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22 min read time

# Cooperative Land Purchasing and Financing Guide: Raising Money in Community

Business Structures, Crowdfunding, Raising Equity,  
and Tax Implications

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# Introduction

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In the companion guide Cooperative Land Purchasing and Financing Guide: FSA Farm Ownership Loans, we addressed how groups of people who aren't related or married can apply for FSA farm ownership loans. There are several limitations to that financing source; for example, all members/owners of the farm must meet the FSA's criteria, including citizenship and creditworthiness requirements, among others. Many groups can structure themselves and their membership to meet FSA regulations. However, some of your co-owners might not meet FSA criteria, requiring your business to seek alternative funding. The truth is that all financing institutions will be of limited use for groups of unrelated people who want to finance the purchase of farmland.

Financing institutions don't prioritize creativity and inclusivity with their financing strategies. Instead, they prioritize the ability to cleanly and quickly exit a bad investment if things go wrong. A clean and quick exit is most efficiently achieved with a **single** borrower, owner, and business. Those who need to pool money to afford access to land find themselves without access to financing solutions. Others affirmatively seek opportunities to work and manage land collectively in an effort to redefine relationships with our community and with the land itself. This creative urge can be all too quickly snuffed out when interacting with financial institutions.

What can we do about this?

Here in this guide, we will be looking at various strategies that may appeal to people interested in collective land purchasing.

First, just like the financial institution that wants to be able to offload a bad investment easily, any farmer contemplating entering a business or land deal with a group of other people will need a strong exit plan in case things go wrong. How do you protect your own interests when you join forces with others? In this section, we'll discuss typical ways

business owners strategize to leave businesses or, for those remaining, how they protect the business. We'll also share some legal strategies for supporting buy-outs of departing members and the continued existence of the collective.

Second, we will talk about the legal and tax implications of raising capital. If you raise money from your community, how is that money taxed? Where is it reported? Are there restrictions on how much you can raise? We will discuss the basics of crowdfunding and new options that have developed recently. We'll also share resources for private businesses that want grants, new forms of crowdsourced funding, and the pros and cons of doing this as a for-profit business and as a non-profit organization. We'll briefly delve into various forms of nonprofit entities that can hold land with less restriction than a typical 501(c)3 organization.

# Designing an Exit Strategy

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People working together as part of a farming operation and/or on a piece of land they manage together *should* have a *written* agreement on how they will work together. These agreements are often called *governance documents*, covering questions about who makes decisions and in what way. Who has access to the bank account? Who can sign on behalf of all of us, and the one we're going to talk about in more depth now—*how does a person get out of this agreement if it no longer serves their needs?*

Lawyers often warn about the difficult 'Ds' in business partnerships. The words that start with 'd' that you need to know how to deal with are death, disability, default, disinterest, disagreement, and divorce. So many bad things can happen when you are working with others! A business partner could die unexpectedly, get hurt and unable to work, become deeply in debt, slowly become more interested in a different career, develop a vision for the business that is not aligned with other members, or get divorced and need to reshuffle their life. Any of these things could very easily lead a member of a business to either be pushed out or decide to leave the business.

Exiting a business and exiting shared ownership of land are two different beasts. We will deal with governance documents and exit plans first before turning toward how business changes might impact the ownership of land.

## The Cost of a Business Exit: Valuation & Financial Planning

In an ideal world, if a business owner wanted to leave a shared business, there would be a reserve of funds available to repurchase the departing owner's share. Additionally, there would be an easy, fair way to establish the value of the company so that the departing owner's share could be easily calculated without any contention. For many small businesses, either one or both of these circumstances are absent when a business partner needs or wants to depart the business.

Typically, the most contentious aspect of a transfer of business ownership is the value of a person's stake in the company, which relies on the value of the company itself. One common and straightforward formula for determining the value of a business is to assign a fair market value to all of the company's assets and subtract any liabilities the company has. This is often called asset-based valuation.

