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FARM PARTNERSHIP ARRANGEMENTS

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FARM PARTNERSHIP ARRANGEMENTS

Introduction

Partnerships are not new in farming. Father and son arrangements of various kinds have existed for a long time. New York State has farms that have passed from father to son for a century or more. However, the financial structure and size of capital investment in modern commercial farm operations makes it more important than ever before that good businesslike arrangements be developed and used.

A common way of transferring a farm business from one generation to another within a family, has been with a father-son partnership arrangement. Farm partnerships, however, are not limited to fathers and sons or daughters, a son-in-law or other relative may be the junior member in a two-generation partnership. Some families that do not have children who are interested in the business take an employee or neighbor into the business with them. Information in this publication focuses on father and son arrangements but in general it applies to any kind of partnership.

Extension bulletins on farm partnerships have been available from Cornell University for many years. This publication is a revision of A.E. Ext. 77-5 entitled "Father and Son Farm Partnership Arrangements."

Purpose of Publication

The purpose of this bulletin is to help farm families develop "good" business arrangements. Persons working with families on partnerships also will find it of use. The information is presented in a general and non-technical manner. It is aimed toward families who may be in the stages of exploring joint-venture farm business arrangements or those who are working out a partnership plan for their situation.

Ideas presented are based on years of experience working with families on partnerships. The materials included here have been used in meetings and workshops on farm partnerships and in counseling with families on their specific arrangements. Basic principles are outlined along with examples. The case study of the "Swanson" farm business arrangements illustrates the steps a family may take in developing and using a partnership to transfer the business from one generation to another.

Types of Business Organization

There are three common types of business organizations found in farming. These are: 1) individual entrepreneurs or operators, 2) partnerships, and 3) corporations. Each farm family needs to select the kind of business organization that seems best for them.

When two or more persons are involved in the management they must choose between a partnership or a corporation. A comparison of the major differences is presented in outline form on page 9. This publication focuses on partnerships but publications on farm corporations are available also.

FARMS BY TYPE OF ORGANIZATION
New York, 1969 and 1978

Type of Business Organization	1969		1978	
	Number of Farms	Percent of All Farms	Number of Farms	Percent of All Farms
Individual operator	30,042	87.3	30,014	85.6
Partnership	3,676	10.7	3,758	10.7
Corporation				
10 or less shareholders	519	1.5	1,102	3.2
More than 10 shareholders	19	.1	107	.3
Other (managers etc.)	148	.4	77	.2
Total	34,404	100.0	35,058	100.0

SOURCE: Census of Agriculture

Seven out of eight New York census farms with sales of \$2,500 or more were operated by individuals during the past decade. Partnerships accounted for 10.7 percent of the farms in 1969 and in 1978. Corporations have been increasing in numbers and accounted for 3.5 percent of the farms in 1978. The census data suggests a slight shift from individual operators to multi-operator businesses such as partnerships and corporations.

Partnership Terminology

Partnerships can be described or classified in various ways. Some of the common ways of describing farm business partnerships are listed below:

Father-son (or son-in-law)	Two-generation partnership
Father-daughter	One-generation partnership
Brothers (brothers-in-law)	
Unrelated individuals	Informal working partnership
Husband and wife	Formal partnership arrangement
General partnership	Oral partnership agreement
Limited partnership	Written partnership agreement
Farm business operating (only) partnership	
Complete farm business partnership (ownership and operating)	

Partnerships in Farm Business Summaries

The proportion of farms in the New York dairy business summaries operated as partnerships increased from 7 percent in 1960 to 21 percent in 1980 (table next page). The steady increase in average operators per farm in the summaries indicates a trend toward more "multi-manager" units on these dairy farms.

NUMBER OF PARTNERSHIPS IN DAIRY FARM BUSINESS SUMMARIES
New York Dairy Farms, 1960 to 1980

Year	Number of		% Partnerships or Corporations	Operators Per Farm
	Farms	Partnerships Corporations		
1960	467	35	NA*	1.07
1965	673	67	NA*	1.10
1970	509	86	NA*	1.18
1975	605	104	13	1.21
1976	615	116	12	1.23
1977	570	100	12	1.23
1978	527	89	8	1.21
1979	610	113	12	1.24
1980	600	115	14	1.25

* Prior to 1973 corporations were reported with the "partnerships".

The total number of partnerships in the business management projects more than doubled from 1960 to 1970 and continued to increase gradually during the seventies. The number of corporations has changed little.

The average partnership business in the 1980 summary group was larger and had higher rates of production and labor efficiency than the "individual" operations but smaller than the corporations. The labor and management income per operator for the partnerships averaged \$4,700 compared with a minus \$993 for the individuals and \$14,000 for the corporations (table below).

COMPARISON OF BUSINESSES OF INDIVIDUALS, PARTNERSHIPS, AND CORPORATIONS
600 New York Dairy Farms, 1980

Financial Summary and Business Factors	471		115		14	
	Individuals		Partnerships		Corporations	
Total farm capital 1/1/81	\$393,000		\$517,000		\$813,000	
Total farm receipts	\$151,644		\$217,065		\$323,456	
Total farm expenses	152,677		197,606		294,455	
Labor & mgt. income/farm	\$- 1,030		\$ 9,459		\$ 29,001	
Number of operators	(493*)	1.05	(233)	2.03	(30)	2.14
Labor & mgt. income/operator	\$- 993		\$ 4,706		\$ 14,010	
Worker equivalent	2.6		3.1		4.3	
Number of cows	69		92		140	
Total acres of crops	226		306		431	
Lbs. of milk sold	982,800		1,334,200		2,094,400	
Lbs. of milk sold/cow	14,200		14,500		14,900	
Tons hay crops/acre	2.4		2.5		3.0	
Lbs. of milk sold/man	381,900		433,000		484,000	

* Includes some farms where both spouses reported months of operator inputs.

Partnerships as a Way to Engage and Disengage

Time waits for no man (or woman) and changes are inevitable. Each of us must accept the inevitable and plan for what's ahead. One characteristic of good management is planning ahead and being "prepared."

Most persons engage in a business or a job as a career. When young, the concern is "how to get started." As we get older, we need to consider how to disengage or retire. This means "retirement planning."

Farm family business partnerships commonly involve two generations, or two stages in the career cycle. The younger member is in the process of getting established or engaged in a farming business. The older generation should be concerned with plans for getting out or disengaging from the operation. This latter aspect of farm management planning is often neglected.

Engaging and Disengaging

Good family partnership arrangements are dynamic (not static). The younger partner who is "engaging" in the business gradually assumes more responsibility and gains more ownership. The older partner on the other hand gradually "disengages" which enables him to retire gracefully.

