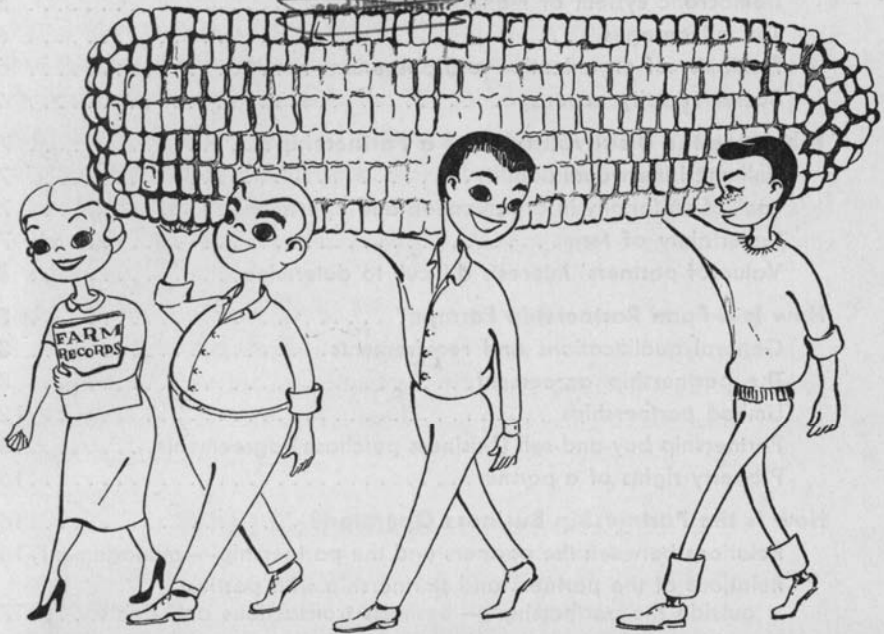


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PARTNERSHIPS

IN THE FARM BUSINESS

by N. G. P. Krausz and Fred L. Mann

CIRCULAR 786

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PARTNERSHIPS IN THE FARM BUSINESS

By N. G. P. KRAUSZ and F. L. MANN¹

WHEN PROPERTY AND INCOME were subject to few taxes and capital investments were fairly small, self-operation or a landlord-tenant agreement satisfied most farm owners. Today farmers are subject to high estate, gift, inheritance, and income taxes, and their capital investment is quite large. These factors plus the growing need for more efficient farming and for continuity in a going business prompt many farmers to seek other forms of business organization. The farm partnership and the farm corporation can, in some cases, meet this demand for efficiency, continuity, more capital, and tax reduction.

The object of this circular is to explain the advantages and disadvantages of partnerships as used in the farm business.² The publication is not a substitute for individual enterprise or professional legal advice and assistance. Solutions to individual problems will usually require expert legal help.

What Constitutes a Partnership?

A partnership is an association of two or more persons to carry on, as co-owners, a business for profit. Partnerships are governed by a code of rules called the Uniform Partnership Act. Additional rules may be adopted in the individual partnership agreement. However, persons dealing with the partners are not bound by the partnership's rules unless they have actual knowledge of them.

A partnership is created by an oral or written agreement. In some cases a partnership may be implied without an agreement if the business is being carried on like a partnership. A carefully drafted written agreement, however, is the best insurance against later misunderstanding between the partners.

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² The advantages and disadvantages of the farm corporation are discussed in the circular, "Corporations in the Farm Business."

What Should You Consider Before Going Into Partnership?

The success of a partnership depends largely upon the ability of the partners to agree on business policy and management. A member of a partnership must often endorse the actions and decisions of his partners. Join in partnership, therefore, only with responsible persons whose ethics and farm practices are congenial to yours.

The business itself must be of such a character and size that it will efficiently use the available time, abilities, and assets of the partners. Outside income of any partner should be considered as should the amount of capital each partner will contribute to the business. In most cases the final decision is based on whether the expected return on their investment will be sufficient to satisfy the partners.

Farm partnerships may be used by father and son, allowing the son an opportunity to get into business without eliminating the father from active participation. Brothers often find the partnership an ideal means of pooling their assets to begin farming. A family partnership including all responsible members of a family is a means of promoting interest and utilizing family ability in farming.

A partnership with one managing partner may be the solution for the heirs where physical division of the estate is not practical or where the father desired that his estate remain a single unit in the family.

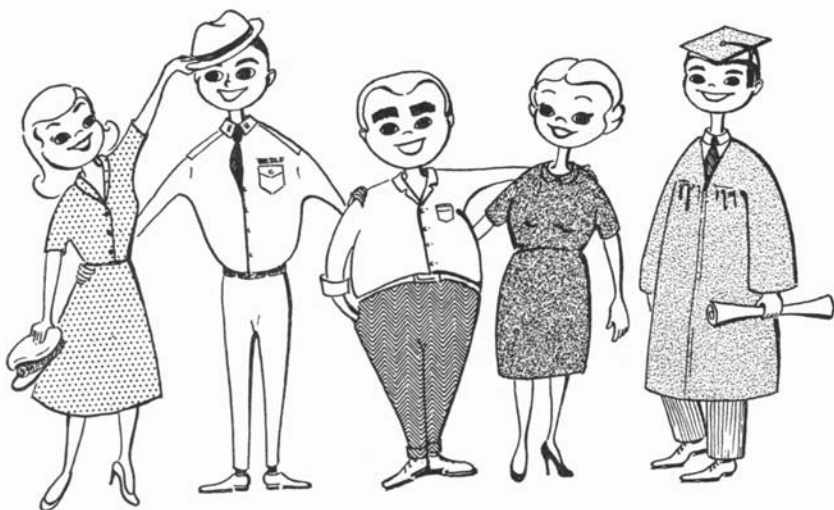
Unrelated individuals such as a landlord and a tenant may find an advantage in combining their assets in a farm partnership. It gives each person an interest in all the property, tending to promote conservation of the land. It also provides a means for making capital contributions in different proportions.

What Are the Advantages of a Partnership?

Means of pooling resources

Individuals wanting to farm as owner-operators may not be able to do so because of a lack of funds. By combining their assets they can often finance a complete farming enterprise. Two individuals, one the owner of land and the other the owner of livestock and machinery, may be able to combine their assets and at the same time increase the efficiency of the farming operation.

In general, the partnership can be used when a combination of assets will increase returns while maintaining the proportionate value of each



Family farming ability may be employed to best advantage in a farm partnership. The Farmer family partnership combines the labor and capital resources of Bill and Mary Farmer, their married son Jack, and younger son Don. The forms they used in their partnership are included on pages 28 through 38.

partner's interest. It also allows contributions of labor and management by one partner in lieu of part or all of his share of the capital contribution.

Democratic system of management

The partners may place management power in anyone they desire so long as they all consent to it. In the absence of such agreement or unless there is unanimous consent on management questions, the Uniform Partnership Act controls. Under this law, all partners have equal rights in the management and conduct of the partnership business regardless of financial interest. No person can become a member of the partnership without the consent of all the partners. Any differences that arise concerning the partnership business are decided by a majority of the partners, but no action that violates any agreement between the partners may be taken without the consent of all the partners.

The whole scheme of partnership ownership allows little chance for partners to lose control of their right to a voice in management. If a partner does lose his right to participate in partnership affairs, it is by his own action and presumably for the mutual benefit of all partners.

Tax advantages

A partnership pays no tax on its income although an information return is filed. Partnership income is taxed only once. The tax is paid by the partners as part of their individual income tax return. By contrast, a corporation is taxed on its profit, and that profit is again taxed to the shareholders when distributed as dividends. Another advantage over a corporation is that a partnership pays no state or federal organization or operation taxes.

Where a family partnership is used, or when a person forms a partnership with others who are his dependents or employees, there may be substantial tax savings. Income is divided among more people and is kept in lower rate brackets. The following table illustrates this advantage.

Taxable income	Compare			
	Tax on sole proprietorship	Tax on two-way partnership	Tax on three-way partnership	Tax on four-way partnership
\$50,000	\$26,820	\$20,300	\$16,599	\$14,460
25,000	10,150	7,230	6,220	5,740
10,000	2,640	2,200	2,080	2,040

Flexibility of organization and operation

Within the broad limits of the Partnership Act, the partners can agree on any partnership structure and operation without filing certificates or getting prior approval from any governmental agency as is usually required of an incorporated business.¹

The partners may change the organization or dissolve it entirely at any time. Annual or special reports need not be made to the state when such changes occur. The authority for the existence and operation of a partnership is the contract between the partners. This contract does not have to be filed with any public agency.

Social security coverage

A farm operator qualifies to participate in social security since he is self-employed and has earned income. A landlord may or may not qualify depending on whether he contributes materially to operating capital or to management.

¹ The Limited Partnership Act requires that a *limited* partnership agreement be filed with the County Recorder of Deeds to be effective. Limited partnerships are discussed in more detail on page 12.