However, a company can have intangible assets as well. A business can have value based on its reputation in the community. Are there annual profits? If so, the value of the business will increase. However, if the company is operating with no or negative profits, the value of the business would decrease. Businesses with reputation-based value typically have been around for a long time and have strong brand recognition. Departing members in the early phases of a business are less likely to get any compensation for their efforts to build the company's reputation.

A governance document should choose a formula for valuing the business before the business gets off the ground. This way, there isn't a scramble to come to a consensus at the point when someone is anxious to leave the company quickly.

There are many valuation techniques to choose from, and they vary in complexity. Some formulas may incorporate the sales price of similar businesses in your area, a projection of future earnings, or how much has been invested into the business by owners and stakeholders. It can be difficult to use peer-based analysis for small farms as many don't get sold, and even if they do, the information on those sales is difficult to obtain. Formulas based on income and projections of what income may be in the future are based on a lot of assumptions and require a stable income to work. And finally, the amount of investments into the farm will likely, for the first decade of the farm's existence, be skewed when compared to the accruing profits. It is likely that no single formula will work perfectly for a small farm business. Nonetheless, mathematical formulas can make what promises to be somewhat of an emotional process a little more objective. Having a third-party professional who understands accounting will be immensely beneficial as well.

Farmers already working with an accountant should ask that professional for advice on a valuation formula. Another resource is the federal Small Business Administration, which runs a network of free small business mentors through their SCORE Business mentoring. These mentorship programs are available nationwide (or meetings can be virtual). Though the executives that staff the SCORE program will likely not be versed in the economics of

agriculture, they will be experienced in valuing businesses and providing general small business advice.

Some valuation formulas are favored by people looking to buy into the business (this person would likely be looking for a lower valuation) or those exiting the business (would want a higher valuation). Choosing a valuation method at the outset of the business formation will decrease potential conflict when one partner needs to exit. Some experts suggest using multiple methods to establish the business value to see the range of possible values. Those outcomes can then be averaged unless one method is clearly more suitable for the farm's circumstances.

Valuing the business is an important step, but it is only one part of the cost of a business exit. What about the actual funds to support a transfer in ownership? The money to support the transition has to come from somewhere.

One option when a business partner is leaving voluntarily is to negotiate a "buy-out" price. This will vary greatly from business to business depending on the length of the exiting member's time in the business, the business' stability, the departing farmer's investments into the business, and the business valuation. The buy-out cost will need to come from the business' savings or by having a new business partner "buy in" to the business. The investment required to "buy in" to the business can be used to pay the departing business owner their share.

If an existing business partner is negotiating for a "buy-out," the length of time that they must be paid back must also be negotiated. Many small businesses with low cash flow will want low payments for a long time in order to manage the "buy-out." This method might allow the business to stay afloat, but will be less than ideal for the departing member.

There is a danger that one business partner leaving the business will force the sale of business assets in order to buy the departing member out of the business. Negotiations will need to consider how the business can fare under the pressure of paying for a departing member. On the other hand, business partners who never made capital contributions to the business and are leaving while the business is still getting established will not have a strong argument for a sizable buy-out.

A strong business exit plan would include budgeting or saving for a transfer of ownership. To ward off the risk of losing a business partner to death, Businesses can also purchase life

insurance policies for business owners. If the business is the beneficiary and pays the premiums, the death benefits received would be tax-free. These benefits can then be used to fund a buyout or keep the business running in the face of losing an income earner.

## Governance Document Protections

A resilient governance document will include agreements on how to transfer business interests and will do so in a way that protects the business against unwanted transfers. Businesses will want to protect against having a section on transfers of business interests to protect the business against unwanted sales of ownership interests. To illustrate one possible governance document structure, we will look at how a limited liability company's Operating Agreement could structure transfers.

Generally, an Operating Agreement will have an entire section dedicated to transfers. Not all transfers will be equal, though. Some transfers will occur because of voluntary withdrawals, others will be agreed upon, but there are some that will be limited in their effectiveness. There are protective mechanisms added to these Operating Agreements that keep unwanted transfers from changing the direction of the business. These mechanisms can include an agreement that no member can leave and simply demand immediate repayment of their capital contribution, limiting voting rights on incoming members, and rights of first refusal, which would allow members who are staying the right to purchase the outgoing member's share before it is sold to a stranger.