Non-farm businesses often have a "compulsory" retirement age. This frequently is age 65 when a worker is eligible for Social Security. Farm partnerships generally have not specified any set retirement age but perhaps they SHOULD!

Retirement is especially important for persons in managerial positions. In some businesses, employees are required to step down from administrative posts before they reach the mandatory retirement age. The pressures that go with the many managerial decisions give rise to these policies. The same kind of management pressures exist in farming as in other businesses.

Retirement Considerations

Retirement or disengaging is just one phase of the management responsibilities of farm families. Like all management it involves the making of some important decisions. Partnerships are a tool that can be used in developing these plans. Below are some retirement decisions that must be considered.

1. When to retire--at what age?
2. Where will you live?
3. What will you do?
4. How will your plans affect others?
5. How will you transfer the business?
6. How will you finance your retirement?

Retirement and Partnership Arrangement

Planning ahead for retirement or disengaging from the partnership is desirable. It is just as important to have a satisfactory partnership termination as it is to have a good beginning. Some families get into "unhappy" situations because the joint venture "drifts" on when the senior partner is no longer able to carry his share of the responsibilities. It is better to terminate while everyone is still "happy" with the arrangement.

Advantages of a Two-generation Partnership

In a "good" two-generation farm business partnership both parties (the younger and the older) benefit by the arrangement. It provides a way for the younger generation to engage in farming and for the older generation to disengage. In many ways the two are complimentary. Some of the advantages for the two-generations are outlined below:

Advantages for the younger generation:

1. The use of capital without too heavy a debt load - this is important with the large investment in farm businesses today. For some young persons it may be the best way to finance their start.
2. An opportunity to start in a "going" business - saves the time of assembling and getting a business on a paying basis.
3. Chance to "grow into" the business - both financially and with management experience. Not faced with full responsibility at start.
4. Advice of an experienced farmer - learn from the experience of another rather than learning the "hard" way which is usually costly.
5. Less confinement to farm duties - with shared management it is easier for a person to get away for a day or more.
6. A better business and more income - studies show larger businesses usually pay better.

Advantages for the older generation:

1. A source of steady, reliable help - a young person in the business usually has more interest than one working for wages only.
2. An opportunity to "let-up" gradually (shift responsibility) - the younger person takes over part of the responsibilities.
3. Protects income and investment in later years. Incomes of older farmers tend to decline - young person will keep them up.
4. New ideas and enthusiasm of a young person - helps to keep one from growing old, becoming "out-of-date".
5. Less confinement to farm duties - with shared responsibilities it is easier to get away for vacations or trips.
6. A better business and more income - the business keeps growing rather than leveling off or declining.

These advantages will be achieved only if there are certain essentials in the situation. It is important that a family considering the possibilities of a partnership take a hard look at the essentials for success. These are outlined in the next section.

Essentials for Success in a Partnership

Successful partnerships do not "just happen", they must be carefully considered and developed on a businesslike basis. Farm partnerships often involve members of the family, which can make it difficult to be objective when considering what it takes to make them work. Many partnership ventures fail because they lack one or more of the essentials for success. Ventures that fail often result in personal conflicts and bitterness. Therefore, it is wise to be frank about the situation and if the necessary qualifications are not present it probably will be better not to enter into a partnership.

Over time certain essentials for success have been identified. These have been divided into the personal and the business characteristics. Below in outline form are some essentials for success. Examine these one by one and decide whether you have what it takes.

Personal Characteristics

It is suggested that the personal characteristics be examined first since these are the most difficult to change. If the personal traits are lacking, do not assume that a formal partnership agreement will change them (IT WON'T).

1. Ability to work with other people. (No place for the "loner").
2. Respect for partner. (Father for son, and son for father, etc.).
3. Willingness to "give and take." If one is always expected to do the giving in time it usually leads to trouble.
4. Good business and work habits. Each carry a fair share of the load.
5. Spouses informed and supportive.
6. Confidence in farm partnership and what it can do for both.

Business Characteristics

A profitable farm business is essential to the long-term success of any partnership. In addition, there are features related to the operating procedures of the business that are important. Examine these characteristics carefully and if certain things are lacking initiate plans to correct them. Business characteristics are easier to change than personal characteristics.

1. Adequate income to support partners' families.
2. Separate living quarters for the families.
3. Management shared by both partners (each must have a voice).
4. Income shared on the basis of what each contributes to the business.
5. A workable plan for handling records and finances.
6. A definite agreement (preferably written).

Determining Contributions of Partners

One of the essentials is that of sharing income on the basis of what each partner contributes. This immediately suggests that partnership incomes may be shared on some basis other than 50-50 since in two-generation arrangements the contributions are usually not equal. For good understanding, the partners need to recognize the variations in contributions.

A problem arises in how to determine the relative contributions of each partner. One approach is to determine what it would cost the business to hire or pay for the contributions made by each party. Since capital and labor are the main contributions, present wage and interest rates are generally used.

In working out business arrangements, the parties may decide to share the income in proportion to each partner's contribution. Sometimes the difference between the receipts and expenses are divided on this basis. In others, the net profits, after paying wages to each partner and paying an interest allowance for the money used, is shared on this basis.

Below is an illustration where the father owns the farm and one-half of the equipment and the livestock:

Item Contributed	Value of Contributions		
	Father	Son	Total
Investment in land and buildings \$225,000 at 10 percent	\$22,500	---	\$22,500
Investment in equipment \$90,000 @ 10 percent	4,500	\$4,500	9,000
Investment in livestock \$135,000 @ 10 percent	6,750	6,750	13,500
Labor, 12 months at \$900 per month	10,800	10,800	21,600
Total value of contributions	\$44,550	\$22,050	\$66,600
Percentage contributed by each	67%	33%	100%

In this example, contributions are at the ratio of 67 percent by the father and 33 percent by the son. Consequently in this arrangement, the income might be split 2/3 to the father and 1/3 to the son.

Figuring the contributions of each party helps to clarify what each is putting into the business. It also can serve as a step in arriving at an understanding of the fundamentals underlying a partnership agreement.

Kinds of Partnership Arrangements

Many different kinds of partnerships have been developed. Details vary according to the desires of the persons concerned. There are some general patterns that exist which provide a basis for considering various alternatives. Four general kinds of arrangements are outlined below. For those in the early stages of thinking about partnerships examine the general kinds and then select the one or two that seem most likely to fit your situation.

Sharing in Farm Profits

Under this arrangement, the senior partner retains all ownership but the younger person receives a share of the net income as pay for his or her efforts.