At the present time, participation in a farm partnership assumes that such material contribution has been made. Each partner is considered to be self-employed in the farming business, and each must contribute to social security on the partnership income and is eligible to receive its benefits upon retirement.

Since the rules on who qualifies have changed frequently, it is advisable to consult with an agent of the Internal Revenue Service or the Social Security Administration if social security is an important reason for considering a farm partnership.

What Are the Disadvantages of a Partnership?

Unlimited individual liability

Except in the case of a limited partnership (where the limited partner is not allowed to take part in the conduct of the business),¹ each partner is personally liable for the debts and obligations of the partnership. The partnership agreement cannot protect a partner from this liability.

Lack of uniformity in organization and operation

The partnership contract or agreement is the basis for the partners' rights and duties. Since each partnership is organized under a different agreement, it is necessary for persons dealing with partnerships to examine each agreement to determine the form and type of operations which exist. The nature and extent of partnership relations with others is often confused because the agreement is incomplete.

In some instances individuals are operating under an agreement which they feel is a partnership agreement when there is, in fact, no legally recognized partnership. This may happen in an attempted limited partnership or an agreement for a joint venture that falls short of a partnership.

Uncertainty of term

While a corporation exists until formally dissolved, a partnership, in the absence of an express agreement to the contrary, is dissolved a) upon the death, expulsion, bankruptcy, or retirement of a partner; b) by the option of any partner when no definite term is stated; c) by agreement of all the partners; or d) by court decree. The partners may,

¹ Discussed on page 12.

of course, agree to continue the business after the loss of a partner. Adjustments must be made between the remaining partners and creditors, however, and when a partner dies, the claims of his estate must be satisfied. These problems directly affect the partnership business and its assets. When the shareholder of a corporation dies or otherwise leaves the corporation, the corporation and its assets are not similarly affected.

Value of partners' interests difficult to determine

A partner owns a part of each individual item that belongs to the partnership while a shareholder owns only the stock which he purchases representing an interest in the whole corporation. The value of a partner's interest is therefore usually more difficult to determine than the value of corporation shares. It is also more difficult to separate and transfer as an individual piece of property. This tends to make partnership interests less marketable than corporation shares and also to make the transfer of a partnership interest more complex.

How Is a Farm Partnership Formed?

General qualifications and requirements

The only legal requirement is that two or more persons combine for the purpose of conducting a business for profit. It is preferable that the partners be adults, but children may be full partners if they make a contribution of capital or labor and participate in management.

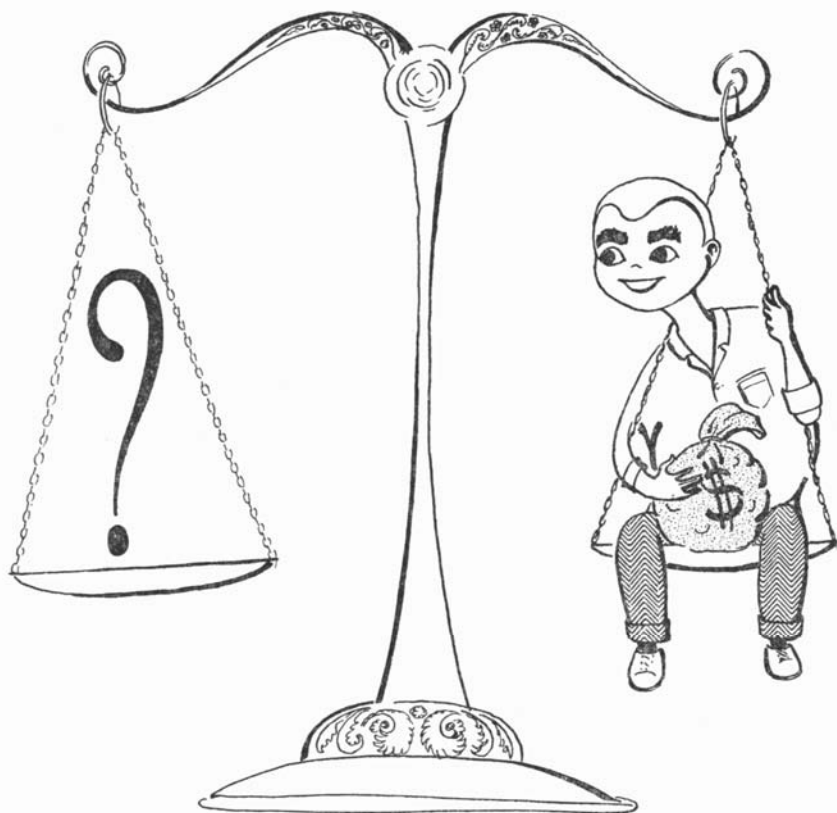
The partners should be able to work and plan together since they have an equal voice in management. Friendliness and patience are important characteristics for a partner.

The partnership agreement

The partnership agreement is the basis for the operation and management of the business and it should be detailed and complete. Although the content and arrangement may differ, the agreement will usually contain the following:

a) A short introduction containing the date, the names of the parties, and the place where the agreement is made. There should be a statement that it is a partnership agreement.

b) The name, place, term, and purpose of the partnership business. The term may be made continuous by stating a definite term with an



The exact value of a partner's interest in a partnership business may be difficult to determine since a partner owns a part of each item of property owned by the partnership.

automatic yearly renewal of the agreement unless notice of termination is given by one or more of the partners.

The purpose clause generally reads “. . . for the general farming business together with all other business necessary and related thereto . . .”

c) Capital contributions, provision for capital accounts of the partners and for withdrawal of money by partners, and a procedure for loaning money to the partnership by a partner.

Initial capital contributions by each partner should be listed in detail. They may be divided into cash, real and personal property, special assets, and service (labor and management) contributions. A

stipulation to leave part of the profits in the business as contributions to capital may be included.

Provision should be made for keeping individual capital accounts, as well as complete books and records of the partnership that are available to all partners. This responsibility should be expressly given to one or more partners.

The amount of withdrawals from capital should be defined. For example, there could be a provision for withdrawals of cash by unanimous consent. Reductions in capital and distribution of capital to the partners could be allowed by a majority of the partners.

If it is contemplated that a partner may loan money to the partnership at some future time, a provision setting out the terms of such a loan is desirable.



A democratic system governs the farm partnership. Generally the majority rules. No partner forfeits his right to participate in the management except by his own action.

d) Management by the partners, the time they devote to the business, and payment of salaries.

Unless there is special provision to the contrary, a decision by a majority of the partners controls. However, there can be a requirement of unanimous decision on important questions such as incurring extraordinary expenses. It may also be provided that a decision by a majority of the partners in interest controls, rather than a majority in number.

It is assumed that a general partner will devote substantially all of his time to the business but it is advisable to include an express statement to this effect. If a partner is to devote only a portion of his time to the business, this should also be stated.

No salary payments are authorized without express agreement. Salary provisions should set out the amount and period of payment of any salary.

e) Sharing of profits and losses. Profits and losses usually are shared equally by the partners or on the basis of their capital contributions. However, the law permits a division in any way the partners desire.

A clause authorizing a maximum monthly withdrawal for living expenses is sometimes included.

f) A general statement of the partners' rights and obligations in connection with operating the partnership business.

Generally included is a partnership checking account, naming the bank, and stating the limitations on the partners in drawing on it. It is desirable to definitely state who has power to sign checks and who, if anyone, must countersign.

g) Termination and dissolution of the partnership.

There should be a provision for voluntary dissolution. This may be done as follows:

1) By giving any partner the right to dissolve the partnership upon giving advance written notice. It may be agreed that a partner causing dissolution is personally liable for any loss incurred by the partnership as a result of dissolution.

2) By requiring the written agreement of a majority or all of the partners before there can be a voluntary dissolution.

The agreement may state that when a partner dies the partnership is automatically dissolved. However, it is usually desirable to provide for continuation of the business after the death of a partner. This may be accomplished by binding the deceased partner's estate for a period of time to give the surviving partners an option to buy out his interest. Special buy-and-sell agreements with life insurance provisions may be used for this purpose. (See page 13.)

A provision may be inserted to allow for the retirement of a partner. The agreement may also include provision for the expulsion of a partner for misconduct or for incapacitation for a stated period of time due to illness or injury.

h) Miscellaneous provisions.

There may be an arbitration clause to be used when the partners cannot agree. A clause may also be included requiring that all notices or additions to the agreement be in writing.

i) "The Witness" or closing statement.

The agreement is closed by a statement called "The Witness." This is a short statement that the parties to the agreement know its contents and intend to bind themselves to it. "The Witness" is followed by the signatures of the partners.

(See the sample farm partnership agreement on pages 30 to 34.)

Limited partnerships

Under the Limited Partnership Act, a partnership may be formed consisting of one or more general partners and one or more limited partners in which the limited partners are not personally bound by obligations of the partnership beyond their financial contribution. It may be desirable for a farm business to use a limited partnership when one partner does not want to take part in managing the business. A limited partnership remains so only as long as the parties comply strictly with the Limited Partnership Act. Failure to comply results in the relationship becoming a general partnership.

