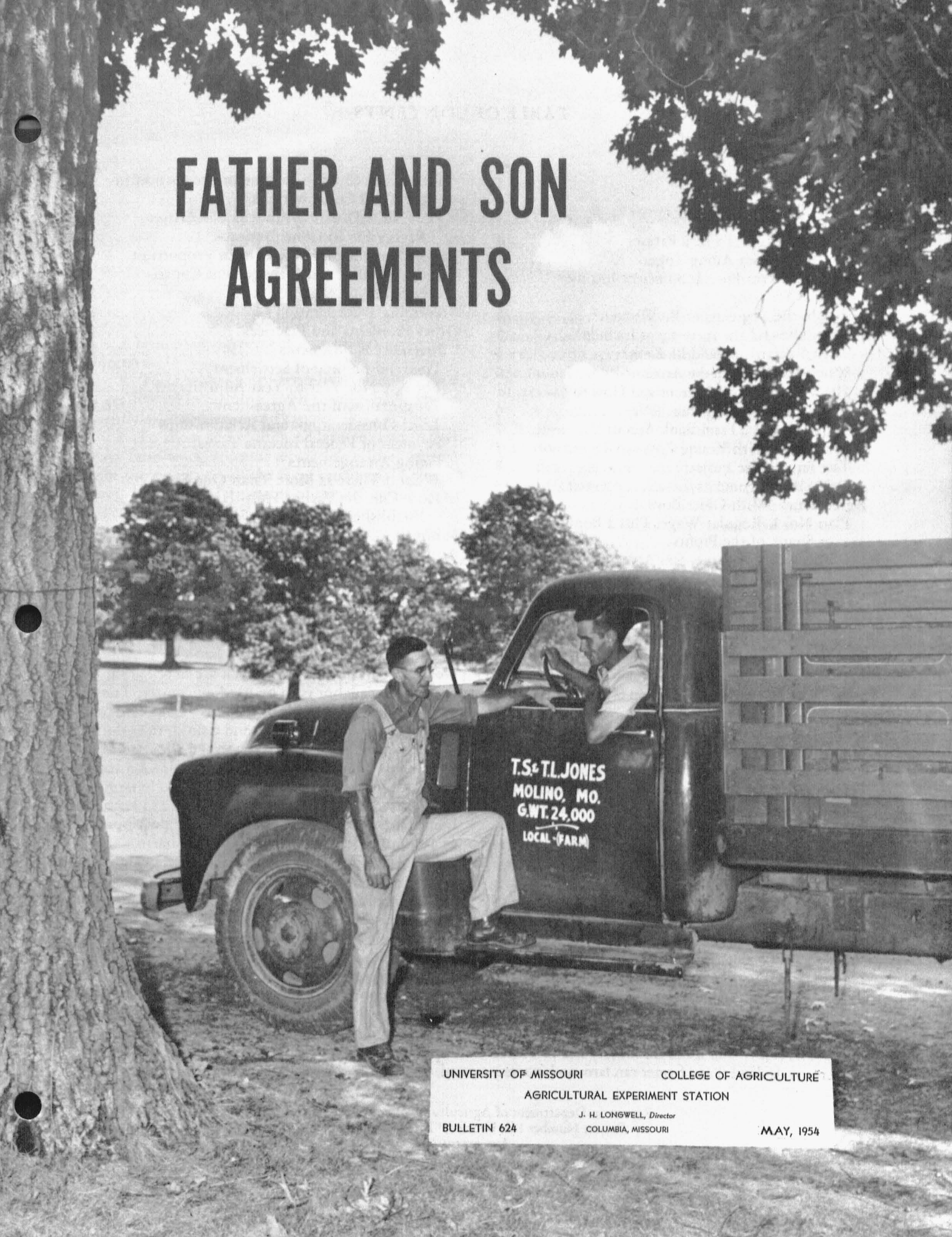
FATHER AND SON AGREEMENTS



UNIVERSITY OF MISSOURI COLLEGE OF AGRICULTURE

AGRICULTURAL EXPERIMENT STATION

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INTRODUCTION

Getting started in farming with a business that is adequate for efficient operation is much more difficult than it was 50 to 75 years ago. The problems in farming and those in family living have changed. A half century ago the nation's farmers were less commercial in their agricultural production. The farm family had a place to live and shared in the food which was produced. Farming was essentially a way of life. Today, a more commercial type of agriculture has developed. A large number of the nation's farms, particularly those in the better agricultural areas, are specialized. They are producing agricultural products primarily for sale. The family has fewer products to share; instead they share with others on the basis of so many dollars. The major portion of the goods and services consumed, as well as those required in operating the farm, have to be purchased. Under these conditions, farming is a business as well as a way of life.

The trend toward commercialization has changed the organization of the farm business considerably. The use of more and more machinery has increased the acreage of land that a farmer can farm and in many areas large numbers of livestock are necessary if the farm family's labor is to be used efficiently. The increased amount of productive factors—land, livestock, machinery and equipment—and rising prices during the last two decades have increased the capital requirements until it is exceedingly difficult for a young man with little or no savings to get started in farming.

These changes, along with the desire to keep the home farm in the family, have led to the development of a number of father and son profit sharing agreements. These agreements must, of course, be developed on a business-like basis if they are to succeed. The procedures followed in setting up an agreement are fairly easy where there is but one child in the family. Where there are several children, the problem is more complicated because it is customary for most parents to want to treat all of the children equally. For this reason, a good set of farm records—farm inventory and farm cash account—must be kept if the income is to be shared correctly, the ownership of the capital kept clear, the man who remains on the farm protected, and his brothers and sisters treated accordingly.

Report on Department of Agricultural Economics Research
Project Number 162, Entitled, "Father-Son Business
Agreements"

Father-Son Farm Business Agreements

Robert C. Suter[1]

Objectives

A father-son agreement usually has three main objectives:

1. To provide an opportunity for a young man to get started in farming, even though he lacks two essentials—experience and capital.
2. To allow an experienced farmer to retire from heavy farm work, without separating himself entirely from the operation of the farm business. In this respect, "timeliness," in terms of the age of the father and the age of the son, plays a big role in determining when a father-son farm business agreement should be started.
3. To provide economic security and social stability for present-day agriculture by maintaining the productivity of the farm unit—in terms of both soil resources and volume of business. If efficient farm units are to be maintained, the ownership of the family farm must be transferred smoothly from one generation to the next.

There are three major types of father-son agreements. One is the arrangement that 'Dad' makes with his 10-year-old son to arouse his interest in farming; a second is the agreement (made when the son is older) for the annual operation of the farm business; a third is that which concerns the transfer of the farm to the next generation.

Definition

This bulletin is concerned primarily with the arrangements necessary for joint operation of the business—the problems encountered and the mechanics involved in setting up records for dividing the income and for keeping the ownership of the farm capital clear. From this standpoint, a father-son farm business agreement has been defined as a mutual understanding between the father and the son, or in some instances, between other members of the family, to supply the various elements—land, labor, capital, and management—which go into the organization of the farm business, the purpose of which is to bring about its successful operation with maximum efficiency and continuous profits. ("Father-son" farm business agreements are quite often set up *with a neighbor's son*).