This arrangement might properly be called an incentive or profit-sharing plan for an employee. The junior member never gains any ownership under this plan. It can be a desirable arrangement during a trial period since no joint ownership is involved and it can be terminated easily.

Share Farm Profits and Grow Into the Business

This type is sometimes referred to as a "growing in" arrangement. In addition to sharing in the net farm income the junior party acquires a share in the ownership of all animals raised and all animals and machinery purchased after the arrangement begins.

Under this arrangement, the junior partner gradually acquires a share in the ownership of the personal property. There are considerations to be worked out in regard to depreciation costs. This plan, although simple on the surface, has potential problems and tends to be lacking in clear-cut business procedures.

Buy Into the Business and Share Farm Profits

"Buying in" is the term often applied to this kind of arrangement. The junior party buys a share of the ownership of the property at the start of the joint venture.

With this plan, the junior partner agrees to buy from the senior party a half interest in all the personal property (some times the real estate too) at the beginning of the arrangement. The senior party often finances the purchase by taking a note. This is a clear-cut businesslike transaction and all ownership of livestock, machinery, feed and supplies is then joint from the very beginning and all increases or decreases in amounts are shared jointly.

Limited Partner Provides Capital Only

Parents or a senior party may not be interested in taking a full-scale active role in the operation of the business yet is willing to provide financing. In this situation, a few have developed "limited partnerships" whereby the senior partner provides capital, possibly some management, but little if any labor.

In this kind of arrangement, all appreciation (due to inflation) and growth may accrue to the younger partner. This may be advantageous to the senior party for estate planning purposes.

A Partnership or a Corporation

In developing plans for a joint farm business arrangement, the question arises of the relative merits of a partnership and of a corporation. Both are types of joint ventures, so a family should consider both and select the one that best suits their situation. Below are advantages and disadvantages often cited for a corporation:

Advantages of a Corporation:

1. Flexibility in dividing ownership.
2. Insulation from personal liability.
3. Employee status for owner (certain benefits).
4. Provides basis for good planning, accounting, and managing.

Disadvantages of a Corporation:

1. Red tape and complexity (filing reports, etc.).
2. Additional costs - to form and to operate.

Situations Where Corporations May be Desirable:

1. Three or more persons involved in the business.
2. Large scale operations.
3. Where owners also operate other businesses.
4. Operation with retail outlet and/or seasonal labor.
5. Owners have sizeable nonfarm investments.
6. Farm business puts owners in 20% or above tax brackets.

Tax Advantages of a Corporation:

1. Start new business, choice of tax year and method of reporting
2. Additional flexibility in leveling income by dividing "profit" between corporation and salaried employees.
3. May qualify some income for lower tax rates.
4. Some expenses can be shifted from personal to business.
5. Increases possibility of IRS accepting salaries or wages of wife or other members of the family.

Tax Disadvantages of a Corporation:

1. If not careful, may incur double taxation.
2. Less favorable capital gains taxation (important on dairy farms).
3. Pay more Social Security Tax (employer and employee rates).
4. Workmen's Compensation and Unemployment Insurance tax or assessment for family members (now employees).
5. Likely to get closer checking by IRS.

In general, partnerships are a simpler form of farm business organization than are corporations. For more information on corporations, see A.E. Res. 76-27, A.E. Res. 76-28, and North Central Regional Publication #11 "The Farm Corporation."

Case Study of a Farm Partnership Arrangement

There is no one formula for successful farm partnerships. Each situation is different so a family must develop their own plan. However, it is helpful to know what others have done. In this section a case study is made of the Swanson farm family. The various stages from first considering the possibilities of a partnership to engage the son, through to the father's retirement or disengaging are examined. Figures are included to show how a proposal might work.

The Swanson Farm Family Situation

Family Bob Swanson, age 51, wife Ellen, age 48. Son Frank, age 25, married and working at home. The Swansons have a daughter, age 22, who is a teacher (no other children). Frank graduated from the College of Agriculture three years ago, and has been working at home for wages (\$150/week). Frank and his wife live in a mobile home which is located on the farm.

Farm Farm contains 500 acres, 350 tillable, excellent soils. Freestall barn for 80 cows was constructed 6 years ago, expanded to 100 cows two years ago. Silo capacity for 1,500 tons, plus sealed storage for high moisture corn. House is in excellent condition. Frank owns a pickup truck now being used for farm business and 15 head of livestock. The truck is valued at \$5,000 and the livestock at \$10,000. This property is not included in Bob's farm inventory. Real estate is all owned by Bob and Ellen as tenants-by-the-entirety with right of survivorship.

Finances Bob owes \$70,000 on a real estate mortgage held by Federal Land Bank. Payments are \$600/month. He also owes \$70,000 to P.C.A., secured by a lien on cattle and equipment. Payments are \$1,400/month. Bob has \$30,000 in nonfarm assets (investments, cash value life insurance, etc.). Bob has \$90,000 of life insurance with Ellen the beneficiary (\$20,000 whole life, \$70,000 term).

Tax Situation Bob files on the cash basis, and uses the calendar year. The adjusted tax basis of the farm real estate is \$50,000, the equipment \$80,000, and the livestock zero. Bob's adjusted gross income last year was \$20,000, taxable income \$18,000, federal personal income tax paid \$3,800.

Plans Bob is in excellent health, and has no desire to slow down at this time. Frank and his wife are looking forward to farming as a career. Bob is willing to share ownership as well as management responsibility with Frank. They have discussed the possibility of a partnership and also of a corporation and are attempting to evaluate the advantages and disadvantages of each for their particular situation.

Swanson Farm Business Summary

<u>The Farm Inventory</u>		<u>Crops Grown</u>		
<u>Item</u>	<u>Market Value</u>	<u>Crop</u>	<u>Acres</u>	<u>Production</u>
Real Estate	\$235,000	Corn Silage	100	1,600 tn.
Equipment*	100,000	Wheat	30	1,500 bu.
Livestock*	150,000	Hay	75	225 tn.
Feed and Supplies	40,000	Corn Grain	<u>130</u>	12,000 bu.
Coop Stocks	6,000	Total	335	
Accounts Receivable	16,000			
Farm Checking Account	<u>3,000</u>			
Total	\$550,000			
<u>Farm Receipts</u>		<u>Farm Expenses</u>		
Milk	\$190,000	Labor**		\$ 16,000
Dairy Cows Sold	13,000	Feed		50,000
Bob Calves, Etc.	3,000	Equipment Expense		10,000
Crop Sales	6,000	Gas & Oil		8,000
Misc. Cash Receipts	<u>3,000</u>	Crop Expense		18,000
Total Cash Receipts	\$215,000	Livestock Expense		15,000
<u>Inventory Increase</u>		Building Repairs		3,000
Livestock	\$ 7,500	Taxes & Insurance		8,000
Feed & Supplies	<u>2,500</u>	Electric & Phone		4,000
Total Farm Receipts	\$225,000	Interest		15,000
		Other Cash		<u>3,000</u>
		Total Cash Expenses		\$150,000
		Depreciation		<u>20,000</u>
		Total Farm Expenses		\$170,000

* Does not include Frank's Farm property (\$15,000).