To form a limited partnership the partners must:

a) Sign and swear to a special certificate which includes 1) the name, location, character, and term of the business, plus the names of the general and limited partners and their addresses; 2) the amount of cash, and description and value of other property contributed by the limited partner and the agreed time, if any, when it is to be returned; 3) any provisions for additional contributions; 4) the compensation which the limited partner will receive on his contributions; 5) any right to admit additional limited partners or to substitute an assignee as contributor in the limited partner's place; 6) the priorities, if any, between limited partners and any rights of a limited partner to receive property other than cash in return for his contribution; and 7) any rights of the remaining general partners to continue the business after the death, retirement, or insanity of a general partner.

b) File this certificate with the county recorder of deeds.

In operating a limited partnership, the following rules must be observed:

a) A limited partner's contribution cannot include services.

b) He cannot take part in the control or management of the business.

c) His name cannot be included in the partnership name.

d) He cannot receive his agreed compensation unless the partnership assets, after such payment, exceed liabilities to outside creditors of the partnership.

A limited partner's interest in the partnership is treated as personal property and is assignable. He may rightfully demand the return of his contribution (only in cash unless agreed otherwise) on dissolution, at the time specified in the certificate, or after he has given six months' notice to the other partners. He may have the partnership dissolved and its affairs wound up if he cannot get a return of his contribution after a rightful demand. On dissolution, the limited partner is entitled to receive payment for his contributions before the general partners receive payment of any kind.

In a limited partnership, the death of a general partner does not dissolve the partnership if the remaining general partners continue the business under the terms of the agreement or with the consent of all the partners. The death of a limited partner transfers all his rights and liabilities in the partnership to his administrator or executor for the purpose of settling his estate.

Creditors of a limited partner may, by court action, charge his partnership interest with the debt and appoint a receiver. A general partner may redeem the interest with his separate property but not with partnership property.

There are other technical provisions on limited partnerships that should be studied before this device is used. The assistance of legal counsel should be used in drafting the agreement.

Partnership buy-and-sell (business purchase) agreements

A buy-and-sell agreement is a contract between the partners for the purchase of a deceased partner's interest by the surviving partners. Such an agreement permits the business to continue and reduces financial problems at the death of a partner. A buy-and-sell agreement need not include a life insurance provision, but proceeds from such insurance assure funds to purchase the partnership interest.

Because of the unique relationship of a partner to his partnership, a buy-and-sell agreement must be precise and complete to avoid later confusion.

An agreement with life insurance should include the following:

a) The names of the partners, a reference to their partnership agreement, its name, and the principal address of the business. In addi-

tion, it should state that the partners are entering into a business purchase agreement pursuant to the terms of the partnership agreement and as a part of it.

b) A requirement that each partner agrees to have his life insured to provide funds for the other partners to buy his partnership interest from his heirs. Each partner to be insured should be named, the amount of his insurance stated, and the beneficiary designated. The amount of insurance should roughly equal the value of the partner's interest in the partnership. The beneficiary may be the deceased's estate, an heir of the insured, another partner or partners, the partnership, or a trustee. Preferably a third party should act as trustee for the beneficiary. As a disinterested party, he would be more likely to carry out the intentions of the partners.

For example, Mr. Mills, a partner in Millbrook Farms, has a partnership interest which is expected to remain at a fairly stable value of \$30,000. He takes out \$30,000 worth of life insurance, naming the local bank, Centertown National, as beneficiary and trustee. The bank is under agreement, upon his death, to use the insurance proceeds to purchase Mr. Mills' interest in Millbrook Farms for the remaining partners from the estate and turn the proceeds from the sale over to the estate.

c) The person responsible for payment of the insurance premiums. This may be the partnership, the partner or partners who are beneficiaries, or the insured himself, depending on the preference of the parties. In addition, language should be included which binds both the estate of the deceased and the surviving partners respectively to sell and buy the partnership interest involved.

d) Provision for paying additional money to the estate by the surviving partners should the insurance proceeds not be adequate.

e) The method of valuation of a partner's interest at his death. The partners and the representative of the estate may select appraisers to determine the value, or the partners may make an annual appraisal of the value of the partnership business.

f) The exact steps which must be taken by a beneficiary upon the death of an insured partner. The beneficiary should be directed to collect the proceeds and pay them to the representative of the deceased's estate when he is satisfied that the debts of the estate have been discharged or properly secured. This is to prevent subsequent claimants from claiming an interest in the partnership assets as a creditor of the deceased partner's estate.

g) A provision for acquiring additional policies of insurance if there is an increase in value of the partnership interests.

h) Miscellaneous provisions:

1) A provision denying the representatives of the deceased partner the right to compel an accounting from the remaining partners. (The representatives may demand an accounting unless such authority is expressly denied them in the agreement.) This provision will save a duplication of accounting costs since the method of valuing a deceased partner's interest is already part of the agreement.

2) A provision for transferring the insurance policies to the insured persons upon termination of the partnership.

3) A statement that the surviving partners will protect the estate from all debts of the partnership.

Other provisions may be included as the parties desire. Those mentioned here are considered necessary to assure a complete and effective agreement.

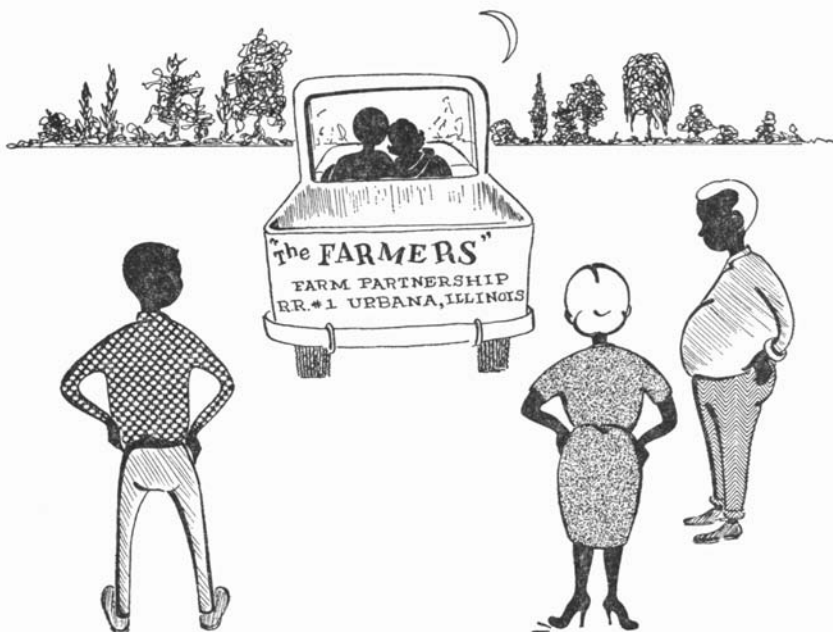
Examples of a buy-and-sell agreement, and an annual appraisal form to be used in connection with it, are given on pages 35 to 37.

Property rights of a partner

Unless the partnership agreement states otherwise, a partner is entitled to three general property rights. They are: a) his rights in specific partnership property, b) his interest in the partnership, and c) his right to participate in the management.

A partner is, with his partners, a co-owner of *specific partnership property* (land, livestock, equipment, etc.) holding it as a "tenant in partnership." He has an equal right with his partners to possess the property for partnership purposes but he has no right to possess or use it for other purposes without the consent of his partners. He cannot assign his right in partnership property unless all the other partners also assign their rights at the same time. Claims against a partner cannot attach to his right in specific partnership property but can attach only to his partnership interest. When a partner dies, his right in specific partnership property goes to the surviving partners and they may possess it for partnership purposes. The deceased partner's representative may require an accounting and payment in cash for the net amount of the deceased partner's share (see also section on dissolution and termination, page 24).

A partner's *interest in the partnership*, which is his share of the profits and surplus, is personal property and is subject to attachment



Don Farmer has a perfect right to court his best girl. But he should have asked his partners first before using the partnership truck, for he must have their consent to use partnership property for other than partnership business.

or execution for claims against the partner. It may be assigned and, on the death of the partner, becomes part of his estate.

An assignment of a partner's interest in the partnership entitles the assignee only to the profits to which the assigning partner would be entitled unless the partners agree that the assignee shall also participate in the management.

How Is the Partnership Business Operated?

Relations between the partners and the partnership — management

The rights and duties of the partners are subject to any agreement between them. Where the agreement has no contrary provision the law provides that: a) a partner is entitled to share equally in the profits and must assume an equal share of the losses of the business; b) each partner has an equal right in the management and conduct of the partnership business; c) any difference arising on ordinary matters

connected with the partnership business may be decided by a majority of the partners; and d) a partner is not entitled to a salary for management services.

When a partner makes a payment or incurs a debt in carrying out the usual partnership business, the partnership must reimburse him. If he makes any payment or advance beyond his agreed capital contribution, he is entitled to receive interest on it until he is repaid.

Variations from these general rules by agreement are discussed in the preceding section on partnership agreements (pages 8 to 12).

