SUGGESTIONS ON
FATHER AND SON
FARMING AGREEMENTS

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SUGGESTIONS ON FATHER AND SON FARMING AGREEMENTS*

by

JEROME E. JOHNSON

This report emphasizes the father and son farm operating partnership. It will help fathers and sons evaluate alternative provisions of a farm operating partnership and discuss the parts of a father-son partnership before visiting an attorney. Few fathers and sons are sufficiently familiar with the legal procedures to write the father-son partnership form itself.

The partnership form of business organization is a very flexible tool. It is the simplest form of business venture of two or more persons. It is easy to create, yet it is a unique interweaving of financial, legal, business, and personal relationships. It is somewhat like the family farm which embodies the many relationships of the family, the home, the farm, and the farm business. A decision in one affects the others in many possible ways. Each partner enters assuming certain duties, rewards, and risks.

This report discusses two basic kinds of father-son partnerships: farm operating partnerships and farm operating and land ownerships. The operating partnership concerns itself with the annual business of operating a farm, renting the land from various land owners. The father-son farm operating and land ownership partnership deals with both operating a farm business and owning farm land together within the partnership. Both types of farm partnerships may be organized as either the 50-50 or equal sharing partnership or the unequal or proportional sharing partnership. In the 50-50 or equal sharing partnership, each partner contributes equal labor and farm personal property to the operating partnership and labor, operating capital and equipment and land equally to the farm operating and land ownerships partners. In the unequal partnerships the son contributes mostly labor and management skills, while the father contributes the similar labor and management skills plus all the operating capital in the operating partnership and in addition, contributes the land in the farm operating and land ownership partnership.

This report does not discuss such father-son agreements as project agreements in 4-H Club or FFA projects, or enterprise agreements which are similar to project agreements. It does present a brief discussion of employment contracts, such as wage and wage-income sharing agreements, but the major emphasis is on the partnership agreement. The partnership agreement will be presented in two formats: that of the farm operating partnership and of the farm operating and land ownership partnerships.

Stages and Goals in Father-Son Agreements

Three stages in father-son farming agreements can be recognized which mark or identify different goals and relationships: the beginning or preparation stage; the established, and ongoing stage; and the father's retirement stages.

In the beginning or preparation stage, the son is out of high school, college, or military service and is considering farming as an occupation. He lacks managerial and financial skills and capital to get started on his own. The son needs the chance to make decisions and take responsibility for errors in judgment in running a project or the farm. The son could be offered a wage or guaranteed wage plus a share of the year-end net farm income. His share of the income may not be large enough since labor is his only input, but that share can be important to him as an incentive. The father and son need to examine the size of the farm business and the relationships of one to the other to determine if they can operate a partnership together. The father and the son in this stage may evaluate each other, discuss the adjustments needed, and their chances for a successful father-son farming arrangement.

The father and son may decide that they can succeed in establishing and operating a partnership. They may seek information from their county agent and from other fathers and sons who are successfully operating partnerships. They may discuss the need to expand the farm business or intensify it so that an adequate income is generated for the two families involved. They may

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continue to examine various provisions to put in a written partnership and each select an attorney and other counsel to help them establish the partnership.

The established partnership stage involves a written partnership agreement has been agreed upon, formulated, and signed by the father and son(s). They have entered the partnership as full, equal partners. It is an ongoing partnership where the son is recognized by others as a full partner with his father. He is a partner in decision making (i.e., in the management of the farm business), as well as in the capital and labor contributions.

It is recommended that the father and son establish an equal sharing farm operating partnership. The son would have purchased one-half of the farm personal property—machinery, breeding stock, and etc.—so that the father and son each contribute about equal share of the labor, management, and capital and treat each other as equals. The farm operating partnership probably rents the land it operates from the father and son as needed. At the year end, the net partnership income can be split 50-50 which greatly simplifies partnership accounting procedures. However, the father and son could establish a proportional partnership instead of an equal sharing partnership where the son only contributes labor and management and receives a relatively small portion of the net partnership income.

The father and son may later establish a farm operating and land ownership partnership. The son would purchase one-half of the farm personal property and one-half of the land owned by the father (plus the partnership may rent more land that is needed). This involves a substantial investment by the son and it is usually recommended that this farm operating and land ownership partnership should only be established after the father and son have operated a farm operating partnership together for, say, five to ten years.

The father’s retirement stage starts when the father wants to take it easier and/or devote more of his time and energy to other things. He may want to be less active in the farm partnership business by contributing less labor and probably less management and let his son and family be more responsible for the management and operation of the farm. The net operating partnership at the end of the year should be divided on the basis of the proportion of the labor and management each partner actually contributed during the year with the son now receiving a larger share.

The retirement stage can be extended gradually over several years or can be a sudden adjustment. The partnership may be terminated when the father retires because of his total withdrawal and his son’s purchase of all of the assets used in the farm business.

Estate planning is a vital part of owning and managing farm assets. Fathers need to plan for both their retirement income and the transfer of the assets they control. Parents have responsibilities to their loved ones both in case one dies or for a loss of income due to accidents. The partnership may be a way that the father aids his son in acquiring the necessary management skills and assets to continue farming in the future. It may also assure that the farm remains or continues as a viable farm operating unit. The estate plan can help the parents determine who should receive what assets and when. It can be used as a plan which minimizes the costs of transferring assets while assuring that the plans of the parents are carried out upon their death. The estate plan may also involve judicious use of gifting, which can greatly reduce the amount of estate taxes liable upon the death of the parents.

The father-son farming arrangement has potential of being a valuable training device, providing the son an apprenticeship needed to succeed in modern-day farming. Initially the son may only offer two hands and the willingness to work. He can only acquire capital through earnings, or inheritance and farm management skills by doing. It is indeed a fortunate son whose father sees to it that his son makes every decision of an enterprise, each step in obtaining a farm loan, every decision in marketing a crop, and so forth, so that after a few years the father can entrust his son with the management of the entire farm operation. The son will need special help if he is to become a good farm manager—he needs the chance to make errors and to do everything in running the farm while the father must strive to control his urge not to do it for him. Father-son farming agreements serve many diverse goals which change with the passage of time and changing fortunes. Successful partnerships recognize and make it a point to regularly discuss possible changes (reduce father’s contribution to the farm partnership) with all concerned. It is well to see the problem from the eyes or views of the other partner whenever a difference arises.

**TYPES OF FATHER-SON LEGAL RELATIONSHIPS**

Three types of father-son legal relationships
may be considered: (a) employer-employee, (b) landlord-tenant, (c) partner-partner. The first comes under the state labor contract law, the second under the farm tenancy laws, while the third is under the stricter general partnership laws.

Examples of the father-son farming agreements under the employer-employee relationships are wage and wage-income sharing agreements. The landlord-tenant relationship exists where the father leases the farm to the son. Leasing bulletins and information are available at your county extension agent's office. Three different partner-partner, father-son farming agreements are discussed here: (1) a father-son farming operating agreement with a 50-50 or equal sharing arrangement, (2) a father-son farm operating partnership with unequal shares, and (3) a father-son operating and land owning partnership.