** Includes \$8,320 paid Frank (\$7,800 wages + \$520 Social Security).

Initiation of Swanson Farm Partnership

The Swansons prefer to start with a "Buy-In" arrangement on the personal property. Bob and Ellen will own the real property and rent it to the partnership. To initiate the partnership Bob will sell Frank a one-half interest in his livestock and machinery, and also buy a half interest in Frank's truck and livestock. Then all partnership livestock and machinery will be jointly owned (50-50) by Bob and Frank.

It has been decided that the feed and supply inventory, which is personal property, will not be included in the sale of a half interest. (The nature of this asset which will be consumed often makes fathers hesitant to charge the son for it, so they contribute it to the partnership as though it had no value.) However, to protect Bob in case of an early termination, it is agreed that if the partnership terminates within five years Frank will, at time of termination, reimburse Bob for one-half of the \$40,000 of feed on hand at the start of the partnership.

It is agreed that the partnership will assume responsibility for all of Bob's outstanding farm debts (on both real and personal property). The half of the debt assumed by Frank will be credited to him toward the purchase of his half interest in the personal property. Frank will give Bob an interest bearing note for the balance owed to purchase a half interest. The calculation for the transfer would be as follows:

Value of Bob's:

Equipment	\$100,000
Livestock	150,000
Cash in checking account	3,000
Accounts receivable	16,000
Coop. stock	<u>6,000</u>
Total of Bob's farm assets	\$275,000
Less Farm Debt assumed by partnership	<u>140,000</u>
Bob's Equity to the partnership	\$135,000
Frank's Equity to the partnership	<u>15,000</u>
Total Equity in the partnership	\$150,000
Frank's half =	\$ 75,000
Frank's Equity contributed	<u>15,000</u>
Balance Frank will owe to Bob	\$ 60,000

As a result of this transaction: Bob and Frank each owns half of \$290,000 of assets or \$145,000, and has half the farm debt of \$140,000 or \$70,000 each. Also Frank owes Bob \$60,000 on a personal note.

Points agreed upon at time of initiating the partnership include:

1. The partnership will start as of January first since income taxes are filed on a calendar year basis.
2. The partnership will be between Bob and Frank. The wives will be kept informed on the terms of the agreement but will not be included as partners.
3. Since the real estate is owned jointly by Bob and Ellen it is essential that Ellen agree to the terms of the partnership. The rental arrangement, the termination agreements, and any future arrangements for the partnership handling of capital improvements, will involve Ellen's ownership interests. Consequently, her approval should be indicated in the legal documents drawn.
4. A written rental agreement between the partnership and Bob and Ellen for use of the real property will be drawn. A purchase option will be included in the rental agreement.
5. Farm inventory values will be used for the purchase price. Bob and Frank considered hiring an appraiser to determine the values to be used but decided both were satisfied with the inventory values and, therefore, could save the cost of the appraiser's fee. They are aware that an appraisal might have an advantage in case of a tax audit.
6. Both the debt on the real estate and the debt on the personal property will be assumed by the partnership even though Bob and Ellen will continue to own the real estate. Frank's debt to Bob for purchasing a half-interest in the personal property will be reduced by the amount of his half of the debt assumed by the partnership. In this way he gets credit for payments he helps make on the debt on Bob and Ellen's real estate. It will be important to get the approval of the lender on this arrangement. This way of handling the debts is equitable to both partners and makes a simple way of handling the debt payments.
7. It is recognized that if the partnership decides to make any major capital improvements to the farm, that the agreement will need to be modified to cover the ownership of these capital improvements.
8. Partnership insurance for funding the buy-sell agreement has been suggested by Frank's life insurance agent. The difference in cost because of the age spread is a factor. It has been agreed that both Bob and Frank will review their personal insurance programs and they will consider possible insurance plans for at least partial funding of the down-payments in their buy-sell agreement.
9. The tax effects of the proposed buying-in arrangement will be considered and checked with Bob's tax consultant before the agreement is finalized.
10. A written partnership agreement is to be worked out using the outline on pages 20 to 24 as a guide.

Tax Considerations Related to the Sale of Farm Property

The allocation of the sale price between livestock and machinery can have a tax effect. There is some flexibility in how the total amount is allocated. It has been suggested that Swansons increase the sale price of the livestock from the inventory value of \$150,000 to \$170,000, and reduce the machinery from \$100,000 to \$80,000 which is the tax base for income tax purposes.

Taxable Amount of Sale by Bob to Frank

- Livestock \$170,000 ÷ 2 = \$85,000 - a key tax consideration since this is eligible for capital gains treatment
- Equipment \$ 80,000 ÷ 2 = \$40,000 - no tax concern as tax base = sale price (investment credit recapture a concern)
- Coop. stock \$6,000 ÷ 2 = \$ 3,000 - tax base = sale price so no problem
- Cash \$3,000 ÷ 2 = \$ 1,500 - tax base = sale price so same as above.
- Accounts receivable \$16,000 ÷ 2 = \$ 8,000 - not reported until cash received so no tax base

Livestock Sale

1. Need to divide livestock into two classes because of capital gain provisions -

	<u>Over 2 Years Old</u>	<u>Under 2 Years Old</u>
a) Total value	\$120,000	\$50,000
b) Sale value or gain (raised animals)	\$ 60,000	\$25,000
c) Taxable gain (40%)	\$ 24,000	(100%) \$25,000 = Total \$49,000

Since these are raised animals, the tax base is zero for (b) above and reporting will be relatively simple. Each year, amount received on principal of contract (Frank's note held by Bob) will be allocated in this order:

- 1) Cash
- 2) Youngstock purchased
- 3) Older cattle purchased
- 4) Equipment purchased

The payments on principal must first be allocated to those items which would result in ordinary gain (1245 and 1250 property). In this instance, that means principal payment first allocated to the youngstock until the \$25,000 is paid.

Investment Credit Recapture

Investment credit taken on machinery purchases which have not been used for the specified life will be subject to some recapture. If there is a recapture on equipment sold by Bob to Frank, Bob must so report on his tax return for the year of sale. Some families decide to have the father furnish the equipment on which there would be a recapture and then rent this to the partnership much as Bob and Ellen are renting the real estate to the partnership.