Relations of the partners and partnership with parties outside the partnership — business transactions and debts

Every partner is an agent of the partnership and of the other partners. A partner who carries on the business in its usual way binds the partnership even though he was expressly prohibited from carrying on such business by the partnership agreement, unless the person with whom he is dealing knows that he is acting without proper authority. This rule includes the execution of any written instrument in the partnership name.

A notice given to any partner relating to partnership affairs is considered notice to the partnership, except in the case of notice of fraud to a partner who allows the fraud to be committed.

A partnership is liable for loss or injury caused to any person (including employees) by the wrongful act or omission of a partner, providing the partner was acting in the ordinary course of the partnership business or with the consent of the other partners. The partnership must also make good any loss caused by a partner misapplying money or property of a person outside the partnership which was received by the partnership or by a partner under apparent authority for the partnership.

Each of the partners is also individually liable for loss or injury in the above cases if the partnership is liable. However, if an injured person recovers damages from an innocent partner for the wrongful act of a copartner, the innocent partner may recover that amount from the guilty partner.

Unless the agreement has contrary provisions, the law requires unanimous agreement of the partners on the following actions:

- a) Assignment of partnership property in trust for creditors.
- b) Disposal of the good will of the business or any other act which would make it impossible to carry on the ordinary business of the

partnership. (For example, a partnership could authorize someone to use the partnership name or could sell an essential item of partnership property such as a famous breeding animal.)

c) Confession of judgment. (This allows a judgment to be entered against the partnership by a creditor without a contested lawsuit.)

d) Submission of a claim or liability of the partnership to arbitration.

Because of possible personal liability, it is advisable for each partner to carry comprehensive personal liability insurance. Such insurance protects the partner against damage payments resulting from injury to third persons (including partnership employees) arising from acts committed by the partners or partnership employees.¹

Transfer of real property belonging to the partnership

The Uniform Partnership Act includes a special section on the transfer of partnership real property. Four situations are covered:

a) Where title to real property is held in the partnership name. If the partner transfers it in his own name, he passes only an equitable interest and not the legal title. Such transfers are valid if the partner is acting under actual or apparent authority of the partnership and the buyer takes the property in good faith.

b) Where title is in the name of one or more but not all of the partners, and there is no indication in the county records that the property belongs to the partnership, the partner or partners in whose name the title is held may make a valid transfer unless the buyer actually knows or should reasonably know that the property belongs to the partnership and that they have no authority to convey it.

c) Where the title is in the name of one or more or all of the partners, or in an outside party in trust for the partnership, a transfer by a partner in the partnership name passes the equitable interest of the partnership unless the partner had no authority to make the transfer and the purchaser knew or should reasonably have known that he had no authority.

d) Where the title is in the names of all the partners, a transfer by all of them, either in their own names or in the partnership name, passes all rights in the property to the purchaser.

¹ If the partnership engages in a hazardous activity not considered farming, the Workmen's Compensation Law will apply.

Any one or more of the partners may be given the authority to transfer real property belonging to the partnership, either in the agreement or by consent of all the partners.

Books and records — accounts

For practical business purposes and because of federal taxes, the partnership should maintain complete records of business transactions and capital items. The Partnership Act provides that partnership books shall be kept at the principal place of business of the partnership unless the partners agree otherwise, and that every partner shall have access to them at all times and may inspect and copy any of them.

A partner is accountable to the partnership for any profit which he realizes from any transaction connected with partnership business. In turn, a partner is entitled to a formal accounting on partnership affairs a) from any other partner who receives a benefit from a transaction connected with partnership business or from any use of partnership property; b) when he is wrongfully excluded from the partnership business or possession of its property by the other partners; and c) when the agreement provides for an accounting or when other circumstances make an accounting just and reasonable.

The partnership agreement may place responsibility for keeping books and records in one partner and allow him extra pay for doing so, or this responsibility may be assigned to an outside person or firm.

Partnership taxation¹

The partnership merely reports income. It pays no income tax. The partners include their shares of partnership profits as income on their own returns, whether that amount is actually distributed or is retained in the business.

a) Transfer of assets by a partner or the partnership. Usually the transfer of assets to a partnership or distribution of partnership property to the partners has no immediate tax consequences, and there is no gain or loss to the partners or the partnership at that time. However, there may be an effect on the tax basis for future transfers and sales. Partners should retain their cost and depreciation records on all property transferred to the partnership.

¹ Partnership tax law is complex. The scope of this publication is limited to a presentation of its broad aspects. The reader is cautioned against generalizing on the basis of this section since many technical exceptions and limitations may be involved. (See page 39 for a table showing income tax computations in transferring assets.)

b) Partner's tax basis for his partnership interest. In order to calculate capital gains or losses for tax purposes, a base value of a partner's interest in a business must be determined. This base value is called the tax basis and the partner's taxes are computed with this figure as a starting point.

The tax basis of an original partner's interest is his cash contribution plus the adjusted basis he had for any property he contributed in setting up the partnership.

When a person buys into an established partnership, the tax basis for his interest is his cash cost plus his share of the partnership liability. For example, a one-third interest in a partnership business with a net worth of \$15,000 (\$30,000 assets minus \$15,000 liability) would cost \$5,000. The tax basis for this interest would be \$5,000 (cash cost) plus \$5,000 (one-third of the liability) or \$10,000. Although the buyer gains a new tax basis, his actual taxes will not be immediately affected when he acquires the partnership interest.

If the seller realizes a gain on the sale of his interest, it is treated as a capital gain (short term if he holds it less than six months). Only in certain cases of uncollected debts or substantially appreciated inventory will part of the gain be treated as regular income.

The tax basis of a partnership, no matter how acquired, is increased by any further contributions by the partner and by his share of partnership profits and increases in partnership liabilities. The basis is decreased by distributions to him by the partnership, by his share of partnership losses, and by partnership expenditures which are non-capital and non-deductible.

c) Transfer of use of assets. A partner may lend or rent property to the partnership. Loaned or rented items of property remain the separate property of the individual partner and do not become a capital item of the partnership.

d) Partnership distributions. Three kinds of property can be distributed by the partners to themselves from the partnership.

1) Capital items such as farm equipment or dairy or breeding stock. When they receive such items from the partnership, the partners do not realize a tax gain or loss. However, if they in turn sell these items, there usually is a taxable gain or loss.

2) Cash that has accumulated in the partnership from past years' operations and from the sale of capital assets (up to the adjusted

basis). Partners will not be taxed on a cash distribution until they receive an amount over the tax basis of their partnership interest.

3) Inventory items such as grain or livestock. Distributing these items, which are normally held for sale, is the same as distributing the cash value of the product. The market value of the distributed inventory items is included in the partner's income tax return whether he sells them or keeps them. The same rule applies to uncollected debts.

In general, income tax law applies the same way to a *current* or a *liquidation* distribution. (In a *current* distribution, surpluses of equipment, cash, or animals built up during the regular course of the partnership business are distributed among the partners. A *liquidation* distribution is made when a partnership is dissolved. Then all of the partnership assets are distributed among the partners.)

When a partner receives property from the partnership his income tax basis on it is the same as was the partnership tax basis on the property, provided that the tax basis of the property plus any cash received is less than the tax basis of his partnership interest. If he receives cash and property with a basis totaling more than the tax basis of his partnership interest, the tax basis of the property will be the tax basis of his interest less any cash received. The remaining value of the property will be taxed at the time the property is sold.

Example I: Partner Robert Jones has a partnership interest with a tax basis of \$15,000 in Jones Bros. Farms. He receives from the partnership \$2,000 cash and a tractor and combine with a total tax basis to the partnership of \$10,000. His income tax basis on the tractor and combine is \$10,000.

$$\begin{array}{r}
 \$10,000 \text{ (tax basis of property received)} \\
 + \quad 2,000 \text{ (cash received)} \\
 \hline
 \$12,000 \text{ (still less than the tax basis of Jones' } \\
 \text{interest in Jones Bros. Farms.)}
 \end{array}$$

Therefore the tax basis on the property is the same as its partnership tax basis.

Example II: Robert Jones receives from Jones Bros. Farms a tractor, a combine, and a baler (total tax basis to the partnership—\$12,000) plus \$5,000 cash. His income tax basis for the property is \$10,000.

\$12,000	(tax basis of property received)
+ 5,000	(cash received)
<hr/>	
\$17,000	(more than Robert Jones' tax basis on his interest in Jones Bros. Farms.)

Therefore to find his tax basis on the property:

\$15,000	(tax basis on his partnership interest)
- 5,000	(cash received)
<hr/>	
\$10,000	(tax basis on property received)

The "extra" \$2,000 worth of property value will be accounted for at the time Robert Jones sells the equipment.

There are special tax rules covering installment payments to a retiring partner or the successor of a deceased partner by the remaining partners for the purpose of purchasing his partnership interest. Special rules also apply where distributions involve a large amount of uncollected debts or inventory items.

