Checklist: Creating a Farm Business as an LLC

With S Corporation Tax Status Option

“This checklist is designed to help farmers understand the big picture as they comply with their state’s LLC laws and gear their farm for success.”

Introduction

This checklist guides farmers who have made the careful decision to establish their farm operation as an LLC. It sketches the basic process a farmer follows to form and organize an LLC. LLCs are a matter of state law and each state may have different requirements. The LLC business entity can help farmers create clear decision-making procedures, outline responsibilities, plan an exit strategy, and manage potential liability. Some of these benefits come from legal best practices such as writing an operating agreement, a step not required in every state to form an LLC. This checklist is designed to help farmers understand the big picture as they comply with their state’s LLC laws and gear their farm for success. Read beyond our summary checklist for more information on each step.

Summary Checklist

Decide and Prepare for the LLC

- Verify that an LLC is the right entity for your farm business
- Settle on a name for your business and verify that your chosen name is available
- Prepare to allocate assets between business and personal ownership
- Select and appoint a registered agent

Form and Organize the LLC

- Draft articles of organization
- File articles of organization
- Get an Employment Identification Number (EIN) if your LLC needs one

Implement Best Practices in Farm Business

- Draft an operating agreement
- Follow the operating agreement
- Allocate assets between personal and business ownership

- Document relationships for personal assets used for farm purposes
- Update websites, brochures, invoices, order forms and other materials with the “LLC” designation, if required
- Establish a risk management plan
- Keep accurate and up to date accounting records for tax purposes
- Make note of and follow any annual obligations such as when, where, and how to file your annual report or fee with the state

Optional: Elect S Corporation Federal Tax Status

- Verify that a S corporation is the right entity
- Elect S corporation tax status with federal government
- Distribute and file S corporation federal tax forms and file and pay state taxes
- Hold annual meetings

Checklist with Explanations

Decide and Prepare for the LLC

- Verify that an LLC is the right entity

Although LLCs are a popular and wise choice for many farm businesses, each farm should do their homework. Consider your state’s filing fees and annual fees, the level of risk faced by the farm business, whether financing is affected, and how farm partners feel about it before creating an LLC. The decision is not necessarily complicated; it should be intentional. As a specific caution, any farm looking to convert from a corporation to an LLC should seek the advice of an attorney before going forward. Converting from a corporation to an LLC may have undesirable tax consequences.

- Settle on a name for your business

Choosing a name is a very significant step. The name helps create an identity for your business, your product, and and all that you represent as a farm operation.

“The decision to form an LLC is not necessarily complicated, but it should be intentional.”

“To avoid legal issues down the road, choose a name that isn’t already in use.”

But, it’s also a legal consideration. Most states prohibit two businesses from registering the same business name in that state. In addition, if you choose the same name as another business already in operation, that business may demand that you stop using their name. If this problem comes up after your operation has been around a few years, changing your name will likely confuse customers. And, it’s sad to lose the name you’ve grown to love. To keep this from happening, you’ll need to choose a name that isn’t already in use.

First, check state and federal databases of trademarks and trade names. Generally, secretary of state’s offices maintain a searchable online database of business names or “trade names.” The United States Patent and Trademark Office (USPTO) has a searchable online database for registered federal trademarks. A basic internet search will point you in the direction of these databases. Although a farm should not automatically assume that federally registered names are unavailable, consider it a red flag. Be sure you get more information and consult a trademark attorney before choosing a name already registered in the federal database. You can do a basic internet search for existing businesses with the same name. Finally, you may want to check if your preferred website address is available and even register that domain name. You can register your preferred domain name on websites like GoDaddy or DreamHost. Also of note, most state LLC statutes require that the name of an LLC include the words “limited liability company” or the abbreviation “LLC” and not have the terms “Corporation” or “Inc.”

□ Prepare to allocate assets between business and personal

“Owners need to decide which assets are personal and which are business.”

The essence of an LLC (or a corporation) is that the business is distinct from its owner or owners. Accordingly, owners have to follow through with that distinction in practice. This means that the owners need to decide which assets are personal and which are business. For farms, the ownership of land can be a delicate decision. Many farmers prefer to keep the land under personal ownership and lease their personal land to the farm business for farm usage. If you decide to go this route, be sure you enter an official lease with the LLC to make this allocation clear and distinct. Also, note that a lease allocation can affect the farm business’ balance sheet. If you work with an accountant, ask them for advice. If your farm is financed through a bank or the Farm Service Agency, talk with your loan agent about any effect on your qualifications or personal loan guarantees.

Although the decision and process of allocation may seem overwhelming considering the large number of assets many farms have, it shouldn’t be too

complicated. A common sense approach is likely the best. If assets are used for the farm, they should likely be farm assets. At this point, the farm should bear in mind that this division will occur and gather any necessary information to make the transfer.

□ **Select and appoint a registered agent**

A registered agent is appointed by the owners of the corporation to receive important legal and tax documents on behalf of the business before the business is officially incorporated, or recognized by the state. The entity is “officially incorporated” when the state agency approves the articles of incorporation. Once the corporation is official, the registered agent is the individual who is notified if and when the corporation is a party in a legal action. This is called service of process. A registered agent can be an officer or employee of the company, but is more often a third party such as the corporation’s lawyer or a service provider that handles this very thing for business entities for a small fee. Whomever you pick, the registered agent’s name and address must be listed in the articles of incorporation.

Form and Organize the LLC

□ **Draft articles of organization**

Each state requires that an LLC file a document titled “articles of organization.” Drafting and filing the articles of organization is an essential yet perhaps the easiest part of creating an LLC. Legally speaking, the articles of organization are defined by state law, which specifies exactly what information must or may be included in the articles of organization. To make things easier on business owners and the government agency processing the articles, many states provide fillable form articles of organization. Some states will require that the business use the form, while others will allow self-drafted articles. Some agencies don’t provide forms at all, and in that case, farmers should simply create a document with the information requested in the statute. Filing is generally handled by the state secretary of state’s office. An internet search should bring up a form and more information for your specific state.

The articles of organization will likely require you to list the business’ “registered agent” Most articles of organization also require listing the business’ street address and may require a listing of “members” and their contact information. Legally speaking, a member is the word used for the owner of an LLC. Finally, the form

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“Drafting and filing the articles of organization is an essential yet perhaps the easiest part of creating and LLC.”
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“If you want all members to make day-to-day decisions, you should designate member-managed. If you want only specific people to make those decisions, the farm may be manager-managed.”

may ask whether the entity is “member-managed” or “manager-managed.” Which one is your farm? It depends on who you determine has the authority to make day-to-day management decisions for the business (i.e. decisions related to managing employees, making small purchases, marketing, and handling customer relations and so forth). If you want all members to make day-to-day decisions, you should designate member-managed. If you want only specific people to make those decisions, the farm may be manager-managed.

□ **File articles of organization**

An LLC does not exist until the date its articles of organization are filed and then approved by the state agency. Approval can take anywhere between one day and one week from the time of filing. The articles of organization form can generally be submitted online, along with the required fee. Each state charges different fees, which vary between \$25 and \$1000. In addition, most states require an annual fee to maintain the LLC, which is generally less than the fee to create an LLC. Note that the information on the articles of organization may be changed at any time by filing amended articles.

□ **Get an Employment Identification Number if your LLC needs one**

An EIN is the identification number that the IRS uses to identify the tax accounts of employers and certain other business entities. Not all LLCs need an EIN. Again, this is because the IRS does not formally recognize LLCs as a separate entity for tax purposes, and instead allows LLCs to choose how they wish to be taxed. LLCs can select to be taxed as corporations (both C- Corporations and S-Corporations as we’ll discuss in the upcoming chapters), general partnerships, or sole proprietorships if there is only one member. LLCs choosing to be taxed as corporations or general partnerships need an EIN. Single-member LLCs need an EIN only if they have employees or if they choose a corporation tax treatment. Otherwise, a single member LLC will handle all of the LLC’s tax issues by filing an individual tax return using his or her social security number. So basically, you’ll need an EIN unless you are a single member LLC that has no employees.

You can get an EIN immediately by applying online through the IRS website. If you prefer, you download the Form SS-4 on the IRS website and fax your

“You’ll need an EIN unless you are a single member LLC that has no employees.”

For more information on operating agreements and guidance on developing your own, review our *Checklist: Preparing for Your Farm's LLC Operating Agreement* and check out our operating agreements in this resource.

completed form to the service center for your state, and they will respond with a return fax in about one week. Some banks will refuse to issue bank accounts without an EIN, even if the IRS does not require the business to have one. In those cases, it can be easier to simply get the EIN than to argue with the bank about the necessity of the EIN.

Implement Best Practices

□ **Draft an operating agreement**

Although not required by most state laws, an operating agreement is highly recommended. The operating agreement lays out exactly who makes decisions for the farm. It outlines how members can enter the business, leave the business, and receive distributions of profit. The agreement also allocates business profits and losses for tax purposes. If a farm does not have its own operating agreement, state law provides default rules. However, those rules may not be best for your particular farm business. The operating agreement is your chance to establish rules and procedures that work best for the farm operation's individual situation.

Writing an operating agreement can be a very valuable process for farm operation owners, even if the state's default rules will work perfectly well. The operating agreement is a chance to think through some very important contingencies. What happens if a farm partner dies? What if one partner wants to leave the business? What if you want to bring another partner on? These problems can cause massive disruption if people haven't thought them through. The discussion process puts everyone on the same page, and can serve to prevent disputes that often lead to crises.

□ **Follow the operating agreement**

If you go to the work to outline how the business should handle important things like decisions, taxes, and departure of a member, it's very important to follow the document. This gives the business legitimacy in court. And, if you went to all that effort, you should make it work for you.

□ **Allocate assets between personal and business ownership**

As discussed above, a farm business needs to follow through on creating an LLC by making the division between business and personal. If the farm doesn't already have a separate bank account, set one up. Farm expenses and payments should

“The operating agreement lays out exactly who makes decision for the farm. It outlines how members can enter the business, leave the business, and receive distributions of profit.”

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 “The owners need to determine which assets are farm and which are personal. If the farm business uses your property, the farm business has a lease with you, which should be in writing.”
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For more information on drafting leases, see Farm Common's print resource: *Drafting a Lease: Questions for Farmers and Landowners to Ask*, available on our website.

move through the farm account, only. Of course, if you forget the farm checkbook and use your personal bank card instead, you may pay yourself back.

Next, determine which assets are farm and which are personal. If there are multiple members and each have promised to make a capital contribution or investment in the LLC, each member needs to follow through with his or her promise. For example, if one member promised to invest \$35,000 in cash, then that money needs to be deposited into the LLC's bank account. If a member promised to invest his or her farm property, then the title of the property needs to be transferred to the LLC.

Overall, a common sense allocation is probably the best route. This process can be quite simple—there's no need to detail every feed scoop, hand weeder, or trash bin. Making your best guess as to the value of the farm's various assets and placing them on the farm's balance sheet is a simple way to document the transfer. There is no need to get creative. If a farm tried to keep all assets personal and leave the farm with nothing, a court would likely not respect the LLC at all. The allocation must be based in reality and the farm must have enough assets to capitalize the operation.

□ Document relationships for personal assets used for farm purposes

If you choose to hold ownership of the land with yourself personally, you should document the new relationship with the LLC. If the farm business uses your property, the farm business has a lease with you, whether one is written or not. Written documents are generally the better choice, and it can be a very simple one-page outline of basic terms such as rental rate, lease term, and renewal procedures. Many individuals choose to lease the farmland for a rate equal to the value of the annual property taxes, but each farm has unique needs.

Now is a good time to discuss our objectives in allocating assets and writing leases. At any point in time, a court should be able to determine which assets are the farm's and which are personal. This is because the farm's creditors can go after business assets. Thus, we need to know what they are. The court should also be able to determine exactly how and why assets are used for both personal and business reasons. Your documentation can go a long way towards creating an efficient process. If records are a mess and there is no documentation, a court may decide for itself which assets are personal or business, and the farm loses an opportunity to influence the process.

□ Update websites, brochures, invoices, order forms with the LLC designation

State statutes require that a limited liability company use the LLC designation in the name of the business. This signals to potential creditors that only business assets are available to satisfy potential judgments against the business. If you don't like the look of the words or you've already invested in marketing materials, check with your secretary of state's office about registering a trade name without the letters. In some states, the county register of deeds handles registration of trade names, so you may need to make a couple phone calls. For invoices and other official business, it's best to include the letters after your name.

□ Establish a risk management strategy

While the LLC designation can provide important liability protection to its owners, it does not act like insurance. The LLC itself is not shielded from liability, and the individual members may lose their protection if the LLC is undercapitalized or not managed properly. The LLC entity is not a substitute for insurance.

In certain situations, your LLC may be required to carry insurance. LLC insurance requirements are set by the state government, so you'll need to make sure you're complying with your state's business insurance laws. Required coverage for your LLC may include workers' compensation, disability insurance, and unemployment insurance.

In addition, you should consider getting a proper insurance policy to cover your farm operation LLC from risks such as crop failure, damage to equipment or property, and injuries or accidents to employees, farm visitors, or customers. The precise policy will depend upon your operation and what is available in your area. It could include a simple farm insurance policy or a more robust commercial policy to cover value-added products or off farm activities. You may want to talk to your insurance agent about coverage for defending the managers of your LLC (also called directors and officers or "D & O" insurance), which protects your LLC if a lawsuit is brought against one of your managers accusing them of negligence or wrongdoing.

□ Keep accurate and up to date accounting records for tax purposes

This includes maintaining an accurate profit and loss statement. While the LLC does not have to pay income taxes itself (unless it elects to be taxed as a C – corporation or S – corporation), each member will need to report his or her share of profits and losses on their individual tax returns. Keeping good accounting

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 "Required insurance for your LLC may include workers' compensation, disability insurance, and unemployment insurance."
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 For more information on insurance options, see Farm Common's print resource: *Managing the Sustainable Farm's Risks with Insurance: Navigating Common Options*, available on our website.

records throughout the year will help streamline this process for everyone and help the LLC manage its finances overall.

□ Fulfill annual obligations

Your state will likely require you to file an annual report and an annual fee to maintain your LLC. If you neglect these duties, the state may dissolve your LLC. The Internal Revenue Service will also expect additional filings, even if you do not need to file a separate income tax return for the LLC. The actual filings will depend on whether you are a single member LLC, you have employees, and whether you have elected to be taxed as a C – corporation or S – corporation. Talk with your accountant or tax preparer, or your secretary of state’s office and the IRS for more information on filing LLC taxes.

Optional: Elect S Corporation Federal Tax Status

□ Verify that a S corporation is the right entity

Although S corporations are a wise choice for many farm businesses, each farm should do their homework. The S corporation federal tax status provides some potential tax benefits for LLC members related to self-employment taxes. However, to get that benefit, the LLC has to meet specific criteria and follow certain formalities, including holding annual meetings and dealing with federal tax paperwork every year. This is above and beyond what a traditional LLC requires. Be sure to review the S corporation chapter in the Farmer’s Guide to Choosing a Business Entity for more on the benefits as well as the eligibility criteria and requirements to obtain and maintain S corporation tax status. The decision is not necessarily complicated; it should be intentional.

□ Elect S corporation tax status with federal government

Electing S corporation tax status for an LLC is quite simple. You’ll first need to fill out and file with the IRS form 8832, “Entity Classification Election.” Here, you’ll elect your preference to be taxed as a corporation. Once you do this, you will be taxed as a C corporation and unless you follow the next step, you’ll face the double taxation dilemma. Next, you will need to fill out and file with the IRS tax form 2553 “Election by a Small Business Corporation.” The Form should be completed up to two months and fifteen days after the beginning of the tax year the election is going to take effect, or at any time during the tax year preceding the tax year it is

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“The S corporation federal tax status provides some potential tax benefits for LLC members related to self-employment taxes.”
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to take effect. This sounds complicated but the IRS provides examples of how the timing works in the instruction sheet for Form 2553.

□ **Distribute and file S corporation federal tax forms and file and pay state taxes**

As an S corporation, you'll have to file the annual Form 1120S with the IRS. This is not a tax return, as the entity does not itself have to pay income taxes. Rather, this is an informational tax document used to report the LLC's income and losses and any profits given to its members (i.e. distributions). Again, the LLC itself will not have to pay taxes, as the business' income passes through to the individual owners.

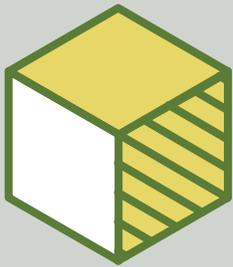
In addition, you will have to provide each of the LLC's members with a schedule K-1. The schedule K-1 is similar to a W-2, the end of the year wage statement that employees receive from their employers. The schedule K-1 shows the self-employment income each of the owners receive from the company. The LLC must also submit a copy of schedule K-1 to the IRS for each LLC member. This allows the IRS to be sure that each member is properly reporting any self-employment income he or she receives from the entity that has S corporation tax status.

Farm Commons recommends that you seek expert tax guidance before filing any of the required S corporation tax forms. Also of note, be sure to abide by all the state income tax requirements for your LLC. The S corporation tax status is only relevant for federal income taxes filed with the IRS.

□ **Hold annual meetings**

While many states don't require LLCs to hold annual meetings, the IRS requires that an S corporation hold an annual meeting. You must have provisions setting forth the parameters for your annual meeting in your operating agreement. This includes the month or season when the annual meeting is to happen. It also includes requirements for when and how you will notify the business owners about the place, time, and other relevant details about the meeting such as matters to be discussed. And, once you set these parameters, you must follow them. You need to also take minutes to evidence what happens at the meetings. The minutes don't have to be elaborate, just enough to provide evidence of what happened and help the participants recall what was discussed and decided if needed.

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“While many states don't require LLCs to hold annual meetings, the IRS requires that an S corporation hold annual meetings.”
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Checklist: Preparing Your Farm's LLC Operating Agreement

“One way of thinking about all the issues on this checklist is to imagine the worst-case scenario and then figure out how you’d want each scenario to be handled.”

Using This Checklist

Are you ready to start putting together your operating agreement? This checklist and explanations details basic issues that should be addressed in a thorough and well-considered operating agreement. Not all questions will be relevant in every situation. One way of thinking about all of the issues on this checklist is to imagine the worst-case scenario—no matter how far-fetched—and then figure out how you’d want each scenario to be handled.

Once you have a basic understanding of the answers to these questions, you might be ready for the next step: drafting. However, drafting an operating agreement can be challenging and may not be the best use of a farmer’s limited time. Bring your responses to these questions to a qualified attorney. Armed with this information, he or she should be able to assemble a terrific operating agreement that is consistent with the laws of your state.

Keep in mind that your operating agreement must comply with certain baseline requirements set forth in your state’s LLC statute. Given these statutes vary from state to state, Farm Commons highly recommends that you work with an attorney to help you through the process. If you decide to draft the operating agreement yourself, you should have an attorney review it. This will help assure that all of the provisions are in line with your state’s statute and that none of the provisions contradict each other, which is sometimes hard to spot. Internal contradictions result in confusion which can lead to disputes. This would defeat the purpose of having an operating agreement.

This checklist is designed to be used with our other resources provided in LLC section of the Farmer’s Guide to Choosing a Business Entity, including the Extensive Operating Agreement for Sun Sisters Farm, LLC and the Brief Operating Agreement for Happy Couple Farm, LLC.

Summary Checklist

Financial Matters

- What is everyone contributing to the business, financially?
- How are profits and losses handled?
- When is the decision made and who decides whether to hand out or “distribute” profits to the members?

Management Matters

- Who makes the day-to-day decisions (i.e. will the LLC be manager-managed or member-managed)?
- What is the protocol for making day-to-day decisions?
- Are there any particular roles, responsibilities, or benefits of any members or managers you want to specify?

Meetings and Voting Matters

- Will you have an annual meeting and, if so, when?
- How are members informed about the time and place of meetings and how meetings can be conducted?
- Who has voting rights and upon what are they based?

“Big” Decisions

- Will you allow additional members and, if so, who decides?
- What happens if a member wants to leave or if a member’s interest in the company is somehow passed on to someone else?
- Who decides whether the company takes on debt?
- Who decides whether to close the company?
- Who decides whether existing members can make additional capital contributions?
- Who decides on amendments to the operating agreement?
- Who decides whether the company can change hands (i.e. be acquired or merged with another company)?
- How are all other “big” decisions (i.e. non day-to-day decisions) made?