Testing the Proposed Financial Arrangement

It is suggested that after a decision has been made on the general financial arrangements, the plan should be tested. Based on last year's business and the plans for the coming year, each party can figure how he will fare under the proposed plan. If it is not satisfactory, the arrangements should be adjusted until it is.

The Swanson's farm business summary for the past year was used to test the proposed plan. The proposed sharing arrangement was applied to the actual receipts and expenses as reported in the summary. The returns that each partner would have received from last year's operations are figured below:

The rent to be paid is 8 percent of the real estate value with the partnership paying the taxes, insurance, and repairs. The wages paid Frank will be taken out as he will now share in the income. Debt payments are \$2,000/month or \$24,000 (interest \$15,000, principal \$9,000). Profits to be shared 50-50. Depreciation is \$12,000 on machinery and \$8,000 on buildings.

Division of farm income for last year would have been:

Total Cash Receipts		\$215,000
Total Cash Expenses	\$150,000	
Less Frank's wages	<u>8,320</u>	
Net Farm Operating Expenses		\$141,680
Rent 8% x \$235,000		18,800
Principal payments on debt		9,000
Allowances @ \$1,000/mo. each		<u>24,000</u>
Total Partnership Expenses		<u>\$193,480</u>
Partnership Profit (50-50)		\$ 21,520

Recap:

	<u>Bob & Ellen</u>	<u>Frank</u>
Allowances to partners	\$12,000	\$12,000
Share of Partnership profit	10,760	10,760
Rent for real estate	<u>18,800</u>	<u>---</u>
Total Cash Income	\$41,560	\$22,760
Farm Credit principal payments	\$ 4,500	\$ 4,500
Increase in inventory	<u>5,000</u>	<u>5,000</u>
Total Income	\$51,060	\$32,260
Less depreciation	<u>14,000</u>	<u>6,000</u>
Net Income from Business	\$37,060	\$26,260

Annual Review of Partnership

The Swanson farm business had been dynamic over the years and continued to be as a partnership. Consequently, an annual review at financial settlement time proved to be desirable. They discussed ways of improving the business arrangement and changes that were mutually agreed upon were incorporated into the agreement.

Adding a Third Partner

During the second year of the partnership Frank's sister married. Jim, the brother-in-law, had grown up on a farm and expressed some interest in joining Bob and Frank in their partnership. The three worked out a plan whereby Jim might come in as an equal partner.

The partnership assets at the end of the second year were about \$330,000 and the debt \$120,000. Jim would "buy into" the business so that he would have a third interest in the partnership. A one-third share in the assets would be \$110,000 and one-third of the debts would be \$40,000. Consequently Jim would have to "buy in" to the extent of \$70,000. He could do this by giving Bob and Frank each a note for \$35,000. Since Frank had given a note to Bob for \$60,000 they might agree that Jim would give Bob a note for the full \$70,000 and Frank's note to Bob would be reduced to \$25,000 (\$60,000 - \$35,000).

Through this relatively simple procedure Jim could be brought into the partnership as an equal partner. It shows that it is not necessary for a family to postpone starting a partnership just because a younger member of the family might wish to join later. After much discussion, however, it was decided that Jim would continue with his career in school administration.

Handling Major Capital Improvements

Bob and Ellen owning the real estate and renting it to the partnership worked well for the first years. During the fifth year they settled on plans for building a house for Frank and his growing family, and for installing a new manure handling system. These were major investments, and brought into focus the need for a change in the ownership arrangement for the real estate.

It was decided that Bob and Ellen's starting equity would be fixed at the value of the real estate at the end of the fifth year which was determined by an appraiser to be \$250,000. Then all improvements would be made by the partnership and debt payments paid out of partnership income. At time of dissolution of the partnership, the value of the real estate would be determined by two appraisers and any increase or decrease from the \$250,000 would be shared equally by the partners.

This system for handling capital improvements has two major advantages. First it is a simple way of handling the costs of the improvements which often includes a lot of "sweat equity" as well as cash outlays. A second point is that it makes it possible for the younger partner to share in the appreciation that is occurring in real estate values.

Projected Disengagement of Father From the Business

Family Situation

At age 63, Bob Swanson thinks he would like to retire from farming and collect his Social Security retirement benefits. Frank at age 37 has made considerable financial progress and wants to exercise the option to buy his father's share of the partnership business. Bob wishes to work out with Frank a transfer plan that will provide him and Ellen with a retirement income.

Partnership Withdrawal Terms

The partnership agreement provides that Bob's equity in the real estate at the beginning of the partnership was \$250,000 and that upon dissolving any increase in value over the \$250,000 will be shared equally by Bob and Frank. The value at dissolution is to be determined by two appraisers. Also the remaining partner can pay 10 percent down and the balance over 20 years and at 7 percent interest.

Financial Situation at Time of Retirement (12 years from now)

With moderate inflation and continued growth of farm businesses it is projected that at time of retirement the value of the real estate might be \$600,000 and the personal property \$600,000. The debt at that time might be a mortgage on real estate of \$150,000 and operating loans of \$150,000. Frank's personal note to Bob had remained at \$60,000.

Calculated Sale Price at Time of Retirement

		<u>Bob</u>	<u>Frank</u>
Appraised value of real estate	\$600,000		
Bob's beginning equity	<u>250,000</u>	\$250,000	
Increase in value	<u>\$350,000</u>		
Partner's to share increase (50-50)		<u>175,000</u>	<u>\$175,000</u>
Net real estate shares		\$425,000	\$175,000
Appraised value personal property	\$600,000		
Partner's share equally		<u>300,000</u>	<u>300,000</u>
Total assets of each partner		\$725,000	\$475,000
Partnership debts	\$300,000		
Partner's share equally		<u>150,000</u>	<u>150,000</u>
Partner's farm net worth		\$575,000	\$325,000
Personal note (Frank to Bob)		<u>+ 60,000</u>	<u>- 60,000</u>
Personal net worths		\$635,000	\$265,000

Frank would purchase Bob's assets in the partnership valued at \$725,000. He would do this by assuming the partnership debt and owing Bob for the balance or for \$575,000. In addition there is the personal note that Frank owes to Bob of \$60,000 which was the original note given at the start of the partnership. This would make a total of \$635,000 that Frank would owe to Bob.

Financial Situation After Sale

Frank would own the entire farm business with total assets of \$1,200,000. He would owe Farm Credit \$300,000 and his father \$635,000 with a net worth of \$265,000. This would be an equity of 22 percent.

Bob would have a net worth of \$635,000 to be used to pay the costs of getting out of the business, purchase a retirement house, and to provide him and Ellen with a retirement income for as long as they live.