**Father-Son Employer-Employee Agreements**

The father-son farming agreement of the employer-employee legal relationship can be either of the wage or wage-income sharing kinds. The son is generally paid the going community wages plus room and board. A share of the entire farm income can be paid as a bonus in addition to the wages, or his total annual wages can include a certain percentage of the total farm business. In the latter case, a year-end settlement is calculated where the son obtains a fixed percentage of the entire farm income and his accumulated monthly wages are subtracted from that total percentage share to determine his year-end bonus.

The wage agreement is adapted to situations where the son is young, relatively inexperienced, lacks capital, and may have not yet settled down. The son may be in college or temporarily working off the farm and may not be married. The wage agreement should be a temporary agreement during the beginning or evaluation and testing period while the son determines if he really wants his life work to be farming. Income share is an incentive to do good work and take an interest in the success of the farm business. If the father and son want to continue farming together it should be either via a farm lease or a partnership agreement in writing.

The father is the employer in any wage or wage income sharing plans. He operates the farm business in his name and contributes his labor and management and pays all farming expenses and receives all of the income. The son's wages, room and board, and income share are included in the farm expenses. The son's contributions are his labor and management skills.

The incentive plan can involve income sharing provisions paid as either year-end bonus or as a minimum guaranteed annual wage. The son is paid a monthly wage in the latter case. His share of income is determined at the end of the year. If the wages already paid are less than the calculated share of the income, the son is paid the difference. There is no payment if the accumulated wages already paid exceed the income share.

Some feel that where the son shares in the net farm returns, a net inventory is necessary. The son receives a share of the net farm returns where all farm receipts are calculated, plus or minus the change in inventory and less cash expenses, depreciation, and capital items. However, wages for labor contributed by the father and interest on investments owned by the father should not be considered as farm expenses.

The guaranteed wage, or fixed percentage of gross farm income or net farm income, can be calculated from Table 1, page 8, even though this is not a partnership. Table 1 presents the total farm income and expenses. The son could receive a fixed percentage of adjusted gross receipts. There may be no real need for written wage contracts, but an attorney can write one if it is desired.

**WHAT IS A PARTNERSHIP?**

The legal relationships of a partnership are different from those of the landlord-tenant or employer-employee situations. The Uniform Partnership Act states, "A partnership is an association of two or more persons to carry on as co-owners of a business from profit." The courts have used five guides to help them determine whether or not an agreement creates a legal partnership. These guides are:

1. **Partnership in Management.** The participation by both parties in management points strongly in the direction of a partnership.

2. **Sharing Profits.** A partnership exists when the profits are divided as profits. If the profits are paid as rent, or merely as pay for services rendered, the relationship is not considered a partnership.

3. **Sharing Losses.** An agreement to share losses points in the direction of a partnership.

4. **Owning the Assets Together.** This points toward a partnership, but there may be other co-owners of property (rented by the farm operators) who are not partners.

5. **Having a Firm Name, A Single Joint Bank Account, A Single Set of Farm Records.** These facts, along with a holding out of the farm business to the public as to indicate
a partnership, point in the direction of a partnership, but again these are not of themselves conclusive on the point.

Be aware of the far-reaching consequences of a partnership. Each partner in a firm partnership assumes the risk that he will be held personally responsible for (a) contracts made by the other partner in connection with the usual operation of a farm and (b) any careless or intentional wrongful acts committed by the other partner while acting in the ordinary course of the business.

The partnership itself does not pay income taxes. Instead, it files an informational tax return. Each partner pays federal and state income taxes on his respective part of the partnership income. Partners are required to pay social security taxes if their net earnings exceed $400. The partnership may own personal and real property in its name.

Avoiding A Partnership

If the father and son wish to farm together in some arrangement other than a partnership, they are well advised to use a written form. This form may involve a lease form which refers to one party as “landlord” and the other party as “tenant” or they may use a form specifying one as the “employer” and the other as “employee.” A lease agreement would provide for payment of rent to the father for use of the farm assets. The father as employer pays wages to the son for his managerial and labor services in an employer-employee agreement. Where the son is not sufficiently prepared to farm on his own, the father may employ him as an employee. The wage agreement in this case would specifically enumerate his son for his services with social security payments paid by the parties as required by law.

KEYS TO SUCCESSFUL PARTNERSHIPS

The partnership form of organizing a farm business appears to be simple and easy to set up however, it is really one of the most versatile, diverse, and complex forms available. Successful father-son partnerships depend on a number of key factors. A partnership means that new personal relationships, as well as business relationships, have been established. Some basic things important to successful father-son farming agreements include:

1. An adequate size or volume of farm business is essential. The net farm earnings must be large enough to satisfy all parties involved and their families. In addition, the size and volume of the business should be large enough to fully utilize the labor of all parties.

2. Getting along well together. It is necessary for the father and the son to get along well together, each being tolerant and understanding of each other’s good points and faults. They must seek to get along together. Equally important is the willingness of their wives to get along, and try viewing the situation from the eyes of the others who are concerned. An attitude of wanting to get along well together is an essential element in a successful farm partnership.

3. An agreement that is fair to each party is essential. It sets the tone for the whole partnership and does much to ease problematic situations. Sharing of expenses and income between father and son should be in proportion to what each contributes to the farm partnership business.

The profit-sharing agreements must be fair to all family members, including contributions of any children concerned. It is usually recommended that each partner share in the entire farm business, although some successful farm partnerships permit each partner to specialize in certain duties or farm enterprises.

4. A separate and satisfactory house for each family is important. The son may live with his parents until he marries but separate living facilities should be provided after marriage. Some father-son farming partnerships have added a second house or mobile home to the farm while others have one family living in town.

If the farm business is not profitable enough to provide separate housing for the families involved, it is questionable whether the farm is profitable enough to support more than one family. Separate housing is as important as adequate size of farm business to the success of farm father-son partnerships.

5. Good farm records are essential to determine how the income is to be shared, how the expenses are to be paid for income tax reporting, and for studying ways to increase farm earnings.
Good farm records are essential to good farm management. The son should be encouraged to maintain the farm records and to utilize the farm records to study ways to improve farm earnings. The son may be encouraged to cooperate with the county agent or similar specialist in interpreting and utilizing farm records as part of his training in becoming a more successful farm manager.

6. Agreements should be written to force the potential partners to think through and work out details of the agreement thoroughly, to provide a written record of their agreements on the many diverse points involved, and to provide a firm foundation on which to build a successful father-son farming agreement.

7. Agreements should be kept up-to-date, reflecting changing goals and circumstances with regular or annual amendments to the agreement which have been prepared with the assistance of an attorney. Make sure that the goals of the written partnership agreement and personal relationships are continually in agreement and known to all concerned. The partners and their families affected must be kept fully informed as goals shift, recognize that change is normal, and that it is easy to modify the written agreement to reflect the partner's new agreements. Use your legal counsel as another valuable resource to the management of the farm and the success of the father-son operating partnership.

EXAMINING THE TYPES OF PARTNERSHIPS

Farm partnerships can be of two basic kinds: farm operating partnerships and farm operating and land ownership partnerships. The latter includes owning both the land and the personal property in partnership, while the farm operating partnership is a partnership to operate the farm business only and not of owning any land.

