FATHER-SON

and Other Farm Partnerships

University of Missouri
Agriculture Experiment Station
B-809 December 1963

by Fred L. Mann and C. R. Meeker

CONTENTS

Father-Son and Other Farm Partnerships
Introduction 3
What do You Wish to Accomplish? 4
What is a Partnership? 4
Requirements of a Successful Partnership 5
Farm Partnership Records and Accounts 5
Preparation Necessary to Form a Partnership 6
How is a Partnership Created and Operated? 7
A Farm Organized as a Father-Son Partnership 8
Appendix A 18
Appendix B 19
Appendix C 20
Appendix D 21
Appendix E 22
Appendix F 22
Appendix G 23
Appendix H 24

FATHER-SON

and Other Farm Partnerships

Fred L. Mann and C. R. Meeker[1]

INTRODUCTION

This bulletin is intended to serve as a practical guide to farm people who desire to associate themselves together as partners in the organization of a farm business.

Two or more people may organize and operate a farm business under several different methods:

1. Employer-employee
2. Joint venture
3. Partnership
4. Limited Partnership
5. Landlord-tenant
6. Debtor-creditor
7. Corporation

Each of these may meet certain needs of people at various times. For example, a rather common sequence of father and son working together over a period of years might be several of these different arrangements.

First, the father pays the son wages—the relationship is employer-employee. As the son becomes older, a father and son agreement may be worked out where the son has some share in management and income.

Later this may be followed by a partnership arrangement, with the son buying into the farm business, usually the personal property such as machinery and livestock, with the father retaining ownership of the farm real estate, although often the partnership arrangement may extend to ownership of the land as well.

When the father becomes older and wishes to slow down, the arrangement may become one of landlord-tenant. The son buys all the personal property and perhaps leases the farm from his parents.

At this time, or at some other time sequence in the relationship, consideration can be given to financing the transfer of the farm to the son with proper safeguards to any other heirs and to the parents.

Each of these different methods of operating a farm business has its advantages and its disadvantages. All possibilities should be considered and the one chosen should most nearly meet the needs of the situation and of the persons involved.

This bulletin is confined largely to a discussion of one type of organization of the farm business—the farm partnership.

Often, to simplify presentation, the material is set out in terms of a father and son. However, it is also applicable if the arrangement is to be between a father and one or more of his sons or sons-in-law, between an older and a younger man whether or not related, or between two or more younger men, such as brothers or neighbors.

It is quite important to understand the type of relationship involved in a partnership and its legal implications. If it is not desirable nor intended to form a true partnership, then another type of organization should be used.

The written contract should describe the rights and duties of the parties. Its terms should clearly indicate the existence of a partnership if a partnership is to be created. Its terms should likewise refute the existence of a partnership if the arrangement is not intended or desired to be one.

The farm partnership can be an excellent type of business organization. There are many successful father-son and other farm partnerships in operation on Missouri farms.

[1]Assistant Professor of Agricultural Economics and Extension Farm Management Specialist, respectively, University of Missouri, Department of Agricultural Economics. Mr. Mann is a member of the American Bar Association.

WHAT DO YOU WISH TO ACCOMPLISH?

Do you wish to combine or "pool" your resources? Perhaps one of you has land and some capital and labor, while another has only capital and labor. Apart, neither of you can be efficient. If you combine your resources, you can form an efficient operating unit. Or, do you have an arrangement where the father has full ownership and management control and it is now desirable to begin sharing ownership and management with the son and to allow and encourage him to remain on the farm?

Do you have a son or sons who could, and also desire, to share in ownership, management and profits thereby splitting income and reducing income taxes?

Do you desire a form of business organization that allows a planned and orderly method of transfer of ownership and management control so that the older generation can gradually retire from active participation and draw social security benefits, while the younger generation gradually takes over the operation and ownership of the business?

If you wish to accomplish one of the above objectives, or if you have similar objectives, you should consider a father-son agreement or related type of partnership arrangement.

WHAT IS A PARTNERSHIP?

If two or more persons associate together for the purpose of carrying on a business, as owners, for profit, sharing in profits and losses and in management control, they have probably created a partnership. The general characteristics of a legal partnership are:

1. An agreement specifying the terms of the arrangement. Although the agreement can be oral, **it should always be in writing.**
2. Sharing of management and labor with a majority of the partners controlling. Each partner has an equal voice in management control unless the agreement expressly states otherwise.
3. Sharing of profits and losses. Each partner shares equally in profits (and losses), unless the agreement expressly states otherwise. Partners may be paid wages by the partnership or they may make withdrawals as advances on their share of profits. Wages to partners may be charged as labor costs, but usually should be treated as advances on shares of profits. In any event, wages end up as self-employment income for social security tax purposes.
4. Sharing in ownership and control of **partnership** property whether it is land or personal property. Unless the agreement expressly states otherwise, each partner has an equal partnership interest and has equal right to possession and control of partnership property. The interest may be agreed upon in any manner. Any property, the use of which is contributed to the partnership, is subject to the terms of use specified in the agreement, but title to such property remains in the person contributing it.
5. The partnership is a separate legal entity. It has a name of its own, can own its own property, and transact its own business through the partners, who speak for it.
6. Partnership records. A partnership must have its own records, especially for income tax purposes. Although it pays no income or social security taxes, a partnership income tax information return must be filed. The partners then pay individual taxes on their share of the partnership income, as specified in the partnership agreement.
7. A partnership bank account. Although it is not required by law, it is nearly always advisable to have a separate partnership business bank account.
8. Unlimited liability. Each partner is liable for all of the debts of the partnership and a creditor of the partnership may go against the assets of individual partners to collect the money due him. This liability cannot be changed unless a special "Limited Partnership" is formed (see below). The unlimited liability feature of the father-son team need not be a serious limitation. There are several factors to consider: There is a close relationship of mutual trust and confidence. There is the opportunity to use a farm checking account with proper safeguards. The