This presents the challenge of developing an arrangement whereby Frank can manage the debt obligations and also provide his parents with a satisfactory retirement income.

Retirement Income for Bob and Ellen

Bob estimates that he and Ellen will need a retirement income of \$50,000 per year to provide them a good living and pay their taxes in the 1990's and the early 2000's. They will also need \$150,000 at time of retirement to purchase a house to live in and to pay taxes, legal fees and other costs involved in the disposal of his business.

The Swansons, during their early farming career, reported only small net tax cash incomes, consequently their Social Security base was also small. Since they have chosen to retire early their benefits will be reduced accordingly. Bob estimates that when the early years are combined with the more profitable years in the partnership that they may have Social Security retirement benefits of about \$800 per month.

To help Frank in the financing of a large farm debt, Bob would be willing to provide \$200,000 of permanent capital @ 7 percent interest with a second mortgage as security. The balance or \$285,000 he would like to have financed under the terms of the partnership agreement which calls for amortizing over 20 years at 7 percent interest. (\$150,000 received to purchase house).

With these arrangements Bob and Ellen would have the following as retirement income:

Social Security Retirement Benefits	\$ 9,600
Interest on \$200,000 @ 7%	14,000
Amortization of \$285,000 @ 7% and 20 years	<u>26,400</u>
Total retirement income per year	\$50,000

This would be in line with the projected need of \$50,000 per year for living and taxes.

Developing a Partnership Arrangement

Good business arrangements usually develop slowly. There are many features to be considered. It is a basic phase of a family's management so it is worthy of time and careful consideration. Developing a partnership is not difficult if taken by steps. One decision leads to the next. The steps do not always occur in the same order, but below are some suggested steps to be taken when developing a partnership.

Suggested Steps to be Taken

Learn about the various types of business organization. What are the general advantages and disadvantages of each? How do joint ventures compare with single operator businesses?

Examine the essentials for success. Consider the personal and the business characteristics needed. Decide whether you have what it takes?

Compare partnerships and corporations. Which appears to be better for you at this time?

Investigate the experience of other families. The cases in this publication can serve as a start. Visit with families that have operated as partnerships or corporations. Their experience and suggestions can be helpful.

Consider the different kinds of partnerships. Based on the general description in this publication and the experience of other families, select the kind that seems to suit you best.

Think through your objectives. Decide where you are now and where you would like to be in the future. This involves both ownership and operation of the business. Tackle these one at a time. Your objectives will affect the specifics of your arrangement.

Work out a general plan. This should include both the ownership and the operating plans. Decide on the general first, then the details later.

Fill in an outline form (see page 20). The potential partners need to discuss and decide upon each point. This first draft will require time.

Test the proposed financial arrangement. Based on last year's business, figure how each party would have fared under the proposed plan. Last year's records can be helpful. This may show that adjustments are needed.

Rework the outline until it fits your objectives. The first draft may be modified several times. Re-examine it a day or so later.

Take proposed draft to your attorney. Ask the attorney to examine, make suggestions, and put it into a legal working-draft form.

Read attorney's draft carefully. When draft is ready, all parties should read it carefully several times. Often further changes need to be made.

Have attorney put into final form. Again read carefully before signing. All parties should sign and each have a copy for his or her files.

Outline for Farm Business Partnership Agreement

The "Outline" below is a tool for use in developing an agreement. It will suggest the things that need to be considered. Each section should be discussed and modified to fit your situation.

This outline is for planning purposes only. Think through what you want, make notes on what you decide, then have your attorney review it and prepare the formal legal document.

FARM PARTNERSHIP AGREEMENT

SECTION I. Parties to the Agreement

This agreement made this _____ day of _____, 19____, by and between the following parties:

SECTION II. Purpose of the Agreement

The above parties form this agreement for the sole purpose of operating a farm business on the following described real estate:

SECTION III. Period Covered

This agreement is to start (mo.) _____ (day) _____ 19____, and to continue from year to year on the terms herein stated until this agreement is dissolved or until it is replaced by another written agreement. The agreement may be dissolved by one party serving notice on the other(s) at least _____ months prior to the end of the year on which dissolution is desired.

SECTION IV. Contributions

A. Labor

Each party shall contribute his or her entire labor and management to the farm business.

SECTION IV. Contributions cont'd.

B. Real Estate

The real estate used in the partnership is to be owned as follows:

Capital improvements shall be made by: _____

Taxes, insurance, and repairs shall be provided by: _____

The owner shall be compensated for the use of the real estate as follows:

C. Personal Property

1. Livestock: _____

2. Machinery and equipment: _____

3. Feed and Supplies: _____

SECTION V. Management

A. General operating plans shall be discussed and agreed upon at the beginning of each year. Adjustments that appear desirable during the year shall be made after being agreed upon by the partners.

B. All purchases involving more than _____ dollars shall be mutually agreed upon.

C. A joint checking account shall be carried with _____
_____ Bank. Checks shall be signed by any partner.

D. The following financial records are to be kept:

1. A complete inventory showing ownership and value of all property used in the farm business shall be made at the time the agreement starts and at the end of each year thereafter. All values shall be agreed upon by all partners and each shall sign the inventory record at the time the inventory is completed.
2. A current record of all farm receipts and expenses, including allowances made to each party, shall be kept by _____

SECTION VI. Receipts, Expenses, and Partnership Profits

Profits for the year shall be calculated as indicated below:

<u>Partnership Receipts:</u>		<u>Partnership Expenses:</u>	
Cash operating receipts	\$ _____	Cash operating expenses	\$ _____
Work off the farm	_____	Allowance for _____	_____
Sale of livestock	_____	Allowance for _____	_____
Sale of machinery	_____	Rent for real estate used by the partnership	_____
Other	_____	Other	_____
Total Receipts	\$ _____	Total Expenses	\$ _____
	Total Receipts	\$ _____	
	Total Expenses	_____	
	Partnership Profit	\$ _____	

Explanation of Items

A. Partnership receipts shall include:

1. All cash operating income from the sale of crops, livestock produced for sale, and livestock products.
2. Income from any work off the farm by any partner.
3. Capital sales of livestock.
4. Capital sales of machinery.
5. Miscellaneous cash income of the farm business.

B. Partnership expenses shall include:

1. Cash operating expenses for: fertilizer and lime; seed; purchased feed; spray materials; wages and related farm labor expenses; real estate taxes; farm business insurance; rent for additional land; purchases of livestock; purchases of new equipment; operating expenses of all equipment and tools; repairs and replacements

necessary to keep buildings, fences, wells, and drains in good condition; machine hire; electric lights and power; debt payments on debts of the partnership; other expenses mutually agreed necessary for the operation of the farm business.