Two basic types of farm operating partnerships can be identified based on the contributions of each partner. One is the 50-50 or equal sharing partnership, where each partner equally contributes labor and farm personal property to the partnership. The equal sharing partnership is based on an equal contribution to the farm business and equal sharing of the ownership of farm personal property, with the farmland rented from its owners.

Second, in the proportional sharing or unequal contributions farm operating partnership, where the partners contribute different shares of labor, management, and capital, but rent all of the land from the father and other landowners.

For an example of the proportional-sharing agreement, Tables 2A and 2B on page 9 present this illustration. Suppose the son only contributes labor and management, say $7,200 a year. The father also contributes $7,200 in labor, management, and pays the taxes, and owns $65,500 in farm personal property and $562,500 in farmland. For these basic items the father's contribution is at least $49,985. This consists of his labor of $7,200; $4,450 for real estate taxes and building depreciation; 7 percent on his personal property investment of $65,500; and 6 percent on his land investment of $562,500.

The total basic contributions to the farm partnership business is estimated at $57,185, as shown on Table 2A, page 9. The son contributed his labor and management input of $7,200 for the year. The father contributed approximately $49,985. Dividing the son's annual input of $7,200 by the total contributions of $57,185 shows that the son contributed about 13 percent of the total basic inputs used by the farm partnership business. In this example, the son contributes about 13 percent of the total farm annual inputs and the father 87 percent; and it is recommended that they share in all farm operating costs and returns in this same proportion.

CHARACTERISTICS OF FARM OPERATING PARTNERSHIPS

A. In the equal sharing of contributions and returns type of farm operating partnerships:
1. Each partner is paid on the basis of the value of his annual contribution, organized about equally in this type.
2. Each devotes about equal time to the management in operation of the farm business.
3. Each owns and contributes half of the farm personal property.
4. All land is rented by the partnership, even though the father may own all or most of the land used by the partnership and thus be one of the partnership's "landlords."
5. Each partner shares equally in the responsibility of management.
6. Net farm partnership earnings after inventory adjustments are divided on the basis of contributions—equally in this partnership.

B. In the proportional or unequal sharing of contributions and returns type of farm operating partnerships:
1. Each partner shares in the cost and returns on the basis of his annual contributions.
2. Labor contributions may be equal, although
this is not necessary, and unequal labor contributions can be accommodated in this type of agreement.

3. Father may contribute most of the farm personal property initially (but son can and should increase his share as quickly as possible if he wants to make farming his career).

4. One of the major contributions of the father is likely to be the farmland used by the partnership.

5. Each share equally in the responsibilities of management.

6. Net farm partnership earnings after inventory adjustments are divided on the basis of annual contributions to the farm business—unequal shares which are proportional to the values of their annual contributions in this partnership.

The essential difference in these two types of farm operating partnerships is in the proportion each partner contributes to the farm partnership business. In the first type, each owns a half-share of the farm personal property; and the partnership rents all the land it operates so that there are equal contributions by the partners. In the second type, the son contributes mainly labor and management, while the father also contributes labor and management, plus farm personal property and the land. This may lead to the 87-13 or similarly unequal sharing ratios of cost and returns.

Some people object to the unequal or proportional sharing of profits and losses in that it rewards one partner's larger investment and fails to adequately reward the other partner's labor and management contributions. This serious objection suggests that the equal sharing plan may be more desirable and should be used. As an alternative, the partners might calculate the interest and depreciation charges paid by each partner with the difference then paid to the person with the largest investment and the remaining net earnings or profits of the partnership to be divided equally between the partners.

EXAMPLES OF FATHER-SON FARM OPERATING PARTNERSHIPS

The partnership is for the father and son wanting an agreement under which they are going to share profits, losses, possession, and management of a farm business using a single farm name, a single joint bank account, and a single set of farm records, and where other people who do business with them are going to think of them as a farm operating partnership. The father-son farm operating partnership is a partnership of the father and the son to operate a farm business together, renting the farmland from the father or using the father's land as part of his contributions to the partnership.

The two basic types of farm operating partnerships may be seen clearly in the procedures used to work out the sharing of costs and returns, with one example of each to follow.

For these examples, assume a 2,500-acre cash grain/livestock farm in central North Dakota. The father owns about 1,250 acres and the partnership rents the rest. The farm has 1,900 tillable acres, with wheat on fallow of 380 acres, wheat after crop of 540 acres, barley on 400 acres, sunflowers on 200 acres, 380 acres in summer fallow, pasture and hay on 570 acres, and about 30 acres in farmstead. Also, they had 142 head of beef cows. The father's land is worth about $450 per acre, plus $37,500 in buildings for a total farm value of about $600,000. They rent additional bare land at $25 an acre (these figures are merely illustrative).

The first example below presents the case of a father-son farm operating partnership where the son has purchased half of the farm personal property, and the father and son each contribute half of the labor and management needed. The partnership rents about 1,250 acres from a neighbor and uses the father's land and buildings by paying him a 6 percent return plus paying his real estate taxes and building depreciation, which is shown in Table 1.

The second example presents an unequal or proportional sharing partnership where the son only contributes labor and management. The father contributes 1,250 acres of land, all of the farm personal property, and 12-months labor and management and the partnership again rents about 1,250 acres from a neighbor. The proportion of annual contributions to the second type of partnership is worked out in Table 2A, and the distribution of earnings is shown in Table 2B.

FARM OPERATING PARTNERSHIP—EQUAL SHARES

In starting the equal-share partnership, the son bought a half-share of the farm personal property and the father and son formed a farm operating partnership which rents farmland from the father and others. The partners contribute labor, management, operating capital, and equipment equally, and they share equally in any profits and losses. The partnership pays the father an investment return, which is calculated as an interest charge on the
TABLE 1. FATHER-SON EQUAL-SHARES FARMING AGREEMENT. EACH OWNS ONE-HALF SHARE OF FARM PERSONAL PROPERTY, AND THE PARTNERSHIP RENTS THE LAND IT OPERATES

<table>
<thead>
<tr>
<th>Line/Item Number</th>
<th>Item Consists of</th>
<th>Total Farm</th>
<th>Share To</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Father</td>
</tr>
<tr>
<td>1.</td>
<td>Total Farm Cash Receipts This Year</td>
<td>$138,460</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Change in Inventory (a decline)</td>
<td>-1,600</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Adjusted Gross Receipts</td>
<td>136,860</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Farm Cash Expenses*</td>
<td>66,100</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Interest on Father's Real Estate:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>6 Percent of $562,500</td>
<td>33,750</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Real Estate Taxes and Building Depreciation</td>
<td>4,450</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Farm Personal Property Depreciation:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>7 Percent of $65,500</td>
<td>4,585</td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Labor Earnings at $600 Monthly</td>
<td>14,400</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Net Partnership Income</td>
<td>13,575</td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>Year-End Distribution: 50-50 Share</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>6,787.50</td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Total Return for the Year</td>
<td>$50,030</td>
<td></td>
</tr>
</tbody>
</table>

*Includes the cash rented neighbor's land.
### TABLE 2A. FINDING PROPORTIONS OF CONTRIBUTIONS TO THE PARTNERSHIP