A satisfactory father-son agreement is one which will allow the son to accumulate capital at the same time that he is acquiring experience in operating the farm business. After the first year or two, it should allow the father, particularly if he is an elderly man, to retire from the heavy work connected with the farm business. Still another reason for setting up a formal agreement is to provide for keeping the ownership of the farm capital (as between father and son) separate so the son doesn't eventually find himself in the position of "paying" for parts of the farm twice. Many a young man has helped his father build a new corn crib or has helped to pay for other improvements on the home farm only to discover later that he must buy out his brothers' and sisters' full share in that same building or improvement. To a number of young men this has been a good reason for leaving the farm at a time when they were most needed.

Hence, after working together and operating the farm successfully under an annual operating agreement, the father and his son might well consider the third type of agreement—that which will eventually transfer the farm to the next generation. A father-son farm transfer agreement may be defined as an agreement which provides the transfer of either part or full ownership of the farm itself (land, buildings, and improvements) to the next generation. This process may begin immediately after the agreement is made, or, it may be set up to go into effect automatically when the father retires, or when he passes away. The essentials of this type of agreement are the provisions (1) that provide security for the parents either through lifetime use of the farm, the home, or both, and (2) that maintain the productivity of the farm unit.

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Getting Started

Breaking the Ice: In setting up a father-son farm business agreement the father and the son must first sit down and talk things over in a business-like manner. This is a very important part of getting started; yet it seems to be a most difficult problem for many fathers and sons. There are but few fathers who will discuss the farm business with their son as they would with the local banker. Likewise, there are few sons who will go to their dad and say, "I'd like to sit down and discuss our farm business." In many instances, breaking the ice is the most difficult problem.

E. B. Hill of Michigan State College illustrates this situation by relating the experience of a county agricultural agent in one of the midwestern states.[2] A farmer approached the county agent one day and said to him, "Mr. J———, my son is taking quite an interest in farming and I believe he has reached the point where he might be interested in a father-son partnership on our farm. He'll be down at the County Fair next week showing cattle; why don't you mention it to him and let me know if he's interested." The county agent thought it was an excellent idea and said he would do so. The following week, when he mentioned it to the boy, however, he was in for a surprise. The son's reply was, "You know, I've been thinking about that, yet I don't know just how to go about mentioning it to Dad. Why don't you talk to him about it sometime?"

A second father-son agreement was started when a farmer happened to say to his son before going to town one afternoon, "Jim, someday we ought to make a sign with our farm name on it, and fasten it up on the front of that new barn." The son was quite interested in farm shop work, and as a result, went ahead, and painted a neat sign—"ROLLING ACRES, J. Jones and Son," —and put it up on the front of the barn. When the father came home that evening he noticed not only the new sign on the barn, but also the fact that he had a new partner. Hence, after supper he said to his son, "Jim, if you want to be a partner on this farm, maybe you'd better come in and take a look at the records. There's a mortgage on the place, and there are some other things you'd better know."

There is no one way of getting a father-son farm business agreement started that can be recommended for all farm families. The main difficulty that sooner or later must be overcome is the problem of taking time out to sit down and talk things over. Usually all members of the family should sit in on at least part of the discussion so they, as well as the father and son, know the reasons for details of the agreement. The majority of father-son farm partnerships affect other members of the family as well as each individual partner.

[2]Hill, E. B., "Family Farm-Operating Agreements," No. Cent. Reg. Pub. 17, Mich. St. Col. Agr. Exp. Sta. Spec. Bul. 368., Jan. 1951.

Son's Decision To Be a Farmer: Before starting a father-son agreement, the son must decide that he wants to be a farmer. This is an important decision. Farming is a life-time job and the capital requirements are high. Furthermore, it usually takes a considerable period of time to accumulate sufficient capital for a successful farm business, even with good weather and favorable prices.

It is often said that "the best accomplishments in life are made by individuals who are enthusiastic about their jobs. . ."[3] To be a success, a young man, as well as his wife, must like farming. A young couple must be able to have some fun on the job and to obtain a certain amount of satisfaction from operating a business of their own despite the hard work and long hours. Usually, a young man with a good background of experience in 4-H Club work or in Vocational Agriculture is well equipped to become a farmer.

Ability To Get Along Together: The success of a father-son partnership depends, to a large extent, on the ability of the partners to get along with each other. Each partner usually discovers (particularly at first) that the other's decisions are slightly different from his own; but eventually each partner must develop complete confidence in the other's business decisions.

A father-son partnership is unique in that it is between two people of widely differing ages. A mutual understanding between the father, who is usually more conservative, and the son, who is more anxious to get ahead, is of paramount importance; not only from the standpoint of the farm, but also from that of the other members of the farm family.

In starting a father-son agreement, the son should recognize that his father has had many years of experience in making managerial decisions. In turn, the father should recognize the drive and desire of his son to get ahead, try out new ideas, and thus assume more and more of the managerial responsibility. The ability or failure to recognize the other's attitudes often accounts for wide differences in the decisions made by fathers and sons. Furthermore, these differences in points of view often lead to dissatisfaction with the partnership arrangement. Personality clashes occur occasionally in any partnership. They arise at

[3]p. 9, Hill, E. B., "Father and Son Farm Partnerships," Mich. Sta. Col. Spec. Bul. 330, Apr. 1944.

times in almost every family. But, when a father and son are operating the farm together, their individual opinions must eventually be reconciled.

In a study made in Virginia, it was found that "although farmers stress the ability to get along together as an important factor. . .they also voice the opinion that frictions, when they do occur, usually result from misunderstandings that could be avoided if the agreement were thoroughly worked out and understood beforehand.[4] Thus in the early stages, a recognition of the various responsibilities on the part of each partner, and a general understanding as to the terms of the agreement itself, are of great importance in "getting along" with each other.

Will the Farm Provide Sufficient Income? One of the first requirements of a successful father-son agreement is a business that will provide an acceptable level of living for two families. A number of today's farms are too small to support even one family properly.[5] A business that is just adequate for one family will not take care of two at the same level of living. Furthermore, a business which has sufficient size today may not be an adequate or an efficient one in the future. Thus, when a father-son agreement is started there is usually a need for increasing the size of the farming operations.

This may be done in a number of ways. Additional land can be rented or purchased; fertilizers can be used to increase crop yields or the carrying capacity of pastures; more livestock can be added or extensive livestock enterprises, such as a beef cow herd, can be shifted to intensive livestock enterprises, such as dairy or poultry; where markets are available, some of the farm products that are being sold wholesale can be packaged and delivered to the consumer. During the first few years a father and son may also supplement the farm income by doing custom work for the neighbors, or one of them may occasionally obtain a part-time job in town during the slack season on the farm.

Time of Starting: A father-son agreement may be started at any time and it may run for as long as is desirable. However, annual settlements should be made, and a new agreement set up each year. January 1 is the most logical time to do this. The farm inventories are usually low at this time of year; a summary of the past year's records can be used to analyze the farming operations and report the income tax returns; and the father and son usually have more time to discuss any changes they may want to make in the terms of the agreement.