Voluntary withdrawals need to be limited so that they don't force a business to liquidate in order to compensate an outgoing member. An important clause in an Operating Agreement would be one that could, for example, say:

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.

Without a provision like this, many state laws would allow an LLC member to withdraw from the LLC upon giving notice to the members and require that the withdrawing member get their capital contribution back. This, of course, could become 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. Instead of a guaranteed right to withdraw,

members operating under an agreement with this clause would have to agree on the terms of their withdrawal, including when and how a withdrawing person is to be paid out for their percentage interest.

There may be times when a departing business member is going to be replaced with an incoming member. Operating Agreements that are protective of the business may include a clause that limits when and how that incoming member can get full membership rights, such as this one:

“The transferee shall not be admitted as a Member unless approved by unanimous consent of the Members who are not transferring their Interests.”

This protects against outgoing members selling their business share to someone who will not work well with the remaining business partners.

Often, how membership rights are controlled is through the extension or retention of voting rights. If someone who is transferring into the business is approved unanimously (or by whatever method the members decide) to become a Member, then they get all benefits of membership—rights to distribution of a share of the profits and a right to vote on business decisions. If the new member hasn't been properly approved, then they only have the right to get distributions and not vote. Without rights to vote, there is no say in when distributions are given, or otherwise in other management decisions. This division of financial and voting rights makes partial membership much less appealing, and so allows the members who are staying a degree of control over the ongoing management of the business.

Another common legal protection for management changes is the right of first refusal. These clauses require that before any member sells their share, they must first present the terms of the proposed sale to the other Members of the business and give them a timeframe in which they must decide to purchase the share or pass on the opportunity. Of course, in order to take advantage of this protection, the Members who are staying must be able to pay for the share that the outgoing member wants to sell.

# Raising Money as a For-Profit Business

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As a for-profit business, you can raise money, get loans, and get grants to support your business.

## Crowdfunding for For-Profit Businesses, Generally

Crowdfunding is a money-raising strategy that emerged in the mid-2000s and continues to grow in popularity. Laws and technologies have shifted since the early 2000s, allowing for more flexibility for small businesses needing to raise funds this way. The riskiest aspect of crowdfunding is unintentionally running afoul of securities laws.

First, let's establish what crowdfunding is— a fundraising strategy that relies on relatively small amounts of money coming from a large number of investors. The advent of the internet made this strategy viable on a large scale, though farmers have been doing a community-based version of this type of fundraising for a long time. Currently, some companies provide easy internet-based online platforms that streamline the crowdfunding process, Kickstarter likely being the most well-known. Some, like Barnraiser, are specifically geared toward farmers and food entrepreneurs.

But what about the risk of securities law infringement? When a business raises money and promises to repay that money **if** the business is successful, then the business is technically doing more than “fundraising.” In a legal sense, they are selling a ‘security’ to a buyer. The product is a conditional promise to repay the money invested, dependent on the business’ potential future profits. Selling securities is a highly regulated field that most farmers will want to avoid.

Fundraising with a promise to repay if the business is successful is highly regulated because it creates a lot of opportunities for fraud and deception. Can a funder trust the business person to make good-faith efforts to make the business successful? Is the business model

strong? How sophisticated must investors be to adequately assess the quality of the business model?

These questions are difficult to answer, so the government (both on the federal and state levels) steps in to regulate the sale of securities or investment activity. The two central ways securities are regulated are by requiring (1) that people who invest capital in businesses be what are called *accredited investors*, essentially high net-worth folks who are assumed to be investment-savvy, and (2) that businesses who solicit funds for their business be registered with government agencies (and comply with copious paperwork).

These laws make it nearly impossible for small businesses to participate in the investor market. Registration with the appropriate governmental agencies is not only cost-prohibitive for small businesses but also nearly administratively impossible. There is too much paperwork, and professionals are required to comply with a maze of rules precisely. And on top of that, local businesses like farms aren't likely to attract high-net-worth individuals who are experienced in the investment field and meet the '*accredited investor*' standard.