Checklist with Explanations

Financial Matters

- What is everyone contributing to the business, financially?

Another way of saying this is what is the form and value of each member’s (the LLC term for “owners”) initial “capital contribution”? The idea is that each member brings something to the table—whether it be cash, land, equipment, past or future services, or other things that are valued as capital.

What each member offers is called a capital contribution. It is important to

Be sure to see an attorney or accountant before offering services as a capital contribution—there are tax implications.

determine upfront and put in writing the form and value of each member’s capital contribution for a number of reasons. First, the LLC needs to be adequately capitalized to be legally legitimate. What is considered adequate will depend on your business. A basic rule of thumb is that you need enough to pay the bills as they come due. Also, the value placed on the capital contribution of each member will coincide with his or her ownership share or “percentage interest” in the company. The percentage interest breakdown may have significant implications as we’ll discuss throughout this checklist, such as how profits and losses are dealt with and what voting rights are based on.

Keep in mind that once capital is offered to the company, it is no longer considered a personal asset. It is now a company asset and the member has no right to get the capital back or to expect anything in exchange for it. This is what makes a capital contribution different than a loan, lease, or sale of land or equipment. In effect, members are liable for the LLC’s debts only to the extent or amount that each has contributed to the LLC. It’s each member’s “stake” in the business.

□ How are profits and losses dealt with?

Unlike corporations, LLCs have flexibility in allocating and distributing profits and losses. Profits and losses are revenue minus expenses. If you have more coming in than going out you have a profit. If you have less coming in than going out you have a loss. The LLC is required to establish how profits and losses are allocated to the members for tax purposes. The allocation of profits and losses will affect the tax basis on each member’s individual tax return.

Profit and loss allocation could be based on the percentage interest breakdown, equal distribution (i.e. if there are three members, each gets one-third allocation regardless of percentage interest), or some other determinant. A member may want to allocate losses in a unique way to lower her tax basis. Farm Commons strongly recommends that you seek the guidance of your accountant or tax attorney if you want to allocate profits and losses on something other than the percentage interest.

□ When is the decision made and who decides whether to hand out or “distribute” profits to the members?

A distribution is when the LLC actually gives members money or property based on profits. This is more akin to a dividend to shareholders in a corporation and is

“The allocation of profits and losses will affect the tax basis on each member’s individual tax return.”

different than a salary or wage.

- **What is your preferred timing for making distributions?**

Typically, the decision is made annually based on year-end accounting. However, you could choose to allow for the decision more or less frequently (e.g. every six months or every two years).

- **How is the decision made?**

You could require unanimous consent of all members, a super-majority, or a simple majority vote (see more below on voting and decision-making options). Or, you could specify that profits will be distributed only if the company has cash reserves above a certain amount. Some LLCs choose to place a high threshold on the decision to distribute profits, particularly early on, as they feel it is important to reinvest profits back into the company. Believe it or not, the distribution of profits is the source of a lot of internal battles in companies.

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“Some LLCs choose to place a high threshold on the decision to distribute profits, particularly early on, as they feel it is important to reinvest profits back into the company.”
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Story of Sun Sisters Farm, LLC

Article 3 of the *Extensive Operating Agreement for Sun Sisters Farm, LLC* requires just a majority consent before making distribution of profit. The story that accompanies this sample operating agreement illustrates how touchy of a topic this can be. One of the members, Marie, prefers to keep the profits in the business. However, she holds less than a majority percentage interest and gets out-voted by the other members.

It's best to determine upfront what is ideal for the timing and process of distribution of profits and put it in writing. This way everyone will know what to expect. Also keep in mind that state statutes generally prohibit distributions if doing so would jeopardize the company's ability to pay its bills.

Management Matters

- **Who makes the day-to-day decisions?**

Another way of saying this is will the entity be “member-managed” or “manager-managed”? Most states have a default rule that the LLC is managed by its members unless otherwise provided for in the operating agreement. If you have just a few members, you'll want to keep the day-to-day decisions and operations of the company in the hands of the members.

“A manager-managed structure allows you to designate a certain person or group of people to run the day-to-day operations.”

However, management issues can get rather cumbersome if you have many members, or just a few members with very diverse interests. A “manager-managed” structure addresses this by allowing you to designate a certain person or group of people as managers of the company. The manager(s) could be members or non-members—it’s up to you to decide the parameters.

The *Extensive Operating Agreement for Sun Sisters Farm, LLC* included in this resource provides one example of a manager-managed LLC. The annotations also include a provision for a member-managed designation. The *Brief Operating Agreement for Happy Couple Farm, LLC* provides an example of a family owner member-managed LLC.

□ **What is the protocol for making day-to-day decisions?**

Whether you decide to go the member-managed or manager-managed route, you still may want to include some basic guidelines on day-to-day operations in your operating agreement. Here are some questions to consider:

- Are day-to-day decisions made by a single person or a set of people?
- Who are the manager(s) and how are they appointed or removed from this role?
- Will you have some sort of a voting process if multiple people are involved in the day-to-day decisions?
- If you have an equal number of members or managers (e.g. two or four), what happens if there’s a 50/50 split on a day-to-day decision?
- Are there restrictions on any day-to-day decisions, such as spending amounts?

Spending restrictions

It is common to require two signatures from authorized members and/or managers on checks over a certain dollar amount (e.g., \$1,000). This ensures that at least one other person has visibility into the farm’s spending and provides an additional safeguard against runaway spending. It’s also common to set a threshold (e.g. \$4,500) for when the decision becomes a “big” decision and requires a vote by all voting members.

It’s helpful to put such key aspects of your management protocol in your operating agreement so that everyone is on the same page and to ensure accountability.

“The operating agreement is not the place to lay out nitty gritty details on day-to-day decisions, but rather the overarching protocol or framework for how those decisions are made.”

Keep in mind, the operating agreement is not the place to lay out nitty gritty details on day-to-day decisions, but rather the overarching protocol or framework for how those decisions are made.

- Are there any particular roles, responsibilities, or benefits of any members or managers you want to specify?

You may want to set forth the details regarding expectations of certain members or managers in the operating agreement itself. The specifics could include a clear description of roles and responsibilities of key members or managers, somewhat like a job description. It could also include any special benefits such as salary, housing arrangements, and health benefits that you may decide to offer any managers of the LLC (if you are a manager-managed LLC).

If you decide to include such details in your operating agreement, it's best to incorporate them as a separate appendix. This will make it far easier to make changes and updates to these nuanced issues. Otherwise, you would have to consistently amend your operating agreement for minor details. Also, you should consider the protocol and threshold (e.g. majority, super-majority, or unanimous consent) for making changes to this appendix. Do you want to make it less than what's required for amending the operating agreement itself? For more on this, see the discussion on “big” decisions below.

Another option altogether is to create an entirely separate employment agreement that will govern all your agreements with your manager(s). Or, you could have a separate a member agreement that governs any special arrangements with particular members, such as roles and responsibilities, housing arrangements, health benefits, etc. Either way, you are encouraged to think through these details at the get go and put them in writing in some form.

Meetings and Voting Matters

- Will you have an annual meeting and, if so, when?

While state law doesn't require it, it's a good idea to have annual meetings for members to bring legitimacy to your company and foster good relations with your members. Annual meetings are a perfect time to vote on “big” decisions, engage in

strategic planning, and set and evaluate goals that will help your farming operation succeed. If you decide to hold annual meetings and designate a month or season for the meeting to be held, it's important to stick to it.

- How are members informed of meetings and how can meetings be conducted?

Operating agreements also typically include a provision saying that in addition to the annual meeting, special meetings can be called if any big decisions need to be made. If you decide to have annual meetings or allow for special meetings, you'll need to set clear ground rules for how your members are notified of the time and place of the meeting. Also, how and where are meetings conducted?

- Can members be notified of a meeting be via email?
- How far in advance must the notice or invitation to a meeting be given?
- Can meetings take place by phone or Internet (e.g. Skype or Google Hangout) or must they be in person?

If a member with voting rights doesn't know that a meeting is taking place and a vote is held on an important issue, he or she could raise issue with the decision that was made. This could result in legal issues down the road.

- Who has voting rights and upon what are they based?

Voting rights will come into play for significant company decisions (and could even play a role on certain day-to-day management decisions if you decide to make your LLC member-managed). The following are some things you'll need to decide.

- **What is the basis of voting rights in your company?**

The default rule in most state LLC statutes is that voting rights are based on the percentage interest of the members.

Story of Sun Sisters Farm, LLC

For example, let's say that an LLC has three members: Marie has a 55% percentage interest, Jema has a 30% percentage interest, and Ingrid has a 15% percentage interest. Based on this, Marie automatically carries a majority vote even though she's just one of three members. Together, Marie and Jema would carry a super-majority (i.e. three-quarters agreement).

You could choose to structure voting rights some other way, such as one-member, one-vote. Or perhaps you want to designate one person as having the final say on *everything* or on certain matters. It's entirely up to you.

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 "Voting rights will come into play for significant company decisions."
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- **Does every member have voting rights?**

You could decide to tier your membership interests so that some members have voting rights while others don't. It may be that you have members that don't really care how the business is run. Or, maybe you don't want them to have a say! On the other hand, you may have members that want a say in every aspect of the company. How you structure the voting rights is entirely up to you.

“Big” Decisions

“Big” decisions are typically addressed separately in the operating agreement, including specifying detailed protocols, establishing certain restrictions, and setting a higher threshold for the decision making process. A higher threshold would be unanimous consent or super-majority versus just a majority. What are the “big” decisions for your farm operation and how do you want to handle them?

The following are the typical “big” decisions that are addressed separately in operating agreements. You may have others that are unique to your farming operation. Again, one way of thinking about these issues is to imagine the worse case scenario—no matter how far-fetched—and to then figure out how you'd want each scenario to be handled. Keep in mind that requiring unanimous consent protects initial founding members and safeguards their vision for how the company operates if additional members are added. However, it may be challenging to reach unanimous consent if you have many or even just a few diverse members. Operating agreements sometimes require only that a super-majority, usually defined as members owning at least three-quarters of the company, approve “big” decisions. This may be advisable if you anticipate it will be very challenging to get *everyone* to agree on anything.

It's up to you to decide and clearly outline in your operating agreement what is required for making various types of decisions—whether a unanimous consent, super-majority, majority, or something else.

- **Will you allow additional members and, if so, who decides?**

Sometimes owners decide upfront that they most likely will not want any additional members. This is often because they don't want their own percentage interest in the company to be reduced or diluted. Dilution could reduce their share in profits and their voting power. However, it's still recommended that a provision is included for a process to add new members. What if the business needs more

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“It's up to you to decide and clearly outline in your operating agreement what is required for making various types of decisions—whether a unanimous consent, super-majority, majority, or something else.”
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funds? What if someone you like and trust wants to invest as a part owner? If you decide to include a provision for additional members, what is the threshold for the decision? Unanimous consent, majority, supermajority, or something else?

- What happens if a member wants to leave or if a member's interest in the company is somehow passed on to someone else?

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 "A member's desire to leave or to transfer his or her interest in the company will inevitably raise several issues."
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A member's desire to leave or to transfer his or her interest in the company to someone else (voluntarily or involuntarily) will inevitably raise several issues. Voluntary transfers refer to the scenario when a member wants leave and sell her interest to someone else. Involuntary transfers include things like a member's death or default on a loan if the member listed his interest in the LLC as collateral. These scenarios are all considered "transfers" in LLC-speak. You should consider them all carefully and set forth detailed parameters in your operating agreement. Here are some guiding questions:

- If a member voluntarily decides to leave, how and when will his or her ownership interest be bought out?
- Can the leaving member automatically transfer his or her interest to another member of his or her choice?
- Can a member transfer his or her interest to a non-member?
 - If so, what's the protocol?
- Will that non-member automatically become a member with voting rights once he or she becomes an interest holder?
- Does there need to be a vote on the decision to allow a voluntary transfer?
 - If so, what's the threshold for the decision?
- As for involuntary transfers, what if a member dies?
- Will the deceased member's interest transfer to his or her heirs?
 - If so, will these heirs be voting members or simply interest holders?
- Will the deceased member's interest somehow be allocated to existing members?
- What if a creditor acquires a member's interest? Will the creditor automatically have voting rights?

For some creative ideas on how to address decisions and issues related to transfers, read through Article 6 of the *Extensive Operating Agreement for Sun Sisters Farm, LLC* and the accompanying story. For example, this sample operating agreement includes a right of first refusal protocol that applies if a member wants to leave and

transfer his interest to a non-member. The departing member has to first make an offer to existing members to give them the option to buy the departing member's interest. This is just one way to address this issue and may or may not be the best option for your farming operation. Either way, carefully think through the line of questions above to help you develop the right transfer provisions for your farm business.

□ Who decides whether the company takes on debt?

Taking on debt will obviously impact the company's financials. It will also ultimately effect the tax basis and overall interest of each member in the farm operation. Again, each member is liable up to their capital contribution. So, taking on debt puts them at risk. It's very important to set parameters for how decisions involving debt are made.

- Do you want to require a member vote before any debt is incurred?
- Or, do you want to set a ceiling, and anything about it requires a member vote?
- Is the ceiling based on a dollar amount or a percentage of company assets?
- If a vote is involved, what is the threshold – unanimous consent, super-majority, majority, or something else?

□ Who decides whether to close the business?

Closing the business—or dissolution and winding up in LLC-speak—is obviously a big decision. Some members may be more optimistic than others and want to keep it going if things start going sour or for whatever reason it no longer makes sense to keep the business running. Others may have a low tolerance for risk. Who decides whether and when to close the business? What is the threshold for making this decision? Unanimous consent, super-majority, majority, or something else?

□ Who decides whether existing members can make additional capital contributions?

Additional capital may be needed to address cash flow issues or to purchase equipment or land that the business may need to grow. While you could take out loans, another option is to seek additional capital contributions from members.

However, this may change the percentage interest breakdown of the company. What's the threshold for making this decision? Unanimous consent, super-majority, majority, or something else?

- Who decides on amendments to the operating agreement?

The operating agreement controls how the business operates. Amending the operating agreement can, in effect, change everything. What is the threshold for making this decision? Unanimous consent, super-majority, majority, or something else?

- Who decides whether the company can change hands (i.e. be acquired or merged with another company)?

The possibility could arise that someone or another company presents an offer to buy the farming business. While to some members it may seem like an offer you can't refuse, to others it may be that they have sentimental value to the company and no amount of money would be enough to sell it. Even if you think it's far-fetched, it's important to set a threshold for decisions regarding a merger or acquisition in your operating agreement as one never knows. What's the threshold for making this decision? Unanimous consent, super-majority, majority, or something else?

- How are all other decisions made?

Typically operating agreements have a default clause for decisions that are not specifically addressed in the operating agreement. Here are some things to think about for other decisions not addressed in this checklist:

- What is your default threshold for any decision not specifically addressed in your operating agreement – unanimous consent, super-majority, majority, or something else?
- Can you imagine any other “big decisions” that may arise that are unique to your farming operation?
 - If so, what is the threshold for these decisions?
- For example, does the farming operating have a special piece of equipment or asset that you want to require unanimous consent before the company sells it or makes it collateral for a debt?
- Or, do you want to require unanimous consent on a decision to launch an additional line of business such as a value-added product line?

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“Typcially operating agreements have a default clause for decisions that are not specifically addressed in the operating agreement.”
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The more you think through this now, the more your unique interests will be protected in the long run.

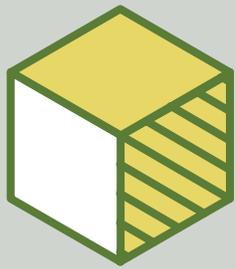
Next Steps

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“Following the rules and procedures your operating agreement sets gives the business legitimacy in court. It also helps facilitate good relations with your members or partners.”
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The intention of this checklist is to get you thinking about how you want to structure your LLC and address certain potential scenarios. Once you’ve answered these questions, you’ll be ready to seek an attorney who can streamline the process of drafting your operating agreement.

Once you have your operating agreement in hand, be sure to follow the document. Following the rules and procedures your operating agreement sets gives the business legitimacy in court. It also helps facilitate good relations with your members or partners.

You should make copies, or make it available in electronic form, so that every member has the agreement and can refer to it as needed. It’s a good idea to keep your operating agreement in one binder along with all meeting minutes and any amendments so that it is readily available. This also helps prove the legitimacy of your LLC by showing you are taking the separate entity seriously. Whenever you have a doubt about what’s required for making a decision or how to deal with a specific scenario when it arises, refer to your operating agreement for guidance.



Sample Brief LLC Operating Agreement with Annotations



THE STORY OF HAPPY COUPLE FARM, LLC

Throughout this Brief Operating Agreement for Happy Couple Farm, LLC we will use the fictitious story of Happy Couple Farm, LLC to help explain some of the more complex legal concepts and to illustrate how certain provisions of the operating agreement actually work. Jackie and Pat Farmer have been married for 20 years. They have an eighteen-year-old son, Chris, and a nineteen-year-old daughter, Sonja. Pat's father passed away 2 years ago. In his last will and testament he granted the family's third generation 40-acre farm property and all his farm tools and equipment to Jackie and Pat. He noted his gratitude for their loving care for him in his last years. Jackie and Pat had been living on the property and taking care of him for two years before he passed. During that time, they began cultivating about 5 acres of the farm and running a small CSA. When Pat's father died, Pat's sister Jan came onto the scene to contest the will. She felt she deserved at least half of the property even though she hadn't visited in over 3 years. Jan ended up losing in court. The whole process took two years! Jackie and Pat learned a lot through the whole ordeal. They realized they wanted to protect their interests in the farm

DISCLAIMER: This operating agreement is provided to illustrate how a married couple might draft a brief operating agreement for their farm LLC.

This operating agreement does not and is not intended to provide any information relative to marital law or division of assets in a divorce. Farmers seeking advice on issues related to marital separation or divorce must seek

Happy Couple Farm, LLC | Operating Agreement¹

This Operating Agreement (the “Agreement”) of Happy Couple Farm, LLC (the “Company”) is entered into as of the date on the signature page by Jackie Farmer and Pat Farmer, (collectively, the “Members,”² and individually, a “Member”)³ for the purpose of making the acknowledgment at the end of this Agreement.



¹No matter how well you and your spouse get along, it’s a good idea to create an operating agreement upon forming an LLC for your farm business. The operating agreement outlines how the LLC is to operate. This is important because operating in accordance with an operating agreement proves that you and your partner are earning the LLC’s liability protection. In addition, if you don’t have an agreement, state law will fill in the blanks, as necessary. The default provisions provided by state law may not be suitable for your farm operation. The operating agreement gives you and your spouse the opportunity to write your own rules. Moreover, it allows you to set more favorable ground rules in your relations with third parties. The operating agreement may not seem to matter much for a couple that has a close working relationship. They could agree on each of the issues addressed here in a casual conversation and that may be good enough. However, if it’s not written down in an operating agreement, it won’t govern anyone else who was not a part of that conversation. For example, let’s say a creditor comes after one of the spouses and takes control of her LLC interest. The creditor must follow the operating agreement, which could say that such a creditor would have no voting rights. This Brief Operating Agreement for Happy Couple Farm, LLC includes the foundational provisions that are particularly important for a married couple LLC. It presumes that the couple’s communication and working relationship are relatively good. This Brief Operating Agreement for Happy Couple Farm, LLC assumes that if the couple divorces, marital or family law may dictate the division of assets to a certain extent, aside from what an operating agreement might require. So the provisions are not as elaborate as some operating agreements. If you think that you will eventually take on new business partners outside your family, you may want to take a look at Farm Common’s Extensive Operating Agreement for Sun Sisters Farm, LLC.

²The word “members” means the same thing as “owners.” Because LLC law uses the word members, we do too.