partners can easily let business men in the community know the terms of their partnership contract, including the authority given to each partner. These things tend to minimize the seriousness of unlimited liability of a farm partnership in contractual obligations. Liability insurance should be used for protection against liability arising out of personal injury or property damage.[2]

9. Dissolution at death. A partnership is automatically dissolved upon the death of a partner. The agreement should provide for an orderly method of continuation of the business by the surviving partners. A "buy-and-sell" agreement, possibly with life insurance provisions, is an important consideration (see below).

REQUIREMENTS FOR A SUCCESSFUL PARTNERSHIP

1. Mutual trust and confidence are essential. A partner must endorse and back up the other partner's decisions. The partners must be able to work closely together, to discuss their differences and to agree on solutions to these differences.
2. The farm operation itself must be of such a size and character that it will efficiently use the available time, abilities and assets that the partners wish to contribute. The amount of capital and labor each partner will contribute to the business and the outside income of any partner should be considered. Usually, the final decision depends on whether the expected returns to the partners' investment, labor and management will be sufficient to satisfy their living requirements and allow satisfactory savings.

   The partnership business must satisfy the basic financial principles for any successful farm business. It must pay operating expenses, depreciation or replacement costs on machinery, equipment and buildings, interest on the investment, returns to all labor at going farm wage rates in the community, and a fair return to management. Earnings must be adequate for the number of families to be supported out of income from the partnership business.

   If the farm business will not pay the returns listed above, or cannot be organized so that conservative estimates of the returns indicate that it will pay these costs at average expected price levels, the partnership is likely to prove disappointing. An accurate estimate of the returns to be expected should be determined in discussions and budgeting procedures leading up to the formation of the partnership.
3. Separate homes are usually essential to the success of a partnership. This is true even in family arrangements, and especially if the son in a father-son partnership is married.

FARM PARTNERSHIP RECORDS AND ACCOUNTS

The same farm business records that should be kept for most farm businesses should be kept for a farm partnership business. In addition, individual partner's accounts and partnership annual settlement accounts, and in some cases, an annual partners' inventory interest account (share of partner's interest in partnership inventory) should be kept. Also, of course, any farm business should always keep a copy of federal and state income tax returns for at least the past five years.

The Missouri Farm Account Book is easily adapted to a partnership business. The records kept there, and income tax returns, plus the annual settlement and annual partner's inventory interest account shown in the appendix should satisfy most record needs for the partnership.

If a partner retains ownership of land and improvements, or of personal property, only the use of which is contributed to the partnership for a specified rental return, that partner should keep an individual depreciation schedule for such property. He can use the Missouri Farm Account Book depreciation schedule forms for this purpose.

Of course, a partnership can also use the Agricultural Extension Farm Record Analysis Service, just as can an individual farm operator. The County Extension Agent or Balanced Farming Agent can explain this service.

[2]For further general information about this matter, see "Farmers Personal Liability and Insurance," Cir. 746, Univ. of Mo.

PREPARATION NECESSARY TO FORM A PARTNERSHIP

After the initial decision has been made to form (or to consider forming) a partnership, further decisions must be made. They are:

1. **Ownership of property.** Certain property should be owned by the partnership. However, the individual partners may wish to retain title to other property and only agree that the partnership is entitled to use it. For example, father may desire, at least initially, to retain title to the farm and rent it to the partnership. Ordinarily, it is preferable for the partnership to own all personal property, although special circumstances may make it advisable for the partners to retain individual ownership.

   If the son does not have sufficient capital to make an equal contribution of personal property to the partnership, he can buy a one-half interest from the father, either at the beginning of the partnership with the father or a third party financing the transaction, or in annual amounts geared to his income from the business, after allowing for living and other necessary expenses.
2. **Labor and management contributions.** Ordinarily, each partner who is active in the farm operation will contribute his full labor and management skills to the business. However, often a partner may work for the partnership only part-time or not at all.
3. **Management control.** Initially, perhaps, the father will desire to maintain management control, with the son participating in the management decisions, while later they share equally in management control. Still later, the son can assume management control, with father participating in making management decisions. The agreement must set out these provisions in detail. Perhaps one partner is to have management control with regard to one enterprise, the other partner with regard to another enterprise, with equal sharing of management control for general partnership affairs.
4. **Sharing profits and losses.** The partners may desire to share profits and losses equally, regardless of property and labor contributions. They may desire to make payments for labor and interest payments on property contributions and then share the remaining net income either equally or in some other proportion.