## Rewards-Based and Pre-Purchase Crowdfunding

The risk of security law infringement left the only option early in the internet's days to be either rewards-based or pre-purchase crowdfunding. These are fundraising techniques where money is raised for a product that will be delivered later in time. There is a delay between payment and delivery of the product. However, funders aren't buying a stake in the business or a potential return on their investment if the business is managed well. Instead, in this model, the funders are buying an actual product, albeit on a delayed schedule.

In pre-purchase crowdfunding, the funder eventually receives the product they are helping to get off the ground. For example, a farmer could raise money to start a line of value-added products. In exchange for \$10 on a crowdfunding platform, each funder receives one of the first produced jars of jam once the operation has been funded, built, and is in operation. Community Supported Agriculture is a classic pre-purchase crowdfunding strategy familiar to farmers. Alternatively, in rewards-based crowdfunding, the funders receive an experience related to the overall project. This could be, for example, a farm tour or a chef-made dinner on the farm.

These two crowdfunding types will rarely fall into the securities arena and are, therefore, less legally risky. However, that doesn't mean these strategies are without risk. Be sure to consult the section below on income tax, as any income raised in this manner will impact your business income and, therefore, your tax liability for the year. If you are fundraising in this way, you should strongly consider creating a business structure that provides limited liability protection—protecting your personal assets from any business debts.

Any farm fundraising with these strategies must carefully manage their funders' expectations. Even if the crowdfunding campaign goes perfectly from the perspective of the business owner, you still have relationships with every person who gave money upfront. Is the product they eventually receive what they expected? Were you clear in your communications about expected deadlines, any delays, and the nature of the final product they were to receive? Be aware, too, that there are governmental agencies that regulate advertising and advocate for consumers. Overpromising or misleading funders can lead to action by these agencies against your business.

Of course, failure of the project could also lead to legal trouble. Most online platforms that support this type of fundraising require that if the monetary goals aren't met, any money that was raised must be returned. Furthermore, they require that if you cannot provide the product or reward you promised, you must return the money you raised. In some cases, failure occurs after the money has been spent, and the business must then still repay the funds. Without clear recordkeeping and a reserve of funds, businesses can face lawsuits and high debt levels.

Rewards-based or pre-purchase crowdfunding should also clearly distinguish itself from what we will talk about next: equity-based crowdfunding. When soliciting funders for rewards-based or pre-purchase campaigns, businesses should be careful not to describe the contributions as "investments" or funders as "investors." Funders should be told clearly that they will not be receiving a stake or equity in the business in exchange for their contribution.

## Selling Equity in Your Business

Typically, whenever you sell a portion of the business to a person who will not be involved in the operations and decision-making process of that business, you are selling a security and have to deal with the onerous federal regulations that come with that territory.

Therefore, selling people a percentage, share, or stake in your company in exchange for a share of the profits down the road is selling a security. Selling stocks of a corporation is, by definition, selling a security. There are a few exemptions, and both state and federal law must be consulted.

## LLC Active Memberships - Are These Securities?

Federally, and in most states, the sale of an active LLC membership in a member-managed LLC will not be a security. This is when a member “buys in” to the company. If that member becomes an active member of the company with voting rights, then that transaction isn’t considered a security. In the context of a farm, members can contribute funds and have voting power without triggering securities law, even if they don’t do the physical labor on the farm. However, a person who invests in the business expecting an eventual return but who has no power to steer the company is the type of person securities laws were designed to protect. In this way, active members can make investments in the company and enjoy those returns later, but ‘silent’ partners are those that trigger greater regulations. Be sure to check your state laws on this, as the exemptions can change from state to state.

## Equity Crowdfunding

In 2016, federal rules were released that opened up options for small businesses to participate in the investor market. What is known as the CROWDFUND Act opened up an avenue for investors who aren’t accredited to be able to help fund ‘emerging businesses’ and for businesses that aren’t registered to solicit investors. Of course, though, there are a lot of limitations and caveats to what is now possible.