³Married couples that live in specific states may choose to form their LLC with one member- the married couple as a single unit. This option is available to couples in states that adopt “community property” systems. The nature of community property is way beyond our scope here! To summarize, some married couples may want to form a single-member LLC for tax reasons. Married couples in community property states should talk with their accountant or tax preparer about the best option for their specific situation. If you were to form a single-member LLC as a married couple, you should still consider creating an operating agreement. As explained above, the operating agreement helps address matters with third parties and also provides the procedure for shutting down the business. Note, in our story, Jackie and Pat have decided to form a multi-member LLC even though they live in a community property state. Again, check with your attorney to find out what’s best for you.

The Members have formed the Company by filing with the Wisconsin Department of Financial Institutions the Company's Articles of Organization⁴, a copy of which is attached to this Agreement as Exhibit A and incorporated by this reference.

The Members wish to enter into this Agreement for the purposes of providing the rights, obligations, and restrictions contained in this Agreement and otherwise to govern the operations and management of the Company, and the Members agree as follows⁵:



⁴ This section creates the official link between the state-filed articles of organization and this operating agreement. It's not necessary, just recommended.

⁵ These aren't the only terms and conditions for running the LLC. In running everyday matters, owners set all sorts of rules or policies for how to conduct business or make decisions. The operating agreement is the place for baseline foundational rules: who owns the business, how members make decisions, how disputes are resolved, how to get out of the business, and those type of things. Day-to-day operational matters are

ARTICLE 1: Business Purpose and Term of Company

Section 1.1: Purpose ⁶

The purpose of the Company shall be to operate a farm business and to do any and all things necessary, convenient, or incidental to that purpose and to conduct any other lawful business.

Section 1.2: Term

Unless dissolved earlier under the terms of this Agreement, the term of the Company shall be perpetual.



⁶ This section is not legally necessary. It's an opportunity for owners to incorporate the business purpose into the legal structure of the farm. The purpose can be binding in that an action taken by a member in opposition to the business purpose could be invalid. But, the phrase "... and to conduct any other lawful business" takes any teeth out of the purpose. Many farmers like incorporating a purpose into the operating agreement because it feels

Section 1.3: Additional Members

Additional Members may be added upon the unanimous consent of the existing Members except as permitted by Section 5.2.⁷



⁷ This provision basically allows you to bring on new members if both you and your spouse agree. However, one exception applies here. Section 5.2 provides that one spouse can transfer some or all of his or her interest to a child or grandchild without the consent of the other. This simplifies matters in times of death of one spouse or, potentially, divorce. Basically, each spouse can determine how to divvy up his or her interest in the company to the children or grandchildren. This is just one way of doing it. You could require unanimous

ARTICLE 2: Capital Contributions**Section 2.1: Initial Capital Contribution and Percentage Interest⁸**

The Members shall contribute the amounts set forth on Exhibit B, attached to this Agreement and incorporated herein, as their initial capital contributions.⁹ The initial capital contributions shall initially entitle them to the Percentage Interests set forth on Exhibit B. The “Percentage Interests” is determined by dividing the Member’s contribution by all contributions to the Company.¹⁰ The Members agree to the amount and value of the Capital Contributions. “Capital Contributions” as subsequently used is defined to include any subsequent Capital Contributions added to the initial capital contributions. “Capital Contributions” as subsequently used is defined to include any subsequent Capital Contributions added to the initial capital contributions.



⁸ “Capital contributions” are the assets each member contributes to the LLC. Assets contributed can be cash, equipment, services and other things of value. (Note that we strongly urge you to see an attorney or accountant before you contribute services because there are tax implications). The section on Capital Contributions is important for several reasons. First, although an LLC provides protection for personal assets, assets contributed to the LLC are no longer personal. In effect, members are liable for the LLC’s debts to the extent that each has contributed to the LLC. That’s why it’s important to get the exact contribution in writing now and into the future. In addition, an LLC needs to be adequately capitalized



to be legally legitimate. How much capital do you need? Common sense suggests that you need enough to pay bills as they come due. If you can do that with cash flow from revenue, you may not need much capital.

Of note, we need to make a distinction between a capital contribution and a loan, lease, or sale. You can loan your LLC cash or sell or lease your LLC land or equipment. None of these situations is considered a capital contribution. For example, a member could loan the LLC a total of \$1,000 for the opening bank account balance. This could cover the business until cash flow is sufficient to pay the member back. Unlike a capital contribution, the member has a right to be paid back for the loan. Of course, if the business folds, the business may need to pay off other creditors first and the member could end up losing that money in the end. Also, a member can sell or lease the LLC physical assets such as land or equipment rather than give the physical assets as a capital contribution. Loans, sales, and leases should all be separately documented. So now you must ask yourself: exactly what capitalization and contribution arrangement is best for your farm operation? It will depend on several factors: costs of starting up the farm, expected cash flow, expected expenses, expected revenue, and more. Contributions, expenses, and revenue all determine income at the end of the year, which determines the members' tax obligations. This subject can be quite detailed. Bringing the farm business plan to an accountant is the quickest way to get answers on these questions. Also, bear in mind that farmers can make additional capital contributions, which may change the percentage interest breakdown, so the initial decision isn't necessarily set in stone.

⁹ Each member must officially transfer whatever capital contribution they have promised. If they agree to contribute cash, they will need to deposit the cash in the LLC's bank account. If they agree to contribute land, they will need to transfer the title of the land to the LLC.



For example, let's say that Jackie and Pat don't transfer the farm property, tools, and equipment to the LLC. Jackie decides to buy hundreds of dollars worth of seeds payable by check. She knows that the LLC's bank account is zero and that the farm has no other assets. She also does not expect revenue to flow in for another two months. She writes the check anyway. When the check bounces, the seed company could pursue the personal assets of both Jackie and Pat. This is because the company is not adequately capitalized.



¹⁰ The "percentage interest" is the LLC way of saying "percentage of ownership." Basically this section boils down to if you contribute half the capital to the entity, you get half ownership. The percentage interest of all the members together will always equal 100%. It is possible for LLC



members to allocate ownership in percentages that are not equal to capital contributions. But, that subjects everyone to more complicated tax rules. Don't do that without consulting an attorney and accountant. As this agreement is written, the percentage interest breakdown in the company determines the weight of each member's vote. If one member has 60% percentage interest, then his or her vote will count 60%, or an automatic majority. Another option would be to make it one-person one vote so that each member's vote carries the same weight despite the percentage interest breakdown. Yet another option would be to tier the membership interests, which could include voting members and non-voting members. Incidentally, this agreement usually requires unanimous consent, so it wouldn't really matter.



Here, let's say that Jackie and Pat decide to contribute the farm property, equipment, and tools Pat's father gave them as their capital contribution. They hire an appraiser who values the property at \$100,000. They transfer title to the property to the LLC. They also make a list of all the equipment and tools that are now the LLC's property. They estimate the additional value of the equipment and tools is another \$10,000. So the total capital is \$110,000. Because Jackie and Pat own all of these assets equally they now each have 50% percentage interest. They fill out Exhibit B accordingly. See Exhibit B below for a sample of how this would look. Next, they decide to loan the company \$1,000 cash to pay for seeds and other supplies before more revenue starts to kick in. They draw up a simple promissory note with 0% interest for the first year and 4% thereafter. Note that they don't add the \$1,000 loan to Exhibit B, because it is not a capital contribution. But they do account for it on their profit and loss statement. Sure enough, the farm makes \$2,000 in the first year and the LLC is able to pay off the loan from Jackie and Pat in full.

Keep in mind that a married couple could decide to set the LLC up so that one spouse is a dominate member. For example, Jackie could decide that she personally wants to invest another \$10,000 of her own money that she received from her mother before she married Pat. If this were the case, Jackie's capital contribution would total \$65,000 and the company's overall capital would total \$120,000. Thus, she would have 54% and Pat would have 46% percentage interest. Jackie's vote would count as an automatic majority.

Section 2.2: Future Capital Contributions by Members¹¹

The Members shall not be required to make any additional Capital Contributions or loans to the Company. Any future Capital Contributions by Members shall be approved in amount and in valuation method by unanimous consent of the Members and recorded on Exhibit B.¹²



¹¹ Because a capital contribution is the member's exposure to liability, as explained in Note 8, this section specifically states that members are not required to contribute additional resources. Generally, a member wants to limit the total contributions to the LLC. As long as the LLC has positive cash flow and can reasonably be expected to pay all of its bills, members might consider making loans to the LLC for on-going needs. This is illustrated in our example above with the \$1,000 cash loan to the LLC from Jackie and Pat. However, some LLCs may want to require future or ongoing capital contributions. This could happen if the members expect that the farm operation will undergo a significant expansion and bank loans would not be an option or desired. If members require on-going or future capital contributions, the members should have more complex rules including penalties or policies for default if a member fails to make the required contribution.

¹² Exhibit B needs to be actively maintained if you add any more capital in the future. This is because Section 3.1 states that profits and losses are distributed according to Exhibit B. The modification of Exhibit B is an amendment to the operating agreement. So, the approval of all members and recording of the change are required. You should update Exhibit B as soon as you give the business money. However, it can also be done at tax time, when you have the whole picture at hand. Either way, it's a good idea to have your accountant or tax attorney review any changes you make and go over any tax implications. Again, as mentioned in the footnotes above and illustrated in the example, a person can loan personal money to an LLC. However, loans do not go on Exhibit B, because it is not a capital contribution.

Section 2.3: Future Capital Contributions by Additional Members

Any future Capital Contributions by Additional Members shall be approved in amount and in valuation method by unanimous consent of the existing Members and recorded on Exhibit B.¹³



¹³ If new members are added, they may be required to invest or make a capital contribution to entitle them to a percentage interest or ownership share in the company. Another option for adding new members would be to transfer interests from existing members. This is addressed in section 5. Either way, the percentage interest will always equal 100% and must always be recorded on Exhibit B.

Section 2.4: Capital Accounts

A capital account¹⁴ shall be maintained for each Member which shall be credited with: (1) the Member's Capital Contributions, (2) the Member's allocable share of profits, and (3) the amount of any debt of the Company that is assumed by the Member or that is secured by any property distributed to the Member. The capital account shall be debited with: (1) the amount of cash and the asset value of any property distributed to the Member, (2) the Member's allocable share of losses, and (3) the amount of any debt of the Member that is assumed by the Company or secured by any property contributed by the Member to the Company.¹⁵



¹⁴ The capital account is a line item account. It exists on a spreadsheet or in a Quickbooks file, for example. It's not a bank account. The capital account is maintained for tax purposes. This section outlines the basic procedures, which are also outlined in federal tax law. Very detailed capital account regulations are at Treasury Regulations 1.704-1(b)(2)(i)(b)(1), (b)(2)(iv). If you file your own taxes, you will need to know these basics. If you work with an accountant or tax preparer, they should know these procedures.



¹⁵To summarize, a member's "stake" in the LLC is the total of what the person puts in, the member's share of the profits, and the value of any debt the member personally takes over from the LLC. A member's stake is reduced by any property the LLC gives to the member personally, the losses it gives the member, and any debt the LLC takes over for the member. Here, Jackie and Pat's stake in the company is the farm property. If the business goes south, they could lose the farm property. However, so long as they keep their personal affairs separate from their business affairs and do their best to reasonably capitalize the company, they will not be at risk of losing their personal assets.

Section 2.5: Return of Capital

No Member is entitled to withdraw from the Company, to receive a return of any part of the Member's Capital Contribution, or to receive a repayment of any balance in the Member's capital account, except as expressly provided in this Agreement.¹⁶ No Member will be paid interest on any Capital Contribution or on the Member's capital account.¹⁷



¹⁶Overall, this provision states that Members are not entitled to simply ask for their investment in the company to be returned. Without a provision like this, state laws might allow a member to withdraw from the LLC upon giving notice to the members. The problem is that a withdrawing member gets the return of their contribution to the LLC. The farm may not have the cash to pay back the capital contributed. So, this section states that a member doesn't have a guaranteed right to withdraw. Instead, the LLC can allow a member to withdraw only if the parties unanimously agree. Here, the members have to agree on the terms of the withdrawal, including when and how a withdrawing person is to be paid out for their Percentage Interest.

¹⁷A capital contribution is not a loan. The members are not entitled to any interest on the amount they contribute.

ARTICLE 3: Allocation of Profits and Losses; Distributions

Section 3.1: Allocation of Profits and Losses ¹⁸

All profits and losses of the Company shall be allocated to the Members in accordance with their Percentage Interests¹⁹ as detailed on Exhibit B.



¹⁸ Allocating profits and losses is done to calculate taxes – it doesn't necessarily mean you hand out money. Members may not actually see any cash from the profit because the business is probably putting profit back into the business – not paying it out. That doesn't matter to the IRS, however. This is because an LLC does not pay taxes on its profit. Instead, the individual members report the LLC's profits and losses on their individual tax returns. The members will each pay income tax on their share of the profits whether or not they actually receive the money. If members get cash or property from the LLC, then the LLC is making a distribution. That's addressed in the next section.

¹⁹ Oftentimes, married couples contribute marital property which they own in equal halves, so all profits and losses are allocated equally. This is the case in our example, where Jackie and Pat own the farm property, tools, and equipment equally. However, if one member makes additional contributions and the percentage changes, the profit and loss allocation changes as well.



This would be the case if Jackie decided to invest an additional \$10,000 of her own cash that she's kept it a separate account throughout her marriage (i.e. so it is not community property). Jackie would then have 54% percentage interest in the LLC. If this were the case, 54% of the profits and losses would be allocated to Jackie and 46% would be allocated to Pat.



Profits and losses can be allocated in a way that separate from percentage interests. LLCs are popular because of this flexibility, which is not permitted in a corporation. However, there are detailed tax regulations as to how losses can be assigned. By assigning profits and losses according to your percentage interest, you can be comfortable that you are complying with those regulations. If a member wants to make changes to loss allocations (which may be desirable if one member has a unique tax situation such as an inheritance or large salary), check with an

Section 3.2: Distributions

Members are not entitled to any distributions. Members may declare distributions by unanimous consent.²⁰ Distributions shall be allocated to Members in accordance with their Percentage Interests. No distribution may be declared that would result in the Company being unable to pay its debts as they become due in the usual course of business or in the fair value of the Company's total assets to be less than the sum of its total liabilities.²¹



²⁰ A distribution is where the LLC actually gives members money or property, above and beyond any salary or wage members already receive for their duties. Distributions are essentially shares of the total profit, above and beyond expenses (including salary), of the business. Again, this is different than allocating profits and losses for the purposes of paying taxes on that amount. This provision requires unanimous consent before profits in the company are distributed to the members. It's good to state specifically that a Member cannot demand that they receive the business' profit in cash. The Company might wish to always put profit back into the business rather than pay it out. However, you are free to make distributions as you wish. You could, for example, only require majority consent. Or you could provide that any profit above a certain threshold at the end of your year must be distributed to the members.



Let's say that the Happy Couple Farm turns a \$10,000 net profit in year two. Jackie's tired of farming and wants to go on a trip to Europe. She tries to convince Pat into making a distribution on the profits so they can have an extravagant holiday away. However, Pat has had an eye on a new greenhouse. He calculates that the farm's revenues could nearly double by extending the growing season with a greenhouse. He insists that the profits are reinvested back in the farm operation. Given this provision requires unanimous consent, Pat's refusal overrules and the profits stay in the company. If Jackie had 60% interest and this provision only required majority consent, she would have the final say.



²¹ State LLC statutes usually prohibit distributions under certain circumstances, so this provision basically reinforces the law. For example, Members can't give themselves the business' assets if doing so would jeopardize its ability to pay the bills. This would subvert the liability protection offered by an LLC.

ARTICLE 4: Management of the Company

Section 4.1: General Powers

The Company shall be managed by its Members.²² The Members shall each have the right, power, and authority to control all of the business and affairs of the Company, to transact business on behalf of the Company, to sign for the Company or on behalf of the Company, or otherwise to bind the Company.

Section 4.2: Manner of Acting²³

Except as otherwise provided in this Agreement, the members may act on majority consent at a meeting in which a quorum of the Members participate. Majority consent means the consent of holders of more than 50% of the Percentage Interests at the time of the consent, unless otherwise expressly provided in the Agreement. Members holding sufficient Percentage Interests to give majority consent to the action taken at any meeting shall constitute a quorum.²⁴ Alternatively, the Members may act by unanimous written consent without a meeting.

²² This provision establishes the LLC as a “Member-Managed LLC.” Basically, the day-to-day affairs are managed by the members themselves. Some LLCs choose to be managed by an appointed manager. This is called a “Manager-managed LLC.” For an example of this structure, see Farm Commons’ Full Operating Agreement for Sun Sisters Farm, LLC.

²³ This is a somewhat confusing phrase. Basically, this section defines how the entity itself makes decisions. This should not be confused with how the members conduct the farm’s day-to-day business affairs. Section 4.1 explains that the members each have the authority to do the usual things required to run the farm, and no vote is needed. Under some circumstances the members might need to make “big” decision together, and they do so by following this process. The default threshold for such big decisions in this agreement is majority consent. Incidentally, many of the provisions in this agreement specifically require unanimous consent. Any provision that requires unanimous consent will overrule the default of majority consent.

²⁴ This seems a bit silly with only two members. If both members have half the ownership, both members must attend to have a quorum and you both need to agree to get majority consent. This section is really only useful if another member is added. (You may want a more thorough operating agreement in that case, regardless.)



Section 4.3: Actions Requiring Unanimous Member Approval²⁵

Notwithstanding any other provision of this Agreement, the unanimous, written consent of the Members shall be required to approve the following matters:

- a. Dissolution or winding up of the Company;
- b. Merger or consolidation of the Company;
- c. Sale, transfer, contribution, exchange, mortgage, pledge, encumbrance, lease or other disposition or transfer of all or substantially all of the assets of the Company;
- d. Declaration of any distributions by the Company; and
- e. Amendments to this Agreement;
- f. Issuance of any interest in the Company, including admission of new Members and additional Capital Contributions from a Member except as permitted by Section 5.1²⁶; and
- g. Conversion of the Company to a different entity.



²⁵ If a farm has only two spouse members and each have 50% interest, if they have majority consent they also have unanimous consent. So, it could be silly to also list out things that require unanimous consent. But, if one person contributes additional capital, that person has more than 50% ownership and then holds majority consent. In that case, only these items that specifically require unanimous approval would need the consent of the minority member. By including these details, this operating agreement may be useful if an additional member, such as a child, is added in the future. If a Member does something like sell the LLC without consent, that action is invalid and the member who didn't participate in the decision may have some recourse.

²⁶ Members generally want to unanimously approve any additional members or capital contributions because it can change the percentage interest breakdown. However, here, Section 5.2 allows each spouse to transfer his or her interest in the LLC to their children, to each other, or to a trust without the consent of the other.

ARTICLE 5: Transfer of Assignment of Interests²⁷

Section 5.1: Definitions

- a. “Transfer” means to sell, assign, give, bequeath, pledge, or otherwise encumber, divest, dispose of, or transfer ownership or control of all of, any part of, or any interest in a Percentage Interest to any person or entity, whether voluntarily or by operation of law, whether before or upon death.
- b. “Permitted Transferee” means: (1) in the case of a Member that is an entity, the owners of the Member; (2) the spouse or the child of a Member or of any individual identified in subsection (1), above; (3) another Member; (4) a trust created for the benefit of a Member and/or any persons identified in subsections (1)–(3), above; (5) an entity controlled by, controlling, or under common control with a Member or any persons identified in subsections (2), (3), and (4), above; or (6) the Company.
- c. “Involuntary Transfer” means any Transfer of a Percentage Interest by operation of law or in any proceeding, including a Transfer resulting from the dissociation of a Member, by or in which a Member would, but for the provisions of this Section 5.2, be involuntarily deprived of any interest in or to the Member’s Percentage Interest, including, without limitation, (a) a Transfer on bankruptcy, (b) any foreclosure of a security interest in the Percentage Interest, (c) any seizure under levy of attachment or execution, or (d) any Transfer to a state or to a public office or agency pursuant to any statute pertaining to escheat, abandoned property, or forfeiture.



²⁷ Here’s a plain-language summary of Section 5: A member can’t sell or give away his or her interest in the LLC to anyone other than their children without approval of the other Member. If the person does, the transfer is invalid. If someone takes over a member’s interest in LLC (the most likely scenario being a creditor seizes it) then the new member receives distributions only- not voting rights. The more exacting, technical language of the section is necessary to be accurate.