(A detailed example of the income tax aspects of a transfer of assets in a partnership business is given in the table on page 39.)

e) Transactions between partner and partnership. A partner may loan money or sell property to the partnership (or borrow money or buy property from the partnership) like any other person providing such arrangements are formal and businesslike. There are three exceptions to this general rule:

1) Losses on the sale or exchange of property from a partner to his partnership are not deductible if he owns more than 50 percent of the partnership capital or interest in profits.

2) If a partner owning more than an 80 percent interest in a partnership realizes a gain on the sale or exchange of property with the partnership, the gain will be treated as ordinary income instead of a capital gain if the property is a noncapital asset in the hands of the partnership.

Example: Partner William Brown owns a \$42,000 interest in the \$50,000 partnership Brown and White Dairy Farm. If Brown sells a \$3,000 tractor to Brown and White for \$3,500 which the partnership immediately resells for only its \$3,000 value, Brown's \$500 profit on the transaction is not considered capital gain. It is ordinary income and is taxed as such.

3) Contributions to the partnership are not considered a sale or loan and therefore do not involve a deductible loss or taxable gain.

Comment: Salaries paid to partners by the partnership are treated as partnership expense but each partner must report his salary, if any, on his individual income tax return.

f) Family partnerships — minors in the partnership. The transfer of property to a partnership by a minor may be questioned by Internal Revenue if the property was first obtained as a gift from another partner. Especially in a family partnership, it is essential that the partnership agreement and the conduct of the partners show a complete gift and transfer to avoid tax difficulties. For example, if the gift is from father to son and the son contributes it to the partnership, the father must not retain any control over the interest if the gift is to be complete for federal tax purposes.

A minor may be a partner in his own right, holding a partnership interest which was a gift to him, if he has sufficient maturity and experience to be treated by disinterested persons as competent to enter business dealings and otherwise to conduct his affairs on a basis of equality with adult persons.

If maturity and experience are not present, a minor's interest may be put in trust and the transfer recognized as complete for tax purposes. A trustee who is unrelated to and independent of the donor of the property should be used. If the donor is the same person as the trustee, or if he has control over the trustee, income tax questions may arise. In any case, the trustee must be recognized as a partner in business dealings with customers and creditors, and the trust's share of the partnership profits must be distributed to him and paid to the minor or properly retained in the business.

Where a gift of property is made which in turn is contributed to the partnership, tax regulations require that the donor be allowed a reasonable compensation for services to the partnership before the profits are shared. For example, if the profits of a partnership in which a father has given one-half interest to his son are \$20,000 and the son performs no duties, the father would receive a reasonable allowance for his services plus a minimum of 50 percent of the remaining profits. Therefore if a reasonable allowance for services is \$5,000, the father would receive an income of \$12,500 and the son \$7,500. If the father and son perform equal services, each would receive \$10,000 as his distributive share.

The absence of a partner due to military service will not result in a reduction of his share of the business' profits for tax purposes unless the partnership agreement provides otherwise.

How Is the Partnership Dissolved and Terminated?

A partnership is automatically *dissolved* when a partner ceases to be associated in the business. However, the partnership is not *terminated* until all partnership affairs are completed.

Dissolution

Dissolution under a partnership agreement occurs **a)** when the term or business in the agreement is finished; **b)** where no definite term is stated and a partner requests a dissolution; **c)** at any time when all the partners decide to dissolve; and **d)** when a partner is expelled from the business in accordance with the partnership agreement.

Dissolution occurs by law at any time **a)** by the death of a partner; **b)** by the bankruptcy of a partner or the partnership; **c)** by any event which makes continuation of the business unlawful; or **d)** by court order when a partner becomes incompetent, has been guilty of conduct prejudicial to the business, or has willfully or persistently breached the partnership agreement, or when the business can only be operated at a loss.

When the partnership affairs are wound up and a liquidation has been completed, the partnership is legally terminated. There are no expenses involved in the termination of a partnership except the actual cost of winding up its affairs.

Where dissolution is in accordance with the partnership agreement, any partner may have the property applied to satisfy partnership liabilities with any surplus paid to the partners. However, if dissolution is caused by the expulsion of a partner under the terms of the agreement, he is entitled only to a cash payment equal to the net value of his partnership interest.

If the dissolution is not in accordance with the partnership agreement, partners not causing the dissolution have the same rights that exist where dissolution is under the terms of the partnership agreement and, in addition, they have a right to damages against the partners who caused the wrongful dissolution for breach of the agreement. The innocent partners in such a case may continue the business in the same name and may use the partnership property.

The partner wrongfully causing the dissolution is entitled only to the value of his net interest in the partnership, less any damages to the other partners. In ascertaining the value of his interest, good will of the business is not considered.

Powers and liabilities of partners after dissolution

Dissolution terminates authority of any partner to act for the partnership except as follows:

- a) When the partner acting has no knowledge of the dissolution.
- b) Transactions necessary to wind up the partnership affairs as provided in the partnership agreement or by any of the partners who have not wrongfully caused the dissolution.
- c) Transactions with parties outside the partnership who had not previously extended credit to the partnership and did not know of its dissolution, providing no notice of the dissolution was published in a local newspaper.

A dissolution, of itself, does not discharge the existing liability of a partner. He may be discharged only by agreement with partnership creditors and any partners who continue the business. In some cases such an agreement may be inferred. For example, when someone agrees to assume obligations of a dissolved partnership, and a creditor who knows of the agreement allows a change in the nature or time of payment of the obligations, there is a release.

A deceased partner's estate is liable for partnership debts subject to the prior payment of his personal debts.

Settlement of accounts between the partners

Unless the partnership agreement provides otherwise, the assets of the partnership at the time of dissolution are partnership property plus any contributions of the partners necessary to pay creditors of the partnership.

The liabilities of the partnership, to which the assets will be applied, rank in order of payment as follows:

- a) Those payable to creditors other than partners.
- b) Those payable to partners other than for capital and profits.
- c) Those payable to partners out of capital.
- d) Those payable to partners out of profits.

The courts have the power to enforce these rules and any partner who has contributed more than his share to the payment of partnership liabilities may recover from the other partners.

Where the individual property of a partner must be used to satisfy partnership debts, it is first subject to the individual debts of the partner.

Continuation of an existing partnership after dissolution

If after a dissolution the partnership is terminated, it has permanently ceased legal existence. However, if on dissolution, whether wrongful or in accordance with the partnership agreement, the partnership is continued without a liquidation of the partnership affairs, creditors of the dissolved partnership are also creditors of the continuing partnership. A new partner coming into the partnership is liable to the creditors of the dissolved partnership only to the extent of his interest in the partnership and only out of partnership property.

If the partners think it desirable to continue the partnership business after a dissolution, the partnership agreement should provide for continuous operation. This avoids many of the difficulties of settling with a partner who leaves the business or with his representatives if he should die.

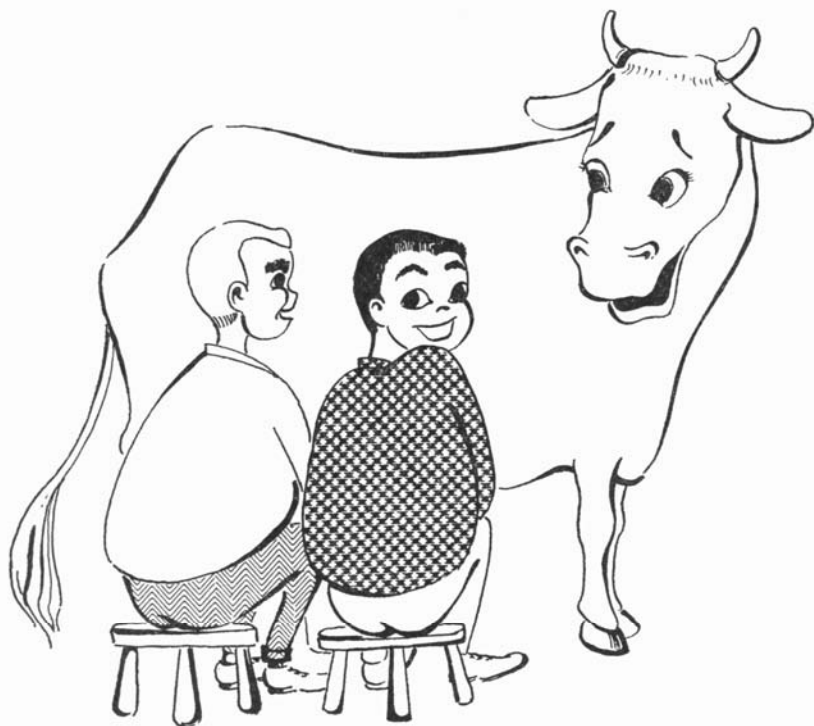
The Uniform Partnership Act considers an altered partnership arrangement, after a dissolution, as a continuation of the original partnership business by a new partnership. For tax purposes, a partnership continues unless none of the original partners remain in the partnership, or interests in over half of the partnership capital and profits are sold or exchanged within any twelve-month period. The partner's tax year closes at the time he sells his entire partnership interest.