   In any event, the sharing should be calculated to provide a fair and adequate return to each partner based on his total contribution to the business and on his needs.
5. **Books and Records.** It must be decided what kind of records will be kept and who will keep them. This is the heart of any partnership. The efficiency of its operation will depend largely on the kind of records it keeps and their use in planning.
6. **Farm Improvements.** If the father retains ownership of the farm and contributes its use to the partnership on a rental basis, provision must be made for the addition of permanent improvements. Who decides if and when they shall be made and who pays for them? If the partnership pays for them, it should be agreed that in the event the partnership ceases to operate the farm, it must be reimbursed for the undepreciated value of any improvements. If the father pays for the improvements, allowance must be made to him in the rental arrangement. In return the partnership, or any other partner, should be reimbursed for any labor or materials expended in making improvements.
7. **Farm Expenses.** It must be decided what expenses are to be included in farm expenses. Usually, this will include the following: Livestock purchases, feed purchases, livestock expenses, crop expenses, wages and cash cost of board and keep for hired labor, personal property taxes and cash rent, expenses for repairs, insurance and maintenance of all farm improvements, purchases of new machinery and equipment, power and machinery expenses, farm share of telephone and electricity, and such other expenses as may be considered to be a part of the farm operating expenses. Real estate taxes and insurance on farm buildings rented to the partnership by partners can be considered partnership expenses and be paid by the partnership if an adjustment is made in the rental arrangement to offset this expense. Expenses usually should be paid from a partnership bank account. A petty cash fund can be maintained for reimbursing partners for small expense items.
8. **Farm Receipts.** The prospective partners must decide what is to be included as partnership re-

ceipts. They should include all receipts from the sale of livestock, livestock products, crops, forestry products, machinery and equipment sales. Custom work income probably should be treated as partnership income. Off-farm labor income can be treated as such, and should be if the partners have all agreed to spend full time on the farm. Individual rental, interest or dividend income not related to the farm business should not be treated as farm receipts.

9. **Net Farm Earnings.** The method of calculating net farm earnings must be determined. The amount remaining of farm receipts after deducting farm expenses is the cash balance for the year.

10. **Settlement.** Usually it is advisable to have a settlement only once each business year, with a monthly wage or withdrawal privilege to provide for monthly living expenses. However, some farm businesses, such as dairy and poultry farms, may find it desirable to settle each month.

    The method for calculating the settlement must be determined. Priorities of payments must be agreed upon. Will a labor return be paid regardless of net cash income? Will labor payments take precedence over payments for land contributions and inventory interests? The method for determining the amount each partner is to receive in cash and is to reinvest in the business must be decided. The method for determining adjustments in partnership interests based on inventory and investment changes must be decided.

11. **Partnership termination and transfer of partnership interest.** At the outset, the partners must decide how property will be divided and distributed if the partnership is later terminated. If they wait until the partnership is in operation it may be too late to find an agreeable solution. Usually, a division based on their proportionate partnership interests is appropriate, but the problem of who is to receive which specific items of property, and at what valuations, must also be answered. A method of arbitration of differences in this regard should be agreed upon.

    One of the purposes of the partnership may be to provide for a planned and orderly method for transferring the complete business to the surviving partner in the case of the death of the other partner, or it may be to provide a gradual transfer of the entire business to one partner. A "buy-and-sell" (or business purchase) agreement should be included in the partnership agreement to fulfill either or both of these purposes. (See Appendix).

12. **Tax considerations.** It is important to know the treatment of income from a partnership for tax purposes. Capital gains problems must be understood and proper arrangements made. (See Appendix for discussion of taxes).

HOW IS A PARTNERSHIP CREATED AND OPERATED?

The prospective partners should first discuss and plan the arrangement they anticipate creating. They must make a decision with regard to each point raised in the previous section. They should then obtain expert legal assistance in drawing up an agreement, including all of the plans they have agreed upon. This agreement then becomes their code of operation. They must turn over property to the partnership as agreed. They must open a partnership bank account. They must make decisions according to the procedure outlined in the agreement. They must make withdrawals and share profits and losses as they have agreed.

In planning the partnership, the partners can decide to create a "50-50 partnership" and make adjustments for unequal capital or labor contributions before profits are shared. Then profits can be shared equally. Any increase in inventory can be shared equally in the partners' capital account. On the other hand, the partners can decide to create a "proportionate-sharing partnership". Under such an arrangement, the partners share profits in proportion to their capital and labor contributions to the partnership. For example, if one partner contributes 80 percent of the capital and labor, while the other partner contributes 20 percent, they will share profits 80-20, without prior payments for rent on land, interest on capital, or wages for labor.

Under the proportionate sharing arrangement, it must be decided whether increases in partnership inventory shall accrue to the partners' inventory interest (capital) account in the same proportion as their sharing of profits and losses, or in equal shares. If the former, the increases in inventory are being

awarded on the basis of the value of capital and labors contributions; if the latter, they are being awarded as a return to management and risk sharing (assuming equal participation in management). There is some justification for dividing partnership inventory increases equally where the son is attempting to buy into the business. It allows him the opportunity to build up his interest at a more rapid rate, thus providing incentive for putting forth his best management efforts.

Some combination of the 50-50 partnership and the proportionate sharing partnership might be preferable. For example, wages for the labor contributions of the partners could be paid at going wage rates prior to a sharing of profits, with profits then being shared according to the proportionate capital contributions of each partner.