²⁸ This means members can transfer interests to each other, to children, and to any trust members might create to manage property or assets, without first getting unanimous consent. This is most useful regarding wills: if members leave their interest to each other, their children, or a trust, it may be easier to execute with this provision. Check with an attorney for more information on planning the estate.



Jackie is really upset with Pat. His refusal to distribute the farm's profits so they could take a holiday was the final straw. She thought that once the farm started making some money, things would get easier. She feels she's been stuck on this farm for over 5 years now, with no break on the horizon. She now realizes that all Pat wants to do is grow the farm business, which will only further tie her to the farm. She insists on getting a divorce and files the paperwork. She could care less about her interest in the farm business and would prefer not to deal with Pat nor the farm business any longer. She decides to gift her interest in the farm to their children, Sonja and Chris. Jackie does not need Pat's consent to do this. Now, Sonja and Chris each have 25% and Pat has 50% percentage interest in the farm business. Pat's vote carries a majority and Sonja and Chris are each minority members. Their vote matters for any provision that requires unanimous consent. Exhibit B would need to record this change in ownership. See the amendments to Exhibit B below for an illustration of how this would look.

Disclaimer: This operating agreement is provided to illustrate how a married couple might draft a brief operating agreement for their farm LLC. This operating agreement does not and is not intended to provide any information relative to marital law or division of assets in a divorce. Farmers seeking advice on issues related to marital separation or divorce must seek the advice of a qualified attorney licensed to practice in their state.

Section 5.2: Transfers without Consent

A Member may Transfer all or part of the Member's Percentage Interest in the Company only with unanimous consent of all Members. Any attempt by a Member to Transfer all or part of his or her Percentage Interest in the Company without the prior approval of the Members shall be void.²⁹ However, a Member may Transfer all or any portion of the Member's Percentage Interest to a Permitted Transferee without unanimous consent.³⁰



²⁹ A void transfer means it's as if it never happened. That means that even if Sonja sold her share of the company for cash to her best friend Erika without consent, the transfer is void. Sonja would still be a member and could still conduct business on behalf of the LLC. If Erika, not knowing that the transfer is void, votes or takes action on the LLC, those actions are void.

³⁰ The first part of this section makes it difficult to transfer membership- all members need to approve it. But, the second part adds in an exception. Transfer is permissible without unanimous consent to certain people such as children, other members, the Company, and other entities such as a trust.

Section 5.2: Involuntary Transfers

- a. An Involuntary Transfer to other than a Permitted Transferee will be effective only after the members have complied with applicable provisions of this Section 6.2.³¹ The creditor, receiver, trust or trustee, estate, beneficiary, or other person or entity to whom a Percentage Interest is Transferred by Involuntary Transfer (the "Involuntary Transferee") will have only the rights provided in this Section 5.2.
- b. Notice to Company. The Transferor and the Involuntary Transferee shall each immediately give written notice to the Company describing the event giving rise to the Involuntary Transfer; the date on which the event occurred; the reason or reasons for the Involuntary Transfer; the name, address, and capacity of the Involuntary Transferee; and the Percentage Interest involved (a "Notice of Involuntary Transfer").
- c. Effect of Involuntary Transfer. Unless and until the Involuntary Transferee is admitted as a member by majority consent³² (determined by excluding the Transferor's Percentage Interest), the Percentage Interest held by the Involuntary Transferee shall have no voting rights. Unless and until the Involuntary Transferee is admitted as a member, the determination of majority consent for all purposes shall be made by excluding the Percentage Interest held by the Involuntary Transferee.



³¹ This means that if one member never receives notice that a creditor has seized a member's interest in section (c) as required, then the member isn't responsible to find out themselves.

³² Members can always admit an Involuntary Transferee as a Member (i.e. give them voting rights, etc.), if wanted.

Section 5.3: Assignment

No member may assign his or her interest in the Company.³³



³³ Assignment is different than transfer of an interest. Assignment means that the person gets the profits/losses and distributions only but cannot vote. Transfer means that the person gets profits/losses/distributions plus voting rights. Some state LLC statues allow a member to assign his or her interest at any time, in whole or in part. This provision, instead, prohibits assignment. Many LLCs prohibit assignment because they don't want a member voting on LLC matters if the member does not have a financial interest in profits and distributions.

ARTICLE 6: Effect of Dissociation

The dissociation of a Member will not entitle a Member to a distribution in redemption of the member's Percentage Interest. An event of dissociation will be treated as an Involuntary Transfer pursuant to Section 5.2 of this Agreement.³⁴



³⁴ This section is basically restating Section 2.4: Members cannot withdraw and demand return of their capital contributions or capital account. It can be useful to repeat just to be sure it's clear.

ARTICLE 7: Dissolution

The Company shall be dissolved, and shall terminate and wind up its affairs, upon the first to occur of the following:

- a. The determination by the Members to dissolve the Company,³⁵ or
- b. The entry of a decree of judicial dissolution.³⁶



³⁶ Although no single member can withdraw without consent of the other members, both can vote to dissolve the entire company.

ARTICLE 8: Winding Up and Distribution of Assets

Section 8.1: Winding Up

If the Company is dissolved, the Members shall wind up the affairs of the Company.³⁷

Section 8.2: Distribution of Assets

Upon the winding up of the Company, the liabilities of the Company, including all costs and expenses of the liquidation, shall be paid first. If there are insufficient assets, liabilities shall be paid according to their priority and, if of equal priority, ratably to the extent of assets available. Any remaining assets shall be distributed to the Members in proportion to their Percentage Interests.



³⁷ This means that if an LLC is dissolved, members won't ignore the dissolution by carrying on business as usual.

ARTICLE 9: Indemnification

- a. To the maximum extent permitted by applicable law, the Members shall not be liable to the Company or any other third party (i) for mistakes of judgment, (ii) for any act or omission by such Member, or (iii) for losses due to any such mistakes, action, or inaction.³⁸
- b. Except as may be restricted by applicable law, the Members shall not be liable for and the Company shall indemnify the Members against, and agrees to hold the Members harmless from, all liabilities and claims (including reasonable attorney's fees and expenses in defending against such liabilities and claims) against the Members, or any of them, arising from the Members' performance of duties in conformance with the terms of this Agreement.³⁹



³⁸ This means that if members make an honest mistake or do something innocently dumb and cause the Company harm, the Company or a third party can't sue the member for it.

³⁹ An indemnification provision is simply a promise by another party to cover your losses if he or she does something that causes you harm or causes a third party to sue you. Indemnification provisions can vary quite a bit. Here, this indemnification provision means that if someone sues members for something they did on behalf of the LLC, the LLC has to pay to defend that lawsuit. An LLC should consider carrying insurance for this – without insurance, the business probably can't afford to follow through on this provision. Farm liability insurance may or may not provide this coverage. A commercial policy might be necessary.

ARTICLE 10: Miscellaneous

Section 10.1: Separability of Provisions

Each provision of this Agreement shall be considered separable. If any provision of this Agreement is determined to be invalid or contrary to any existing or future law, the invalidity shall not affect of those portions of this Agreement that are valid.

Section 10.2: Governing Law and Jurisdiction

This Agreement and the rights of the Members shall be governed by the State of Wisconsin.

Section 10.3: Dispute Resolution⁴⁰

If a dispute arises out of this Agreement, or a breach hereof, or otherwise develops between or among the Members, then the Members effected shall (before resorting to arbitration, litigation, or any other dispute resolution procedure) each proceed to negotiate with each other in good faith, on a commercially reasonable basis. They must meet in person with one another at least three times in an effort to reach a resolution. If no resolution has been reached after such efforts, then they shall proceed to mediation administered by the American Arbitration Association under its Commercial Mediation Rules. If mediation is not successful in resolving the entire dispute or is unavailable, any outstanding issues shall be submitted to final and binding arbitration in accordance with the laws of the State of Wisconsin. The arbitrator's award will be final and the judgment may be entered upon it by any court having jurisdiction within the State of Wisconsin.



⁴⁰ It is highly recommended that you include a dispute resolution clause. Keep in mind that a dispute may come into play with third parties, such as creditors. Here, mediation is preferred as it is generally the least expensive and most efficient way for resolving disputes. While many consider them effective for achieving just outcomes, both litigation and arbitration can be timely and expensive regardless of a “winning” outcome, the former more so than the latter. So as a safeguard, consider the worst case scenario, a super messy dispute involving facts and he said, she said opinions, and then determine how you’d want the dispute to be resolved so that you can get on with your farming operations.

THE MEMBERS HAVE EXECUTED THIS OPERATING AGREEMENT AS
OF THE DAY AND YEAR WRITTEN ABOVE.

Jackie
Farmer

Signature: _____

Pat
Farmer

Signature: _____

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EXHIBIT A:**[The Articles of Organization]****EXHIBIT B:⁴¹****Member Contributions****Member Contributions**

Member	Item	Value	Percentage Interest
Pat Farmer	Farm property located at [address and official parcel number]	\$50,000	50%
	Farmall Super A	\$900	
	Water wheel transpalnter	\$3,000	
	Irrigation equipment	\$2,500	
	1998 Ford F150	\$3,700	
	...and so forth...		

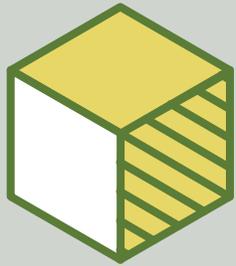


⁴¹ It is important to update this exhibit if the members contribute additional capital. However, the exhibit does not need to be updated as the value of the contributions change. The value of the contributions into the future is necessary for accounting and tax filings, but it's not relevant to whether and how an LLC is created.

Member Contributions

Amendment 1

Member	Item	Value	Percentage Interest
Pat Farmer	Farm property located at [address and official parcel number]	\$50,000	50%
	Farmall Super A	\$900	
	Water wheel transpalnter	\$3,000	
	Irrigation equipment	\$2,500	
	1998 Ford F150	\$3,700	
	...and so forth...		
Sonja Farmer	Farm property located at [address and official parcel number]	\$25,000	25%
	Farmall Super A	\$400	
	Water wheel transpalnter	\$1,250	
	Irrigation equipment	\$1,250	
	1998 Ford F150	\$1,850	
	...and so forth...		
Chris Farmer	Farm property located at [address and official parcel number]	\$25,000	25%
	Farmall Super A	\$400	
	Water wheel transpalnter	\$1,250	
	Irrigation equipment	\$1,250	
	1998 Ford F150	\$1,850	
	...and so forth...		
		\$110,000	100%



Sample Extensive LLC Operating Agreement with Annotations



THE STORY OF SUN SISTERS FARM, LLC

Throughout this Extensive Operating Agreement for Sun Sisters Farm, LLC we'll be using the fictitious story of Sun Sisters Farm, LLC to help guide you through various legal issues and scenarios that come up. We find that stories really help explain complex legal concepts. We first introduced Sun Sisters Farm, LLC in the section 1 of the LLC chapter (part 2, chapter 3 in the *Farmer's Guide to Choosing an Entity*). As you recall, the three sisters—Marie, Ingrid, and Jema—have decided to start a farm business together. They each have always dreamt of starting a farm. Jema loves everything culinary and wants to cater to the local restaurants with fresh herbs and specialty items including heirloom vegetables, herbs, and edible flowers. Ingrid is all about supporting the local community and wants to start a CSA. Marie has a keen business sense and currently runs a successful marketing company. In fact, Marie owns a beautiful 10 acre farm property that she purchased ten years ago with a dream of leaving her marketing career and running a farm business. But she's torn, as she loves her work and she's nervous to run a farm all by herself. The property has a run down shed, a tiny two bedroom farmhouse, and about a one-half acre fruit orchard. The rest is overgrown alfalfa fields. The sisters meet up for Jema's 30th birthday and get to talking about their shared dream. They decide to go in on it together! They choose to form an LLC to protect them individually from liability. They come up with the name "Sun Sisters Farm, LLC" and file their articles of organization. They now start discussing how they want to manage the company and they put the details into this operating agreement. For demonstration purposes, Sun Sisters Farm, LLC is located and organized within Wisconsin. The educational material below is broadly applicable to farms in other states, as well.

DISCLAIMER: This operating agreement is a more thorough companion to Farm Commons' Brief Operating Agreement for Happy Couple Farm, LLC. This extensive version illustrates some of the deeper complexities non-married individuals might benefit from exploring before going into business together.

Sun Sisters Farm, LLC | LLC OPERATING AGREEMENT¹

This Operating Agreement (the “Agreement”) of Sun Sisters Farm LLC (the “Company”) is made by the signatory parties (the “Members”²) for the purpose of making the acknowledgment at the end of this Agreement and is entered into as of the date entered on the signature page. The Members have formed the Company by filing with the Wisconsin Department of Financial Institutions the Company’s Articles of Organization, a copy of which is attached to this Agreement as Appendix A and incorporated by this reference.³



¹ An operating agreement outlines how the LLC entity is to operate or run its business. As discussed in the chapter on LLCs, it is important to create an operating agreement primarily for three reasons: (1) it helps safeguard the personal liability protection LLCs provide for individual members, (2) it lets your farm operation to take advantage of the flexibility aspects of the LLC (otherwise your state’s LLC statute will control how you must manage and operate your business), and (3) it allows you to set more favorable ground rules in your relations with third parties. The rules included in this sample operating agreement provide just one example of how an LLC could be managed and operated. The annotations point out various other ideas and ways for managing and operating an LLC. Again, the LLC structure is often preferred over a corporation because it provides far greater flexibility to adapt rules to best suit your unique business. So use your imagination and really think about what would be ideal given the interests and objectives of your particular farm operation. A lot of the “rules” in this model agreement may seem drastic and overly specific, but it’s better to have them in place than to just hope for the best. One way of thinking about an operating agreement is to imagine all worse case scenarios and then figure out how you’d want each scenario to be handled. Nevertheless, keep in mind that your operating agreement must comply with certain baseline requirements set forth in each state’s LLC statute and regulations, which do vary from state to state. It is advisable to have an attorney draft or at least review your operating agreement before finalizing it

²The term “members” means the same thing as “owners.” Because LLC law uses the term members, we do too.

³This creates the official link between the state-filed articles of organization and this operating agreement. It’s not necessary, but it is recommended.

The Members wish to enter into this Agreement for the purposes of providing the rights, obligations, and restrictions contained in this Agreement and otherwise to govern the operations and management of the Company, and the Members agree as follows:⁴



⁴ *The terms set forth in the operating agreement are not the only terms and conditions for operating the LLC. In running everyday matters, members of the LLC set all sorts of policies and procedures for how to manage the business or make routine decisions. These policies shift and evolve with changing circumstances. The operating agreement is the place for more overarching rules: who owns the business, how are big decisions made, how and when are profits and losses allocated, how are disputes resolved, how can owners get out of the business, etc. While members can change these foundational rules by amending the operating agreement, they are typically more stable and long lasting. It's recommended not to include too many day-to-day operational matters in an operating agreement. Administrative issues can arise when frequently amending the operating agreement, which may involve getting every member to sign on to the amendments. If it's important to you that some of these day-to-day matters are included, you could make a reference to an appendix and add them there. We do this a few times in this model operating agreement as an example, including a reference to the roles, responsibilities and benefits of "manager-members." (See, e.g., Article 4.2.)*

ARTICLE 1 : Organization and Purpose

Section 1.1: Name of the Company

The name of the Company shall be "Sun Sisters Farm, LLC."⁵ The Company may do business under that name and under any other name or names that the Members approve. If the Company does business under a name other than that set forth in its Certificate of Formation, then the Company shall file assumed business name certificates as required by law.⁶



⁵ *Most state laws require that the name include the words "limited liability company" or the abbreviation "LLC."*

⁶ *This basically provides that the Company could operate under another name through a "doing business as" (DBA), and wouldn't have to enter into another operating agreement.*

Section 1.2: Purpose

The Company is organized to operate a farm business and to do any and all things necessary, convenient, or incidental to that purpose and to conduct any other lawful business.⁷

Section 1.3: Term

Unless dissolved earlier under the terms of this Agreement, the term of the Company shall be perpetual.⁸

Sections 1.4: Principal Office

The principal office of the Company in the State of Wisconsin shall be located at 11 Get Along Ln., Madison, WI 53593 or at any other place within the State of Wisconsin approved by a Majority Vote of the Members.

Section 1.5: Registered Agent.

The name and address of the Company's registered agent in the State of Wisconsin shall be Jema Member.⁹



⁷*This section is not legally necessary. It's an opportunity for owners to incorporate the business purpose into the legal structure of the farm, if you want to. The purpose can be binding in that an action taken by a member in opposition to the business purpose could be invalid. But, the phrase "... and to conduct any other lawful business" takes any teeth out of the purpose. Many farmers like incorporating a purpose into the operating agreement because it feels good to do so and serves as a reminder of why they are in business.*

⁸*It's standard to make LLC's perpetual instead of setting a specific number of years, as it allows for the option to keep the business running as long as you want without having to jump through additional hurdles.*

⁹*The registered agent is the person that will be notified on behalf of the LLC if any lawsuit is filed against the company. All states require you to identify an official address and a registered agent, which must be included in the articles of organization. It's not necessary to include them both again here, but it can help to have a direct reference for those just reading the operating agreement.*

Section 1.6: Designation of Members.**Section 1.6.1:**

On Appendix B shall be set forth the name of each Member and the appropriate contact information for such Member (including, without limitation, such Member's mailing address, telephone number, and facsimile number as well as, in the case of a Member that is an entity, the name and title of an individual to whom notices and other correspondence should be directed).¹⁰ Each Member shall promptly provide the Company with the information required to be set forth for such Member on Appendix B and shall thereafter promptly notify the Company of any change to such information.



¹⁰*Appendix B is the way to track your members' contact information and percentage interests (or percent of ownership) in the company. It's important to keep Appendix B up to date if and when anything changes, including the addition of new members or additional capital investments, which we'll discuss soon.*



For example, let's say that Marie decides she'll grant the LLC the title to her farmland valued at \$45,000 as her capital contribution (again, we'll discuss more about capital contribution's soon). Jema invests \$30,000 in cash as her capital contribution. Ingrid offers one year of her services as farm labor as her capital contribution, which is valued at \$25,000. Based on this, Marie has 45%, Jema has 30% and Ingrid has 25% percentage interest. See Appendix B at the end of this Model Agreement for a sample of how this would look in a table.

Section 1.6.2: Additional Members may be admitted, from time to time, with the unanimous consent of all Members.¹¹ Upon (i) the prospective Additional Member's execution of this Agreement, as amended to reflect the terms of its membership, and (ii) the prospective Additional Member's paying in full the Initial Capital Contribution¹² (the amount of which shall be determined by the unanimous consent of all Members), such prospective Additional Member shall be admitted as a Member.



¹¹Sometimes owners decide up front that they most likely will not want any additional members. This is often because they don't want their own percentage interest to be reduced or diluted, which could reduce their share in profits/losses as well as their voting power. However, it's still recommended that a provision is included for a process to add new members, as one never knows. What if the business needs more funds, and someone you like and trust wants to invest as a part owner? This Article requires that all members must agree to admit any additional members, which is an added safeguard. Another option would be to only require consent of a super-majority (typically defined as 75 percent) or even just the consent of a majority. Requiring less than unanimous consent may be advisable when the LLC has numerous and diverse members or you otherwise anticipate that it will be challenging to get everyone to agree.



Let's say that two years go by and the farm is beginning to really take off. They're selling consistently to about 6 local upscale restaurants and the local food co-op and have grown from 8 CSA members in the first year to 25 in the second. They're also selling at three local farmers markets. The beets and cabbages are especially abundant and delicious! Margo, Ingrid's best friend, has a longstanding passion for canning and fermentations and has been experimenting with making sauerkraut and beet kvass with the beets and cabbages. She's shared her creations with some locals, and everyone loves them! She asks Ingrid whether she can start this business as part of Sun Sisters Farm. Ingrid runs it by her sister Jema and after discussing it they decide that if Margo wants to start her own segment of the business she needs to become a member and must come up with at least \$10,000 as an initial capital investment so that she has some skin in the game. Ingrid presents this idea to Margo and Margo is excited about the opportunity. Now they just need to convince Marie as they review the operating agreement and realize they need unanimous consent to add an additional member. Marie has a bit of hesitation in letting Margo in as a member because that will dilute Marie's 45%. Jema and Ingrid convince Marie that having the additional fermentation products will really enhance the business as they can be sold year round. Marie finally agrees.