Summary

Larger capital requirements for land and equipment and higher and more complex taxes are causing many farmers to take a close look at partnership farming. Partnership laws have been in the books for many years and used constantly by nonfarm businesses. Only in recent years have farm people given any attention to adapting the partnership to the farm business.

There are advantages for some farm families and for some non-related farmers in using a partnership in the farm business. The partnership is a means of bringing together needed capital and labor resources, of reducing income taxes where income can be split, and of keeping sons and daughters in the farm business when this is desired. At the same time it can provide a democratic system of management that is sufficiently flexible to allow the highest efficiency in the farm operation.

A partnership also has disadvantages to consider. Partners have unlimited liability for the business acts of all other partners. The partner must assume such risk or protect himself with insurance.



Daisy seems to feel that Bill and Jack Farmer are carrying partnership cooperation too far when they both milk her at once. This *may* be the wrong way to milk a cow, but when it comes to running a farm partnership, cooperation among the partners is the essence of success.

A partnership agreement need not be publicly recorded or filed. Persons outside the partnership, therefore, do not have ready access to the agreement.

The duration of the partnership is indefinite since a partnership dissolves at the death of a partner unless the agreement provides that it continue.

The value of the partnership interest is not as easily appraised as the sole-proprietorship interest in the event a partner dies or leaves the business.

Most of these disadvantages can be overcome by using insurance and a well-drafted partnership agreement. Even the matter of placing a price on a partner's interest can be nicely resolved in the agreement.

Parties considering a farm partnership should study both its advantages and disadvantages in the light of the specific farm businesses involved. If the advantages appear to outweigh the disadvantages, and if the interested parties believe they can harmoniously carry out a farm operation as a partnership, an agreement should be roughed out and studied. Legal assistance should be used at this point and also for drafting a final agreement after all amendments have been made.

One excellent reason for having a well-drafted written agreement is to avoid any pitfalls of partnership tax law. As a general rule, a partnership will not increase the over-all tax burden of the partners, and it can be a tool for tax savings. Partnership income tax laws, however, are more complex than those applying to an individual, and a properly-drafted agreement is needed to channel partnership operations in the right direction. Adequate records and a good accounting system also help to avoid income tax difficulties.

The actual operation of a farm by a partnership is little different than its operation by one person. The same decisions must be made and the same labor performed. However, all partners who make contributions to the farm business have a right to help make management decisions. Each partner has an equal right with the other partners in managing the farm unless this authority is delegated to one partner by agreement. It is customary to delegate such authority for day-to-day operations, but to reserve to all the partners the right to determine major issues, usually by majority vote.

To give the reader an insight into the organization and operation of a farm partnership, the following section contains sample agreements used by an imaginary farm family who settled upon a partnership as the farm business organization best suited to their needs. As you read these examples of legal instruments, refer back to the text frequently for explanations of meaning and purpose.

Sample Farm Partnership Agreements

For the purposes of illustration the following sample partnership forms have been drawn up for an imaginary farm family who wish to organize a farm partnership.

This hypothetical family consists of Bill Farmer, 55, his wife, Mary, and their two sons, Jack and Don. Jack has a degree from the College of Agriculture at the state university and has served two years as an officer in the Army. He is married. Don has recently graduated from high school and desires to begin farming.



The farm partnership is a means of bringing together various resources into a unified, efficient business.

Each member of the family will make the following capital contributions.

- 1) Bill and Mary will lease their 240-acre farm, held in joint tenancy, to the partnership for \$3,500 per year under a five-year lease.
- 2) Bill will contribute \$10,000 worth of farm machinery.
- 3) Mary will contribute \$3,000 cash.
- 4) Jack will contribute \$5,000 cash and a 25-cow beef herd worth \$5,000.

(Don will make no capital contribution but will contribute his full-time services for a percent of the partnership returns.)

The total value of the partnership assets is \$23,000 plus the value of the lease. The farm unit has, in the past, been returning a net income of \$12,000.

The following forms made up for the Farmer family are *samples only*. They are not suggested for use in a specific farm business without adaptation, with the aid of an attorney, by the parties actually involved in the business.

FARM PARTNERSHIP AGREEMENT

This partnership agreement is made this *1st* day of *March*, 195*7*, between *Bill Farmer*, *Mary Farmer*, *Jack Farmer*, and *Don Farmer*.

Whereas the above persons desire to associate themselves as partners in business, it is mutually agreed as follows:

Article I

Name, Place, Purpose, and Term of Partnership

1. The name of the partnership shall be *The Farmers*.
2. The principal place of business of the partnership shall be at *R. R. #1, Urbana, Illinois*, and at such other farms or places as may be agreed upon by the partners.
3. The partnership shall engage in the business of farming, together with all other business necessary and related thereto, as shall be agreed upon by the partners.
4. The partnership shall begin on *March 1*, 195*7*, and continue for *five* years, and from year to year thereafter unless terminated as hereinafter provided.

Article II

Capital Contributions, Withdrawals, Loans, and Accounts

1. **Initial capital.** The initial capital of the partnership shall consist of the following, contributed by each partner in the amounts set forth:

a. Cash contributions:

Name	Amount
(1) <i>Bill Farmer</i>	\$.....
(2) <i>Mary Farmer</i>	\$..... <i>3,000</i>
(3) <i>Jack Farmer</i>	\$..... <i>5,000</i>
(4) <i>Don Farmer</i>	\$.....

b. Property contributions (real or personal property):

- (1) *Bill Farmer* shall convey by bill of sale property valued at \$.....*10,000*....., consisting of *a complete line of farm machinery* located at *R. R. #1, Urbana, Illinois*, and now owned by him. (See Schedule A* attached, for more particular description.)
- (2) *Jack Farmer* shall convey by bill of sale property valued at \$.....*5,000*....., consisting of *a 25-cow beef herd of Black Angus brood cows*, located at *R. R. #1, Urbana, Illinois*, and now owned by him. (See Schedule B* attached for more particular description.)

c. Leasing or use of property:

- (1) *Bill and Mary Farmer* are the owners of *a 240-acre farm* and do hereby lease said property to the partnership for the annual rent of \$.....*3,500 under a five-year lease*..... A more detailed lease or agreement for use is to be attached as Schedule *C** and, when attached, shall become a part of this agreement.

d. Service contributions:

Don Farmer shall make no contribution to the commencement of the partnership. He shall devote his full time to the partnership and for such services shall be entitled to *15* percent of the profits, and liable for such

* Samples of these schedules are not included in this circular.

share of the losses. His annual share, in excess of \$.....1,000.... shall be contributed to his capital account in the business until the total amount of his contributions shall be \$.....3,000.....

e. Profit contributions:

Each partner shall leave in the business each year, until all the partners agree otherwise in writing, as his contribution toward the partnership capital an amount equal to10.... percent of the amount of the partnership profits distributable to him at each annual accounting.

f. Additional capital contributions and advances:

Any partner may at any time, but only with the consent of all the partners, make additional contributions to partnership capital, and thereafter the division of profits shall be reapportioned accordingly. Partners shall not be required to make additional capital contributions to the partnership.

2. Withdrawals and loans.

a. Any partner who made a cash contribution to the partnership may withdraw part or all of that contribution with the consent of all the partners. If reduction of the capital of the partnership is ever deemed advisable, the managing partners may determine the amount of such reduction and distribute it in pro rata amounts to the partners, according to their respective interests in the partnership.

b. Should a partner advance money to the partnership by way of a loan approved by a majority of the partners, such advance shall bear interest at the rate of7.... percent per annum until repayment. The partner advancing money agrees not to demand repayment unless the partnership is financially able to do so.

3. Accounts.

a. It shall be the duty and responsibility ofMary Farmer..... to keep full and accurate books of account showing the condition of the business, finances of the partnership, individual capital and income accounts, and any other necessary books and records. At the close of each fiscal year she shall make an annual accounting to the partners of all the profits or losses, assets and liabilities of the business, and individual capital and income in the business.

b. The partnership fiscal year shall begin onMarch 1st..... of each year.

Article III

Management, Salaries, and Time Devoted to the Business

1. Each of the partners shall have an equal voice in the management and policy decisions of the partnership business. Except as otherwise stated, *all management and policy decisions shall be by a majority vote*, each partner being entitled to one vote. (Such decisions include amount and kind of livestock, time of their purchase or sale, cropping system and crop rotation, participation in governmental programs for agriculture, major soil conservation practices, etc.)

2. Each partner shall devote substantially all his time, skill, and attention to the partnership business except thatBill Farmer..... andMary Farmer..... shall not be required to devote their entire time or attention to the business of the partnership, but only such part thereof as they shall deem necessary or proper.

3. For the general conduct of the business, all partners shall be consulted so far as practicable; but for the purpose of harmonizing the policies and practices of the partnership and of securing uniformity and continuity in the conduct of its business, the general daily management decisions, except as otherwise provided in this agreement, shall rest inJack Farmer....., herein referred to as managing partner.

The managing partner shall reside in the tenant house on the farm leased by the partnership, and*Bill Farmer*..... shall continue to reside in the house where he now lives, until the partners agree otherwise.