<table>
<thead>
<tr>
<th>Items Contributing to the Partnership</th>
<th>Its Value</th>
<th>Rate of Return</th>
<th>Farm Total</th>
<th>Share Of</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Estate—1,250 Acres</td>
<td>$562,500</td>
<td>6%</td>
<td>$33,750</td>
<td>$33,750</td>
<td></td>
</tr>
<tr>
<td>Taxes and Building Depreciation</td>
<td>4,450</td>
<td></td>
<td>4,450</td>
<td>4,450</td>
<td></td>
</tr>
<tr>
<td>Farm Personal Property</td>
<td>65,500</td>
<td>7%</td>
<td>4,585</td>
<td>4,585</td>
<td></td>
</tr>
<tr>
<td>Labor—24 Months at $600 Per Month</td>
<td>14,400</td>
<td></td>
<td>7,200</td>
<td>$7,200</td>
<td></td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>57,185</td>
<td></td>
<td>49,985</td>
<td>7,200</td>
<td></td>
</tr>
</tbody>
</table>

Percentage Contributed By Each Partner  
100% | 87% | 13%

### TABLE 2B. FATHER-SON PROPORTIONAL SHARING FARMING AGREEMENT. FATHER CONTRIBUTES HIS FARM PERSONAL PROPERTY AND REAL ESTATE PLUS THE SAME AMOUNT OF LABOR AND MANAGEMENT THAT HIS SON CONtributes

<table>
<thead>
<tr>
<th>Line/Item Number</th>
<th>Item Consists of</th>
<th>Total Farm</th>
<th>Share To</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Total Farm Cash Receipts for the Year</td>
<td>$138,460</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>PLUS Inventory Change (decline)</td>
<td>1,600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Adjusted Gross Receipts</td>
<td>136,860</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Farm Cash Expenses</td>
<td>66,100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Interest on Father's Real Estate Investment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>6 Percent on $562,500</td>
<td>33,750</td>
<td>$33,750</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Taxes and Building Depreciation</td>
<td>4,450</td>
<td>4,450</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Farm Personal Property Depreciation</td>
<td>4,585</td>
<td>4,585</td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Labor Earnings, Advances at $600 Per Month</td>
<td>14,400</td>
<td>7,200</td>
<td>$7,200</td>
</tr>
<tr>
<td>8.</td>
<td>Net Partnership Farm Income</td>
<td>13,575</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>Year-End Distribution (father—87 percent, son—13 percent)</td>
<td>11,810</td>
<td>1,765</td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Total Yearly Earnings of Each Partner</td>
<td>70,760</td>
<td>61,795</td>
<td>8,965</td>
</tr>
<tr>
<td>11.</td>
<td>Percentage Distribution of Earnings</td>
<td>100%</td>
<td>87%</td>
<td>13%</td>
</tr>
</tbody>
</table>
capital invested in the owned land; and the partnership agrees as a part of the rental agreement to pay all real estate taxes, building insurance, and building repair costs. The father's land has the farm headquarters and all major buildings with the partnership paying a depreciation charge on them.

The son can buy his half-share of the farm personal property in either of two ways. He can give his father a mortgage note or installment sales contract for his share and make annual payments at the time of the year-end settlements, or he can obtain a loan from a credit agency to secure the money to buy his share. The son should be responsible as to how he buys and pays for his share of the farm personal property. A prepayment provision may be included in the father-son agreement for years when the son's share of farm income is adequate to pay ahead on his machinery loan.

The equal-share type of farm operating partnership is clearly more acceptable to the beginning or younger partner than is proportional partnership. The proportional partnership is likely to have unequal shares for a long time, with the younger partner soon feeling a dissatisfaction over his small share and his slow progress in acquiring ownership. Simply put, if the farm operating partnership is operating a large enough farm business, it should yield a return sufficient for the son to live on and pay for his half-share. If the son cannot pay for his share, the return on his investment is insufficient and makes the investment of doubtful value.

First, let us work through the equal-sharing farm operating partnership example (Table 1) in which the father and son each own one-half shares of the farm personal property, while the partnership rents all of the land it operates. The partnership received $138,460 in cash receipts during the year (Line 1) which was calculated using recent farm prices. This was reduced by the $1,600 decline in inventory (Line 2) for the additional amount of resources used in producing this year's total cash income. The partnership paid out $66,100 in cash expenses (Line 4).

The partnership rents 1,250 acres from a neighbor for $25 an acre and could cash rent the father's land at the same rate plus a building charge. However, the father offered his land and buildings to the partnership for a 6 percent return on his land and building investment with the partnership paying his real estate taxes and a building depreciation charge. This is usually less costly to the partnership than cash renting his land plus building rental.

The father and son each contributes half of the farm personal property (Line 6) and half of the labor and management (Line 7). The partners receive $600 monthly in labor earnings and advances. The net partnership shareable income is $13,575 (Line 8), which is shared 50-50 or equally (Line 9). The father and son each receive the same yearly earnings for labor and management; but, in addition, the father receives payment for his land and buildings which the partnership rents. The son received $16,280 for the year and the father received $16,280 plus the land use payment of $33,750 for a total of $50,030.

**FARM OPERATING PARTNERSHIP—PROPORTIONAL SHARES**

In this example the father-son farm operating partnership is based on the relative or proportional amounts of the total annual resources contributed by each partner to the partnership business. Some tenure specialists do not recommend this particular form of partnership. They feel that while this arrangement yields returns to the partners on the basis of their capital and labor contributions, it fails to consider and properly give a return to differences in management qualities and often in actual labor contributions.

One objection arises from the son's viewpoint in that he gets a relatively small part of the year-end distribution of net earnings for his contribution of risk and management. Even if the son buys a small share of the farm personal property and even some of the real estate, the increases in his share of net earnings distributed at the year-end settlement is so small that he soon becomes dissatisfied with this type of partnership. So it is usually recommended that the son buy a half-share of the farm personal property at the start of the partnership and pay for this as a separate contract, as was shown in the previous example.

Each partner's share of the profits (or losses) in the unequal shares or proportional partnership is based on his share of the annual resources used by the partnership. They must work out a table similar to Tables 2A and 2B, which show each partner's annual contributions to the total amount of resources used during the year by the partnership business and use this ratio or proportion to figure out each partner's share of the profits (or losses). This is illustrated in Tables 2A and 2B, which show that the return to the partner with the larger share of inputs is larger than the return to the partner who contributes less. The following example happened to work out to be an 87-13 percent proportional sharing father-son agreement.
The exact ratio was determined by the amount of resources each partner contributed, as shown in Table 2A.

In the unequal shares or proportional partnership example, assume that the father and son each contribute 12 months of labor and management and that this is the only annual contribution by the son. The father annually contributes the use of his farm personal property (worth $65,500) and his land and buildings, which the partnership uses as its headquarters. The partnership rents an additional 1,250 acres at $25 an acre from a neighbor. Let us figure out the sharing ratio of annual contributions to the farm partnership business.