Should the Agreement Be Written? Many families think that a written agreement is unnecessary when a father and his son set up a farm business agreement on the home farm. Yet, putting the provisions in writing is a business-like procedure, and it does not imply any distrust on the part of either partner.

A written agreement is recommended for a number of reasons. First, unless an agreement is written out its provisions are quite likely to be vague or incomplete. Hence, a verbal agreement is more likely to result in misunderstandings. Memories are sometimes quite short, particularly with respect to the details, and some provisions are easily forgotten. Second, when the terms of an agreement have to be put in writing more serious thought usually is given to the contributions and responsibilities of each party. This, in itself, leads to a clearer understanding of the agreement. Third, a written agreement "is evidence of what is being contributed by each party and this protects the equity of either party in case of the other's death.[6] Hence, a written agreement "serves as protection for the heirs of the deceased party. This protection is especially important when property which is to be improved during the life of the agreement will later be inherited by the son and other heirs."[7] For these reasons it is considered to be good business to put in writing all important agreements dealing with the ownership and operation of the farm business.

What Should the Agreement Include? In writing up the agreement the purpose or objectives should be clearly stated. An accurate description of all real estate, the date the agreement is to begin, the length of the period it is to run, and the contributions of each party, such as labor, management, machinery, equipment, livestock, feed, and supplies, should be given. The method of paying the expenses, the provisions for keeping the records, the method for making the financial settlement at the end of the year, as well as a provision concerning the length of notice to be given by either party wishing to terminate the agreement, should be included. Sometimes a farm

[4]p. 8, Gibson, Jr., W. L., and F. D. Hansing, "Father-Son Farm Agreements," So. Coop. Ser. Bul. 9, Va. Agr. Exp. Sta., Apr. 1951.

[5]This statement, of course, depends on how a farm unit is defined.

[6]p. 7, "Father-Son Farm Agreements," So. Farm Mgt. Ext. Pub. No. 1, (n.d.).

[7]p. 13, Stuck, H. R., and L. S. Thompson, "Montana Father-Son Business Agreement for Farm or Ranch," Mont. Agri. Ext. Serv. Bul. 247, July, 1947.

plan and a statement of the financial affairs of the farm business are recommended, and provisions for separate living quarters may also be included.[8]

What Records Should Be Kept? A good set of farm records is essential in any profit sharing arrangement. An inventory of all farm property owned by each partner plus a record of all cash receipts and expenses is usually regarded as the minimum amount of records required for a father-son farm business agreement.

Who Should Keep the Accounts? The father and the son should each keep a record of the capital each is contributing to the farm business in their own inventory books. At the beginning of each year there must be a mutual agreement as to the value of each item in these inventories from the standpoint of the farm business. Then the responsibility for keeping a running account of all receipts and expenses should be delegated to one particular partner or member of the family. Keeping records is usually more of a chore to an older man than it is to a young man, and for this reason, it often is recommended that the son keep the records. Also, when this duty is assigned to him, the son usually gains experience faster than he would otherwise. Occasionally the mother or the son's wife keeps the books. However, no matter who is responsible for them, it is desirable for the father and the son to sit down together and go over the accounts at frequent intervals to check for errors and omissions. The suggested method of valuing each type of farm property is as follows:

Type of Farm Property	Recommended Method of Valuation
Feed and supplies that have been purchased	Cost
Home grown feed and supplies	Present market value
Livestock raised to be sold	Present market value
Livestock raised for breeding purposes	Normal market value
Machinery and equipment	Cost less depreciation
Buildings	
Large permanent structures	Normal market value
Small temporary structures	Cost less depreciation
Other	Cost less depreciation
Land	Normal market value

The Various Contributions and How To Establish Their Values: Contributions to a farm business usually fall into two general categories—farm capital, and labor and management. The total value of these items usually is used either as the basis for sharing returns, or for purposes of testing the fairness of a lease or agreement. It is for these reasons that a value should be placed on each of them prior to the setting up of a father-son farm business agreement.

The rate of interest charged for the use of capital should depend on the prevailing rate being charged for farm real estate loans and for short-term credit loans in the local community, and on the rate which might be expected from alternative opportunities if the father or his own son were to invest that capital somewhere else. In other words, the rate should be no higher than that paid on borrowed funds, nor lower than that realized, perhaps, on bonds or savings accounts. Within this range a four or five percent rate is probably the one most commonly used. Sometimes a lower rate is used on the farm real estate than on the operating capital. This is, of course, in line with the lending practices of the majority of credit agencies. Usually a conservative rate is recommended, as in the "poor" years the total farm receipts may not completely cover all operating expenses, interest on average capital, and the value of all labor and management.

Local cash rental values are sometimes used in place of an interest charge in order to determine the value of the real estate contribution. In areas where a considerable amount of farm land is rented, a rental value may reflect a more accurate use-value of the land used for farming purposes. This is because it eliminates the speculative aspect of farm land values. However, in the midwest there is but little farmland rented on a cash basis, and a good standard of comparison may not be available.

The method used to estimate the value of the labor and management contribution is similar to the one used to determine the value of the capital contributions. The prevailing wage rates being paid for hired men in the local community as well as the wage rate which could be expected in alternative opportunities are usually used as guides. The farm wage rates paid hired men provided with a house and those provided with board and room are published by the Bureau of Agricultural Economics.[9] These rates give some idea of the alternative opportunities which might be expected in agriculture if the father and son did not form a partnership and work together. Hence, they may represent the lower limit rather than the higher, and for that reason, should be increased to cover the value of the entrepreneur's managerial ability as well as the physical labor involved.

[8]p. 19, Ratchford, C. B., and C. E. Clark, "Father-Son Business Arrangements," No. Car. Ext. Cir. 330, Nov. 1948.

[9]Weekly, daily and hourly wage rates also are available. *"Farm Labor," B.A.E., U.S.D.A.*

What About a Farm Bank Account? A question often arises on the best method of paying farm expenses while at the same time keeping them separate from personal expenses. Probably the simplest and easiest way is to use a farm name, and a farm bank account in this name. Either partner may deposit money in the account and write checks on it for purposes of the farm business. Each partner would still have an account for his own and his wife's personal business and living expenses. Hence, a farm bank account is actually another step towards setting up the farm records and the agreement on a business-like basis.

However, occasionally a father and son think that a bank account for the farm complicates the problem of keeping records. When this happens they usually pay the farm business expenses out of two personal bank accounts and make settlements each month. Regardless of the method used, an accurate account of all farm expenses should be kept in the farm cash account book.

Agreements With Young Boys

A number of father-son agreements are started when the son is young, before he has made any decision as to his future. These arrangements are usually made with the purpose of developing an interest, on the part of the son, in farming. They are often developed with the idea that a definite arrangement will give him something to do which is productive, and at the same time, will provide him with spending money as he goes through school or college.

Quite often the first agreement—which is usually made with boys less than 10 years old—is the "ice-cream cone" agreement. This is hardly a part of farm management, yet a definite agreement based on a simple chore or two at this early age usually provides the son with some valuable experience. Many times, however, there is little or no relationship between the amount of work accomplished and the number of payments or ice cream cones.