4. The following partners shall be paid salaries in the annual amounts set opposite their names:

.....*Jack Farmer*..... \$2,000.....

Such salaries shall be paid semiannually in cash. The amounts of such salaries may be changed by a majority vote of the partners. Such salaries shall be an obligation of the partnership only, and not an obligation of the individual partners. Salaries shall be treated as expenses of the partnership in determining net profits or net losses.

5. In all matters incurring expenses or indebtedness in excess of \$.....500....., the agreement of all the partners shall be necessary.

6. A majority of the partners may, if it is deemed necessary to the proper operation of the partnership business, sell or replace any of the partnership assets, provided the first opportunity to purchase such property is given to the individual partners, jointly or severally.

The following described property is exempted from the above provision and cannot be sold or replaced without the consent of all partners:

.....*Lease of a 240-acre farm to the partnership by Bill and Mary Farmer, located at R. R. #1, Urbana, Illinois*.....

Article IV

Profits and Losses

1. Unless otherwise provided in this agreement, partners shall be entitled to the net profits or liable for the net losses of the business, according to the following schedule of percentages, until otherwise unanimously agreed in writing:

Name	Percentage
..... <i>Bill Farmer</i>.....	.....35.....
..... <i>Jack Farmer</i>.....	.....35.....
..... <i>Don Farmer</i>.....	.....15.....
..... <i>Mary Farmer</i>.....	.....15.....

2. Each partner may withdraw from the partnership for his own use a sum not to exceed \$.....100..... per month. This sum will then be offset against his distributive share for that year. If, on annual accounting, any partner has withdrawn in excess of his distributive share, he shall either refund the difference within 30 days of the annual accounting or not exercise his future withdrawal rights until such difference has been forfeited, whichever a majority of the partners shall require.

3. Expenses to be deducted from annual cash income, before division of earnings, shall be farm real estate and personal property taxes, repair and maintenance of all capital investments, interest on borrowed monies if necessary in the operation of the farm, purchased feed, livestock, fertilizers, seed, seed treatment, crop insurance, machine hire, spray materials, livestock expense, insurance on farm property, and any other expenses normally attributable to the farm business.

Article V

Checks and Checking Accounts, Partners' Powers and Limitations

1. The partnership shall maintain two checking accounts in the*National*..... Bank at*Urbana, Illinois*....., one account to be designated as the Petty Cash

Account and the other as the General Checking Account. The Petty Cash Account shall contain a maximum balance of \$....100.... Checks drawn on this account shall not exceed \$....25.... and may be signed by any partner. The general checking account shall contain the balance of the partnership assets. Checks in excess of \$....25.... shall be drawn on this account and must be signed by*Jack Farmer and any other partner*..... The Petty Cash Account shall be replenished by checks drawn on the general checking account whenever its minimum balance falls below \$....25....

2. Every partner shall at all times, unless otherwise provided:
 - a. Pay and satisfy his own personal debts.
 - b. Devote all his time and attention to the business of the partnership.
 - c. Inform the other partners of all work for and transactions in behalf of said partnership.
 - d. Neither assign, mortgage, nor sell his share of the partnership, nor any part thereof, or enter into any agreement as a result of which any person, firm or corporation may become interested with him therein, except as herein provided.
 - e. Neither endorse notes nor become surety or guarantor for any person or persons upon any obligation whatsoever, *except in relation to partnership business after first obtaining the written consent of a majority of the partners.*
3. No partner shall, without the consent of all the partners:
 - a. Use partnership funds as security.
 - b. Release or compound any debt owing to or claimed by the partnership.
 - c. Enter into any bond or become surety for any person.

Article VI

Termination and Dissolution of the Partnership

1. The partnership may be voluntarily dissolved by the unanimous consent of the partners, with or without cause.
2. Any partner may retire from the partnership as of the end of any fiscal year after giving the other partners at least180.... days' notice in writing of his intention to do so. Any partner who shall be disabled so that he cannot perform his duties as a partner for a continuous period of six months may be retired from the partnership by a vote of*all*..... of the remaining partners. In the event of the retirement, bankruptcy, or death of a partner, neither the partnership nor its fiscal year shall be terminated, and the remaining partners shall continue the business and shall succeed to the interest of the retired or deceased partner by paying to him or his representative, within6....months after such event, the balance then in his capital and undistributed profits account. (This payment shall be made pursuant to the terms of the partnership insurance agreement hereto attached and incorporated into this agreement.)
3. Upon dissolution, the partnership assets will be distributed according to the following priorities:
 - a. To the payment of the debts and liabilities of the partnership owing to creditors other than partners, and to the payment of expenses of liquidation.
 - b. To the payment of debts and liabilities owing to partners other than for capital and profits.
 - c. To the repayment of the capital contributed by the partners, the partners to share the remaining assets, if they shall not be sufficient to repay such contributions in full, pro rata according to the ratio that the amounts of their respective contributions bear to the amount of all the contributions.

- d. The surplus, if any, of the assets remaining shall be divided among the partners in the same proportion as that to which they are entitled, as herein provided, to share in the profits of the partnership.
4. Upon termination of the partnership, an accounting shall be had between the parties, and the land, produce, stock, and other property belonging to the partnership shall be divided according to the respective capital contributions of the partners. When possible, each partner who so requests shall receive among his distributive share of the partnership assets the specific property which he contributed to the partnership upon its commencement or during its existence. Such division shall be final and binding on all the parties.

If a proper settlement cannot be made in the above manner, the parties agree to submit all matters of disagreement to an arbitration committee as provided in Article VII, Section 3. Failing a proper settlement by arbitration, they agree to have a public sale on the premises. After all debts of the partnership and the expenses of having the sale are paid, the proceeds shall be divided according to the respective interests of the partners.

Article VII

Miscellaneous

1. Any partner who shall violate any of the terms, conditions, or provisions of this agreement, or who shall make the partnership liable to third persons by an act outside the scope of his authority, shall, in addition to being subject to other remedies, liabilities, and obligations herein imposed upon him therefor, keep and save harmless the partnership property and shall also indemnify the other partners from any and all claims, demands, and actions of every kind and nature whatsoever which may arise out of or by reason of such misconduct.
2. This agreement may be revoked, modified, or added to if all the partners agree, in writing, to such action. A copy of any such change, when attached hereto, becomes a part of this agreement.
3. If the partners cannot agree upon a solution to any question arising under this agreement in the manner herein provided, the partners may elect to arbitrate a settlement by the following procedure: Within 30 days after electing to arbitrate, the partners shall choose an arbitrator or, if one person cannot be found that is acceptable to all partners, then each partner shall choose an arbitrator and those so chosen shall select another. Within a reasonable time the arbitrator(s) shall make whatever inspection and inquiry is necessary and report findings in writing to both parties. The arbitrator(s) shall have power to make an award or determination on any issue which arises out of this agreement, and it shall be binding on all partners. The expenses of arbitration shall be paid by the partnership.
4. The term "partnership assets," as herein used, includes all assets held in the partnership name, but does not include property whose title remains in the individual partners.

In witness whereof, the parties hereto set their hands and seals the day and year first above written.

.....*Bill Farmer*..... (Seal)

.....*Mary Farmer*..... (Seal)

.....*Jack Farmer*..... (Seal)

.....*Don Farmer*..... (Seal)

INSURANCE AGREEMENT FOR PURCHASE OF A PARTNERSHIP INTEREST AT DEATH OF A PARTNER

.....*Bill Farmer*.....,*Mary Farmer*.....,*Jack Farmer*....., and*Don Farmer*..... have, on the*1st*..... day of*March*....., 195.....*7*....., entered into a partnership agreement for the purpose of carrying on the business of farming under the name of*The Farmers*....., located at*R. R. #1, Urbana, Illinois*.....

This partnership business purchase agreement is entered into by and between the above-named partners and*National Bank at Urbana, Illinois*....., pursuant to the terms of the above-named partnership agreement, and when attached thereto as Schedule*D*..... it becomes a part of that agreement.