The partners carefully consider what resources each annually contributes to the partnership business, its total value or worth, and the rate of return the resources should earn. Each of the resources is listed in the table and its annual use-value to the partnership business is determined, and that use-value is listed to the credit of the partner(s) contributing it. For example, if members of the son’s family are needed to drive grain trucks and contribute other labor at vital times, the value of this labor should be credited to the son in this table. These percentages are then used in the year-end settlement calculations which Table 2B of this example shows.

The expenses of the farm partnership are included in items 4 through 7. The partnership had a year-end net farm income of $13,575, which was shared in the same proportion as the partners contributed resources to the farm partnership. The son received about 13 percent of the net farm income or $1,765 which, when added to his monthly advances of labor earnings, brings his yearly total income to $8,965. The $8,965 is about 13 percent of the total returns earned by the resources provided in the partnership. The father received about 87 percent of the net partnership income, plus labor advances and payment for the use of his farm personal property and land and buildings for a total income of $61,795 (which is 87 percent of the total earnings of $70,760).

**SUMMARY OF EXAMPLES**

To recap, let us compare the income of the son in each of the two types of father-son farm operating partnerships. In the equal shares partnership (shown in Table 1), the yearly income of the son was $16,280, which provides an adequate income for his household plus substantial repayment capacity for any loan he might have had to purchase half of the farm personal property.

Suppose the son had to borrow $30,000 to purchase a half-interest in the farm personal property when he entered the farm partnership because he had not accumulated capital previously. If he wished to pay his loan off in eight years at 8 percent interest, the yearly principal and interest payments would total $5,220. This would leave him and his family $11,060 for family living and other purchases.

Two points should be emphasized: (1) the farm business had enough resources, volume of business, and net income to support two farm families and to utilize their labor supply; and (2) it generated enough income at low product prices so the son could accumulate capital (via loan repayment capacity) from his earnings in the partnership.

The second example showed a son putting in about 13 percent of the annual resources used (see Tables 2A and 2B) and getting his fair share of 13 percent of the partnership earnings, but his total returns for the year of $8,965 can hardly be considered a strong base on which to obtain a loan. His $1,765 return over labor earnings does not permit a rapid accumulation of capital, hence, the son gets discouraged at his lack of progress in farming.

The examples presented above are illustrative only and reflect prices for early 1977. The farm product prices of July 1, 1977, in the proportional or unequal partnership in the Tables 2A and 2B would not have generated enough income to pay the labor earnings advances at a rate of $600 a month to the father and the son and the son’s income would not have provided satisfactory family living and no repayment of any money borrowed. The partnership business net income for the equal sharing partnership (Line 8 of Table 1) would have been negative or not adequate to pay labor advances of $600 a month to each partner. The return to the son would not have been adequate to support his family.

Farm product prices fluctuate a lot and the partners need to consider all the risk carefully in estimating an adequate volume of business. For example, using July 1, 1975, prices resulted in a net partnership income allocatable to the partners of $86,750 using the July 1, 1976, farm product prices yielded a net partnership income of $44,290 utilizing the July 1, 1977, prices indicated the partnership did not generate enough money to pay the labor advances of $14,400. The partners
would have been in substantial difficulty using the July 1, 1977, prices and the farm business would not have had an adequate volume of business to support two families. There are other risks, such as hail or drought, that exist and their possible effects on the farm partnership business must also be carefully considered. Farm management accounting techniques exist to estimate net earnings under different product prices and cost relationships with possible hail and drought losses. You may visit your county extension agent for assistance in developing these models.

Father-son partnerships should operate farms large enough to fully utilize the labor supply available (about 24 months of labor). This may be about 3,000 acres for a cash grain farm in western North Dakota and about 1,800 acres in eastern North Dakota. Annual reports from the North Dakota State University Cooperative Extension Service farm record system will provide detailed figures that can be combined with local information to yield fairly good estimates of the resources it takes to have a successful two-man farm as a father-son partnership under today’s farming conditions.

The examples shown here use a 6 percent rate of return on the value of the real estate and 7 percent return on the investment in the farm personal property. Where a partner has considerable indebtedness on the property he is contributing, the rate of return charged should be at least equal to the rate of interest he is paying.

FATHER-SON FARM OPERATING AND LAND-OWNERSHIP PARTNERSHIP

The father and son can enter a father-son farm operating and real estate partnership initially or as a separate agreement after seeing how the farm operating partnership works out. It is often better as the second agreement instead of together in an initial agreement between the father and son. It can also be used as a means of transferring farm ownership where it is a part of a family estate planning transfer agreement, as well as a farm operating partnership.

The father and son farm operating and land ownership partnership can be either the equal shares or the proportional shares type. If the son has fully acquired his share of the farm personal property, say in four to ten years after starting the farm operating partnership, then the son is ready to buy a half-share of the farm real estate and begin paying for his share of the land. If the partners wish, they can create an equal partner-

ship on the farm personal property and real estate at the outset; the size of the son’s debt prohibits this in most cases.

If the partners have been successful in a farm operating partnership, the additional partnership for land ownership will not be a great change in their procedures. An attorney can readily write the new agreement, which will include both the farm operating partnership and a land ownership partnership into one new agreement.

As a farm transfer agreement, the father-son farm operating and real estate owner-partnership may be used for transferring ownership of the farm as an ongoing unit to the son who is farming it. The transfer may be immediate, or as a gradual transfer of ownership to the son while the father is living, or it may specify certain conditions for its transfer at his death. The main purposes of the transfer agreement are to assure the son who operates the farm protection against the loss of his equity in the business upon the death of the father, to provide security for the parents in their later years, and to treat the children equitably.

The proportional sharing concept in the father-son farm operating and land ownership partnership is less favored than the equal sharing type. Again, the reasons are: the son would have a small share of the partnership profits, and he may feel that he has a small say in the operation of the business. The immediate purchase of a half-share by the son not only gives him an equal say in the operation of the partnership, but it also leads to a certain amount of "force draft" savings and thrift by his family, which may lead the son to appreciate the ownership of land. The half-share method of purchasing an interest is favored since the son has greater pride and interest in the partnership business because of his substantial ownership interest.

The sharing arrangements in this partnership for expenses and profits can be the same as in the farm operating partnership. If there is equal ownership of the farm personal property and the farm real estate, the share can be as shown under the farm operating partnership—equal shares. If the father and son have previously used proportional sharing in the farm operating partnership and wish to continue this in the new farm operating and land ownership partnership, the new agreement can readily be written this way.

Once the father and the son have reached an agreement as to the contributions and the sharing
in the partnership, an attorney can readily write this into a legally acceptable agreement. It is most important that the ownership and transfer of farm real estate agreement be in writing. This agreement should be prepared by an attorney and should be properly signed and recorded.

ADDITIONAL POINTS TO CONSIDER

1. PAYING FOR THE LAND USED. There are a number of ways of dealing with the land that the partnership operates. In the unequal or proportional agreement, the father usually will include as one of his contributions the land operated by the partnership.

Another possibility is for the partnership to rent the farm from the father on a crop and livestock share basis. The father is the landlord and also a partner of the partnership, which is the renter.

In the 50-50 or equal partnership, the partnership may rent all the land it operates at the going cash rental rate of the community. The rental rates are the same for father-owned as for other lands rented. The landowner pays the taxes, insurance, and other ownership costs.