Another type of agreement similar to this is an allowance or a set amount of wages. Again with young boys, the relationship between the amount of work done and the amount of the allowance is usually small. However, as the son becomes older, the number of jobs for which he is responsible is usually increased with the amount of wages becoming more closely related.

The Enterprise Project: Farm boys sometimes obtain a project of their own for use in 4-H Club or Vocational Agricultural activities. These projects usually develop considerable interest in farming and provide a small yet important source of income while the son is in school. They also aid in developing responsibility and provide valuable experience as far as one or two farm enterprises are concerned. In fact, they are highly satisfactory (especially from the son's standpoint) as long as the father is willing that the son feed "undivided corn" to his livestock (usually in return for some labor or help on dad's livestock) and as long as the father is willing that the son use the farm tractor on his enterprise without sharing in the expense of its operation.

Furthermore, these projects often develop into sizeable proportions. In the transition period between the time the project is started and the time when the son has actually decided to be a farmer, he often segregates one particular farm enterprise from the rest of the farm business and develops it to the point where it provides him with a major source of income through high school and college, and sometimes even longer. Then, after finishing school, the project frequently becomes the basis for setting up a father-son agreement and for sharing in the farming operations. This type of agreement is sometimes referred to as an "enterprise split."

An enterprise spilt, whereby the son receives the income from one enterprise (perhaps the hogs or the beef cattle) and the father receives the income from a second or from all other enterprises, or, whereby the expenses and returns from two separate parts of the farm business are similarly allocated, is usually unsatisfactory from the standpoint of sharing returns. For one reason the tractor, as well as other machinery or equipment, is usually used in connection with each enterprise or by each partner. When this happens, the costs of its operation cannot be allocated accurately unless a detailed record is kept of the tractor and equipment hours spent on each enterprise. Similar problems also are encountered in allocating building costs and other general farm expenses. Unless a set of detailed cost accounts is kept, considerable difficulty is experienced in allocating these costs between two or more farm enterprises.

Changes in the general price level usually affect the various cost-price relationships differently and they, in turn, influence the various farm enterprises. This is particularly true when changes in the price level result in changes in the various livestock-feed ratios. For example, the hog-corn ratio might become relatively favorable, while at the same time, the milk-feed ratio might become relatively unfavorable. If so, the father and son would soon find themselves in a position where the profits of the hog enterprise would accrue to one member of the family and the losses of the dairy enterprise would accrue to another. If this situation were to occur, it would soon lead to a feeling of unfairness and eventually to a complete breakdown of the agreement.

There is a disadvantage in the enterprise split from the standpoint of gaining experience. If the son is interested in and obtains an income from only one or two enterprises he is less likely to obtain the overall experience needed in the operation of the entire business. Yet, undoubtedly, he will eventually own an entire farm, operating it as a unit. When that time comes he should have a complete understanding of and experience in all of its phases.

Other Arrangements: Other father-son arrangements are often developed with boys who are still in school and who have not yet made the decision to be farmers. On a specialized farm where only one crop is grown, or only one class of livestock is kept, the son may receive a portion or a share of the income from that enterprise. Occasionally an agreement is set up whereby the son has a project of his own and then receives an allowance or some additional wages during the summer months when he is home from school and can work on the farm. The type of agreement that works on one farm doesn't always work on another; furthermore, an agreement with a 14-year-old boy may not work when he is a few years older.

Agreements With Older Boys

When the son has made the decision to be a farmer, a father-son agreement should be set up on the entire farm business. Several methods of sharing returns can be used, depending on the experience and the amount of capital the son has accumulated. A trial period usually is desirable at first to make sure that the son has a lasting interest in farming and to ascertain whether or not the father and son can get along together. In these cases, Plan No. 1, which is described below, is suggested for a two or three-year period. After that, several methods of sharing returns may be used. Plan No. 2 sometimes is recommended in areas where there is considerable tenancy and where the local rental practices are fairly well established. Plans No. 3, 4, or 5 are the ones that are more often recommended for sharing income, profits, or returns. The choice among the various plans depends on the likes and dislikes of the father and son, and how soon (or sometimes, on the extent to which) the responsibility for the operation of the farm is to be turned over to the son.

Plan No. 1—Regular Wages Plus a Bonus or Share of the Profits

This type of agreement is primarily for sons with little, if any managerial experience and little or no capital.[10] It is recommended in other cases where the son is not yet certain that he wants to be a farmer. Under the provisions of this agreement the son is to receive regular wages plus his board, if single, or the use of the tenant house along with a certain amount of farm products if he is married, plus a share (usually 10 or 15 percent, sometimes more) of the end-of-the-year profits from the farm business. The method for calculating profits, along with the calculations for a 420-acre Callaway County, Mo., farm in 1951 follow.[11]

Explanation of Items

1. Cash receipts include all receipts from the sale of crops, livestock, livestock products, and any miscellaneous cash receipts from the farm business.
2. Cash expenses include all expenses necessary for the operation of the farm business, including cash rent, purchase of livestock, new machinery, feed, fertilizer, supplies, hired labor and all other operating expenses.
3. Withdrawals of son (or hired man) are the cash withdrawals of the man with whom the agreement is made. The cash value of board should also be included.
4. Withdrawals of the father or operator are as specified under the agreement and represent what he requires for his living needs. Interest on equity of both parties (capital investment) in the business should be allowed for before any division is made in remaining income.

[10]It is also recommended for the hired man who works best under incentive payments.

[11]See Appendix.

Suggestions For A Bonus Or Profit Sharing Agreement For Sons Or Hired Men With Little Or No Equity In The Farm Business

The son is to receive regular wages of $______ per month, plus his board, if single, or the use of the tenant house and a certain amount of farm products, if he is married, plus______percent of the end-of-the-year profits from the farm business.

Farm Receipts

1. Total cash receipts. $______
2. Increase in farm inventory (buildings and improvements, livestock, machinery and equipment, feed, grain and supplies). $______
3. Total farm receipts. $______

Farm Expenses

4. Total cash expenses, except withdrawals of partners. $______
5. Withdrawals of the son (or hired man) in the agreement. $______
6. Withdrawals of the father or farm proprietor (see below) $______
7. Value of unpaid family labor. $______
8. Interest on debts (actual). $______
9. Decrease in farm inventory (buildings and improvement, livestock, machinery and equipment, feed, grain, and supplies). $______
10. Interest on equity of proprietor and partner. $______
11. Total farm expenses. $______

Net Income To Be Divided

12. Income to be divided (line 3 minus line 11). $______
13. Percent which goes to the son (or hired man). ______%
14. Dollar share which goes to the son (or hired man). $______

5. Value of unpaid family labor refers only to members of the father's or operator's family.

6. Increases or decreases in inventory of buildings, improvements, livestock, and machinery and equipment should not include changes in the value due to changes in the general price level. Include only changes due to increases or decreases in numbers of livestock, machinery and equipment, or better or poorer livestock, machinery and equipment.

7. The percent of the net income which the son is to receive will, of necessity, vary on different farms and for different sons. The best way to determine a fair share on each farm and for each son is to calculate the net income for last year's business (considering any exceptional gains or losses) and determine the bonus which would have been obtained under last year's conditions.