2. The allowance or draw for each partner shall be paid _____ (weekly or monthly). The amount of the allowances shall be agreed upon at the beginning of each year.
3. Rent paid for the use of real estate furnished by one partner shall be paid _____ (monthly or annually); the amount to be figured at _____ % on the beginning inventory value.

SECTION VII. Financial Settlement

Each party is to have a _____ share of the profits as calculated in SECTION VI. A complete financial settlement shall be made within _____ days of the end of the business year. The amount to be left in the partnership checking account shall be mutually agreed upon and the balance transferred to the individual partners.

SECTION VIII. Living Arrangements

Living quarters for the partners shall be provided as follows _____

SECTION IX. Death of a Partner

At the death of a partner, this partnership agreement shall terminate. It is agreed that the survivor may continue to operate as a partnership to the end of the year in which death occurs with the executor representing the deceased's interest. Dissolution of the partnership shall be effected in the following manner:

The surviving partner(s) shall have the option to buy the deceased partner's share as follows:

1. The purchase price shall be _____
2. The survivor(s) must accept or reject this offer within _____ days of a partner's death. If they accept, they shall pay _____ % down within _____ days and an additional _____ % at the end of each succeeding year. Interest on the outstanding balance shall be at _____ % per annum payable at the end of the year.
3. If the survivor(s) reject the option to buy, all partnership property shall be sold at public or private sale within _____ months of the end of the year in which death of a partner occurs.

SECTION X. Dissolution for Reasons Other than Death

If a partner wishes to withdraw or terminate the partnership for any reason other than death, he must offer his share of partnership property to his partner(s) on the following terms:

1. Notice of intent as required in Article III must first be given in writing.
2. The purchase price shall be _____

3. The remaining partner(s) must accept or reject this offer within _____ days. If they accept, they must pay _____% at the time of dissolution and an additional _____% at the end of each succeeding year. Interest on the unpaid balance shall be at _____% per annum payable at the end of the year.
4. If the remaining partner(s) reject the option to buy, all partnership property shall be sold at public or private sale within _____ months of the original offer.

SECTION XI. Disability of a Partner

In case a partner is disabled for a period of _____ months or more, the following arrangements shall be made: The disabled partner shall continue to receive his regular partnership draw for _____ months of disability, and his partnership share of profit for _____ months of disability. If disability continues more than _____ months, he must then offer to withdraw on the same terms as listed in Article X.

SECTION XII. Review of Agreement

This agreement shall be reviewed each year at the time of financial settlement and changes that are mutually agreeable shall be incorporated.

SECTION XIII. Arbitration

If any matter pertaining to the farm business cannot be settled by mutual agreement, that matter shall be submitted to one disinterested person agreeable to both.

SECTION XIV. Agreement Binding on Heirs

It is agreed that the terms of this partnership agreement shall be binding upon the partner's heirs, executors, administrators, or any other concerned persons.

SECTION XV. It is further agreed that _____

Example of a Father and Son Farm Business Agreement

Below is an example of an arrangement that was worked out by one farm family. It is not presented as a "model", it simply shows an agreement by one father and son.

FARM BUSINESS AGREEMENT

This agreement made this first day of January 1976, by and between Allan Paine the father and James Paine the son.

I. Purpose

The aforesaid father and son hereby form this agreement for the sole purpose of operating a farm business on the following described real estate: Happy Valley Farms, consisting of 465 acres, located about six miles south of Bellmore, in the Towns of York and Pike, situated in the County of Lincoln, in the State of New York and on any other land which said partners may agree to rent for farming purposes.

II. Period Covered

This agreement is to start January 1, 1976 to continue from year to year on the terms herein stated until this agreement is dissolved or until it is replaced by another written agreement. The agreement may be dissolved by either party serving notice on the other at least six months prior to the end of the year on which dissolution is desired.

III. Contributions

A. Labor

Each party shall contribute his entire labor and management to the farm business.

B. Real Estate

The value of the father's equity in the farm real estate at the beginning of the agreement is \$100,000. It is agreed that the father shall receive annual rent at five percent of his beginning equity in real estate and that the partnership shall have use of this real estate. The partnership shall pay real estate taxes, and keep farm buildings insured at or above levels existing at the time this agreement is initiated. The partnership shall make all payments of interest and principal on debts against the real estate, and shall make all repairs and capital improvements to said real estate.

At time of dissolution of the partnership or the sale of the real estate, the father's ownership in the real estate shall be the beginning equity as shown above plus one-half of the increase (or decrease) above that amount. The son shall own the other half of the increase or decrease.

C. Personal Property

At the beginning of this agreement, the father shall sell to the son a one-half interest in his equity in all farm machinery and all live-stock. The son shall give to the father a personal note for the full amount of the transaction, said note to bear interest at six percent.

The father shall contribute all feed and supplies now on the farm to the partnership without charge to the son, with the stipulation that in the event the son leaves the partnership within five years, the feed and supplies on hand at the time the son leaves within that period shall be considered the property of the father.

Hereafter, except for the above stipulation, all personal farm prop-erty, raised or purchased, shall be owned in equal shares by the father and the son, and all debts against this personal property shall be the responsibility of the partnership.

IV. Management

- A. General operating plans shall be discussed and agreed upon at the beginning of each year. Adjustments that appear desirable during the year shall be made after being agreed upon by both parties.
- B. All purchases involving more than \$500 shall be mutually agreed upon.
- C. A joint checking account shall be carried with First National Bank of Bellmore. Checks shall be signed by either party.
- D. The following financial records are to be kept:
 - 1. A complete inventory showing ownership and value of all property used in the farm business shall be made at the time the agreement starts and at the end of each year thereafter. All values shall be agreed upon by both parties.
 - 2. A current record of all farm receipts and expenses, including allowances made to each party, shall be kept by James Paine.

V. Receipts and Expenses

Profits for the year shall be calculated as indicated below:

Receipts:

Total cash farm receipts \$ _____

Expenses:

Cash farm expenses	\$ _____
Son's allowance	_____
Father's allowance	_____
Interest on father's beginning equity in real estate	_____
Total Expenses	\$ _____
Partnership Profit	\$ _____

Explanation of Items

- A. Cash receipts shall include all income from the sale of crops, livestock, and livestock products. Also all income from work off the farm by either party. Also any miscellaneous cash income of the farm business.
- B. Cash expenses of the farm business shall include fertilizer and lime; seed; purchased feed; spray materials; wages and cash cost of board for hired labor furnished by either partner; taxes; insurance; rent for additional land; purchases of livestock; purchases of new equipment; capital improvements to farm real estate; operating expenses of all equipment and tools; repairs and replacements necessary to keep buildings, fences, wells, and drains in good condition; machine hire; electric lights and power including that for the partners' houses; telephone expense of both partners, except for toll charges for personal calls; heat for houses of the partners; debt payments on debts of the partnership; and other such expenses mutually agreed necessary for the operation of the farm business.
- C. The allowance for each party shall be paid weekly. The amount of these allowances shall be agreed upon at the beginning of each year.