Another way is for the parent to assume the role of a land investor so the partnership pays him a 4 to 6 percent investment return on the value of the farm, while the partnership pays all the taxes, insurance, and other ownership costs.

2. MORE THAN ONE SON. The partnership organizations discussed here apply equally where there is more than one son. The shares can be one-third or one-fourth instead of one-half. The critical problem is whether or not the volume of farm business and net income is adequate to support more than two full-time farm families.

Everything presented here for father-son partnerships can as readily apply to any other young man. Many an older man has earned the eternal gratitude of an established farmer today by helping a neighbor’s boy get started in farming through a father-“son” farming agreement. Service to another is a noble human trait, richly rewarding to both parties and their families.

The concepts discussed here also apply to two-family farms of unrelated families. Make sure that the partnership agreement is written in sufficient detail by your own attorney and keep it up-to-date.

3. OFF-FARM INCOME is growing in frequency and importance to some farmers. Some partnerships start out too small to fully use the labor of the son or with insufficient resources to support both families. Sometimes a son wants to help out at home while working part-time or even full-time in town.

Some partnerships might consider the off-farm job as just another farm enterprise—an “off-farm” enterprise with all earnings credited to the partnership. A better solution is an unequal farm operating partnership or a wage-income sharing arrangement where the off-farm earnings are not part of the partnership. But, know your goals, discuss your plans and problems honestly and openly with your partners, and change the written agreement as the circumstances change.

4. PAYMENT PRIORITIES for a “bad” or “poor” year should be considered and made part of your written father/son agreement. Poor years can be expected and an agreement prepared as to which bills will be paid first, which second in order of importance, and so forth. The order of this list might be (depending on individual situations):

   a. All farm cash operating expenses.

   b. Interest on farm debts.

   c. Wage or living allowance for father and the son(s).

   d. Interest charge on debt-free investment used by the partnership.

   e. Depreciation charges on property not jointly owned but used by the partnership.

5. WRITTEN FATHER-SON AGREEMENTS ARE ESSENTIAL. All partnership agreements should be written. This is a good business practice that should be used in all father-son farming agreements as well. This will prevent misunderstandings that may arise when either partner forgets or when their recollections of a verbal agreement differ.

The Department of Agricultural Economics does not offer a printed partnership form as it does for the contract for deed and leasing forms. The reason is that the partnership law is more complex and far-reaching in its legal implications. The chance of a farmer getting into an expensive lawsuit by writing his own partnership agreement is always present. This report presents the provisions that
should be evaluated in forming a partnership. This will help the partners decide what to put in their partnership agreement fitted to their needs and which will result in helpful instead of a potentially harmful legal instrument.

WRITING THE PARTNERSHIP AGREEMENT

Choosing Its Provisions

This discussion deals with some of the basic provisions to be included in a written farm operating partnership agreement. In some instances alternative provisions are offered to fit different father-son situations.

INTRODUCTORY ARTICLES. The first three articles in most farm operating partnership agreements typically state that the agreement creates a partnership, identifies the partners and their addresses, and states its purposes and duration.

The title may be: Father-Son Partnership Agreement, Partnership Agreement, Farm Partnership Agreement, or any similar title. It may include the names of the partners. The initial statement provides a place for the names of the partners. Article 1 names the partnership and states the location or address of the principal place of business. Article 2 explains the general nature of the business and indicates the real estate operated. If there are no "exceptions" or "reservations" in this article, these words should not appear in the agreement. Article 3 sets the duration of the partnership, either for a specific term or an indefinite term. The following is merely an illustration of the form that these articles may take:

FATHER-SON FARM OPERATING PARTNERSHIP AGREEMENT

1. This farm partnership agreement is entered into this __________ day of ____________,

19__, by and between ________________________, the father, and ________________________, the son.

Article I. Name and Place of Business

1. The name of this farm partnership is ________________________.

2. The principal place of business shall be ________________________ County, ________________________, and at such other places within or without the State of North Dakota as may be agreed upon by the partners.

3. Its legal address is ____________________________________________.

Article II. Nature of Business

This partnership shall engage in a general farming business including the growing, purchasing, and marketing of crops, livestock, and other farm products and in such other businesses as may be agreed upon by the partners on the following described real estate:

__________________________________________

situated in the County of _______________________ in the State of North Dakota, and on any other land which said parties may agree to rent or purchase for farming purposes. Exceptions or reservations:

__________________________________________

Article III. Duration

This partnership shall continue in the farm business for the period of __________ years, commencing __________, 19__, and terminating __________, 19__. 
ARTICLE IV. CAPITAL CONTRIBUTIONS, ACCOUNTS AND WITHDRAWALS. This important article is for entering the various contributions of the partners to the partnership. Section 1 of Article IV deals with the real estate contribution if contributed by one of the parties to the partnership. This article may be omitted if all the real estate to be operated by the partnership is to be rented from the father or other people. The following is intended to be illustrative:

1. The Real Estate Contribution. The real estate contribution of each party is as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Parties' names</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acres</td>
<td></td>
</tr>
<tr>
<td>Value per acre</td>
<td>$ $ $</td>
</tr>
<tr>
<td>Total value</td>
<td>$ $ $</td>
</tr>
<tr>
<td>Rate of return</td>
<td>% % %</td>
</tr>
<tr>
<td>Total investment charges</td>
<td>$ $ $</td>
</tr>
</tbody>
</table>

Section 2 of Article IV is for entering the contributions of the farm personal property. At the top of the table enter in the names of each partner and below it the value of his machinery contribution to the partnership. Then decide upon a rate of return to use and calculate the investment charge. A suggested implementation of this is as follows:

2. The Farm Personal Property. The contribution of farm personal property by each party shall be as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Parties' names</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery</td>
<td>$ $ $</td>
</tr>
<tr>
<td>Livestock</td>
<td>$ $ $</td>
</tr>
<tr>
<td>Feed</td>
<td>$ $ $</td>
</tr>
<tr>
<td>Total value contributed</td>
<td>$ $ $</td>
</tr>
<tr>
<td>Rate of return</td>
<td>% % %</td>
</tr>
<tr>
<td>Total investment charges</td>
<td>$ $ $</td>
</tr>
</tbody>
</table>
Section 3 of Article IV is for entering the yearly contributions of labor by each partner and the prearranged advances on earnings. Enter the names of the partners across the top and the number of months of labor to be worked by each partner. Then enter the agreed-on monthly rate for the advance on earnings and the total advances for the year. This section provides an opportunity to adjust the labor contributions for where the father or son may wish to provide less than 12 months of labor to the partnership. A suggested format follows:

3. Labor Contributions. The yearly contributions of labor by each party and the monthly withdrawal of earnings represented thereby are as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Parties' names</th>
</tr>
</thead>
<tbody>
<tr>
<td>Months of labor</td>
<td></td>
</tr>
<tr>
<td>Monthly rate</td>
<td>$</td>
</tr>
<tr>
<td>Total advances</td>
<td>$</td>
</tr>
</tbody>
</table>

Section 4 states that each partner agrees to do his best to maintain and preserve the partnership property. Section 5 deals with the use of partnership funds for improving property of individual partners that has been contributed to the partnership for use only. If the partnership should invest in (improve) the property for which it has the use only, when the partnership terminates, the individual partner owning the property shall be responsible to the partnership for the undepreciated value of the improvement. Illustrative provisions are as follows:

4. Each party agrees to use his best efforts to maintain and preserve partnership property.

5. Any improvements made with partnership funds upon property remaining the separate property of an individual partner who contributes its use only shall be partnership property and each individual partner shall be responsible to the partnership for the value of the improvement when the use of the property by the partnership terminates.