This type of agreement might be recommended for all young men the first few years they farm with their fathers, particularly where the son has not had much experience. It also is recommended when the agreement is with the neighbor's son rather than one's own son. In this way, the agreement serves as a trial period which gives the father a chance to try out his son, and the son a chance to try out farming.

ILLUSTRATION OF PLAN NO 1. -- CALCULATIONS FOR A BONUS OR A SHARE OF THE PROFITS.
A 421 Acre Farm, Callaway County, Missouri, 1951.

Receipts	Amount	Total
1. Total cash receipts	$20,095	
2. Increase in farm inventory	4,683	
3. Total farm receipts		$24,778
Expenses		
4. Total cash expenses, except labor	$13,059	
5. Wages of the son--$125 per month	1,500	
6. Cost of other hired labor	552	
7. Withdrawals of the father or operator and interest on equity*	3,778	
8. Value of unpaid labor	250	
9. Interest on debts (actual)	452	
10. Decrease in farm inventory	0	
11. Total farm expenses		$19,591
Net Income to be Shared	Total and Share	
12. Net income to be divided	$5,187	
13. Percent which goes to son	15%	
14. Dollar share which goes to son	$ 778	

*The farmer's equity is this particular example amounted to $47,960 out of $56,995. He paid interest (5%) on $9,035.

Plan No. 2—A Father-Son Agreement on a Landlord-Tenant Basis

Preliminary Considerations. Whenever a landlord-tenant relationship is created, it becomes necessary to introduce the problem of appraisal of resources which each member of the firm contributes and to provide rather complete arrangements for a "firm" checking account to take care of the firm's current expense requirements and to provide a place to deposit the receipts from sales.

The necessity for inventorying each party's contribution makes it necessary for the partners to agree on what constitutes a fair value of each resource contribution. They must agree on what the land or real estate is worth and what constitutes a fair value for whatever livetock and equipment either contributes. This is necessary because each should expect a reasonable rate of return on his property contribution when income is divided.

The real estate value should be a fair, long-time value for the land and a reasonable "use" value for improvements on that land. If partners can agree on what that value should be then that problem is simple. If they cannot agree, then perhaps they can obtain the services of an experienced appraiser to determine just what each contribution is worth. If they are unwilling to accept an experienced appraiser's decision, they will have to go through the process of arbitration, which means that each member of the partnership will pick someone to represent him, and then have these two representatives select a third party. When the three members of this arbitration committee have made the decision, the father and son or landlord and tenant should be willing to accept this decision.

Every farm business will require cash operating capital in addition to any other form of property. Usually the father, or the landlord, has capital which could be used or is able to borrow at a bank the necessary capital. He may have to provide all the capital for this checking account, in which case he should require his son or tenant to give him a note covering the son's or tenant's fair share. Or, he and the son or tenant may, together, sign a note at the bank and borrow all the capital outright. In any event, the two parties should contribute to this operating capital for a checking account in the same proportion that they contribute to the operation of the farm and share in its receipts.

Among the many needs which may arise in the sale of products, making deposits, paying bills, etc., a deposit and checking account will be a major one. Both members of the firm will require funds for their personal living needs. They must not use checks on a firm's bank account for this purpose. The firm, should, by agreement, pay to each party monthly from this firm account a certain sum of money estimated to be sufficient to cover that party's living expense requirements. This may or may not be approximately equivalent to a nominal wage for that person's service for the month. Such a payment is then used by each party for his family cash living needs. This amount, whatever it is, must be considered as a part of his income from the business when the partners settle up every six months or at the end of the year.

Some agreements provide for a monthly balancing of accounts. Some do not have a joint farm expense account. Each party has his own account from which he pays necessary bills. When significant sales are made these are divided at once, then each month these receipts and expenses are compared and the balance due either party is paid by check by the other party. The joint or firm account usually is considered less burdensome than this method.

The Father-Son Agreement. A father-son farm business agreement sometimes is set up on a landlord-tenant basis with the father assuming the role of the landlord and the father-son partnership assuming the role of the tenant. Thus, if the usual share arrangements in the community between a landlord and tenant were on a 50-50 basis, the share between father and son would be on a 75-25 basis.

(In some cases, fathers and sons form the regular landlord-tenant relationship with the father assuming the responsibilities of the landlord and the son the responsibilities of the tenant. This is usually where the father has retired, or where he has a fairly sizeable income from non-farm sources, and has relatively little to do with the management of the farm. This type of agreement or lease is similar to any landlord-tenant lease and for that reason is not considered here).

The landlord-partnership tenant type of agreement is usually easy to set up in areas where landlord-tenant arrangements are fairly well established. The agreement between the father and son is applicable to either the crop-share, cash lease or the livestock-share lease. However, the ease of determining the various contributions made by each party depends on how well the customs and practices are known in the local community.

To illustrate a father-son agreement on a landlord-tenant basis, a livestock share lease, in an area where the soil is medium in productivity, is assumed to be as follows.

1. The landlord contributes the land, buildings, and permanent improvements; he contributes one-half of the machinery and equipment and one-half of the productive livestock; he pays the real estate taxes, the insurance on the buildings, and one-half of all operating expenses except hired labor, which is usually furnished by the tenant. He receives one-half of the total farm receipts.

2. The tenant contributes one-half of the machinery and equipment, one-half of the productive livestock; he contributes his labor, and pays one-half of all operating expenses. He receives one-half of the total farm receipts. (In the more productive and better land areas in the state the tenant often provides all machinery and equipment, paying for its maintenance and repair. He usually pays the expense of all hired labor. A great deal of variation, however, is found from one area to another throughout the state.)

With these assumptions concerning a livestock share lease between landlord and tenant, the proportioning of the various contributions and returns in a father-son agreement would be as follows:

1. The father (as the landlord and one-half of the tenant partnership would contribute the land, buildings, and permanent improvements; he would contribute three-quarters of the machinery and equipment, and three-quarters of the productive livestock; he would contribute his own labor, and would pay the real estate taxes, the insurance on the buildings, and three-quarters of all operating expenses. He would receive three-quarters of the total farm receipts.

2. The son would contribute one-quarter of the machinery and equipment, and one-quarter of the productive livestock. He would contribute his labor, pay one-quarter of all operating expenses, and receive one-quarter of the total farm receipts.

Using the same 421 acre farm, the division of inputs and returns under the above landlord-tenant arrangement and under the corresponding father-son agreement is as follows:

ILLUSTRATION OF PLAN NO. 2. -- THE DIVISION OF INPUTS AND RETURNS FOR A LANDLORD-TENANT ARRANGEMENT AND FOR THE CORRESPONDING FATHER-SON AGREEMENT.[1/]

A 421 Acre Farm, Callaway County, Missouri, 1951.