Where land is included as a part of the capital contribution of a partner, it often should be treated differently than other capital contributions in calculating returns. This problem is discussed in more detail on pages 10 and 11.

In any event, the first step is complete planning. If you understand the nature of a partnership, if you have determined that a partnership will accomplish the ends you intend and desire, if you understand the essential requisites for a successful partnership and feel that you satisfy these, then you are ready to carry out the preparation necessary to form a partnership.

Each item discussed in the previous section should be considered in detail. Refer to the Appendix if you need further clarification. If you still do not understand or cannot come to a decision, seek expert advice from your Extension Service. If your problem is a legal one, you should consult your attorney.

Use the checklist in Appendix 1 to be sure you have carried out the necessary preparation.

When you have completed this step, you are ready to seek expert legal assistance in drawing up the partnership agreement.

A FARM ORGANIZED AS A FATHER-SON PARTNERSHIP

Ownership of Property

The father owns a 320 acre farm and has recently purchased another farm of 180 acres that joins him. There is no mortgage on the 320 acres, but there is a first mortgage of $15,000 on the newly acquired farm.

The son is ready to farm full-time, he is married and he and his father both feel the partnership would be a satisfactory arrangement.

The father owns livestock and machinery, and the son also owns certain livestock and machinery. The son's livestock and machinery are free of debt. He has accumulated this property over the years in 4-H club work, FFA projects, etc., on his dad's farm. The personal property of the father is free of debt, except for a $4,000 cattle loan against the feeder cattle, which are valued at $6,000. The partnership is to be formed and start operation on the first of January. Plans are being made and the written agreement drawn up in November and December.

Alternative One: 50-50 Partnership

Father and son agree to work substantially full-time in the business and, in return for their labor, each will be allowed a residence in which to live, including a garden area, plus $250 per month in wages. They agree also to the following:

1. Each partner will withdraw $150 per month for living expenses as an advance against earnings, but will be paid this amount regardless of earnings.
2. Each partner will pay his own electricity, heating and car expenses for personal use.
3. The partners will share equally in management responsibility and control.
4. The partnership will borrow needed operating capital from the bank or Production Credit Association and the interest will be treated as a farm expense item.
5. Father will contribute the use of the land to the partnership while retaining title, but both father and son will transfer title to all personal property to the partnership.
6. Farm income will be subject to the following priorities:
   a. Farm operating expenses
   b. Annual wages allowance

TABLE 1 - CONTRIBUTIONS AND COMPUTATION OF AGREED PERCENTAGE ALLOCATION OF RETURNS

Property and Labor Contributions: Father	Son	Value	Rate of return (per cent)	Father's Return	Son's Return	Total
Land		$ 50,000	4	$2,000*	$	$ 2,000
Buildings		22,000	4	880*		880
Breeding Livestock		8,000	6	480		480
	Breeding Livestock	6,000	6		360	360
Other Livestock		6,000	6	360		360
Machinery		8,000	6	480		480
	Machinery	4,000	6		240	240
Feed and supplies		7,000	6	420		420
Total		$111,000		$4,620	$ 600	$ 5,220
Per cent				88.5	11.5	100
Labor		12 mo.	$250/mo.	$3,000		$ 3,000
	Labor	12 mo.	$250/mo.		$3,000	3,000
Total				$7,620	$3,600	$11,220
Per cent				67.91	32.09	100

* If the rental for land and buildings is to be treated as an operating expense of the partnership, then the father's return would be $4,740 or 56.84 percent, and the son's return would be $3,600 or 43.16 percent.

The following listing shows the property each prospective partner owns and the net values agreed upon:

		Indebtedness	Depreciated Book Value	Estimated Net Market Value	Total Market Value
	LAND AND IMPROVEMENTS				
Father					
Residence			$ 2,000	$ 6,000	
Residence			2,000	6,000	
Other Buildings			5,000	10,000	
Land		$ 15,000*	30,000	50,000	
Total Real Estate		$ 15,000*	$ 39,000	$ 72,000	$ 72,000
	PERSONAL PROPERTY				
Breeding livestock -	38 raised beef cows and 2 purchased bulls		$ 500	$ 6,000	
	Sows - 40 head (raised)			2,000	
Feeder livestock -	40 purchased steer calves	$ 4,000	6,000	2,000**	
	36 raised calves			4,000	
Machinery and equipment			8,000	8,000	
Feed and Supplies on hand			7,000	7,000	
Total Personal Property		$ 4,000	$ 21,000	$ 29,000	$ 33,000
Father's Total Property		$ 19,000	$ 60,000	$ 101,000	$105,000
Son					
Breeding livestock-	20 raised beef cows			$ 3,000	
	18 raised calves			2,250	
	15 raised brood sows			750	
Machinery			$ 4,000	4,000	
Son's Total Property			$ 4,000	$ 10,000	$ 10,000
Total Real Estate				72,000	72,000
Total Personal Property		$ 4,000		39,000	43,000
Total, All Property		19,000		111,000	115,000

* The father is continuing to assume this debt. Thus, it is not deducted from the value of the real estate which he is contributing to the business.

**It is agreed that the $4,000 cattle loan is to be assumed by the partnership. For this reason the father's contribution will be $2,000 worth of feeder cattle, their excess value above the loan.

c. Pro rata allocation for contributions of partners (Partnership inventory interest) according to percentages determined from Table 1.

d. Equal division between partner of balance, as return to risk and management contribution.