Therefore, in consideration of the mutual promises and covenants herein, and for the purpose of insuring funds for surviving partners to pay the purchase price of the partnership interest of a deceased partner, it is agreed between the parties that:

1. Insurance policies shall be obtained as follows:
 - a.*Bill Farmer*..... shall have his life insured for the sum of \$.....*15,000*....., naming*National Bank, Urbana, Illinois*..... as the beneficiary.
 - b.*Mary Farmer*..... shall have her life insured for the sum of \$.....*5,000*....., naming*National Bank, Urbana, Illinois*..... as the beneficiary.
 - c.*Jack Farmer*..... shall have his life insured for the sum of \$.....*15,000*....., naming*National Bank, Urbana, Illinois*..... as the beneficiary.
 - d.*Don Farmer*..... shall have his life insured for the sum of \$.....*5,000*....., naming*National Bank, Urbana, Illinois*..... as the beneficiary.
2. The partnership shall pay the premiums on the policies. In the event of the death of an insured, the proceeds from his policy shall be received and used by the beneficiary, along with any additional payments as provided in Section 3, to purchase or pay for the interest of the deceased partner for the benefit of all surviving partners according to their respective interests in the partnership. Each partner hereby obligates himself and his estate, in the event of his death, to sell and convey to the surviving partners his interest in the partnership in the manner herein provided, and the surviving partners do hereby agree to purchase said interest in the same manner.
3. If the aggregate of all insurance proceeds payable on the death of the insured is less than the purchase price of the deceased's partnership interest, the surviving partners shall pay to the beneficiary of the deceased's policy the balance of the purchase price in cash. The beneficiary receiving the balance of such purchase price shall dispose of it pursuant to Section 2 of this agreement.
4. The price at which the partnership interests will be sold and purchased shall be determined as follows:

At the end of each partnership fiscal year, the partners shall determine the value of the partnership and prorate this value among the partners according to their capital contributions. If the partners fail to stipulate the valuation for a particular year, the last previous valuation shall be taken, except that, if no valuation is made for two successive years immediately preceding the proposed sale, the surviving partners and the legal representative of the deceased's estate shall agree on the value as of the date of sale. If within 30 days they cannot agree on such value, the purchase price shall be determined by an appraiser selected by the bank.

The appraisal value of the partnership business this*1st*..... day of*March*....., 195.....*7*..... is \$.....*23,000*....., the value of the interest of each partner being as follows:

	Name	Amount
a.	.....<i>Bill Farmer</i>	\$..... <i>10,000</i>
b.	.....<i>Mary Farmer</i>.....	..... <i>3,000</i>
c.	.....<i>Jack Farmer</i>	\$..... <i>10,000</i>
d.	.....<i>Don Farmer</i>.....	..... <i>0</i>

(Subsequent annual appraisals, when attached to this agreement and signed by all of the partners, nullify all preceding appraisals.)

5. It is understood that if the value of the deceased's share is less than the proceeds of the insurance, such excess shall be paid to the partnership and shall be applied to the capital accounts of the surviving partners proportionately.
6. On receipt of due notice of the death of a partner:
 - a. The beneficiary of his life insurance shall collect the proceeds therefrom and hold and dispose of them, within six months after the partner's death, as herein provided.
 - b. The executor or administrator of the deceased partner shall pay and discharge, or secure, to the full satisfaction of said beneficiary, the payment and discharge of all personal debts of said deceased partner which would be a charge upon his estate, except partnership debts.
 - c. The beneficiary shall then pay to the executor or administrator of the estate of the deceased partner as much of the insurance proceeds as may be necessary to purchase his portion of the partnership.
7. Additional policies of insurance shall be taken out to provide for increased value of the partnership interest of any partner. Such additional policies are included in this agreement when listed in a schedule attached hereto and signed by the partners.
8. The provisions of this agreement shall and do hereby extend to and are binding upon the heirs, executors, and administrators of the respective partners.
9. The surviving partners shall save the estate of the deceased partner harmless from all debts of the partnership.
10. In the event of dissolution of the partnership, each partner may purchase the policies on his own life at cash surrender value. If any partner shall fail or refuse to purchase the policy on his life, it may be surrendered for its cash value which thereafter becomes a part of the general partnership assets.
11. In the event of death of a partner, the surviving partners shall be relieved of any statutory duty to file an inventory or to make an accounting in any court, and the estate of the deceased shall be relieved of liability for partnership obligations (which are assumed by the surviving partners) when the terms of this agreement are carried out.

In witness whereof, said partners hereunto affix their respective hands and seals this*1st*.... day of*March*...., 195..7...

.....*Bill Farmer*..... (Seal)
*Mary Farmer*..... (Seal)
*Jack Farmer*..... (Seal)
*Don Farmer*..... (Seal)

EXAMPLE OF A PARTNERSHIP INSURANCE AGREEMENT ANNUAL APPRAISAL FORM

Pursuant to the terms of the partnership business purchase agreement entered into*March 1*....., 195..7., between*Bill Farmer*.....,*Mary Farmer*.....,*Jack Farmer*....., and*Don Farmer*....., partners in the*The Farmers*..... partnership, the above-named partners mutually agree that:

The appraisal value of the partnership business this*1st*.... day of*March*...., 195..8.. is \$.....*29,000*....., the appraisal value of the interest of each partner being as follows:

	Name	Amount
a.	.....<i>Bill Farmer</i>	\$..... <i>12,000</i>
b.	.....<i>Mary Farmer</i>	\$..... <i>4,000</i>
c.	.....<i>Jack Farmer</i>	\$..... <i>12,000</i>
d.	.....<i>Don Farmer</i>	\$..... <i>1,000</i>

Upon being attached to the partnership insurance agreement hereinabove referred to, this instrument is thereby incorporated into and becomes a part of that agreement.

In witness whereof, said partners hereunto affix their hands and seals this*1st*.... day of*March*...., 195..8..

.....*Bill Farmer*..... (Seal)

.....*Mary Farmer*..... (Seal)

.....*Jack Farmer*..... (Seal)

.....*Don Farmer*..... (Seal)

EXAMPLE OF CONSENT FORM FOR USE WITH PARTNERSHIP AGREEMENT

I,*Bill Farmer*....., by reason of, and under the authority of the farm partnership agreement between*Bill Farmer*.....,*Mary Farmer*.....,*Jack Farmer*....., and*Don Farmer*..... entered into on*March 1*...., 195..7., do hereby consent to the following action:*That Jack Farmer purchase for the partnership a new 3-plow tractor from the Wheel Implement Company for \$2,500*.....

Signed*Bill Farmer*..... (Seal)

Date*July 1, 1957*.....

EXAMPLE OF AN AGREEMENT FOR VOLUNTARY TERMINATION OF A PARTNERSHIP

.....*Bill Farmer*.....,*Mary Farmer*.....,*Jack Farmer*....., and*Don Farmer*....., partners in*The Farmers*..... partnership located at*R. R. #1, Urbana, Illinois*....., operating under the terms of the partnership agreement entered into on the*1st*.... day of*March*...., 195..7., do, in consideration of the mutual covenants herein contained, agree to dissolve the partnership this*1st*.... day of*March*...., 195..9., and hereby authorize the winding up of partnership affairs for final termination.

1.*Jack Farmer*..... shall be responsible for winding up the partnership affairs and final distribution of its assets in the manner provided in Article*VI*.... of the partnership agreement.

2. In the absence of a specific provision in the partnership agreement covering a particular situation in winding up, it shall be handled in accordance with the provisions of the Uniform Partnership Act or the written agreement of all the partners.

3. The partnership affairs shall be wound up and termination completed within a reasonable time and in a reasonable manner.

4. When the partnership affairs have been wound up and upon submission of a final account by the partner responsible for terminating the business, the partners shall make final approval of the account.

5. The partner responsible for the winding up of partnership affairs shall include in the final account\$500.... as compensation for his services in bringing the partnership to a termination after dissolution.

6. When distribution has been completed pursuant to the final account, the partnership is thereby permanently terminated and all interests therein cease to exist.

In witness whereof, said partners hereunto affix their respective hands and seals this1st.... day ofMarch...., 195..9..

.....*Bill Farmer*..... (Seal)

.....*Mary Farmer*..... (Seal)

.....*Jack Farmer*..... (Seal)

.....*Don Farmer*..... (Seal)

Acknowledgment is made of valuable assistance by the following persons in the preparation of this circular: George T. Frampton, Professor of Law, University of Illinois; James J. Elson, Instructor and Research Associate in Agricultural Economics, University of Illinois; Philip C. Zimmerly, Attorney at Law, Champaign, Illinois; and W. A. Herrington, Farm Manager, LeRoy, Illinois.

Income Tax Aspects in the Transfer of Assets

This table illustrates only the tax consequences of contributions to a partnership, the sale of partnership assets by the partnership, and the sale of partnership interests, and is not intended to show the complete tax structure of a partnership.

Partners		Contributions						Sale of assets by partnership					Sale of partnership interest		
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
Name	Interest in partnership	Description	Original cost to partner	Fair market value	Partner's adjusted basis*	Partner's basis (see 6)	Partner's original basis for partnership interest (see 6)	Sale price	Gain or loss to partnership (9-7)	Partner's distributive share of gain (see 10, 2)	Partner's adjusted basis for partnership interest (8+11)	Sale price	Gain or loss to partner (13-12)	Basis for buyer (cost) (see 13)	
A	40 (percent)	240 acres land	\$35,000	\$48,000	\$35,000	\$35,000	\$35,000	\$49,000	\$14,000 gain	\$4,000	\$39,000	\$40,000	\$1,000 gain	\$40,000	
B	30	farm machinery	35,000	30,000	29,000	29,000	29,000	25,000	4,000 loss	3,000	32,000	25,000	7,000 loss	25,000	
C	30	\$5,000 cash; beef herd	\$5,000 cash; 25,000	5,000	5,000	5,000	30,000 (total)	.....	.....	3,000	33,000	33,000	none	33,000

* Adjusted basis = original cost of property plus value of improvements minus depreciation up to time of transfer.