Party Approximate Share or Percent		Landlord -50-	Tenant -50-	Father -75-	Son -25-
Farm Capital	Total	Landlord	Tenant	Father	Son
Land	$15,050	$15,050	$------	$15,050	$------
Buildings and improvements	14,015	14,015	------	14,015	------
Livestock	15,520	7,760	7,760	11,640	3,880
Machinery and equipment	5,193	2,596	2,597	3,895	1,298
Feed, grain, and supplies	5,217	2,609	2,608	3,913	1,304
Total farm capital	$54,995	$42,030	$12,965	$48,513	$6,482
Contributions[2/]	Total	Landlord	Tenant	Father	Son
Interest on capital @ 5%	$ 2,750	$ 2,102	$ 648	$ 2,426	$ 324
Labor and management[3/]					
Under a landlord-tenant arrangement					
Operator	1,380	------	1,380	-------	------
Hired	2,052	1,026	1,026	-------	------
Family	250	------	250	-------	------
Under a father-son agreement					
Operator	2,880	------	------	1,380	1,500
Hired	552	------	------	414	138
Family	250	------	------	125	125
Cash farm expenditures					
Real Estate taxes	215	215	------	215	-----
Insurance on buildings	114	114	------	114	-----
Other landlord expenditures	138	138	------	138	-----
Other operating expenses	12,592	6,296	6,296	9,444	3,148
Inventory decreases	------	------	------	------	-----
Total contributions,	$19,491	$ 9,891	$ 9,600	$14,256	$5,235
Percent	------	50.7%	49.3%	73.1%	26.9%
Returns[4/]	Total	Landlord	Tenant	Father	Son
Cash farm receipts	$20,095	$10,047	$10,048	$15,071	$5,024
Inventory increases					
Buildings and improvements	992	496	496	744	248
Livestock	1,064	532	532	798	266
Machinery and equipment	1,726	863	863	1,295	431
Feed, grain, and supplies	901	451	450	676	225
Total farm receipts	$24,778	$12,389	$12,389	$18,584	$6,194
Percent	------	50%	50%	75%	25%

1/ With either a landlord-tenant arrangement or a father-son agreement the fairness of the lease or the agreement depends on whether the returns from the farm business are divided between the two parties in the same proportion as are the expenses or contributions which are put into the business. The method used to ascertain the equitability of a lease or an agreement is usually referred to as an input-output analysis. The contributions made by each party--interest on the farm capital invested, the labor and management inputs, the cash operating expenses or operating capital furnished, and any decreases in the inventories--are evaluated and totaled. The total receipts--cash receipts, any increases in the inventories, along with the value of any other items, such as value of the products used in the household are obtained. Then the percent of the total contributions which are made by each party, and the percent of the total receipts which are obtained by each party, are calculated and are used as a basis for comparing the relative inputs and returns. For example, if the tenant (or son) contributes 40 percent of the inputs, the lease or agreement is fair if he receives 40 percent of the returns. In other words, an agreement is equitable, if each partner receives approximately the same percent of the returns as the percent of the inputs he contributes to the business.

2/ In a crop-snare cash lease, the cash rent paid for pasture may be included as one of the tenant's inputs. In a father-son agreement where a certain amount of cash is paid by the son for his board, then this along with the cash cost of the board furnished by his father may be included.

3/ Under a regular landlord-tenant agreement the tenant would be the operator (10 months @ $1,380) and all other labor would be hired. Under a father-son arrangement the father and son would each be considered as an operator (10 and 12 months @ $1,380 and $1,500 respectively) and the other hired labor would be the $552.

4/ In a crop-share cash lease the cash rent for pasture may be included as one of the landlord's returns. The value of the dwelling furnished the operator as well as the farm products used in the household is sometimes included.

A father-son agreement on a landlord-tenant basis is sometimes recommended for those sons with only a limited amount of capital. The son's share in these agreements usually amounts to only 25 or 30 percent.[12] This type of agreement works very well on farms which are partly owned. For example, if a father owns 240 acres and rents an additional 160, then the father receives a share, (as the landlord) on his 240 acres, and the father and son together, have a father-son agreement (as the tenant) on the whole 400 acres. Furthermore, this type of agreement is practical for those farm families where there are several sons interested in farming. The older son may be in the agreement for two or three years; then, when a younger son wants to come into the business the older brother can become a tenant on another farm in the community leaving room for the younger boy to enter into the same agreement.

One of the disadvantages of this arrangement is the difficulty involved in keeping the farm records straight—particularly the various expenses in the right record book or in the right column. With this plan the father should keep a farm inventory of his own, which shows the extent of ownership of each item, and a farm cash account book in which the landlord's (the father's) expenses and receipts are recorded. The son should keep a farm inventory of all of his property, and a farm cash account book in which the tenant's receipts and expenses (those which are shared by the father and son together) are recorded.

[12]These agreements can be set up on a 60-40 or a 75-25 basis between the landlord and tenant as well as on a 50-50 basis. In these cases, the sharing between the father and son would be on a 70-30 or 62½-37½ basis, respectively.

Plan No. 3—Sharing Income in Proportion to the Total Contributions

This plan (as well as 4 and 5) is primarily for the son who has obtained some experience in farming and has accumulated some capital of his own. He may have built up an equity (in either livestock or machinery) through an enterprise project or through another arrangement, such as Plan No. 1.

This agreement is essentially an income-sharing arrangement on the entire farm business based on the concept of equitability which was illustrated under Plan No. 2 After paying all operating expenses out of undivided farm income, and after making the proper inventory adjustments for keeping the ownership of capital clear, the farm income is divided in the same proportion as the two parties contribute to the business. The methods of paying expenses out of undivided income (through a farm bank account) and making end-of-the-year inventory adjustments are explained in the chapter on "Getting Started" and in Plan No. 2.

The following procedures can be used to calculate the farm income or the "cash to be divided."

Suggested Father-Son Farm Business Agreement Where Sons Have Some Experience And Capital

A. Ownership of Farm Capital:	Total	Father	Son_1	Son_2
Land.	$_____	$_____	$_____	$_____
Buildings and improvements.	_____	_____	_____	_____
Livestock.	_____	_____	_____	_____
Machinery and equipment.	_____	_____	_____	_____
Feed, grain, and supplies.	_____	_____	_____	_____
Operating capital.	_____	_____	_____	_____
Total farm capital	$_____	$_____	$_____	$_____

B. Labor and Management Contributions:

Months of labor furnished. ____mo. ____mo. ____mo.

• For purposes of these calculations, each partner's time (labor and management) is to be valued at $______ per month.

C. Total Contributions and Percent:

Interest on capital @____%	$_____	$_____	$_____	$_____
Labor and management.	_____	_____	_____	_____
Total Contributions.	$_____	$_____	$_____	$_____
Percent of total.	100%	____%	____%	____%

D. Cash Receipts and Cash Expenses:

General considerations for handling cash expenses, deposits, and advances to the partners have been mentioned in the first section of the Father-Son Partnership discussion. Labor performed by other family members could best be handled by treating these services as "hired labor" and paying for them from the firm account in an orderly way.

E. Inventory Adjustments.

If property is owned by the partnership in any given percent, no adjustment of inventory values involving the payment to or receipt from a member of the firm is necessary except in case of dissolution of the partnership.

Individual ownership of any specific animal or other item by a member of the firm is rare in practice, but if such practice is involved, then adjustments at regular intervals may become necessary. Shrinkage of a partner's individual inventory items, not due to general price change, means that sales beyond natural increase have occurred. Receipts from such sale must have been deposited in the firm account, so the amount should pay to the owner of the property sold an amount equal to the inventory shrinkage.