The annual settlement account of this partnership would be as follows (using hypothetical receipts and expenses):

invested in the business. If these savings are being made, it would be essential in the example that wages have a priority since the son's percent is so small as compared to the father's.

This is not ordinarily considered a problem. However, it should be recognized that percentages do not change unless a way is set up to change them. Usually, the only way for the son to increase his percentage is to buy into the business from his

	Partnership Account	Fathers Account	Sons Account
Total receipts	$ 25,268	$	$
Less cash expenses	13,376		
Gross income for allocation	11,892		
Annual wages	6,000	3,000	3,000
Sub-total	$ 5,892		
Allocation for partners property interest	5,220	4,620	600
Equal allocation of remainder as return to risk and management	672	336	336
Total income credit to partners	11,892	7,956	3,936
Cash withdrawals	3,600	1,800	1,800
Net amount accruing to partners	7,792	6,156	2,136

This type of settlement will work out quite well.

However, in order to stay on a sound financial basis it is essential that a complete financial analysis be made each year. This financial analysis will determine if all the income shown as cash balance will actually be allocated.

Net farm and family earnings need to be figured. This involves not only the cash balance but also all changes in inventory. Inventory changes involve depreciation charged, new purchases of machinery or buildings and equipment, and livestock, crops and supplies on the farm at the close of the business year.

Allocation to the partners of funds may be based on the cash balance, and farm income for tax purposes may be reported on the cash basis. However, sound financial management requires that careful inventories and depreciation schedules be established in the farm record book. The cash balance does not always give the true farm income or earnings in any one year.

The change in inventory could be considered each year and made a part of the settlement. This is seldom done with partnerships. The percentage each partner owns remains the same regardless of changes in the inventories. Usually inventories rise and fall from year to year unless farm earnings are being re-

father or to add to his holdings and percentage by buying additional breeding stock or machinery outside the farm.

Variations of Alternative One:

If father is to pay the fixed costs to land (taxes and insurance), he could be allowed a priority for rental on land above the allocation for the other inventory interests of the partners. In other words, rent on land could be treated as an operating expense. However, wages, at least to the extent of necessary living expenses, should always receive first priority. To assure that fixed costs to land will be paid, it is usually preferable to include them as partnership expenses, and then make a downward adjustment in the rental return to contributed land.

Determination of the rental payment to be made for land contributed to the use of the partnership is often difficult. Too high a rental will reduce the return to other contributions to such an extent that the partner who has not contributed land will not receive a fair return on his inputs. Too low a rental is unfair to the partner contributing the land.

Returns to land should not be calculated on the same basis as other capital inputs because the land itself does not depreciate in value with use, and the improvements on land depreciate at a much slower

rate than do most other capital inputs. Advances in technology, improvements in operation of the farm, and the adoption of any outstanding system of farming, as well as many outside factors, are capitalized into the value of land, but not into the value of other capital contributions to the business. To offset this advantageous position of use in relation to other capital assets used in the farm operation, the valuation of land for contribution purposes should be conservative, and the rate of return to be paid to it in a 50-50 partnership should be at least one percent lower than for other capital contributions. Because of the difficulty of making this valuation for land, it may be preferable to fix a rental value based on the amount for which the land could be rented in the community.

In calculating returns to land, both father and son must take a practical approach. If the partnership is to pay fixed costs to land, many agreements provide for a flat four percent rental return on the land using a conservative valuation. Sometimes the partners will agree on a dollar figure for returns per acre of cropland, and a lower figure for pasture land. From $5.00 to $12.00 per acre has been used for crop land, and from $3.00 to $8.00 per acre has been used for pasture land, depending on the quality of land, and other factors.

The annual settlement account of the above partnership, treating rental for land and buildings as a partnership operating expense, and allowing property and labor contributions equal priority, would be as follows:

	Partnership Account	Fathers Account	Sons Account
Total receipts	$ 25,268	$	$
Less cash expenses, including rental for land and buildings	16,256	2,880	
Gross income for allocation	9,012		
Allocation for contributions	8,340	4,746*	3,600*
Equal allocation of remainder as return to risk and management	672	336	336
Total income credit to partners	11,892	7,956	3,936
Cash withdrawals	3,600	1,800	1,800
	$ 7,792	$ 6,156	$ 2,136

* 56.84 per cent as shown in footnote to table 1
** 43.16 per cent as shown in footnote to table 1

The above arrangement for a 50-50 partnership provides only for adjusting for differences in the partnership interests of the partners. However, the son will usually desire to become a 50-50 partner in his partnership interest. Provision must be made to allow him to progress toward this goal.

The two general methods for the purchase of an increased share of the partnership business are discussed on pages 12 and 13. It is important to include provisions in the partnership agreement that allow the son to eventually "buy into" the business sufficiently to become a full partner in ownership.

Alternative Two:

Proportionate Sharing Partnership

Father and son agree to the same arrangement as in Alternative One, except that farm income will be subject to the following priorities:

a. Farm operating expenses;
b. Proportionate sharing of remainder of income according to the percentage of total property and labor contributions by both partners (using Table I, page 9). In addition, inventory increases will be shared in the same manner.