¹²Again, we discuss capital contributions more below. This just means that any additional members must make an investment of some asset, whether it be cash or in-kind (e.g. services, equipment), in the company before becoming a member.

Section 1.6.3:

A Person shall not be admitted as a Member prior to the execution of this Agreement, as updated to reflect that Person's Percentage Interest and the making of the full Initial Capital Contribution.¹³

Section 1.6.4:

The Capital Contributions of each Additional Member shall be set forth on Appendix B. The Percentage Interest of each Additional Member shall dilute the Percentage Interests of the previously admitted Members in proportion to their respective Percentage Interests.¹⁴



¹³This just means that any new member must sign and abide by this operating agreement.

¹⁴Appendix B must be updated with information related to any additional member, because Article 3.1 states that profits and losses are distributed according to Appendix B. With the addition of new members and their investment of capital, the percentage interest of existing members will be diluted or reduced – so that at any given time, if you add up the percentage interests of all members it will equate to 100%. This article explains that the dilution will be based on the most recent proportion of interest between the existing members, which may be different than the initial proportion (i.e. if one of the initial members had made an additional capital contribution the proportion of ownership will have changed).



Prior to bringing Margo on as a new member, none of the sisters have made an additional capital contribution. Once Margo invests her \$10,000 cash as her capital contribution, the Appendix B would need to be revised. It will now include Margo's contact info, her initial capital contribution, and adjustments to the percentage interest breakdown. Marie now has 40.9%, Jema has 27.3%, Ingrid has 22.7%, and Margo has 9.1% percentage interest. See Appendix B at the end of this operating agreement for an illustration of how this amendment would look.

ARTICLE 2: Capital Contributions

Section 2.1: Initial Capital Contributions.¹⁵

Upon the execution of this Agreement, the Members shall contribute the amount set forth on Appendix B as such Member's initial Capital Contribution, which shall entitle them to the Percentage Interests¹⁶ set forth on Appendix B. The "Percentage Interests" is determined by dividing the Member's contribution by all contributions to the Company. The Company shall record the amount of the initial Capital Contribution of each Member as a contribution to the capital of the Company. The Members agree to the amount and value of the Capital Contributions. "Capital Contributions" as hereafter used is defined to include any subsequent capital contributions added to the initial Capital Contributions.



¹⁵"Capital contributions" are the assets each member contributes to the LLC. Assets contributed can be cash, equipment, services and other things of value.



As a special note, it's important to see an attorney or accountant before you contribute services because there are tax implications. In our example, Ingrid contributes \$25,000 in farm labor as her capital contribution. She will have to pay taxes on this money as if she received it as a salary and then gave it back to the company, even though it doesn't tangibly reach her pockets. The tax implications are definitely something you need to consider before promising services as your capital contribution.



The article on Capital Contributions is important for several reasons. First, although an LLC provides protection for personal assets, assets contributed to the LLC are no longer personal. In effect, members are liable for the LLC's debts to the extent that each has contributed to the LLC. That's why it's important to get the exact contribution in writing now and into the future. Second, an LLC needs to be adequately capitalized to be legally legitimate. How much capital do you need? Common sense suggests that you need enough to pay bills as they come due. If you can do that with cash flow from revenue, you may not need much capital.



Recall the example we provided in the LLC Chapter of the Choosing an Entity Guidebook on how the Sun Sisters Farm becomes undercapitalized. The sisters agree to take out a \$35,000 loan for a tractor and then they enter an agreement with a contractor to build a greenhouse for \$40,000. The LLC has blown through all its cash and there's no way it will be able to make due on these debts. It is severely undercapitalized, and it's likely a court would conclude that each member is individually on the hook for these debts.



Of note, we need to make a distinction between a capital contribution and a loan, lease, or sale. You can loan your LLC cash or sell or lease your LLC land or equipment. None of these situations is considered a capital contribution. For example, a member could loan the LLC a total of \$1000 for the opening bank account balance. This could cover the business until cash flow is sufficient to pay the member back. Unlike a capital contribution, the member has a right to be paid back for the loan. Of course, if the business folds, the business may need to pay off other creditors first and the member could end up losing that money in the end. Also, a member can sell or lease the LLC physical assets such as land or equipment rather than give the physical assets as a capital contribution. Loans, sales, and leases should all be separately documented. So now you must ask yourself: exactly what capitalization and contribution arrangement is best for your farm operation? It will depend on several factors: costs of starting up the farm, expected cash flow, expected expenses, expected revenue, and more. Contributions, expenses, and revenue all determine income at the end of the year, which determines the members' tax obligations. This subject can be quite detailed. Bringing the farm business plan to an accountant is the quickest way to get answers on these questions. Also, bear in mind that farmers can make additional capital contributions, which may change the percentage interest breakdown, so the initial decision isn't necessarily set in stone.

¹⁶The "percentage interest" is the LLC way of saying "percentage of ownership." Basically, as this provision is written, if you contribute half the capital to the entity, you get half ownership. It is possible for LLC members to allocate ownership in percentages that are not equal to capital contributions. But, that subjects everyone to more complicated tax rules. Don't do that without consulting an attorney and accountant.



At the initial start-up, Marie has 45%, Jema has 30%, and Ingrid as 25% percentage interest – together equaling 100%. This changes when Margo comes on. To make room for Margo and to account for her \$10,000 capital contribution, Marie’s percentage interest drops to 40.9%, Jema’s drops to 27.3% and Ingrid’s drops to 22.7% so that Margo as 9.1% - together equaling 100%. Take a look at the Appendix B at the end to illustrate how this looks.

Section 2.2: Capital Accounts.¹⁷

A separate Capital Account shall be maintained for each Member which shall be credited with: (1) the Member’s Capital Contributions, (2) the Member’s allocable share of profits, and (3) the amount of any debt of the Company that is assumed by the Member or that is secured by any property distributed to the Member. The capital account shall be debited with: (1) the amount of cash and the asset value of the property distributed¹⁸ to the Member, (2) the Member’s allocable share of losses, and (3) the amount of any debt of the Member that is assumed by the Company or secured by any property contributed by the Member to the Company.¹⁹



¹⁷The capital account is a line item account. It exists on a spreadsheet or in a QuickBooks file, for example. It’s not a bank account. The capital account is maintained for tax purposes. Requirements for capital accounts are outlined in federal tax law. This article outlines the basic procedures. It’s helpful to include it to be sure that everyone understands that a capital account must be maintained. Very detailed capital account regulations are at Treasury Regulations 1.704-1(b)(2) (ii)(b)(1), (b)(2)(iv). If you file your own taxes, you will need to know these basics. If you work with an accountant or tax preparer, they will already know and follow these procedures.

¹⁸“Distributed” is a legal term that means you’ve transferred legal ownership of an item from the LLC to a member. It is the opposite of a capital contribution.

¹⁹To summarize, a member’s “stake” in the LLC is the total of what the person puts in, the member’s share of the profits, and the value of any debt the member personally takes over from the LLC. A member’s stake is reduced by any property the LLC gives to the member personally, the losses it gives the member, and any debt the LLC takes over for the member.

Section 2.3: No Additional Capital Contributions.

No Member shall be required to contribute any additional capital or loans to the Company.²⁰ Any future Capital Contributions by Members shall be approved in amount and in valuation method by the Members and recorded on *Appendix B*.²¹

Section 2.4: No Interest on Capital Contributions.

No Member shall be paid interest on their Capital Contributions.²²



²⁰This article specifically states that members are not required to contribute additional resources. Again, a capital contribution is the member's exposure to liability. Generally, a member wants to limit the total contributions to the LLC. As long as the LLC has positive cash flow and can reasonably be expected to pay all of its bills, including the loan payment, members shouldn't have to invest more money. Instead, they might consider making loans to the LLC for on-going needs. Some LLCs want to require future or ongoing contributions (for example, if planning a significant expansion and bank loans can't be gotten or aren't wanted). If on-going or future capital contributions are required, the operating agreement should have more complex rules such as what happens on default, etc.

²¹Again, *Appendix B* needs to be actively maintained if any member, new or existing, invests more capital. Also note that modifying *Appendix B* is an amendment to the operating agreement. Thus, you will have to follow the amendment process and to record the change on *Appendix B* by basically updating the percentage interest for it to take effect. This agreement requires unanimous consent for any amendment. This means that Marie, Jema, and Ingrid all have to agree on amendments to *Appendix B*. When Margo comes on, she too has to agree before any amendment can be made. It is advisable to consult with an attorney or your accountant before making changes to *Appendix B* as there may be tax implications. You should update *Appendix B* as soon as the capital is invested in the business. Again, as mentioned in the footnotes above, a person can loan personal money to an LLC, which is not considered a capital investment and would not have to be tracked in *Appendix B*. A loan represents a debt of the business to an individual; no ownership is established.

²²A capital investment isn't a loan, so members don't get interest on capital investments.

Section 2.5: Return of Capital Contributions.

Except as otherwise provided in this Agreement, no Member shall have the right to receive any return of any Capital Contribution, or to receive a repayment of any balance in the Member's capital account.²³

Section 2.6: Penalties for Failure to Make Required Contributions.

If a Member fails to make a Capital Contribution when due, the Manager shall promptly notify such Member in writing that he/she/it is a "Defaulting Member." If within fourteen (14) days after actual receipt of such notice the Defaulting Member has not made the required Capital Contribution, such Defaulting Member shall be subject to any and all penalties and remedies available at law or equity, as selected by the Members. In addition, the Members may determine by a Majority Vote that a Defaulting Member shall withdraw as a Member.²⁴



²³Overall, this article states that members are not entitled to simply ask for their investment back. Without a provision like this, many state laws would allow a member to withdraw from the LLC upon giving notice to the members and require that the withdrawing member gets her capital contribution back. This becomes a problem if the farm operation does not have the cash flow to pay back the value of the capital contributed or would prefer to keep it invested in the company. This article addresses this issue by saying that a member doesn't have a guaranteed right to withdraw. Instead, the members have to agree on the terms of the withdrawal, including when and how a withdrawing person is to be paid out for their percentage interest.

²⁴This article ensures that all members make their initial investment on time so that the company will be adequately capitalized. If a member doesn't follow through, he or she will be considered a Defaulting Member and the other members could file a lawsuit to get the promised initial investment or require that the Defaulting Member leave the Company.



If for some reason one member can't afford to make the initial investment, there are other solutions. For example, let's say that our three sisters – Marie, Jema, and Ingrid – want to have equal one-third interests in the LLC with an initial valuation of the farm operation set at \$120,000. Marie offers her farm property valued at \$40,000 to cover her capital contribution, so she's all set.



But Jema and Ingrid don't have the money to cover the full \$40,000 to make a capital contribution in proportion to their equal interest. Jema only has \$35,000 cash to offer and Ingrid can only offer \$25,000 in services. So, Jema could enter a promissory note for \$5,000 and Ingrid could write up a promissory note for \$15,000 to cover the difference. This would operate somewhat like a loan to them from the company. They would be promising to pay this additional capital contribution to the company by a certain time. This is fine, if the company doesn't need the money right away. Or, using an entirely different scenario, let's say that there's no property or services involved and the three sisters want equal one-third interest with an initial valuation at \$120,000. Say Marie has quite a bit of savings. She could loan the company \$117,000, which the company would agree to pay back over time. Then, each of the sisters would invest \$1,000 to get their one-third percentage interest. The company is now properly capitalized through the loan and each sister as one-third interest in the company.

Section 2.7: Limitation of Liability.

Except as otherwise required by applicable law or as provided in this Agreement, Members shall have no personal liability for the debts and obligations of the Company.²⁵



Bottomline, there are many creative ways to capitalize the company, but it's important to set some penalties in the operating agreement for failing to make a capital contribution to make sure everyone does what they say they're going to do.

²⁵*Members are personally liable only up to the amount of their capital investment in the sense that you may not get that money back if, for example, the company is sued.*



Here, Marie is only on the line for the \$40,000 value of her farm property, Jema for \$35,000 in cash, Ingrid for \$25,000 worth of services, and Margo for \$10,000 in cash. This reflects each member's stake in the business.

Section 2.8: Contributed Property.

With respect to any property contributed by a Member to the Company, such Member shall provide to the Company any information reasonably requested by the Company for purposes of determining the Company's tax basis in such property.²⁶



²⁶If a member gives property as the capital contribution, that member will need to provide a valuation of the property (i.e. through an appraisal or other legitimate process), which is considered the basis. Basis is used to figure depreciation, amortization, depletion, casualty losses, and any gain or loss on the sale, exchange, or other disposition of the property, all of which will be necessary for allocating profits and losses.



Here, Marie must give documentation to evidence that the farm property is in fact worth \$40,000.

ARTICLE 3: Allocations and Distributions**Section 3.1: Allocation of Profit or Loss.²⁷**

For financial accounting and tax purposes, the Company's net Profit or Loss shall be determined on an annual basis and shall be allocated to the Members in proportion to each Member's Percentage Interests²⁸ as set forth in Appendix B as amended from time to time in accordance with U.S. Department of the Treasury Regulations (hereafter "Regulations") Section 1.704-1.²⁹



²⁷Allocating profits and losses is done to calculate taxes – it doesn't necessarily mean you hand out money. Members may not actually see any cash from the profit because the business is probably putting profit back into the business – not paying it out. It doesn't matter to the IRS. Members are required to pay taxes on the profit whether or not they actually receive it. This is because an LLC does not pay taxes on its profit itself - members must account for the business' profits on their personal tax returns. If the LLC pays members cash or property, then the LLC is making a distribution, which is addressed in the next section.



²⁸LLCs are popular because members can choose how to allocate profits and losses, which is not permitted in a corporation. However, there are detailed tax regulations as to how losses can be assigned. By assigning profits and losses according to your percentage interest, you can be comfortable that you are complying with those regulations. If members want to make changes to your loss allocations (which maybe desirable if one member has a unique tax situation such as an inheritance or large salary), check with an accountant or attorney before taking action.

²⁹It's advisable to check with a tax attorney or accountant when making any amendments to Appendix B, just to make sure the effect will be as intended. This reference to the Regulations is a safeguard to make sure you stay in compliance.

Section 3.2: Distributions.³⁰

The Members may, but shall not be required to, distribute to the Members in proportion to their Percentage Interests any portion of available funds for each taxable year of the Company as the Members shall determine by Majority Vote.³¹ The phrase "available funds" shall mean the net cash of the Company available after appropriate provision to pay current operating expenses and to pay or establish reasonable reserves for future expenses, debt payments, capital improvements, and replacements as determined by the Managers. No distribution may be declared that would result in the Company being unable to pay its debts as they become due in the usual course of business or in the fair value of the Company's total assets to be less than the sum of its total liabilities.³²



³⁰A distribution is where the LLC actually gives members money or property based on profits, which is above and beyond any salary or wage members already receive for their duties. If you want to give out the equivalent of a "salary" to a member, you do that in a different way, and you have to make sure the company's revenue can sustain it if you write that into the operating agreement. Many folks who are more uncertain of their revenue/ expenses or who are growing the business will simply use the procedures of this article: vote on a distribution when you think your revenue is exceeding your expenses and the business can afford it. Please note that a distribution is different than allocating profits and losses for the purposes of paying taxes on that amount. A distribution means you put money in your pocket. When you allocate yourself profits/ losses, you do so for tax purposes – you may or may not actually see the money counted as profit on your tax return as you might choose to reinvest the profit in the business (rather than make a distribution).



³¹*It's good to state specifically that a member cannot demand that they receive the business' profit in actual money. The company might wish to always put profit back into the business rather than pay it out. However, you are free to make distributions as you wish. This article provides that a distribution may be made upon majority vote. However, you could require unanimous consent of all members if you are concerned about cash flow.*



For example, let's say two years go by and the farm is beginning to gain traction. They finally make a profit, albeit small at \$1,200. However, so far, the three sisters have decided not to make any distributions, and rather keep all earnings in the business. A year later, after Margo is brought on as a member, the business really starts taking off. Her fermentation products are flying off the shelves! By the end of year three, the farm makes a net profit of \$10,000. Ingrid and Margo are particularly excited because they've been working so hard. They decide they want to take a distribution on the year's profit. They turn to the operating agreement and realize that Article 3.2 requires approval by a majority of percentage interest. They present the idea to Jema and Marie. Jema thinks it sounds great as she could use some extra cash. Marie feels like they should keep the money in the business so she votes against it. However, Jema, Ingrid, and Margo together have a majority of the percentage interest. So it's decided the \$10,000 profits are distributed amongst the four members based on the percentage interest breakdown (i.e. Marie gets \$4,090, Jema gets \$2,730, Ingrid gets \$2270, and Margo gets \$910). Of course, they each have to pay taxes on these profits when filing their individual tax returns!



³²*State laws usually prohibit distributions under some circumstances. Members can't give themselves the business' assets if doing so would jeopardize its ability to pay its bills. Doing so would subvert the liability protection offered by an LLC.*



So, for example, if the Sun Sisters Farm LLC was undercapitalized and not able to make due on its debts, then the decision to distribute the \$10,000 in profits could be subverted by the courts. Basically, the court could take that money back and give it to the creditors.

Section 3.2.1: Distributions in liquidation.

Distributions in liquidation of the Company or in liquidation of a Member's interest shall be made in accordance with the positive capital account balances pursuant to Section 1.704.1(b)(2)(ii)(b)(2) of the Regulations.³³

Section 3.2.2: Negative account balances.

To the extent a Member has a negative capital account balance, there shall be a qualified income offset, as set forth in Section 1.70.1(b)(2)(ii)(d) of the Regulations.³⁴



³³An operating agreement can establish certain tax designations, but they will be honored only if they have a substantial economic effect. This is quite a cumbersome area of tax law. The legal lingo in this article is included to ensure that you will meet this "substantial economic effect test" if and when the company's interests or a member's assets are liquidated or sold off upon dissolution of the company or termination of a member (i.e. the valuation and allocation of these interests passes muster). It's not necessary to include this legalese (which complex-sounding legal language), but advisable.

³⁴Again, this legal lingo is advisable to include, as if it is followed it will permit the substantial economic effect test to be met.

ARTICLE 4: Administrative Provisions³⁵**Section 4.1: Management of the Company Generally.**

Except as otherwise specifically provided in this Agreement:

Section 4.1.1: Manager Managed.³⁶

The business of the Company shall be managed by Manager(s). Ingrid Sister and Margo Friend, shall be the initial Managers. Except as otherwise set forth in this Agreement or applicable law, all decisions concerning the day-to-day management of the Company shall be made by the Managers, whereby each Manager will have one vote; if the Managers fail to reach a majority agreement on a management issue, the matter shall be determined by a Majority Vote of Members.³⁷



³⁵This Article could also be titled “Management of the Company” and is an area of LLC law that provides a great deal of flexibility for determining how the day-to-day affairs of the company are to be managed and how more substantive decisions affecting the company are made. The provisions set forth in this model agreement provide just one example of how the day-to-day affairs and big decisions of an LLC could be managed. Most farm operations are unique, which is largely driven by the nature and diversity of farming as well as the diversity, interests, and overall objectives of their founding members. You are encouraged to think creatively, and devise a management protocol that best addresses the uniqueness of your business and your members’ interests. However, it is advised that you consult with an attorney to ensure that the management provisions in particular, and your operating agreement as a whole, comply with your state’s LLC statute and regulations.

³⁶Most states have a default rule that the LLC is managed by its members unless otherwise provided for in the operating agreement. The provisions included in this model agreement designate this LLC as a “manager-managed” LLC. Basically one or more persons are designated as managers, and are responsible for managing the day-to-day activities of the company. Of note, the managers don’t necessarily have to be members. If you want to require that the managers be members, you should clearly specify this in your operating agreement. Managers typically have the authority to act on behalf of the LLC, and to contractually bind the LLC. A manager-managed structure is recommended for farm operations with many and/or diverse members, some of whom either are not in close proximity to the day-to-day affairs or have no interest in running the Company per se but who want to have a say in issues that have a substantial effect on their interests in the company (e.g. adding additional members or allowing additional contributions that will dilute their percentage interest, dissolving the entity, declaring distributions, etc.). Another option would be to have a member-managed LLC in which the members manage the day-to-day operations. An alternative section for a member-managed LLC may include:

Member Managed. The Company shall be managed by its members. The members shall each have the right, power, and authority to control all of the business and affairs of the Company, to transact business on behalf of the Company, to sign for the Company or on behalf of the Company, or otherwise bind the Company.