Should inventory value of such individually owned item increase, this would mean that sales equal to normal increase were not made; therefore, the partner owning the accumulating item of property should pay to the firm the amount of the increase in inventory.

F. End-Of-The-Year Calculations:

Cash farm receipts. $_____

Cash farm expenses. $_____

Unpaid family labor. $_____

Total farm expenses. $_____

Receipts minus expenses. $_____

Inventory adjustments:	Father	Son_1	Son_2		Total
Increases	$_____	$_____	$_____	(plus)	$_____
Decreases	$_____	$_____	$_____	(minus)	$_____

Farm income or cash to be divided $_____

G. Methods of Sharing:

Under Plan No. 3 the farm income or cash to be divided should be shared in proportion to the contribution of each partner.

Under Plan No. 4 each partner should first be paid the full amount of his contributions, and the remaining cash should be divided equally between the partners.

Under Plan No. 5 each partner should first be paid the amount of his capital contribution (the interest on his investment) and the remaining cash should be shared between the partners in proportion to the value of the total labor and management each contributed to the business.

For purposes of illustrating Plan No. 3 (as well as 4 and 5), the following assumptions are made with regard to the ownership of the farm capital on the 421 acre farm previously described.

1. All land, buildings, and improvements are owned by the father.

2. The son has bought into the business to the extent that the hogs are completely owned by him. The beef cattle, the machinery and equipment, and all feed, grain, and supplies are owned 50-50 between the father and the son. The other livestock belongs to the father.

3. The father provides $2,000 operating capital in the farm bank account at the beginning of each year.

ILLUSTRATION OF PLAN NO. 3. -- SHARING INCOME IN PROPORTION TO THE TOTAL CONTRIBUTIONS.
A 421 Acre Farm, Callaway County, Missouri, 1951.

Ownership of Farm Capital	Total	Father	Son
Land	$15,050	$15,050	$------
Buildings and improvements	14,015	14,015	------
Livestock, beef cattle	12,950	6,475	6,475
hogs	2,070	------	2,070
Other	500	500	------
Machinery and equipment	5,193	2,597	2,596
Feed, grain, and supplies	5,217	2,608	2,609
Operating capital	2,000	2,000	------
Total farm capital	$56,995	$43,245	$13,750
Labor and Management Contributions	**Total**	**Father**	**Son**
Months of labor	22 mo.	10 mo.	12 mo.
Value per month	$	$ 138	$ 125
Total Contributions and Percent	**Total**	**Father**	**Son**
Interest on capital @ 5%	$ 2,850	$ 2,162	$ 688
Labor and management	2,880	1,380	1,500
Total contributions	$ 5,730	$ 3,542	$ 2,188
Percent	100%	61.8%	38.2%

End-Of-The-Year Calculations

Cash farm receipts				$20,095
Cash farm expenses (excluding son's labor)		$13,611		
Unpaid family labor		250		
Total farm expenses				$13,861
Receipts less expenses				6,234
Inventory adjustments: Father increase	$3,005 1/	$2,014 2/	(plus)	$ 5,019
decreases	$ 100 3/	$ 236 4/	(minus)	$ 336
Farm income or cash to be divided				$10,917

Total Income to Each Partner

$10,917 (Farm Income) x 61.8% = $6,747 Father's share
x 38.2% = $4,170 Son's share

1/ Includes $992 on buildings and improvements, $700 on beef cattle, $863 on machinery and equipment, $450 on feed, grain, and supplies; see appendix for farm record.

2/ Includes $700 on beef cattle, $863 on machinery and equipment, $451 on feed, grain, and supplies.

3/ Other livestock.

4/ The hog enterprise.

The main advantage of a plan set up in this way is that the amount of work involved in keeping the farm record is reduced to a minimum. This is primarily because the agreement is based on the entire farm business with the father and son both considered as farm operators. Furthermore, the record keeping procedures and the methods of sharing usually are less confusing than plans which are in use on some farms today.

This method of sharing was originally developed in the corn belt states. It has been used primarily in regions where there is a considerable amount of tenancy. In these regions the majority of father-son agreements have been developed for the primary purpose of profit-sharing, as the father, in most instances, has not yet reached the age when he is ready to turn the responsibility for the operation of the farm business over to the son.

Plan No. 4—Dividing Profit Equally After Paying for All Contributions

This plan is a profit sharing plan which, similar to Plan No. 3, will be useful in those instances where the son has obtained some experience in farming and has accumulated some capital of his own. It is also similar to Plan No. 3 in that all operating expenses are paid out of undivided farm income and inventory adjustments are made at the end of each year. However, instead of dividing the farm income in proportion to the total contributions, the partners are first paid the value of their contributions, then the remainder (Farm Income minus the value of all contributions) is divided equally.

The recommended procedure for calculating the farm income is the same as under Plan No. 3 (pages 12 and 13). The following illustration shows the return which would be obtained by each partner (on the same farm) if this plan were used.

ILLUSTRATION OF PLAN NO. 4. -- DIVIDING THE PROFIT EQUALLY AFTER PAYING FOR ALL CONTRIBUTIONS.
A 421 Acre Farm, Callaway County, Missouri, 1951.

Item	Total	Father	Son
Farm Income, or cash to be divided	$10,917 1/	$------	$-----
Total Contributions	5,730 1/	3,542	2,188
Remainder	$ 5,187		
Divided equally		2,594	2,593
Total return to each partner		$6,136	$4,781

1/ The calculation of these figures is shown on page 35.

This plan was developed in the dairy region. It has been used more in the northern and northeastern states where the farms are smaller than in the midwest. There is little, if any, tenancy in this region, and when a farm is rented it usually is rented for cash. Furthermore, the father-son agreements developed in this region have been aimed toward getting a young man started in farming and transferring the farm to the next generation. Hence, rather than share the income in proportion to the total contributions, the profit is divided equally, "giving" the son a slight advantage.

By dividing the profit equally, the son usually obtains a larger total income than he would under Plan No. 3 (in the illustration used it was $4,031 compared to $3,597). This method of sharing allows the son to build up an equity in the business a little more rapidly and allows the father to retire from the heavy work and responsibilities of the farm business somewhat earlier.

Plan No. 5. Sharing Returns in Proportion to the Labor and Management Contributions

Sometimes the theory is advanced that all income above a fair return to capital should accrue to labor. In this sense, labor receives the residual, which, in a good year, often amounts to a fairly high return. A father-son agreement may be set up on this basis.

With this approach the farm income is calculated in the same manner as under Plans No. 3 and 4. Each partner is then paid the interest on his equity in the business, and the remainder (or labor income) is divided in proportion to the value of the labor and management each partner contributes to the business. The following illustration shows the mechanics involved with this method and the returns received by each partner (again using the same farm as in the previous illustration).

ILLUSTRATION OF PLAN NO. 5. -- SHARING RETURNS IN PROPORTION TO THE LABOR AND MANAGEMENT CONTRIBUTIONS;
A 421 Acre Farm, Callaway County, Missouri, 1951.