The annual settlement account of this partnership would be as follows (using the same receipts and expenses as in Alternative One):

	Partnership Account	Fathers Account	Sons Account
Total receipts	$ 25,268	$	$
Less cash expenses	13,376		
Gross income for allocation	11,892		
Total income credit to partners (68% to father; 32% to son)	11,892	8,324	3,568
Less cash withdrawals	3,600	1,800	1,800
Net amount due partners	8,292	6,524	1,768

Variations of Alternative Two:

It should be noted that in Alternative Two, the father and son are being compensated on a 68 percent—32 percent basis, treating all inputs equally, including labor, inventory interest, management and risk. If the partners desire a priority of compensation for labor, a deduction for labor contributions should be made immediately following the deduction for cash expenses. If this were done, with wages being calculated at $250 per month, the annual settlement account would be as follows:

	Partnership Account	Fathers Account	Sons Account
Total receipts	$ 25,268		
Less cash expenses	13,376		
Gross income for allocation	11,892		
Annual wages	6,000	$ 3,000	$ 3,000
Remaining income to be proportionately shared (88.5% to father, 11.5% to son)	5,892	5,214	678
Total income credit to partners	10,892	8,214	3,678
Less cash withdrawals	3,600	1,800	1,800
Net amount due partners	7,292	6,414	1,878

Even in this latter arrangement, the partners are not being compensated equally for management and risk as they are in Alternative One. If the partnership agreement specifies that the partners are to share equally in management control and responsibility, it seems that they should be compensated equally for it. Thus, Alternative One may be preferable in such circumstances.

However, in the event that father is to retain management control at the outset, perhaps Alternative Two is the more equitable arrangement in the beginning. In this connection, it is important to be sure that the arrangement gives sufficient incentive to the son to induce him to stay in the business. If he has little or no property of his own to contribute to the partnership business, he should be given an opportunity to buy into the business to increase his share of ownership. He must also be allowed a sufficient share of the return from the partnership to provide enough accumulation of funds with which to buy into the business. As he increases his share of ownership, he also increases his share of the net income.

Equal sharing of increase in partnership inventory, instead of proportionate sharing, provides an opportunity for the son to increase his proportionate share of ownership of the business.

Business Interest Purchase Arrangements:

Two general methods for buying into the business are available:

1. At the time of entering into the partnership agreement, father can sell to son on an installment basis certain personal property that is to be contributed to the partnership. The son agrees to make annual payments measured by his share of the returns from the partnership and agrees to pay interest on the unpaid balance at a specified rate. Son then contributes this property to the partnership and it is included in his share of the partnership (partnership inventory interest)

for allocating returns to inventory interests (see example in Appendix).

2. The partnership agreement includes a provision by which father agrees to sell to son, each year, an amount of his partnership interest measured by the son's share of the returns from the partnership, until father and son own equal shares in the partnership (or until some other agreed proportion is reached).

It is apparent that the first method increases the son's ownership share in the partnership from the outset, and thus increases his share of the returns, but it also increases his personal interest expense. Under the second method, the son's share of the returns from the partnership does not increase until he actually makes payments to his father. Thus, his initial earning capacity is lower than under the first method, but, on the other hand, he has no annual interest payment to make to his father as under the first method. There are at least four variations in the method of computation of returns under the latter method of business interest purchase by the son. The father and son can share equally or proportionately in returns to risk and management. In addition, they can share equally or proportionately in inventory increases. They need not share returns to risk and management in the same manner that they share inventory increases. Thus, they may share equally in returns to risk and management, and share proportionately in inventory increases, or vice versa.

The methods of buying into the business can be illustrated by using the example figures set out on page 9. Since father is retaining title to the land, the values of the partnership interests include only the personal property. Father's personal property is valued at $29,000 net and son's is valued at $10,000.

For the partners to have equal partnership interests at the outset, it would be necessary for the son to purchase $9,500 worth of father's partnership interest. This would also be true if the partners shared equally in inventory increases and the son made annual partnership interest purchases from his father, geared to his annual net income available for capital accumulation. However, if the partners start out on the basis of $29,000 (father) and $10,000 (son) and share inventory increases at the same ratio, the son's total purchases over the years would exceed $9,500 because he must purchase a share of the greater inventory interest which his father receives until the ratio becomes 50-50.

Business Purchase at Death or Retirement of Partner

To assure that when one partner dies or otherwise leaves the business, the other partner can continue operation, a "buy-and-sell agreement" is important. In addition, such an agreement can be made so the son begins to buy out father when father desires to slow down, but does so at a rate that allows father to get out of the business only so fast as he wishes (See example in Appendix).

CHECKLIST IN PREPARATION FOR FORMING A PARTNERSHIP

Following is a planning checklist for use by prospective partners to assist in assuring that they consider all relevant provisions.