³⁷It is important to clearly set forth how the day-to-day decisions will be made for manager-managed LLCs; particularly if there is more than one manager. Here, the day-to-day decisions are decided by one vote per person, and not their percentage interest in the company, because the managers may or may not be members. But voting by percentage interest would be an option if the operating agreement requires that the managers are also members, in which case the manager-member(s) with the most percentage interest would ultimately control the day-to-day operating decisions.



Let's take a step back to the beginning of the Sun Sisters Farm, LLC formation. The three sisters unanimously decide to designate Ingrid and her best friend from childhood, Margo, as the managing partners. (Note: this is before Margo comes on as a member). They opt for this manager-managed structure, because Jema and Marie don't have time to deal with the day-to-day operations and would rather assign Ingrid and Margo the tasks. As Ingrid's best friend, Margo has been like a sister to them all.

They get along great, and are having no trouble deciding on day-to-day matters. However, when planning the initial year's crops, Ingrid and Margo have a blow out dispute on what varietal of beets to plant. It becomes so contentious that they decide to take it to the members to decide by majority vote. They decide on the Krautman varietal of cabbage and the Ruby Queen varietal for beets.

Section 4.1.2: Member Action; Voting Rights.³⁸

When actions are to be taken by the Members, each Member shall vote in proportion to the Member's Percentage Interest as of the Record Date. Unless otherwise determined by the Majority of the Members, the Record Date shall be defined as ten calendar days before the date of the meeting at which the vote is taken.³⁹ Manager Members shall not partake in any vote affecting his/her/their roles, responsibilities, benefits, or dismissal.⁴⁰



³⁸This model agreement gives all members voting rights based on their percentage interest in the company. As outlined in the sample Appendix B above, at the beginning, Marie's vote counts for 45%, Jema's for 30% and Ingrid's for 25%. Once Margo comes on as a voting member, this changes so that Marie's vote counts for 40.9%, Jema's for 27.3%, Ingrid's for 22.7%, and Margo's for 9.1%. Another option would be to make it one-person one vote so that each member's vote carries the same weight despite the percentage interest breakdown. Yet another option would be to tier the membership interests (whether for a manager-managed or member-managed structure), which could include voting members and non-voting members. This could be of interest for farm operations with founding members that are driven by a distinct vision and mission, but have brought on additional investor members that basically trust the judgment of the founding members to decide how the Company operates and just want a share in profits/losses. Or, you could designate certain committees where certain members have voting rights on certain issues. The possibilities are quite endless for LLCs. Just be sure to have an attorney review your agreement before finalizing to be sure your it is compliant with your state's baseline LLC laws and regulations.



³⁹The record date is basically the cut off date for determining the percentage interest allocation that will control the voting rights for a scheduled meeting. This is important, because the percentage interest could change between the time the meeting is called and the time the meeting takes place. Here, the record date is set at 10 days before the meeting unless the majority of the members agree otherwise. You could set the record date to be shorter or longer, or even on the date of the meeting itself.



Here's an example of how the record date may matter. The three sisters schedule an annual meeting for April 15. The record date of this meeting is ten days prior, or April 5. Let's say Margo is brought on as a member on April 10. Based on the record date, Margo's percentage interest vote won't count on any matter voted on unless a majority of the other members agree otherwise.



⁴⁰This makes it clear that if managers are members, they cannot vote on anything that affects their roles and responsibilities as managers. This would present a "conflict" between their personal interests and the best interests of the company. For example, Ingrid can't vote on anything related to her salary as she has a personal interest in the matter. This also serves to protect the managers themselves as such conflicts of interest could subject them to liability if a dispute were to arise.

Section 4.1.3: Appointment of Managers.

The Manager(s) shall serve until his/her/their resignation, a Majority of the Members vote to remove or replace the Manager(s), retirement, death, or Permanent Incapacity. If such event results in the Company having no Manager, a Majority of the Members shall select one or more new Manager(s).

Section 4.2: The Manager(s) will carry on the day-to-day affairs of the Company.

The Manager(s) shall have the full authority to bind the Company with respect to matters in the ordinary course of business.⁴¹ Except as otherwise specifically determined by unanimous resolution of the Members or required by law, checks, drafts, promissory notes, orders for the payment of money and other evidence of indebtedness of the Company must be signed by two authorized Members if over \$1,000 and must be approved by a Majority Vote of the Members if over \$4,500.⁴² Except as authorized by this Section 4.2 or by a Majority Vote of the Members, the Manager(s)

shall not have the power or authority to bind the Company in any way, pledge its credit or render it liable for any purpose.⁴³ The Manager(s) shall be entitled to compensation commensurate with the value of such services rendered as determined by a Majority of the Members. The roles, responsibilities, and benefits of the Manager(s) are further set forth in Appendix C, which may be amended from time to time by the consent of a Majority of the Members.⁴⁴



⁴¹This section provides that the managers have the authority to do the usual things required to run the farm, and a member vote is not needed.

⁴²This is an example of how you could restrict the powers of the managers. It is common to require two authorized signatures on checks over a certain dollar amount, here \$1,000. This ensures that at least one other person has visibility into the farm's spending, which helps prevent runaway spending. Also, here, the managers can only bind the company up to \$4,500. These limitations could be set as more or less, or taken out altogether.



As managers, Ingrid and Margo want to purchase some basic farming tools and supplies at the local farm store that cost about \$1,500. They review the operating agreement and realize they need to get two members to approve the transaction because it is over \$1,000. Jema agrees to sign along with Ingrid who are both members.

Ingrid and Margo then decide that they want to purchase a tractor that costs \$45,000. They only have \$10,000 cash and would need to enter a loan for the remaining \$35,000. They realize they'll need to get a Majority approval to enter such a transaction. Jema and Marie are both reluctant to buy a new tractor as they're concerned about cash flow. They suggest renting a tractor on an as needed basis instead. Ingrid and Margo persist and finally win Jema over. This gives them the majority approval they need. They purchase the tractor even though Marie is against it.



⁴³This is another safeguard. Basically, here managers can bind the company on any matter that is in the ordinary course of business and equates to less than \$4,500 of indebtedness.



⁴⁴The specifics of roles, responsibilities, and benefits of managers may be set forth in the operating agreement itself. However, it's often easier to incorporate them as a separate appendix that can provide more details and be more efficient for tracking changes. The specifics would include a clear description of roles and responsibilities, somewhat like a job description, as well as any special benefits such as salary, housing arrangements, and health benefits, which are common for farm LLC managers. Here, this appendix may be amended by a majority vote of the members, and thus does not require unanimous consent like other amendments to the operating agreement. This makes it easier to resolve such nuanced issues. However, you could require unanimous consent. Another option is to create an entirely separate employment agreement with your manager(s).



Here, let's say that Margo is willing to work on the farm and co-manage the LLC in exchange for living in the tiny farmhouse, fruit and veg, and a \$25,000 a year salary. Recall that Ingrid's salary in the first year is her initial contribution in "services" – for co-managing the LLC and farm labor – which is valued at \$25,000. Part of Ingrid's compensation package includes living in the farmhouse and farm food. Instead of putting all these nuanced details in the operating agreement, they decide to include these terms and more detailed descriptions of the roles and responsibilities of Ingrid and Margo as managers as an Appendix. This may include either an employment agreement for each or some other memorandum of understanding outlining the terms of their duties, housing arrangement, and salary. If amendments ever need to be made to this Appendix, all that's needed is a majority vote. Note, however, that Ingrid and Margo cannot vote on issues that relate to each of their arrangements, as that would be a conflict of interest.

Section 4.3: Reimbursement.

The Company shall reimburse the Manager(s) and/or Members for all direct out-of-pocket expenses incurred in managing and supervising the Company.

Section 4.4: Member Action; Voting Process⁴⁵**Section 4.4.1: Voting at Meetings.**

All Members shall be entitled to vote on any matter submitted to a vote of the Member. Members may vote either in person or by proxy at any meeting.⁴⁶ No proxy shall be valid after eleven (11) months from the date of its execution, unless otherwise provided in the proxy.⁴⁷ Unless otherwise specifically provided herein, the Majority Vote of the Member shall be determinative. Majority Vote means the consent of holders of more than 50% of the Percentage Interests at the time of the vote.⁴⁸ A quorum shall be met when Members and proxies holding a majority of Percentage Interests are present.⁴⁹



⁴⁵*Under some circumstances, the members might need to make a decision together, and they do so by following these processes.*

⁴⁶*A proxy is a separate agreement in writing that one member has with another member that specifies that the other member can vote on his or her behalf. Proxies count toward a quorum (the minimum percentage interest that must be present at a meeting to make actions valid), so allowing for proxies can make it easier for the company to ensure that things get done, especially if there are a lot of members. By allowing votes by proxy, members are free to decide for themselves whether they want to delegate their voting privileges to another member and not necessarily have to attend meetings. If it is important to you that all of your members make critical decisions for themselves, and that they attend meetings, then you shouldn't allow proxy voting.*

⁴⁷*State law generally establishes an 11-month default time limit on proxies, which protects the member initiating the proxy from potential abuse, and this simply reiterates the default law.*

⁴⁸*This article explains that the default threshold for making a decision is a majority vote of the members, which is based on the percentage interest allocation. You have many options here. First, you could set the threshold differently, such as a super-majority (or three-quarters consent) or unanimous consent. Also, you could base the voting rights on something different such as one member one vote. You could also specify that some members have voting rights and others don't. It's also important to note that this is the default voting threshold. Other places in the operating agreement specify a more stringent threshold, including a list of "big" decisions requiring unanimous consent set forth in Article 4.5*

⁴⁹*A quorum is a requirement that a certain number of people attend a meeting to even vote on a decision. Here, if less than a majority of members are present or accounted for through a proxy then no vote can be held.*

Section 4.4.2: Written Consent.

Any action that may be taken at a meeting of the Members may be taken without a meeting if the Members consent in writing. Such consent shall set forth the action to be taken, be signed and dated by Members holding the requisite Percentage Interests.⁵⁰

Section 4.5: Actions Requiring Unanimous Member Approval.⁵¹

Notwithstanding any other provision of this Agreement, the unanimous, written consent of the Members shall be required to approve the following matters:

- a. Dissolution or winding up of the Company;
- b. Merger or consolidation of the Company;
- c. Sale, transfer, contribution, exchange, mortgage, pledge, encumbrance, lease or other disposition or transfer of all or substantially all of the assets of the Company;
- d. Amendments to this Agreement;
- e. Issuance of any interest in the Company, including admission of new Members and additional Capital Contributions from a Member; and
- f. Conversion of the Company to a different entity.



⁵⁰This provides another option for making decisions, which doesn't necessitate holding a meeting.

⁵¹The actions set forth here have a substantial impact on the business and therefore LLC Agreements most often list them as requiring unanimous consent, which overrules the majority agreement default set forth in Article 4.4.1. If a member or set of members does something like sell the LLC without consent, that action is invalid and the member(s) who didn't make the decision have some protection. Of note, operating agreements sometimes require only that a super-majority, usually defined as members owning at least three-quarters of the company, approve these types of decisions, including an amendment to the operating agreement. This may be advisable if the LLC has numerous and diverse members, and it's anticipated that it would be very challenging to get everyone to agree. For example, if 10 members of an LLC have equal ownership and 9 of the 10 want to wind down the farm or sell it, then 9 in favor would not be able to proceed if unanimous consent were required. However, they would be able to choose their favored course of action if the threshold were set at 75%. Keep in mind, however, that requiring unanimous consent protects initial founding members and safeguards their vision for how the company operates. Indeed, if and when additional members are added, the Percentage Interest of the initial members will get diluted, and the additional members could eventually hold a super-majority! Again, it's up to you to decide and clearly outline in your operating agreement what is required for making various types of decisions – whether a majority, super-majority, unanimous consent, or something else – so that it is most suited for the unique nature and make-up of your farm operation.

Section 4.6: Place of Meetings.⁵²

Meetings of the Member shall be held at such place within or without the State of Wisconsin as determined by a Majority Vote of the Members.

Section 4.7: Annual Meeting.

The annual meeting of the Members of the Company shall be held during the month of April of each year on the date and at the time each year as determined by a Majority Vote of the Member. The failure to hold an annual meeting at the time stated herein does not affect the validity of any action taken by the Company.⁵³

Section 4.8: Special Meetings.

Meetings of the Members may be called for any proper purpose or purposes⁵⁴ by a Member or Members who hold at least twenty percent (20%) of the Percentage Interests.



⁵²*This clause sounds obvious- it simply says the meeting could be held in Wisconsin or it could be held anywhere else. This clause is followed by several more that detail when, how, why, and where a meeting might be held. Why state these obvious things? This is because we write an operating agreement anticipating that bad things might happen. If relationships between members sour, some members might try to hold covert meetings where they make decisions that affect the farm's sustainability or the rights of the members who aren't present. These meeting notice and time/place provisions help prevent that possibility by preventing covert meetings from occurring.*

⁵³*Most state laws don't require members to have annual meetings. If you do decide to hold one, it's important to designate a time and place. It's also advisable to have an out clause so that if your annual meeting isn't in fact held in the specified month, your actions at the annual meeting aren't held invalid.*

⁵⁴*Proper purpose is really anything that's legal and reasonably worth the time and effort to hold a meeting. This is in here as a safeguard to raise issue if some member is unreasonably asking to have a meeting for anything and everything, or some "illegal" purpose.*

Section 4.9: Conference Telephone Meetings.

Meetings of the Member may be held by means of conference telephone or similar communications equipment so long as all Persons participating in the meeting can hear each other. Participation in a meeting by means of conference telephone shall constitute presence in person at such meeting.⁵⁵

Section 4.10: Notice of Meetings.

A notice of all meetings, stating the place, day and hour of the meeting and in the case of a special meeting, the purpose or purposes for which the meeting is called, shall be delivered not less than ten (10) nor more than sixty (60) days before the meeting to each Member entitled to attend.⁵⁶

Section 4.11: Waiver of Notice.

Attendance of a Member at a meeting shall constitute a waiver of notice of the meeting, except where such Member attends for the express purpose of objecting to the transaction of any business on the ground that the meeting is not lawfully called or convened. A Member may also waive notification of a meeting in writing.⁵⁷



⁵⁵Allowing for teleconference meetings gives members leeway in logistically making decisions, and is advisable if members are particularly busy or geographically dispersed making physical attendance to meetings challenging.

⁵⁶This Article is important to ensure that your members actually know when your meetings are being held. See also Article 4.10, which specifies how notice must take place.

⁵⁷This basically means that if a member didn't receive formal notice (the announcement that the meeting will be held) as specified in Article 4.10, and yet they attend the meeting, then they can't complain that they didn't receive notice. However, the member can raise objections at the meeting about how notice was given. This Article protects members who may feel that somehow their interests are being subverted by the majority. It's not necessary, but is advisable if you expect to have a lot of members or a diversity of interests or otherwise think it's likely that things may get contentious.

ARTICLE 5: Limitation of Liability; Independent Activities; Indemnification

Section 5.1: Limitation of Liability.

To the maximum extent permitted by applicable law, the Members and Managers shall not be liable to the Company or any other third party (i) for mistakes of judgment, (ii) for any act or omission by such Member or Manager, or (iii) for losses due to any such mistakes, action, or inaction.⁵⁸

Section 5.2: Independent Activities.

Any Member or Manager may engage in or possess an interest in other business ventures of every nature and description, independently or with others, including, without limitation, the ownership, financing, management, employment by, lending or otherwise participating in businesses that are similar to the business of the Company. Neither the Company nor the other Member shall have any right by virtue of this Agreement in and to such independent ventures as to the income or profits therefrom and shall not be liable for a breach of duty of loyalty or any other duty.⁵⁹



⁵⁸This means that if members or managers make an honest mistake or do something innocently dumb and cause the company harm, the company or a third party can't sue the member or manager personally for it. Of course, the members and managers have responsibility to be conscientious and make good business decisions. The courts will decide whether a mistake is innocent or the result of really bad judgment on behalf of the member or manager.

⁵⁹This Article protects members and managers that may be involved in related ventures or businesses. It basically allows them to compete with the business. Most states frown on "non compete provisions" in any operating agreements or employment agreements, so if you do decide to place any limitations on members or managers with respect to activities outside of the farm operations, they must be reasonable in both subject and geographic scope. It is advisable to consult an attorney before writing non-compete limitations into your operating agreement.

Section 5.3: Indemnification.**Section 5.3.1: Indemnification.**

To the fullest extent permitted by applicable law, a Member, a Manager and each director, officer, partner, employee or agent thereof (“Covered Person”) shall be entitled to indemnification from the Company for any loss, damage, or claim (including attorney fees and costs) incurred by such Covered Person by reason or any act or omission performed or omitted by such Covered Person in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of authority conferred on such Covered Person by this Agreement. Notwithstanding the prior sentence, no Covered Person shall be entitled to be indemnified in respect of any loss, damage or claim incurred by such Covered Person by reason of gross negligence, bad faith, or willful misconduct with respect to such act or omissions. Any indemnity under this Section 5.3.1 shall be provided out of and to the extent of Company assets only, and no other Covered Person shall have any personal liability on account thereof.⁶⁰

Section 5.3.2: Notice.

In the event that any claim, demand, action, suit or proceeding shall be instituted or asserted or any loss, damage or claim shall arise in respect of which indemnity may be sought by a Covered Person pursuant to Section 5.3.1, such Covered Person shall promptly notify the Company thereof in writing. Failure to provide notice shall not affect the Company’s obligations hereunder except to the extent the Company is actually prejudiced thereby.⁶¹



⁶⁰An indemnification provision is simply a promise by the other party to cover your losses if he or she does something that causes you harm or causes a third party to sue you. Indemnification provisions can vary quite a bit. Here, this indemnification clause means that if someone sues members for something they did on behalf of the LLC, the LLC has to pay to defend that lawsuit. An LLC should consider carrying insurance for this – without insurance, the business probably can’t afford to follow through on this provision. Farm liability insurance may or may not provide this coverage. A commercial policy might be necessary.

⁶¹This requires that any member sued for their work with the LLC tell the Company that the suit was filed. That way the company can monitor the issue and have adequate opportunity to represent its interests. However, the company can’t get out of its obligations to the person filing the suit simply because the member or manager failed to tell the company. Basically, this provision gives the company a right to go after members or managers who fail to give proper notice and yet protects any third party that has a valid claim against the company.

Section 5.3.3: Contest.

The Company shall have the right, exercisable subject to the approval of the disinterested Covered Persons, to participate in and control the defense of any such claim, demand, action, suit or proceeding, and in connection therewith, to retain counsel reasonably satisfactory to each Covered Person, at the Company's expense, to represent each Covered Person and any others the Company may designate in such claim, demand, action, suit or proceeding.⁶² The Company shall keep the Covered Person advised of the status of such claim, demand, action, suit or proceeding and the defense thereof and shall consider in good faith recommendations made by the Covered Person.⁶³



⁶²*This ensures that the company has a say and can monitor the effectiveness of the outcome of any dispute that may arise involving its managers and/or members and that it is required to essentially pay for.*

⁶³*Indemnification is easiest to understand through examples. Recall that Ingrid handles the production and Community Supported Agriculture program of Sun Sisters Farm, LLC. A couple of years into her CSA, Ingrid runs into a very disgruntled customer named Mildred. Mildred wasn't familiar with the CSA concept before she signed up for a Sun Sisters Farm share, and she was under the impression that she would receive a greater quantity and variety of vegetables. Mildred is also inclined to use the court system rather than talk things out. At the end of the season, Mildred files a lawsuit against Ingrid claiming Ingrid's sale of the CSA share was fraudulent. Ingrid tells her co-members at Sun Sisters Farm, LLC about the suit immediately and asks for the farm business to defend her. At first, some of the other members are hesitant- they aren't sure if the farm can afford this process... and they might be wondering if Ingrid should be personally responsible, not the farm business as a whole. While trying not to offend Ingrid, they explore the issue of whether Ingrid made the sale in her capacity as a member of the LLC. Considering that Ingrid made the sale through the farm business and her sale was a perfectly reasonable exercise of her authority within the farm, the members realize that Article 5.3.1 requires the LLC to defend Ingrid. The business must "indemnify" Ingrid. The members contact their insurance company immediately to get the ball rolling on a defense.*

ARTICLE 6: Transfers of Interest⁶⁴

Section 6.1: Transfers.