VI. Financial Settlement

Each party is to have one-half of the profits as calculated in Section V. A complete financial accounting shall be made at the end of each year. The partners shall agree at the time of the accounting whether there shall be capital withdrawn from the partnership account or whether all profits shall be allowed to remain in the business.

VII. Living Arrangements

Living arrangements are to be provided as at present for both father and son and their families. All expenses for exterior repairs and upkeep to the houses shall be borne by the partnership. All interior expenses shall be borne by the individual partner. In the event the partnership is dissolved for any reason, the son or his heirs shall have the option to purchase the house in which he lives at the price of \$25,000.

VIII. Death of Either Party

In the event of the death of either partner, this partnership shall terminate. In the event of the death of the son, the father shall have option to buy the son's share of jointly owned farm property at the inventory value as of the previous January 1. The father shall accept or reject said option within 60 days of the death of the son, and if he accepts, shall pay at least 25 percent down, and the remainder within three years. If he rejects the option to buy, the jointly owned property shall be sold at private or public sale within six months.

In the event of the death of the father, the son shall have the option to rent the father's share of all farm property used in the farm business at six percent of the inventory value as of the previous January 1. The option to rent shall be on a year to year basis, to be renewed by the son at his discretion for a total period not to exceed five years from date of father's death. At or before expiration of the five year rental period, the son may exercise an option to purchase father's share of all farm property at the value listed on the farm inventory books the January 1 prior to father's death. If he exercises the option to buy, he must pay at least ten percent down and at least ten percent additional each succeeding year until the debt is paid in full. Interest at 5 percent per annum on the unpaid balance shall be paid at the end of each year.

If the son fails to exercise his option to rent, or upon expiration of the rental option period, if he fails to purchase, then all jointly owned farm property shall be sold at private or public sale.

IX. Dissolution of Partnership for Reasons Other Than Death of a Partner

It is agreed that if the son wishes to dissolve the partnership, he shall give the required six months notice, and he shall offer his share of all jointly owned property to the father at the book value as of the previous January 1.

The father shall accept or reject this offer within 60 days, and if he accepts, shall pay the son a minimum of 25 percent down and the remainder within three years. Interest at 5 percent per annum on the unpaid balance shall be paid at the end of each year.

If he rejects the option, the jointly owned property shall be sold at public or private sale within the period required for dissolution.

If the father wishes to dissolve the partnership he shall offer his share of jointly owned property to the son at the inventory value as of the previous January 1. If the son accepts the option, he must pay at least ten percent down and the remainder in equal installments over a period of ten years. Interest at 5 percent per annum on the unpaid balance shall be paid at the end of each year. If he rejects the option, the property will be sold at public or private sale within the required period for dissolution.

X. Arbitration

If any matter pertaining to the farm business cannot be settled by mutual agreement, that matter shall be submitted to one disinterested person agreeable to both.

General Tips on Partnerships

Many decisions confront a family in the process of developing a good farm business arrangement. A few general suggestions, based on experience working with families on partnerships are offered as a help in making these decisions.

Partners Must Get Along

The individuals in a partnership must be able to work together and get along. This calls for a willingness to give and take and the ability to talk over differences and to come to mutual decisions. These traits should exist when the partnership is formed. A written partnership agreement will not "make" the partners get along. If they didn't get along before, they probably won't after the agreement is signed.

Wives Are an Important Part

The mother and the son's wife can play a big part in making the partnership successful. They must be interested in, and should be familiar with, the business arrangements. Involve them in the development of the agreement.

Other Family Members Concerned

Brothers and sisters have an interest and a financial stake in the home-farm situation. Troubles often can be avoided by keeping all members of the family informed on the general features of a father-son partnership.

Brothers in a Partnership

Two or more sons can be included successfully in a father-son partnership, but problems tend to increase with the number of partners. The attitudes of the brothers and their wives toward each other is extremely important.

Be Businesslike Within the Family

Father and son farm partnerships are business arrangements. Therefore, it is important that financial affairs be handled in a businesslike manner. A common cause of troubles and misunderstandings in partnerships is the lack of clear-cut, businesslike procedures. A good rule is to handle financial matters of the partnership the same as they would be if the partners were nonrelated.

Transfer of Farm Ownership

Good partnerships are progressive. The first stage usually makes it possible for the son to acquire ownership in the personal property (livestock and machinery). Later plans should be made for the eventual transfer of ownership of the real estate.

Father Eventually Retires

Retirement is another stage in life and should be planned carefully. When father becomes eligible for social security retirement benefits, it is often a good time to terminate the partnership. Dad may still work part-time for the son.

Share in Entire Business

Projects are used effectively as an incentive for young boys on the farm. Some families continue the projects after the son finishes school. If the son is to continue on the farm and work into a partnership with his father, there are distinct advantages to shifting from the project basis to an arrangement involving the entire farm business.

A Farm Checking Account

A common arrangement for handling partnership finances is the farm checking account. This is usually a joint account with both partners able to sign checks. All farm receipts are deposited in the account and all farm expenses paid from it. The partners draw a monthly allowance for their personal and living expenses. Businesslike procedures are important here. This account should be used strictly for partnership transactions.

Keep Arrangements Simple

Simple, definite arrangements are easier to understand and present fewer problems than complicated ones. A straight 50-50 ownership arrangement for livestock and machinery with the father given an interest allowance for his real estate investment and all other items shared 50-50 has much to be said for it. There is no one best arrangement but in general avoid complicated and unusual features.

Written Agreements

A written agreement in itself will not make a partnership work but it can help. Putting the agreement in writing causes the partners to think through the details and to arrive at definite understandings. This may prevent troubles later. It also serves as a record of what was agreed upon in case of a death or someone forgets.

Check the Tax Effects

Taxes become involved when a father sells or gives property to a son. Before a specific agreement is reached, explore the likely tax impact.

Provide For Dissolution

All partnerships must be terminated at some time. How the partnership is to be terminated should be decided before the partnership starts and included in the written agreement. Provide for possible dissolution due to disability, death, disagreement or retirement.

Use Your Management Team

Use your attorney, tax accountant, lender, and insurance agent as a management team to help you in developing a partnership agreement.