A. Ownership of property:

1. Property to be owned by partner #1, the use of which is contributed to partnership.

____

____

____

2. Property to be owned by partner #2, the use of which is contributed to partnership.

____

____

____

3. Property, title to which is to be transferred to partnership:

(a) From partner #1:

(b) From partner #2:

B. Labor and management contributions:

	Amount
Partner #1	
Partner #2	

C. Management control:

________________ to have management control. ________________ and

________________ to share management control equally.

________________ to have management control of ________________ enterprise;

________________ to have management control of ________________ enterprise.

____

____

____

D. Sharing of profits and losses

________________ to be shared equally, with no prior payments for labor and interest or rent.

________________ to be shared (equally, proportionately) after payments for

1. Labor: Partner # 1 ______________________ Priorities of Payments: ________

Partner # 2 ______________________ ______________________

2. Interest on inventory interests:

Partner # 1 ______________________ ______________________

Partner # 2 ______________________ ______________________

3. Rent on land contributions:

Partner # 1 ______________________ ______________________

Partner # 2 ______________________ ______________________

E. Allocation of inventory increase ____________ Equal sharing

____________ Proportionate sharing

F. Buying into partnership by son

1. ____________ Son entitled to buy into partnership up to 50 percent by purchases of father's interest at rate of: $ ____________ annually

____________ % of son's net return annually.

2. ____________ Son buys 50 percent of partnership at outset by note to father for $ ________ principal, at ________ percent interest payable at $ ________ annually, (including interest.)

G. Books and Records. Who is to keep books and records? ______________________.

H. Farm improvements

Cost of new buildings, or of substantial alteration of old buildings, is to be borne as follows: ______

____

Depreciation on new or altered buildings is to be claimed by Partnership ____________, Father ____________, Son ____________.

Cost of other improvements is to be borne by ______________________

____.

Depreciation on other improvements is to be claimed by ______________________

____.

Allowance in rental arrangement is to be made as follows: ______________________

____

Reimbursement for undepreciated value of improvements is to be made as follows in the event of

dissolution of partnership: ____

____

I. Farm partnership expenses include:

__________ Livestock purchases, __________ feed purchases, __________ livestock expense, __________ crop expense, __________ wages, __________ cash cost of board and room, __________ personal property taxes, __________ cash rent, __________ hired labor, expenses of __________ repair __________ insurance __________ maintenance of farm improvements, __________ purchase of new machinery and equipment, __________ hired machinery expenses, __________ share of telephone and electricity, __________ real estate taxes, __________ insurance on farm residences, other, __________

J. Farm receipts to include:

__________ Receipts from sale of livestock and livestock products.

__________ Receipts from sale of crops.

__________ Receipts from sale of forestry products.

__________ Machinery and equipment sales __________.

__________ Custom work receipts.

__________ Off-farm labor income __________.

__________ Individual rental, interest or dividend incomes __________

____

K. __________ Partnership bank account to be maintained. Withdrawals to be authorized on signature of __________ in manner as follows: __________.

____

__________ Petty cash fund to be maintained under control of __________.

__________ Personal memos or sales tickets to be used as record of petty cash expenditures.

L. 1. Settlement:

__________ annually

__________ monthly

__________ other __________

__________ withdrawal privilege __________

____

2. Method of Computing Settlement:

____________based on annual inventory

____________equal sharing of total inventory increase

____________equal sharing after payment of wages and interest based on partners' share of annual inventory, with ____________cash rent, or ____________share rent, for land contribution ____.

3. Inventory Determination:

________last prior inventory, less depreciation, plus cost of new purchases, plus market value of raised crops and livestock.

________________market value of all items.

4. Determination of partners' inventory interest:

____________same proportion as last prior inventory interest with adjustment for purchase or sale of interest between partners.

____________amount of last prior inventory interest, plus equal share of inventory increase.

M. Termination and business purchase arrangement:

1. ______________on termination, distribution to be based on inventory interest

______________on termination, distribution to be equal

2. ______________sale to be held with distribution of cash proceeds

______________distribution to be in kind

3. ______________to include business purchase agreement at death

______________with life insurance provisions

______________to pay premiums

______________with installment payment provisions

______________only by lump sum

4. ______________to include business purchase agreement during life, on __________retirement, __________disability, __________any time

______________by option of younger partner

______________by installment payments

______________with payment at __________percent interest

______________purchase price to be determined by latest annual inventory figure,

______________purchase price to be $ ____________for father's interest,

$ ____________for son's interest,

________________other ____

Appendix A

[This is an example of a business interest purchase agreement where the "buying-in" partner makes the purchase at the outset, and pays interest on the unpaid balance (See page 12, method one).]

Schedule A: This agreement entered into this ________________ day of ______________, 19 ____ between ____________________________, seller, and _________________________, buyer, partners under the partnership agreement to which this contract is attached as Schedule A. It is agreed as follows: THAT ______________________________, of ___________________________, Missouri for and in consideration of the sum of ____________________ dollars, lawful money of the United States of America has granted, bargained, sold and delivered, and, by these presents, does grant, bargain, sell and deliver, unto ______________________ all the following GOODS, CHATTELS, AND PROPERTY, to-wit:

1. It is understood and agreed that the book value of the above-described property is __________. It is further understood and agreed that any difference between the fair market value of the above-described property and the price agreed to by buyer and seller herein, is to be considered a gift from seller to buyer for any and all purposes whatsoever.
2. Buyer agrees to pay the cash consideration of ____________________________________ in annual installments, including principal, and interest at ____________ percent per annum, equal to __________ percent of his annual net return from the partnership, payable at the time of each partnership settlement. Buyer is entitled to prepay any amount at any regular payment date.
3. Buyer to have and to hold the said Goods, Chattels and Property unto the said buyer, his heirs, executors, administrators and assigns, to and for his own proper use and behoof, forever. And the said seller does vouch himself to be the true and lawful owner of the said Goods, Chattels and Property, and have in his full power, good, right and lawful authority, to dispose of the said Goods, Chattels and Property, in manner as aforesaid: And he does for his heirs, executors and administrators, covenant and agree to and with the said buyer to Warrant and Defend the said Goods, Chattels and Property to the said buyer, his executors,

administrators, and assigns, against the lawful claims and demands of all and every person and persons whomsoever.