ARTICLE V. PROFITS AND LOSSES. This important article of the agreement should be worked out carefully. The seven sections illustrated below show how to determine the year-end settlements. Sections 1, 2 and 3 specify the composition of the farm expenses. The cash expenses of the partnership are listed, and Section 3 specifies the rate of depreciation that will be charged on the farm improvements. Section 4 defines the farm receipts. In this case it includes the government payments, which may not be desirable in all agreements. It also states that custom work and other off-farm work by either partner are considered partnership income rather than the individual partner’s income. This latter provision may not be desirable in some agreements, but it should be handled one way or the other in the agreement.

Section 5 on inventory changes states that the inventory changes are used in the annual and the terminating partnership settlements. The foregoing examples show annual inventory adjustments. This provision similarly makes annual inventory adjustments to the net farm income. Section 6 reinforces Section 3 of Article IV in that it specifies the monthly withdrawal of earnings that has been entered previously.

The procedure for determining the year-end settlement is specified. There are various wordings for this section. It must be written very carefully to conform with either the equal-sharing or the proportional-sharing type partnership. The following provisions are illustrative:

Article V. Profits and Losses.

1. Farm Expenses. Farm expenses include the cash farm expenses and depreciation on farm improvements as indicated below.

2. Cash Expenses. The items include cash rent; crop expense; feed expense; livestock expense; livestock purchases; hired labor; custom work hired; farm insurance; purchase of new or used machinery and equipment; repairs and maintenance for farm machinery and equipment; repairs and maintenance for buildings, fences, tiling, ditches
and water supply; property taxes; and miscellaneous farm expenses. Exceptions: 

3. Depreciation. The amount of the annual depreciation of farm improvements to be charged to the partnership is as follows: 

4. Farm Receipts. Farm receipts shall include income from all farm sources including such items as the sale of livestock and livestock products, crops, machinery and equipment, government payments, and custom work and other off-farm work by either party.

5. Inventory Changes. The differences between the beginning and ending values of “inventory” items of farm personal property, such as livestock, feed and grain, machinery and equipment, shall be considered inventory gains or losses annually and for the entire period of agreement.

6. Monthly Withdrawal of Earnings. Each partner may withdraw up to the total of the agreed-upon monthly allowance. If during the year a partner has withdrawn more than his annual year-end settlement distributive share, he shall refund the difference at the time of the annual accounting.

7. Year-end Settlement. The net profits and losses of this partnership shall be shared as determined in this year-end settlement procedure: (a) from the total cash income for the year shall be subtracted the farm expenses to obtain the net cash partnership income; (b) from the net cash partnership income will be deducted such rent and depreciation allowances as are included as a farm expense in this agreement; (c) from the balance remaining in Item 6, (1) for equal partnerships will be deducted the withdrawals, or (2) for proportional partnerships distribute the income per the sharing proportions calculated of their relative contributions and then deduct the withdrawals from each share; and (d) the balance remaining is equally shared in the equal partnership, or in the proportional partnership the individual balances remaining are paid to the partners.

ARTICLE VI. RECORDS AND ACCOUNTS.

This article names who is responsible for maintaining the partnership account books and provides that the record books are open to inspection at reasonable times. Further, it provides for a capital account to be maintained on each partner. An important part of this article is Section 4 which specifies that an inventory should be taken at the beginning of the partnership and then annually and that these inventories become a part of the partnership agreement. The maintenance of good records over a period of years is not only required by law and good business practice, but is needed for filing the federal income tax information form. The following provisions are illustrative:

Article VI. Records and Accounts.

1. shall have the responsibility and duty to establish and maintain the account books and records of this farm partnership for the purpose of showing partnership income and expenses, each individual's contributions and income status, the financial condition of the business, and other information necessary for good management of the farm business. At the close of each year he shall make a full accounting. The books shall be open to inspection by the partners at any reasonable time.

2. The partnership accounts shall be on a cash basis.

3. A capital account shall be maintained showing the ownership interests of each partner. The capital account of each partner shall consist of his original contributions at the start of this partnership plus any additional contributions and minus his share of partnership losses and of capital distributions made to him.

4. An inventory of all farm real estate and farm personal property shall be taken at the beginning of this agreement and then annually, and these inventories shall become a part of this agreement.

ARTICLE VII. PARTNERS’ POWERS AND LIMITATIONS.

The first section names the bank and city where the bank account of the partnership is maintained. Some partnerships include a clause that limits the size of check that may be drawn by either partner without the counter-signature of the other partner. Some partnerships specify that only one partner may sign the checks. Section 2 lists a series of limitations placed upon the personal activities of a partner. There are other provisions that might be included in this list of partner limitations. For instance, the partners may agree to a limitation on the amount of money that can be borrowed for personal use by any one of the partners to avoid a partner building up a large personal indebtedness. Another limiting provision may state.
that a partner cannot have any interest in or carry on any other business besides that of farming, to avoid a partner's becoming entangled or engrossed in other lines of business and failing to do his duty to the partnership. An additional provision to consider prevents a partner from selling, leasing, assigning or pledging his interest to any outside person without the permission of his partner except to the other partner himself. The following is merely intended to be illustrative:

Article VII. Partners' Powers and Limitations.

1. A partnership bank account shall be established and maintained by the name of

_________________________ at __________________________.

Checks drawn on this account shall be signed by either partner.

2. Without the consent of the other partner no partner shall:
   a. Make, execute, or deliver an assignment of partnership property for the benefit of creditors.
   b. Contract to sell or lease all or substantially all of the property of the partnership.
   c. Submit a partnership claim or liability to arbitration.
   d. Confess a judgment against the partnership or any of his partners.
   e. Dispose of the good will of the business or do any other act that would make it impossible to carry on the ordinary business of the partnership.
   f. Admit a new member to the partnership.
   g. Act as surety, guarantor or accommodation party to any obligation in the name of the partnership.
   h. Sell, mortgage, lease, or assign any partnership real property.
   i. Borrow or lend money on behalf of the partnership.
   j. Compromise any claim due the partnership.
   k. Contract or incur expenses or indebtedness on behalf of the partnership in any transaction involving more than $__________.

Both partners should know that these provisions may not be binding on third parties unless they had notice of them at the time they dealt with the partner involved.

ARTICLE VIII. MANAGEMENT. In the typical father-son farm operating partnership each partner has an equal voice in the management of the partnership business. Each partner devotes his full time to the business of the partnership. However, it may be that if the father wishes a longer vacation, a provision should be entered indicating that the son would have the major (not equal) responsibility for the management of the business. If there is more than one son as partner, it may be desirable to specify one person, either the father or son, as the general manager of the partnership, or they may specify one person as manager of crop enterprises, another the manager of livestock enterprises, and so forth. An additional alternative is that annually they would name the managers of the various enterprises of the partnership. Illustrative provisions include:

Article VIII. Management.