Except as permitted by this Agreement, a Member shall not Transfer any portion of the Member's Interest. "Transfer" means to sell, assign,⁶⁵ give, bequeath, pledge, or otherwise encumber, divest, dispose of, or transfer ownership or control of all of, any part of, or any interest in a Percentage Interest to any person or entity, whether voluntarily or by operation of law, whether before or upon death. The Transfer of all or a portion of an Interest does entitle the transferee to become a Member or to exercise any rights of a Member.⁶⁶ Unless provided otherwise by this Agreement, a transferee shall be entitled to receive only the distributions to which the transferor would be entitled. The transferee shall not be admitted as a Member unless approved by unanimous consent of the Members who are not transferring their Interests.⁶⁷ Unless and until the transferee is admitted as a member, the determination of majority consent for all purposes shall be made by excluding the Percentage Interest held by the transferee.⁶⁸



⁶⁴Here's a plain-language summary of Article 6: A member can't sell or give away his or her interest in the LLC without approval of the other members and without following the process set forth in the agreement, which includes a "right of first refusal" by the other members. If a member tries to transfer his or her interest without doing so, the transfer is invalid. Such an elaborate process included in this model agreement as a sample is certainly not required. Indeed, you could just simply require that all members unanimously – or a super-majority or a majority – agree to the transfer, otherwise it is not allowable. Or, you could openly allow any and all transfers (which is generally not advisable), but it's up to you.

⁶⁵This definition of transfer includes an assignment, which basically means to transfer a right or set of rights. This prohibits assignment unless the provisions set forth in Article 6 are followed. Many LLCs prohibit assignment because they don't want a member voting on LLC matters if the member does not have a financial interest in profits and distributions.

⁶⁶If someone takes over a member's interest in the company, then the new member receives distributions only - not voting rights. Here's what this means. Let's say a member goes on vacation to another state, causes a vehicle accident, and is sued by the injured person. Let's also say that the member doesn't have car insurance and the injured person goes after the member's personal assets for compensation. The member's interest in this LLC is a personal asset. If the injured person successfully sues the member, the court could



award the injured person the member's interest in this LLC. With this provision, that injured person gets a right to receive any distributions (remember, that's cash or property paid out to members) that would have been made to the member. But, the injured individual can't vote on issues – they don't become a "real" member, basically.

⁶⁷Even if an interest is transferred, the transferee won't become an actual member with voting privileges, etc. unless a majority of the members agree to make them a full member.

⁶⁸Given the transferee doesn't have voting rights, their percentage interest will be excluded from the mix when counting up votes to get a majority. For example, if the transferee has a 10% interest, then the total percentage interest of members will actually be 90%, and it will just take a consent of 46% to get a majority.

Section 6.2: Voluntary Withdrawal.

No Member shall have the right or power to voluntarily withdraw from the Company, except as otherwise provided by this Agreement.⁶⁹

Section 6.3: Member's Right of First Refusal.⁷⁰

In the event a Member wishes to Transfer such Member's Interest, such Member (the "Transferring Member") shall first be required to provide the Manager(s) and the other Members with a written offer ("Offer") which shall set forth the following: (a) the intention to Transfer; (b) the name and address of the prospective transferee; (c) the Interest being offered ("Offered Interest"); and (d) the terms and conditions of the Transfer, including the purchase price for the Offered Interest.



⁶⁹This reiterates Article 2.5 (and explanation in Note 22) that a member can't simply withdraw from the company and expect the return of his/her/their capital investment, which is generally the default rule of state LLC laws and regulations. It's important to include this provision to protect the company from cash flow and other issues resulting from a member's arbitrary decision to simply withdraw his/her/their interest.

⁷⁰Requiring this right of first refusal process gives the members the opportunity to keep all interests in the company within the existing members versus allowing any member to just transfer their interest to some stranger.



Here's an example of how the right-of-first-refusal transfer provisions in this operating agreement could play out. Let's say that Marie is increasingly frustrated with how the business is being run, as it's counter to her keen business sense. She still upset about the "majority" decisions to buy an expensive tractor and to distribute profits at year three, both of which she was against. She decides she wants to leave the Company. Marie has a good friend, Juliet, who is interested in taking over her 40.9% interest. Marie and Juliet decide on a price of \$60,000. This price takes into account the thriving business and the increased value in the farm property that Marie originally invested as her capital contribution. However, Marie reviews the operating agreement and realizes that she first needs to follow Article 6 and provide a "right of first refusal" to the other existing members – Jema, Ingrid, and Margo. So Marie follows the provisions. She first writes up an "offer" to the members for the amount of \$60,000 that she negotiated with Juliet, an actual prospective buyer. Jema, Ingrid, and Margo each consider whether to buy in at their pro rata share. Jema decides to do it. However, Ingrid and Margo aren't able to come up with the money to buy their share. So, Ingrid and Margo then each write up an offer to Jema for their pro rata share of Marie's interest based on this negotiated price of \$60,000. Jema decides not to make such a huge investment- that means she would have to buy all of Marie's interest. Instead, Jema rejects the offers from Ingrid and Margo and takes the offer from Marie to just buy pro rata share. Ingrid and Margo's pro rata shares are still on the table (Ingrid and Margo can't buy them and Jema chooses not to). This means Marie can sell that remaining interest to Juliet.

Now for the math! Jema's pro rata share vis a vis her, Ingrid, and Margo is 46%. In other words, presuming Marie's out, Jema's original capital contribution of \$30,000 equates to 46% of the remaining three's total capital contribution of \$65,000. So for Jema to purchase her pro-rata share of Marie's interest, based on the negotiated price of \$60,000 for all, Jema must invest an additional \$27,600 (46% of \$60,000). Juliet must then invest the remaining \$32,400. Now, Jema has 46%, Juliet has 26%, Ingrid has 20%, and Margo has 8%. Marie has 0% and is out. Exhibit B will also need to be adjusted to remove Marie, add Juliet, include Jema's additional contribution, and adjust everyone's percentage interest accordingly. See Exhibit B to illustrate how this would look.



Nevertheless, Jema, Ingrid, and Margo decide not to let Juliet in as a member. So Juliet basically owns “equity interest” but has no voting rights. (This is called an equity interest because it’s an interest primarily in the distributions the company may make, which come out of equity.) So now, Jema holds a majority of percentage interest for voting purposes (vis a vis the percentage interest of Jema, Ingrid, and Margo—the three members).

Section 6.3.1: Acceptance Offer.

Each of the remaining Members may elect within forty-five (45) days after receipt of the Offer, to purchase his or her prorated portion of the Offered Interest by giving written notice within such forty-five (45) day period to the Transferring Member and to the Company.

Section 6.3.2: Pro Rata Portion.

For purposes of this Section 6.3, each accepting Member’s pro rata portion of the Offered Interest is that proportion of the Offered Interest as the Interest held by such accepting Member(s) bears to the Interests held by all other accepting Members. If any accepting Member elects not to accept all or any part of his or her pro rata portion of the Offered Interest, the Member(s) shall give written notice on or before the thirty-fifth (35th) day after receipt of the Offer of the Member’s election to the other accepting Member(s). The Accepting Member(s) may accept his or her respective pro rata portion of that accepting Member’s pro rata portion of the Offered Interest.⁷¹



⁷¹*This article basically allows each member the opportunity to purchase a portion of the offered interest based on his/her percentage interest. If one or more choose not to purchase their share, then it is offered to the members (if any) who have chosen to purchase their portion. This way, everyone gets an equal chance to further buy into the company, and the members as a whole have the opportunity to keep the interest within their group instead of having it transferred to some outsider.*

Section 6.3.3: Offer Not Accepted as to All Interests.

If the accepting Member(s) have not elected to accept all the Offered Interest within the time periods specified above, the Transferring Member may Transfer the Offered Interest to the prospective transferee named in the Offer as provided in Section 6.3, such transfer to be made only in strict compliance with the terms set forth in such statement and to be completed within ninety (90) days following the expiration of the time provided for the election by the Member to accept the Offered Interest, after which time any such Transfer shall again become subject to all the restrictions of this Agreement.

Section 6.4: Interests Not Subject to Restrictions.

Notwithstanding any other provision of this Agreement to the contrary, the restrictions on Transfer of a Member's Interest set forth in this Agreement shall not apply, subject to Section 6.1, to the gift, by bequest or otherwise, of Membership Rights to the spouse of a Member, or to a Member's lineal descendants, or to trusts for the benefit of a Member's spouse or lineal descendants, which Transfers may take place after the date of the execution of this Agreement and are hereby consented to by the Member.⁷²



⁷²This means members can transfer interests to their spouse, their children, and to any trust members might create to manage property or assets, without first getting unanimous consent. This is most useful regarding wills: if members leave their interest to each other, their children, or a trust, it may be easier to execute with this provision. Check with an attorney for more information on planning the estate. Oftentimes operating agreements also permit transfers to other members without first getting unanimous consent, which is something you may want to consider including in this list. Note that this is subject to Article 6.1, which means that the transferee doesn't automatically become a member with voting rights until and unless all members unanimously agree to admit them as a member.

⁷³This basically means that if a transfer is effective, the transferee (i.e. the one that now holds the interest) must sign and abide by the operating agreement.

Section 6.5: Effect of Transfer.

In the event of any Transfer accomplished in accordance with this Agreement, including a Transfer permitted by Sections 6.3 or 6.4, the transferee and transferee's spouse, if any, shall receive and hold the Interest transferred subject to the terms and provisions of this Agreement. The transferee shall be subject to the obligations of the transferor set forth in this Agreement and shall, upon request by the Company or any Member, execute an endorsement to this Agreement.⁷³

Section 6.6: Void Transfers.

Any Transfer of any Interest by a Member shall be deemed void, and the Company shall not record or recognize any such Transfer, until there has been compliance with the provisions of this Agreement.⁷⁴ If no Offer is made as herein required, the Company and the Member may nevertheless exercise their rights hereunder as to the Interest being transferred, and they may do so at any time, even after the Transfer of the Interest.

Section 6.7: Involuntary Transfers.

An Involuntary Transfer will be effective only after compliance with applicable provisions of this Section 6.7.⁷⁵ The creditor, receiver, trust or trustee, estate, beneficiary, or other person or entity to whom a Percentage Interest is Transferred by Involuntary Transfer (the "Involuntary Transferee") will have only the rights provided in this Section 6.7.



⁷⁴A void transfer means it's as if it never happened. That means that even if Member A sold his or her share of the company for cash to Member Z without consent, the transfer is void. Then Member A is still a member and can still conduct business on behalf of the LLC. If Member Z, not knowing that the transfer is void, votes or takes action on the LLC, those actions are void.

⁷⁵An involuntary transfer typically happens as a matter of law because of a default of some kind, whether through a creditor taking the interest, bankruptcy, foreclosure, etc. This article basically requires that whoever receives the interest through such a scenario, for example a creditor who seizes the interest, has the obligation to immediately notify the members of the LLC that they have seized the interest. Otherwise, they have no legal rights to future distributions.

Section 6.7.1: Definition.

“Involuntary Transfer” means any Transfer of a Percentage Interest by operation of law or in any proceeding, including a Transfer resulting from the dissociation of a Member, by or in which a Member would, but for the provisions of this Section 6.2, be involuntarily deprived of any interest in or to the Member’s Percentage Interest. “Involuntary Transfer” includes, without limitation, (a) a Transfer from bankruptcy, (b) any foreclosure of a security interest in the Percentage Interest, (c) any seizure under levy of attachment or execution, or (d) any Transfer to a state or to a public office or agency pursuant to any statute pertaining to escheat, abandoned property, or forfeiture.

Section 6.7.2: Notice to the Company.

The Transferor and the Involuntary Transferee shall each immediately give written notice to the Company describing the event giving rise to the Involuntary Transfer; the date on which the event occurred; the reason or reasons for the Involuntary Transfer; the name, address, and capacity of the Involuntary Transferee; and the Percentage Interest involved (a “Notice of Involuntary Transfer”).

Section 6.7.3: Effect of Involuntary Transfer.

Upon the receipt of the Notice of Involuntary Transfer, the Involuntary Transferee shall have the rights of an assignee of the Transferor’s Percentage Interest as set out in section 183.0704(1) (b) of the Wisconsin Limited Liability Company Law.⁷⁶ Unless and until the Involuntary Transferee is admitted as a member by unanimous consent, the Percentage Interest held by the Involuntary Transferee shall have no voting rights.⁷⁷



⁷⁶As discussed earlier, one of the reasons to write an operating agreement is to outline when and how the LLC members want to deviate from the “default” rules provided by state law. That’s the role of this reference to Wisconsin law--it helps the company clearly communicate how it relates to state law. It may not be strictly necessary at times, but it’s always a best practice.

⁷⁷Members can always admit the Involuntary Transferee as a member, if wanted. Recall that until and unless that’s done, the percentage interest held by the transferee will be excluded from the majority vote.

Section 6.8: Effect of Dissociation.

The dissociation of a Member will not entitle a Member to a distribution in redemption of the member's Percentage Interest. An event of dissociation under section 183.0802(1)(d)-(k) of the Wisconsin Limited Liability Company Law will be treated as an Involuntary Transfer pursuant to Section 7.4 of this Agreement.⁷⁸



⁷⁸*This article is basically restating Article 2.5 (and explanation in Note 24): Members cannot withdraw and demand return of their capital contributions or capital account. It's helpful to repeat it here in the specific context of transfer can be useful to repeat and incorporate a state law citation just to be sure it's clear.*

ARTICLE 7: Books, Records, and Accounting**Section 7.1: Bank Accounts.**

All funds of the Company shall be deposited in a bank account or accounts opened in the Company's name. The Manager(s) shall determine the institution or institutions at which the accounts will be opened and maintained, the types of accounts, and the Persons who will have authority with respect to the accounts and the funds therein.⁷⁹

Section 7.2: Books and Records.⁸⁰**Section 7.2.1:**

The Manager(s) shall cause to be kept complete and accurate books and records of the Company and supporting documentation of the transactions with respect to the conduct of the Company's business. The records shall include, but not be limited to, complete and accurate information regarding the state of the business and financial condition of the Company, a copy of the Certificate of Formation and this Agreement and all amendments thereto, a current list of the names and last known business, residence, or mailing addresses of all Members, and the Company's federal, state, and local tax returns.



⁷⁹*It's important that the LLC has a separate banking account to ensure that its funds are not inappropriately commingled with the funds of its members.*

⁸⁰*This Article basically says that all members have access to the books and records of the company; however, they must pay for any costs the company incurs in inspection, including copying.*

Section 7.2.2:

The books and records shall be maintained in accordance with sound accounting practices consistently applied and shall be available at the Company's principal place of business for examination by any Member or the Member's duly authorized representative at any and all reasonable times during normal business hours. The Company shall maintain reasonable internal controls to safeguard its assets and business.

Section 7.2.3:

Each Member shall reimburse the Company for all costs and expenses incurred by the Company in connection with the Member's inspection and copying of the Company's books and records.

Section 7.3: Annual Accounting Period.

The annual accounting period of the Company shall be the calendar year. The Company's taxable year shall be the calendar year, subject to the requirements and limitations of the Internal Revenue Code of 1986 ("Code") and Regulations.⁸¹



⁸¹For tax purposes, some companies prefer to designate their accounting period to end on another date, including March, June, September, or another date – mostly based on the predicted cycle of profits and losses. You should consult an attorney or your accountant to determine what would be best based on your specific farming operation.

Section 7.4: Reports to Member.

Within seventyfive (75) days after the end of each taxable year of the Company, the Manager shall cause to be sent to each Person who was a Member at any time during the taxable year then ended: (i) an annual report, prepared by the Company's independent accountants in accordance with generally accepted auditing standards and expressing an unqualified opinion on the financial statements presented therein; and (ii) a report summarizing the fees and other remuneration paid by the Company to any Member, or any Affiliate in respect of the taxable year. In addition, within seventyfive (75) days after the end of each taxable year of the Company, the Manager shall cause to be sent to each Person who was a Member at any time during the taxable year then ended, that tax information concerning the Company necessary for preparing the Member's income tax returns for that year.⁸²



⁸²Some states require that annual reports are prepared and filed with the secretary of state or financial institutions agency. Regardless, it can be beneficial for the company to require that an annual report is prepared, which keeps all members informed of key issues related to the farm operations. It's also important to ensure that all requisite tax information is sent to each member each year, as the LLC entity does not itself pay taxes. Rather, each member is required to account for their respective profit/loss related to the company on their individual tax returns.

Section 7.5: Tax Matters Member.

A Member shall serve as the Company's tax matters partner ("Tax Matters Member"). The Tax Matters Member shall have all powers and responsibilities of a "tax matters partner" as defined in Section 6231 of the Code. The Tax Matters Member shall keep all Member informed of all notices from government taxing authorities that may come to the attention of the Tax Matters Member. The Company shall pay and be responsible for all reasonable thirdparty costs and expenses incurred by the Tax Matters Member in performing those duties. A Member shall be responsible for any costs incurred by the Member with respect to any tax audit or taxrelated administrative or judicial proceeding against any Member, even though it relates to the Company. The Tax Matters Member shall not compromise any dispute with the Internal Revenue Service without the approval of the Member.⁸³

Section 7.6: Tax Elections.

The Company shall make those elections permitted under the Internal Revenue Code and Regulations, including, without limitation, elections of methods of depreciation and elections under Section 754 of the Code, as approved by a Majority Vote of the Member.⁸⁴



⁸³All states require that a tax matters member be designated, who will ultimately be responsible for keeping all members informed of tax related issues.

⁸⁴Tax laws offer some flexibility in how certain allocations and accounting for depreciation of company and/or member assets are made. This Article basically allows the LLC members to decide these tax issues by a majority vote. However, members are advised to consult with an attorney or accountant when making such decisions.

Section 7.7: Title to Company Property.

All real and personal property acquired by the Company shall be acquired and held by the Company in its name.⁸⁵

Section 7.8: Valuation of Company Assets and Interests.⁸⁶**Section 7.8.1:**

General. In the event that the Fair Market Value of a Company asset or Interest must be determined, such value shall be determined by a Majority of the Members, each acting in good faith. Within ninety (90) days after such determination, the determining party shall provide notice thereof to all the other Members (a "Valuation Notice").

Section 7.8.2:

Dispute. In the event that, within thirty (30) days after having been given a Valuation Notice, any Member (an "Objecting Member") provides notice to the Company asserting that the value set forth in such Valuation Notice is materially inaccurate due to manifest error (a "Dispute Notice"), the Company and the Objecting Member shall undertake reasonable efforts to resolve their differences regarding such valuation through consultation and negotiation. In the event that the Company and the Objecting Member agree upon a revised Fair Market Value, such revised value shall be set forth in a new Valuation Notice to all the Members. In the event that the Company and the Objecting Member do not reach agreement within sixty (60) days after the date of the Dispute Notice, the Objecting Member may, by notice to the Company within thirty (30) days after the end of such sixty (60) day period, require that the matter be submitted to mediation pursuant to Section 9.8.



⁸⁵Most companies prefer that the title to its property, including land and farm equipment, be held in the name of the company and not its members. This does not apply to leases, only things that are "owned" in whole or in part by the company. If your farm operation includes land or equipment that is co-owned or involved in some other unique ownership arrangement where the company does not have full title, then this provision would need to specify that.

⁸⁶Determining the valuation, or projected overall worth, of a company can be a relatively subjective process, as there are many ways of doing it, and everyone will have their opinion as to what's best (particularly when they have a vested interest). Determining the valuation is an essential exercise, as among other things, it will help determine the value of each member's percentage interest in the company. Article 7.8 provides that the valuation is to be determined by the majority of the members, but also provides a process for disputes. Other options for determining valuation could include specifying precise calculations based on accounting principles. Regardless, it's recommended that you include a protocol for determining the valuation in the operating agreement as this area is ripe for contention.