First and foremost, businesses cannot go directly to the public. Equity-based fundraising campaigns must be run through an intermediary registered with the appropriate state and federal agencies. These intermediaries could be the type created by the CROWDFUND Act, the funding portal. Or, the intermediary could be a traditional broker-dealer. Funding portals are more accessible but are also more limited in what they can do. Broker-dealers are more heavily regulated and can, therefore, participate in more of the investment process than funding portals can. For example, broker-dealers can offer investment advice and recommendations, whereas funding portals cannot.

Under the CROWDFUND Act, the business itself doesn't have to register with federal agencies, but the intermediaries do. All funding portals are also required to be a member of the Financial Industry Regulatory Authority (FINRA), which is helpful because they maintain a list of all registered funding portals [here](#).

There are other restrictions to equity-based crowdfunding other than having to work with an intermediary. These solicitations must be conducted online. Campaigns cannot go on longer than 12 months and cannot raise more than \$5 million. Furthermore, investors are limited on how much they can individually contribute based on their income or net worth. Businesses must still provide a fair amount of information to the intermediary with whom they are working, though businesses that gross less than \$500,000 do not have to provide audited financial statements.

The CROWDFUND Act created optimism that small and local businesses would be able to raise funds in exchange for business equity and have access to investors. However, the changes are less than a decade old, which isn't much time in the legal world. Generally, equity-based crowdfunding is still considered overly restrictive and expensive for small companies. However, the rise of funding portals as an option did help create several investment companies with environmental and even agricultural concerns front and center. NetGreen is one example of a farming-specific funding portal. With time, these services may become more accessible, consistent, and viable for small, local food-based businesses.

## Grants & Loans for your For-Profit Business

### Federal Programs

There are several federal programs for farm business grants or cost-shares that can drastically reduce specific costs. While these grants can be helpful, especially if there is a new practice or new infrastructure you want to add to your farm, they aren't a sustainable strategy to capitalize or fund your farming venture. Most will not allow funds to be used to start a farm but only to deepen or innovate certain farming practices.

The USDA has resources specific to small and midsize producers that can be found here detailing what access to capital they are able to provide, as well as cost shares for land management, conservation practices, and risk management.

The Sustainable Agriculture Research Foundation has regional offices that issue grants for farmers and ranchers to do research on-farm or implement new practices. The National Young Farmers Coalition has a grant program, as does Food Animal Concerns Trust (FACT). There are many other regional options for grants for small and mid-sized farms. Connect with non-profits and universities in your area that support farmers and ask about grant opportunities.

If you want to apply for grants, do know that the applications can be burdensome, and they will likely require references letters. And, after grants are received, there will be reporting requirements attached to the funding.

## Tax Implications of Income from Crowdfunding and Grants

If you and your business partners are able to raise funds in any of the ways discussed above—via crowdfunding or grants—bravo! Access to capital is a huge barrier to farming, and you should congratulate yourself on your creativity and perseverance. There is always a 'but,' though! In this case, the 'but' is that the government still wants its cut. Money raised via grants or crowdfunding is, in fact, business income. And what, you might ask, is the consequence of that? The business's income tax liability!

This is not a problem, but it is an accounting issue. The IRS defines gross income as *all* income, no matter the source from which it is derived. Unless there is a specific exclusion, any taxpayer receiving something of value is subject to taxation. For-profit businesses will not have exclusions for income of this type. The budget for the project and the projections for how much should be raised should take into consideration the tax burden that will arise from the additional income. Alternatively, the business can plan the fundraising campaign and expenditures in such a way that the money earned through fundraising is spent during the same year it was raised. If your business raises more than \$600/year, a Form 1099K will need to be filed to report the income.

## Untraditional Loans for Your For-Profit Business

Private or personal loans can also help support farm businesses. These are potentially coming from family and friends who want to help you start your operation but do not want to gift you the money. Typically, this looks like getting the money with a written agreement stating you promise to pay the money back, usually with interest.