4. This contract shall be binding upon the parties, their executors, administrators, heirs, and assigns.

In Witness Whereof, the parties have hereunto set their hands and seals, the ________ day of ________ 19___.

Appendix B

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:

1. Sign and swear to a special certificate which includes
   - a. the name, location, character, and term of the business, plus the names of the general and limited partners and their addresses
   - b. 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
   - c. any provisions for additional contributions
   - d. the compensation which the limited partner will receive on his contributions
   - e. any right to admit additional limited partners or to substitute an assignee as contributor in the limited partner's place

f. 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

g. any rights of the remaining general partners to continue the business after the death, retirement, or insanity of a general partner

2. File this certificate with county recorder of deeds.

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

1. A limited partner's contribution cannot include services.
2. He cannot take part in the control or management of the business.
3. His name cannot be included in the partnership name.
4. 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.

Appendix C

PARTNERSHIP BUY-AND-SELL (*BUSINESS PURCHASE AT DEATH OR RETIREMENT*) AGREEMENT

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:

1. The names of the partners, a reference to their partnership agreement, its name, and the principal address of the business. In addition, 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.
2. 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.
3. 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 de-

ceased and the surviving partners, respectively, to sell and buy the partnership interest involved.

4. Provision for paying additional money to the estate by the surviving partners should the insurance proceeds not be adequate.
5. 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.
6. 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.
7. A provision for acquiring additional policies of insurance if there is an increase in value of the partnership interests.
8. Miscellaneous provisions:
   a. 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.
   b. A provision for transferring the insurance policies to the insured persons upon termination of the partnership.
   c. 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.

Appendix D

PROPERTY RIGHTS OF A PARTNER

Unless the partnership agreement states otherwise, a partner is entitled to three general property rights. They are:

1. his rights in specific partnership property
2. his interest in the partnership
3. his right to participate in the management of the partnership business.

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.

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

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 sections.

Appendix E

RELATION 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 persons 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 co-partner, 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:

1. Assignment of partnership property in trust for creditors.
2. 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.)
3. 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.[3]

Appendix F

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:

1. Where title to real property is held in the partnership name. If a 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.
2. 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.

[3]If the partnership engages in a hazardous activity, not considered to be farming, the Workmen's Compensation Law might apply.

3. 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 intest 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.

4. 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.

   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.

Appendix G

PARTNERSHIP INVENTORY VALUE AND PARTNER'S INVENTORY INTEREST ON 31 DECEMBER 19 ____ FOR COMPUTING RETURNS TO INVENTORY

Pursuant to the terms of the partnership agreement entered into on ______________, between ____________________, and ____________________ partners in ____________________,

the above-named partners mutually agree that:

The inventory value of the partnership business this 31st day of December, 196 __ is $__________,

the inventory interest of each partner [based on the percentage of their partnership interest or based on the last inventory interest plus an equal share in partnership inventory increases.] being as follows:

Name	Amount
A.	____________________
B.	____________________

Upon being signed by the partners, this instrument is thereby incorporated into and becomes a part of the partnership agreement hereinabove referred to.

In Witness Whereof, said partners hereunto affix their hands and seals this ____________ day of ____________________, 19 _____.

____________________ (Seal)

____________________ (Seal)

Appendix H

TAXES AND THE FARM PARTNERSHIP[4]

Income Taxes.

The partnership merely reports income. It can be reported on either the cash or the accrual basis. The partnership pays no income tax. The partners include their share of the partnership profits as income on their own returns, whether that amount is actually distributed or is retained in the business.

1. 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 less 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.
2. 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 be worth $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.
3. 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.
4. Partnership distributions. Three kinds of property can be distributed by the partners to themselves from the partnership.
   a. 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.
   b. 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 unless they receive an amount over the tax basis of their partnership interest.
   c. Inventory items such as raised 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.)

[4]Tax laws and regulations change from year to year. Be sure to rely on current tax advice when dealing with tax problems.

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.

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 property interest. Special rules also apply where distributions involve a large amount of uncollected debts or inventory items.

5. Transactions between partner and partnership. A partner may loan money or sell property to the partnership like any other person, providing such arrangements are formal and businesslike. There are three exceptions to this general rule:
   a. 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.
   b. 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 non-capital asset in the hands of the partnership.
   c. 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 can be treated as partnership expense but each partner must report his salary, if any, on his individual income tax return.
6. 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 into 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 (giver) 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 must 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 performed equal services, each would receive $10,000 as their distributive shares.

   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.

Social Security Taxes.

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.

At the present time, participation in a partnership that operates a farm 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 his share of the partnership income and is eligible to receive benefits upon retirement.

Since the rules on who qualifies have changed frequently, it is advisable to obtain expert advice if social security is an important reason for considering a farm partnership.