ARTICLE 8: Dissolution And Liquidation

Section 8.1: Events of Dissolution.

The Company shall be dissolved, and shall terminate and wind up its affairs, upon the first to occur of the following: (a) the determination by the Members to dissolve the Company;⁸⁷ or (b) the entry of a decree of judicial dissolution pursuant to 183.0902 of the WLLCL.⁸⁸ The death, retirement, resignation, expulsion, or bankruptcy of a Member or the occurrence of any other event which otherwise terminates the continued membership of a Member in the Company shall not result in the dissolution of the Company.

Section 8.2: Procedure for Winding Up and Dissolution.

If the Company is dissolved, the Members shall be collectively responsible for winding up its affairs.⁸⁹ On winding up of the Company, the assets of the Company shall be distributed, first, to creditors of the Company, including Members who are creditors, in satisfaction of the liabilities of the Company. Then, amounts in excess of any reserves deemed reasonably necessary by the Members to pay all of the Company's claims and obligations shall be distributed to the Members in accordance with Section 4.5 of this Agreement.

Section 8.3: Termination.

The Members shall comply with any requirements of applicable law pertaining to the winding up of the affairs of the Company and the final distribution of its assets. Upon completion of the winding up, liquidation and distribution of the assets, the Company shall be deemed terminated.



⁸⁷Although no single member can withdraw without consent of the other members, the members together can unanimously agree to dissolve the entire company.

⁸⁸A court can require an LLC to dissolve. This can happen if one member is "oppressing" other members, which can include things like threatening them. Or, if the LLC isn't acting in accordance with the operating agreement or the members are doing something illegal. Those are very, very unlikely to ever happen. But, you can be administratively dissolved if you fail to file your annual report with the state (it's easy and they send you a reminder) for five years in a row or so. You then have a year or two to file for reinstatement- if you don't, your LLC is gone.

⁸⁹This means that if an LLC is dissolved, members won't ignore the dissolution by carrying on business as usual.

ARTICLE 9: Amendments; General Provisions; Investment Representations

Section 9.1: Assurances.

Each Member shall execute all certificates and other documents and shall do all such filing, recording, publishing, and other acts as the Members deem appropriate to comply with the requirements of law for the formation and operation of the Company. Each Member shall also comply with any laws, rules, and regulations relating to the acquisition, operation, or holding of the property of the Company.⁹⁰



⁹⁰This requires that all members do what's necessary to make sure that all documents are signed, amended, and filed with state or federal agencies and others, including creditors, so that the company is legally sound at all times.

Section 9.2: Notifications.

Any notice, demand, consent, election, offer, approval, request, or other communication (collectively a "notice") required or permitted under this Agreement must be in writing and either (a) delivered personally, (b) sent by certified or registered mail, with postage prepaid and a tracking number, (c) sent by a nationally reputable private carrier, or (d) sent by email or text. A notice must be addressed to a Member at the Member's last known address or transmitted to the Member's last known email address or mobile number accepting texts on the records of the Company. A notice to the Company must be addressed to the Company's principal office or to the official email address provided on the records of the Company. A notice delivered personally will be deemed given only when acknowledged in writing by the person to whom it is delivered. A notice that is sent by mail will be deemed given three (3) business days after it is mailed. A notice sent by reputable overnight carrier will be deemed given on the date of delivery indicated on the carrier's delivery slip (no recipient signature required). A notice sent by email or text will be deemed given when sent. Any party may designate, by notice to all of the others, substitute addresses or addressees for notices; thereafter, notices are to be directed to those substitute addresses or addressees.⁹¹



⁹¹*It's important to clearly set forth how any "notice" required by the provisions of the operating agreement will be delivered. This all sounds quite formal, but the formalities protect the members by ensuring that they have been properly notified well in advance of any significant issues. It helps that it's in writing. Here, email and text is provided as an option for giving notice. It's entirely up to you to decide how you prefer notice to be given.*

Section 9.3: Specific Performance.

The parties recognize that irreparable injury will result from a breach of any provision of this Agreement and that money damages will be inadequate to remedy the injury fully. Accordingly, in the event of a breach or threatened breach of one or more of the provisions of this Agreement, any party who may be injured (in addition to any other remedies which may be available to that party) shall be entitled to one or more preliminary or permanent orders (a) restraining and enjoining any act that would constitute a breach, or (b) compelling the performance of any obligation that, if not performed, would constitute a breach.⁹²



⁹²*Specific performance is a type of remedy that is specified in contracts where paying monetary damages wouldn't make the parties whole if the agreement is breached. For example, if you spend thirty years farming your land with blood, sweat, and tears, and one of the members somehow breaches the operating agreement and illegally takes title to the land, that member's payment of the market value of the land may not adequately remedy the situation. Instead, the member would have to transfer title back to the company.*

Section 9.4: Complete Agreement.

This Agreement constitutes the complete and exclusive statement of the agreement among the Members and the Company. It supersedes all prior written and oral statements, including any prior representation, statement, condition, or warranty.⁹³



⁹³*This is typical contract legalese to confirm that any drafts or side agreements entered into by members are superseded by this agreement if a conflict were to arise.*

Section 9.5: Applicable Law.

All questions concerning the construction, validity, and interpretation of this Agreement and the performance of the obligations imposed by this Agreement shall be governed by the internal law, not the law of conflicts, of the State of Wisconsin.⁹⁴



⁹⁴It's important to designate which state's laws will govern the agreement, even if all your operations and your members are in one state, as otherwise creditors or other interest holders could bring you to court elsewhere.

Section 9.6: Section Titles.

The headings herein are inserted as a matter of convenience only and do not define, limit, or describe the scope of this Agreement or the intent of the provisions hereof.⁹⁵



⁹⁵This is typical contract legalese to guide the courts in interpreting the agreement if a dispute arises.

Section 9.7: Binding Provisions.

This Agreement is binding upon, and inures to the benefit of, the parties hereto and their respective heirs, executors, administrators, personal and legal representatives, successors, and permitted assigns.⁹⁶



⁹⁶This basically means that this agreement is binding on anyone who gets a legitimate interest in the company, even if they don't sign the agreement.

Section 9.8: Dispute Resolution.⁹⁷

If a dispute arises out of this Agreement, or a breach hereof, or otherwise develops between or among the Members and/or Managers with respect to the Company and/or its operation, business, or affairs, then the Members and the Managers effected shall (before resorting to arbitration, litigation, or any other dispute resolution procedure) each proceed to negotiate with each other in good faith, on a commercially reasonable basis. They must meet in person with one another at least three times in an effort to reach a resolution. If no resolution has been reached after such efforts, then they shall proceed to mediation administered by the American Arbitration Association under its Commercial Mediation Rules. If mediation is not successful in resolving the entire dispute or is unavailable, any outstanding issues shall be submitted to final and binding arbitration in accordance with the laws of the State of Wisconsin. The arbitrator's award will be final and the judgment may be entered upon it by any court having jurisdiction within the State of Wisconsin.



⁹⁷It is highly recommended that you include a dispute resolution clause. Here, mediation is preferred as it is generally the least expensive and most efficient way for resolving disputes. While many consider them effective for achieving just outcomes, both litigation and arbitration can be timely and expensive regardless of a "winning" outcome, the former more so than the latter. The key is to have a clear and comprehensive operating agreement so that disputes do not arise, but you can never be so sure. So as a safeguard, consider the worst case scenario, a super messy dispute involving facts and he said, she said opinions, and then determine how you'd want the dispute to be resolved so that you can get on with your farming operations.

Section 9.9: Terms.

Common nouns and pronouns shall be deemed to refer to the masculine, feminine, neuter, singular, and plural, as the identity of the Person may in the context require.⁹⁸



⁹⁸This ensures that all terms are interpreted to include all parties, even if a singular is used. It's more legal jargon.

Section 9.10: Separability of Provisions.⁹⁹

Each provision of this Agreement shall be considered separable. If, for any reason, any provision or provisions herein are determined to be invalid and contrary to any existing or future law, such invalidity shall not impair the operation of or affect those portions of this Agreement, which are valid.

Section 9.11: Counterparts.

This Agreement may be executed simultaneously in two or more counterparts, each of which shall be deemed an original and all of which, when taken together, constitute one and the same document. The signature of any party to any counterpart shall be deemed a signature to, and may be appended to, any other counterpart.¹⁰⁰

Section 9.12: Investment Representations.¹⁰¹

The Interests have not been registered under the Securities Act of 1933, as amended, or any state securities laws (collectively, the "Securities Acts"), because the Company is issuing the Interests in reliance upon the exemptions from the registration requirements of the Securities Acts, and the Company is relying upon the fact that the Interests are to be held by each Member for investment. Accordingly, each Member hereby confirms the following representations:



⁹⁹This Article basically provides that if a court were to interpret one article of this agreement as illegal or otherwise invalid, the other sections of the operating agreement will still stand.

¹⁰⁰This is legal jargon that basically allows members to sign the agreement on separate pieces of paper.

¹⁰¹These Articles offer some measure of protection to the Company because by signing this agreement, the members are each effectively making certain representations regarding his or her qualifications and fitness to serve as a member. Also, each member is effectively making certain representations regarding his or her investment objectives, which are necessary representations to comply with state and federal securities laws. If these provisions are not included in the operating agreement, it is advisable that you have all members sign an investment representation letter upon making their initial capital investment, which will effectively do the same thing.

Section 9.12.1:

Interests have been acquired for such Member's own account, for investment and not with a view to the resale or distribution thereof and may not be offered or sold to anyone unless there is an effective registration or other qualification relating thereto under all applicable Securities Acts or unless such Member delivers to the Company an opinion of counsel, satisfactory to the Company, that such registration or other qualification is not required;

Section 9.12.2:

The Member understands that the Company is under no obligation to register the Interests or to assist any Member in complying with any exemption from registration under the Securities Acts;

Section 9.12.3:

The Member is experienced in evaluating and investing in companies such as the Company.¹⁰²

The Member is aware of the Company's business affairs and financial condition and has acquired sufficient information about the Company to reach an informed and knowledgeable decision to acquire the Interests;

Section 9.12.4:

The Member understands that: (i) the Company is a newly formed limited liability company with no prior operating history, revenues or earnings; (ii) there can be no assurance as to the amount, if any, of revenues or profits that the Company may generate; (iii) an investment in the Interest is highly speculative; (iv) investors must accept the risk of potentially losing their entire investment in the Company; (v) the Company has only very limited amounts of cash and may be required to obtain additional cash in order to finance its operations; and (vi) there can be no assurance that the Company will be able to obtain additional capital on acceptable terms or at all.



¹⁰²Again, these provisions are provided to protect the Company. By signing this agreement, the members are representing that they have some level of savviness in understanding how businesses operate and the risks involved. It does not necessarily mean that a member is an expert or even have prior experience in an LLC. Ultimately, it means they are taking this seriously, have done the due diligence or research into the business affairs prior to signing on as a member and making their capital contribution, and realize that they have no right to get their money back.

Section 9.12.5:

The Member acknowledges that the Company has not made any representation or warranty, either express or implied, to Member regarding the Company, the Interest or the investment in the Interests.

**THE MEMBERS HAVE EXECUTED THIS OPERATING AGREEMENT AS
OF THE DAY AND YEAR WRITTEN ABOVE.**

**Maria
Sister**

Signature: _____

**Jema
Sister**

Signature: _____

**Margo
Friend**

Signature: _____

**Juliet
Friend**

Signature: _____



Note: Both Margo and Juliet need to sign the operating agreement when they come on.

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EXHIBIT A:

[The Articles of Organization]

EXHIBIT B: Member Capital Contributions

Based on our story of Sun Sisters Farm, LLC, the following is what Appendix B would look like at the outset.

Name & Contact Info	Initial Capital Contribution	Percentage Interest
Marie Sister 33 Appleview Ln Madison, WI marie@susnsister.com	\$45,000 farm property	45%
Jema Sister 44 Creekside St Madison, WI jema@susnsister.com	\$30,000 cash	30%
Ingrid Sister 55 Suncircle Rd Madison, WI ingrid@susnsister.com	\$25,000 services	25%
Total	\$100,000	100%

EXHIBIT B: Member Capital Contributions - Amendment 1

The following is what Appendix B would look like once Margo Friend is brought on as a Member:

Name & Contact Info	Initial Capital Contribution	Percentage Interest
Marie Sister 33 Appleview Ln Madison, WI marie@susnsister.com	\$45,000 farm property	40.9%
Jema Sister 44 Creekside St Madison, WI jema@susnsister.com	\$30,000 cash	27.3%
Ingrid Sister 55 Suncircle Rd Madison, WI ingrid@susnsister.com	\$25,000 services	22.7%
Margo Friend 66 Crabtree St Madison, WI margo@susnsister.com	\$10,000 cash	9.1%
Total	\$110,000	100%

EXHIBIT B: Member Capital Contributions - Amendment 2

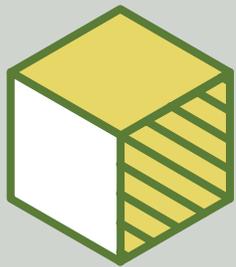
The following is what Appendix B would look like once Marie Leaves, Jema buys her per rata share of Marie's interest, and Juliet buys Marie's remaining interest but is not brought on as a member so has no voting rights

Name & Contact Info	Initial Capital Contribution	Percentage Interest
Jema Sister 44 Creekside St Madison, WI jema@susnsister.com	\$30,000 cash \$27,600 cash	46%
Ingrid Sister 55 Suncircle Rd Madison, WI ingrid@susnsister.com	\$25,000 services	20%
Margo Friend 66 Crabtree St Madison, WI margo@susnsister.com	\$10,000 cash	8%
Juliet Friend 33 Applevue Ln Madison, WI juliet@susnsister.com	\$45,000 cash	26% *Non-Voting
Total	\$110,000	100%

APPENDIX C

This would include the following for Ingrid and Margo as the managers:

- the job description outlining the roles and responsibilities
- employment agreements, and
- details of compensation package.



Sample Annual Member Meeting Minutes with Annotations

ANNUAL MEMBERS MEETING MINUTES FOR SUN SISTERS FARM, LLC¹

The annual meeting of this limited liability company was held on on February 11, 2018 at 2:00 P.M. at the Sun Sisters Farm, LLC. office, in Wisconsin.²



¹ Annual member meetings are not required by most state LLC statutes.

However, if the LLC chooses to elect S corporation tax status it must hold annual meetings. The IRS requires all S corporations, whether organized as an LLC or C corporation, to hold meetings to ensure a layer of accountability in the operation of the company. These meeting minutes are included as a sample should you choose to hold annual member meetings, regardless of whether you elect S corporation tax status for your farm operation LLC.

²The place, time, and date information needs to be in line with whatever is specified, if anything, in the LLCs operating agreement for holding annual meetings. For Sun Sisters Farm, LLC, the operating agreement does not specify an exact time or place. Your operating agreement could be more precise, such as specifying an exact month or the the third Thursday of February for when annual meetings take place. If so, be sure that you follow what your operating agreement says and report it in your minutes.

The following members and/or managers were present at this annual meeting with the represented percentage interest:

- Marie Sister, member: 40.9%
- Jema Sister, member: 27.3%
- Ingrid Sister, member/manager: 22.7%
- Margo Friend, member/manager: 9.1%

Marie was designated as chairperson and Jema was designated as secretary for the purpose of the meeting. the Uncultivated Areas after [JUNE 1].³



³ It can be helpful to designate a chairperson and secretary of the meeting. The chairperson basically makes sure that the meeting agenda is followed and keeps the discussion on track. The secretary is responsible for taking minutes and keeping them in the LLC book for reference should an issue or dispute arise.

The chairperson announced that the meeting was called by the members of the limited liability company and determined that a quorum was present.⁴

The minutes from the previous meeting were distributed. The complete LLC book was made available to inspect the articles of organization and any amendments, the operating agreement, the member's capital contributions and percentage interest breakdown, all meeting minutes, and a current print out of the articles of organization filed with the state agency, showing what the records currently look like on that state agency's database. All members that were present read the previous meeting's minutes and



⁴ If you include provisions in your operating agreement requiring an annual meeting, they should specify what a quorum is, or how many members need to be present for a vote to take place. A quorum will depend on the voting basis set forth in your operating agreement. For example, if voting is based on the percentage interest breakdown, a quorum will typically be member(s) representing a majority of the percentage interest in the company. If the voting is instead based on the number of members (i.e. one member one vote), the quorum would be a majority of the number of members. Either way, by requiring a quorum at the annual member meeting ensures that if there's a vote on an issue that requires a "majority" (i.e. percentage interest or number of members, it can effectively take place.

⁵ It's advisable to make the entire LLC book as described here available, as this shows the transparency of the company's official status and records. In other words, it helps guarantee that no member is wrongly being subverted or pushed out and shows to all the members that the LLC is up to date so to speak. Including a statement about it in the minutes is good practice.

inspected any LLC records if they wanted to.⁵

The annual financial report from the previous ending year was presented that stated the LLC had a net profit of \$10,000. Upon a motion made and carried, the annual financial report was approved, attached to the minutes of the LLC.⁶

Ingrid made a motion and Margo seconded the motion to vote on the distribution of the net profit.⁷

Ingrid, Margo, and Jema voted in favor of the motion, together carrying a majority in favor of a distribution as required by the operating agreement.⁸ It was decided that the net profit would be distributed in the following manner based on percentage interests:

Member name:	Distribution amount:
• Marie Sister	\$4,090
• Jema Sister	\$2,730
• Ingrid Sister	\$2,270



⁶ If any reports are presented at the meeting, be sure to attach them to the minutes. Again, this serves to track what information was presented in case a dispute arises. Reviewing the financial performance annually can be a helpful exercise. Doing this at an annual meeting ensures that all members have the opportunity to review it together, ask for clarifications as need, discuss any issues, and suggest tips financial improvement.

⁷ “Making a motion” and “seconding the motion” is a custom formality in corporate meetings. Surely you’ve seen it in the movies. Basically, any official action or vote that is to be taken at a meeting requires at least two people to agree. The first “moves” or “makes a motion” for the vote and the second person “seconds” the motion. Then the vote can take place. This helps assure that only relevant and significant matters go to a vote.

⁸ This is certainly a matter that may come up in the annual meeting, as the decision whether to distribute the year’s profits, if any, will come up annually. Here, Article 3.2 of the Sun Sisters Farm, LLC Operating Agreement requires approval by a majority of percentage interest before profits are distributed to members. Marie feels like they should keep the money in the business so she votes against it. However, Jema, Ingrid, and Margo together have a majority of the percentage interest. So it’s decided the \$10,000 profits are distributed amongst the four members based on the percentage interest breakdown.

- Margo Friend \$910

The following people were named as the managers of the LLC for the next year. ⁹

Ingrid Sister

Margo Friend

Upon motion made and carried by the members, the manager's salaries were fixed at the following rates until another meeting:¹⁰

Ingrid Sister \$20,000



⁹ Another issue that can be addressed at the annual meeting is the appointment of managers. Here, Ingrid and Margo, who both were already serving as managers, were again named to continue in their posts. However, if for whatever reason there needed to be a switch in who served as manager(s), the annual meeting would be a great time and place to discuss and vote on the matter..

¹⁰ The salary of managers may go up or down each year. The annual meeting is a perfect place to discuss it, particular because the financial matters were just reviewed by all members. Note that if the issue of raising or reducing salaries goes to vote, Ingrid may not vote on her own salary and Margo may not vote on her own salary. This would raise a conflict of interest, and be highly suspect in the eyes of the IRS and the courts should an issue or dispute arise regarding financial matters of the company.

Margo Friend \$20,000

Upon motion made and carried, the members decide that the next annual meeting shall be held on February 12, 2019.

Since there was no further business to come before the meeting, upon a motion by Jema and carried, the meeting was adjourned.¹¹



¹¹ If there is no further business discussed, the meeting can be adjourned. Again, customarily, this official action requires two people to agree by making a motion and seconding the motion.

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RACHEL
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