1. Partners shall have equal voice in the management of the partnership business.

2. Each partner shall devote his full time and best efforts to the partnership business.

DISSOLUTION OF THE PARTNERSHIP. The termination of a partnership is a very important event. In many father-son partnerships it is the expectation of the father that the son will continue operation of the farm. Termination of the partnership with an immediate settlement may not be in the best interests of the son. Termination of a partnership is so important that it should receive the most detailed discussion and agreement by the parties involved.

ARTICLE IX. VOLUNTARY DISSOLUTION. Article III specified whether or not this partnership had a definite or indefinite term. The partnership can be dissolved by unanimous agreement at any time. Upon agreeing to dissolve, it is important that the dissolution provisions spell out clearly the steps to follow. Section 2 indicates that when there is a voluntary dissolution, the partnership is terminated immediately with no further business transacted. The settlement is by auction sale, or one partner may buy out the other. An inventory should be taken immediately at termination time so the final shares of ownership may be determined, and Section 4 states that the final shares are calculated on the same basis as the shares in the division of farm earnings. For an equal-sharing partnership this would be a 50-50 share. Illustrative provisions are as follows:

Article IX. Voluntary Dissolution.

1. The partnership shall be dissolved at any time by unanimous agreement.
2. Upon dissolution, no further business shall be transacted by the partners except that necessary for the orderly termination of the partnership and distribution of its assets.

3. If at the termination of this agreement actual division of the property owned in common is not possible or desirable, settlement may be by auction sale or by one party, within a __________ day period, buying out the share of the other party at the value arrived at by a joint appraisal.

4. Upon the termination of this agreement, an ending inventory of farm personal property shall be taken and appraised jointly by the parties to this contract to determine the value of the final share to each party. The parties to this agreement shall share in the value of any increase or decrease in the farm personal property in the same proportion as they currently share in the annual division of farm earnings.

ARTICLE X. RETIREMENT, INCAPACITY OR DEATH OF A PARTNER. This article is important. Section 1 indicates that after a certain number of years, to be agreed upon by the partners, the partnership cannot be dissolved by retirement unless there has been at least a three-month period of written notice to the other partner. Section 2 states that the remaining partner will have the property appraised, and he then has the option of purchasing it. It also states that the partners agree that there is no goodwill asset of the partnership because this is hard to value. Section 3 indicates that when a partner dies, the partnership is not immediately dissolved but that the decedent's estate becomes a partner. This may not be desirable, and this provision could be changed, for example, to allow the surviving partner to continue the partnership for six months before either liquidating it or buying it out. Section 4 indicates that during the period of partnership liquidation the remaining partner has full authority to operate the partnership.

Partner insurance can be used advantageous to reduce the problem of the surviving partner in acquiring the partnership property. Each partner can carry enough insurance on the life of the other to cover payments of terminating the partnership and purchasing the decedent's interest. If there is a partnership life insurance policy used, this should be stated and made part of the agreement. The fact that the life insurance policy is purchased from partnership funds on the life of each partner should be specified, and the amount of the payment should also be listed.

Alternative provisions may be included in Article X instead of the provisions specified. One provision might state that the partnership shall continue among the remaining partners in the event of the withdrawal of a partner, or it might state that upon the withdrawal of any partner the partnership business shall be terminated and that the partnership assets must be distributed immediately. A provision might state that a partner shall retire from the partnership at a certain birthday, or it might state that a certain partner may retire at a certain birthday but that he continues as a limited partner. The latter fits when a father wishes to retire, say at his 65th birthday, but would continue to share in the partnership even though he does not contribute labor.

In the event of the incapacity of a partner several possible actions can be used. One is to dissolve the partnership in the event of insanity or other total legal or physical disability of a partner. Another, in case of total legal or other physical disability of a partner, is that the partnership shall continue but that the disabled partner's share should be reduced by a specified percentage because of his reduced labor and other participation.

In the event of the death of a partner a number of alternative provisions can be used. One provision would immediately terminate the partnership and liquidate it. Another would have the deceased partner's interest remain in the partnership, and his partnership share would be distributed to his estate. Another states that the decedent partner's share will go to the surviving partners.

How the partnership is liquidated is important. The procedures for liquidation should be stated specifically in the agreement. There may be a buy-sell agreement where one partner has a definite time period within which to purchase the other partner's share, or it may state that a sale will occur and the payment should be on four or five annual installments, or similar sale-purchase provisions. A clause may permit and name the partner who is to continue to operate the business and supervise the liquidation. If there are certain specific properties contributed to the partnership that in a liquidation should go to one or another partner, these individual properties should be identified specifically and the fact stated that they shall revert in ownership to a specific partner as his sole and absolute property.

There are a number of alternatives that a father-son partnership should consider if one of the intents
of the partnership is to help the son acquire ownership in and continue the operation of the farm. As detailed in preceding page, the partnership may be terminated immediately and liquidated upon the death or withdrawal of one of the partners. However, this action may force the sale of the farm assets. One alternative would be to provide for the wife or minor children through guardianship to remain as a limited partner by substitution, or the survivor shall be given the right to purchase the interest of the deceased partner, if he desires, over an agreed-upon period, say, of 20 or so years. Either provision would provide the surviving wife with a source of support, via profits of the farm or through the purchase payments of the surviving partner.

The following provisions are merely intended to be illustrative:

Article X. Retirement, Incapacity or Death of a Partner.

1. Any partner may retire from the partnership at the end of any year after ____________ years following the formation of the partnership by giving written notice to the other partner at least three months prior to the time of retirement.

2. Upon the retirement, incapacity or death of a partner the remaining partner shall have the option to purchase the retired, incapacitated or deceased partner's interest in the partnership at market value as determined by a competent appraiser selected by the remaining partner and the departing partner or his representative. The partners agree that there is no goodwill asset of the partnership.

3. The partnership shall not be terminated upon the death of a partner. The deceased partner's interest in the partnership shall remain in the partnership and the partnership shall distribute to the estate of the deceased partner its share of the annual profits or losses of the partnership at the end of each year.

4. The remaining partners shall have full authority to manage partnership affairs during the termination proceedings if the partnership is liquidated, and he shall make an accounting to the other partner or his legal representative when the partnership affairs are terminated.

OTHER PROVISIONS. The partners may indicate when each may take his vacation. Another may show in detail how an additional partner will be taken into the partnership, especially if there are plans that another son may enter at a certain definite year or birth date.

The preparation of a father-son farming agreement or partnership is not a task to be taken lightly. The father and son and their families must discuss thoroughly all parts of the proposed farming agreement together in an open and mutually considerate manner. Other things may need to be discussed and agreed upon either before or in conjunction with the partnership agreement, such as the parents' estate plans.

Fortunately, attorneys by training and experience are fully capable of understanding the many complex problems involved in these family affairs and in preparing the legal papers necessary to accomplish the goals of the parties. Your attorney will need your most generous help and information to be able to serve you fully.