The key in these situations is coming to a consensus on the agreement and making sure it is written down. There are so many things to talk about! For the sake of clarity and everyone's memory, everything should be written down and signed. A promissory note is the typical legal document that controls transactions such as these. Making the agreement professional and using promissory notes as templates for your own agreement will cut down on the risk of the IRS considering the loan a gift (see below for considerations regarding gifts).

The written agreement should detail the interest rate and the schedule for repayments. When do repayments begin? How are those payments expected? How are the principal and interest allocated between payments? Is there an early payoff penalty? What happens if a payment is missed? Can the responsibility for paying the loan off be transferred?

Family and friends are often willing to loan money at below-market interest rates. Be aware, however, that the IRS may treat overly low interest rates as a gift to the loan recipient, which can then count toward the lender's annual tax-free gift maximum (see gift section below). A good rule of thumb is to track the current interest rate on a savings account, or a Certificate of Deposit is for a low-interest rate that wouldn't be at risk of being considered a gift.

A family member or friend may be less stringent than a traditional lender when dealing with repayment. Even so, the business does need to expect to make payments that will repay the loan within the allotted time frame.

# Tax Implications of Income from Gifts

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Your business can accept gifts of cash or tangible property, such as equipment or land.

A small legal technicality might be helpful here to avoid confusion about what is meant by the term *gift*. Gifts are, legally, the transfer of cash or property between individuals or from one individual to an organization with no expectation of anything in return. *Donations*, on the other hand, refer to the transfer of money or things to a qualified charitable organization. Donations could be the same tangible object as a gift—cash, equipment, land, or other property—but a donation is tax deductible for the person making that donation. The value of gifts is not tax deductible. In fact, if the value of the gift is high, the person making the gift could actually *incur* a tax obligation.

There may be little practical distinction between gifts and donations as almost 90% of taxpayers who give money claim the standard deduction rather than rely on a compilation of their charitable donations for the year in order to get a tax break. Furthermore, the gift tax will not impact modest gifts because the value of the gift must soar above \$15,000 before the person making the gift needs to be concerned about having to contend with the gift tax. However, there will be people who are interested in gifting businesses money but who are only interested in making tax-deductible contributions. And, there will be others who want to gift things of such high value that the gift tax will come into play.

The business' responsibility as far as these tax issues go is just clear communication. Organizations that are considered qualified charitable organizations must register with a state agency before they solicit the public for donations. Nonprofit organizations go through an extensive application process with the IRS before being able to operate. In short, businesses that accept gifts must make it clear that they are not nonprofit organizations and that no gift will provide supporters any tax-deductible benefit.

Communications with gift-givers should also clearly establish that the gift is not in exchange for *anything* at all. This is to protect the business from having to pay income tax on the gift's value for that year. To firmly document the gift as such, a letter explaining that the

money is a gift is all that is needed. Both parties should keep a copy of the letter explaining the nature of the value transferred in case it is needed for tax purposes.

The gift giver is at risk of a much higher tax bill depending on the value of the gift. As stated above, the value has to be above \$15,000 to qualify for the gift tax (the exact amount changes annually; check the IRS website for up-to-date rates). If the gift does exceed the threshold, the giver is required to file a gift tax return stating the amount they gave. That year, they could face a large tax bill, up to 40% of the value. Furthermore, any amount given over the annual threshold is applied to a lifetime giving limit, which changes annually as well.

Farm Commons' mission is to empower communities to resolve their own legal vulnerabilities, within an ecosystem of support.

Find legal workshops, timely resources, and a community for farmers, ranchers, and their service providers online at [farmcommons.org](https://farmcommons.org).



This research was supported by the intramural research program of the U.S. Department of Agriculture, National Institute of Food and Agriculture, American Rescue Plan Technical Assistant Investment Program, project #2023 70417 39228 in partnership with Viva Farms.

The findings and conclusions in this preliminary publication have not been formally disseminated by the U. S. Department of Agriculture and should not be construed to represent any agency determination or policy.



# INVESTING IN AMERICA



National Institute of Food and Agriculture  
U.S. DEPARTMENT OF AGRICULTURE