Item	Total	Father	Son
Farm Income, or cash to be divided	$10,917 1/	$------	$-------
Interest on capital	2,850 1/	2,162	688
Labor Income, or remainder to be divided	8,067		
Value of labor and management	$ 2,880	1,380	1,500
Percent of labor and management furnished by each partner		47.9%	52.1%
Share to each partner $8,067 x 47.9%		3,848	
x 52.1%			4,219
Total return to each partner		$6,010	$4,907

1/ The calculation of these figures is shown on page 13.

This method of sharing is not used in any one particular agricultural area. It is slightly more favorable to the partner who contributes the most labor and management. In the illustration used, this plan shows a return to the son of $4,907 compared to $4,781 under Plan 4 and $4,170 under Plan 3. Hence, if the son is furnishing more labor and management than the father, this plan would be slightly more favorable to him.

Forming a Corporation

Incorporating a farm business is sometimes recommended when the farm is an extremely large business and when there are complicated ownership relations. However, corporation farms usually are few in number as they are more complicated to establish and more expensive to maintain than the sharing plans mentioned above.

"Organizing and carrying on a corporation involves considerable paper work. Articles of incorporation and by-laws. . .must be drawn up. The corporation must be chartered by the state, and must remain under its supervision. An annual financial report must be made and any transfer of stock, changes in officials, and other activities may have to be reported. An annual stockholders' meeting generally must be held. . ."

"The liability of members of a corporation, for corporate obligations, is usually limited to their capital investment plus their share of undistributed profits. But in the case of a father and son engaged in farming, the capital invested by each, and especially by the son, may represent his total assets."

"Stock certificates are evidence of ownership in a corporation. They provide a clear record of each stockholder's proportionate rights in corporate assets and profits and, therefore, a clear-cut method by which the son may gradually buy into the corporate business. But they are of no help in distinguishing corporate property from the separate property of father and son."[13]

"In general, incorporation is recommended only when the farm is exceptionally large and the business exceedingly complicated. Even then the father and son should investigate thoroughly other possible forms of organization. They should also learn how to incorporate and what they must do to meet requirements as they operate."[14]

Perhaps the main advantage of a corporation is its longevity. If a stockholder or a member of the corporation should die, this need not affect the life of the organization. However, even though a corporation usually is considerd to continue indefinitely, the need occasionally arises for one to be dissolved. When this happens it is usually a bothersome and expensive process.

The main disadvantage is that a corporation farm is subject to the payment of income taxes. The stockholders (or members) also have to pay personal income taxes on the dividends distributed to them by the corporation.

Other Problems and Practices

Inventory adjustments: The farm income or cash to be divided at the end of the year is actually derived from two sources—the cash balance (cash receipts minus cash expenditures) and changes in the farm inventory. When a father-son agreement is started the first-of-the-year inventory is used as the basis for ascertaining the interest on the capital contributions of each partner, and for sharing returns. However, during the year the machinery and equipment may depreciate; the number of livestock may change; or, some new improvements, such as a fence or some terraces, may increase the value of the farm. It is of paramount importance that the ownership of these capital items be assigned to the person who has title to them and that each partner receive a return at the end of the year which accounts for the inventory changes as well as the cash income. Hence, after inventory of farm property has been completed at the end of the year, adjustments described earlier should be made to allow each partner full benefit of inventory changes.

1. If there is a decrease in the inventory value or the equity owned by any one partner, he should be paid from the undivided income (or the farm bank account) an amount equal to the decrease in his capital.

2. If there is an increase in the inventory value of the equity owned by any one partner, he should pay to the firm account (or the farm bank account) an amount equal to the increase in inventory, thus paying the partnership for the increase in his capital.

Several illustrations may help to clarify this procedure. Suppose a father and son have entered into a farm business agreement where a new building and several land improvements, such as use of lime and rock phosphate, are made the first year of the partner-

[13]p. 33, Tharp, M. M., and H. H. Ellis, "Father-Son Operating Agreements," *U.S.D.A. Farmers' Bul.* 2026, Mar. 1951.

[14]p. 20, Hill, E. B., "Family Farm-Operating Agreements," No. Cent. Reg. Pub. 17, Mich. Sta. Col. Spec. Bul. 368, Jan. 1951.

ship in order to operate the farm most profitably. The cost of these improvements totals $640. This amount is entered in the farm cash account. Yet, theoretically, the son does not own any of the real estate and, therefore, should not help pay for these improvements. At the end of the year the father's farm inventory (including real estate owned by the father) shows that these improvements have added $560 to the value of the farm. ($640 minus $560, or $80, was "used" by the farm business the first year. The $80 is the amount of depreciation). To make the proper inventory adjustment, the father pays this amount ($560) into the farm bank account (which is still undivided income) in order that the ownership of all land, buildings, and improvements are kept in his name.

Another example: The father happens to own all machinery and equipment and during the year the use of that machinery (by the farm business) leads to a depreciation or decline in its value. As a result, the father's end-of-the-year inventory shows a decrease of $340. The farm business has used up this amount of his capital and, therefore, pays him (out of undivided income) for the decrease in his investment.

The same procedure applies to increases and decreases in the inventory value of livestock, feed, grain, and supplies. Actually though, it is not necessary to calculate the inventory changes for each type of farm property owned by each partner. Only the total inventory change (for each partner) is necessary for making the end-of-the-year inventory adjustments.

Time and method of settlement: The question whether the father and son should settle up at the end of each month or whether they should settle up once or twice a year probably depends on how the income is distributed throughout the year. On a dairy farm where a milk check comes in each month there is more reason to make monthly settlements than on a cash-grain farm where crops are sold at irregular intervals during the year.

When both partners are doing business out of a personal bank account, a monthly settlement usually is made to keep the expenses straight. Advocates of the monthly settlement system claim that. . ."It develops more individual action, personal satisfaction, and interest in the partnership than does a yearly settlement plan."[15]

When a farm bank account is being used, however, the final settlement is usually made only once a year. The method of settlement may be on either a cash basis or on a basis which includes inventory changes as well. The final year-end settlement should include both of these. Otherwise the returns for the second, third, and each succeeding year will be shared (at least partially) according to the original capital contributions. Yet, the capital owned by each partner at the beginning of the first year, may or may not be an accurate measure of the contributions that each partner is making several years later. Hence, in order for each partner to obtain a fair return from the farm business each year, inventory changes should be considered along with cash income.

The need for year to year adjustments: Any father-son arrangement for sharing returns is likely to need some changes each year. Hence, flexibility is highly desirable. When the agreement is first started the son's labor plus a small share of the farm capital will probably be his only contributions. Yet, by investing his savings he soon should be able to increase his equity in the business and as a result, earn a larger proportion of the total returns. If the father intends to remain active, the size of the farm business will undoubtedly increase. If he intends to retire from the business, the size of the business may remain the same, yet the son's share in the farm capital may increase. Hence, as the son gains in experience the agreement or plan for sharing returns will undoubtedly need to be changed. As he accumulates more and more capital, his contributions will increase and his share of the returns will need to be adjusted to allow for that increase.

What Happens in Case of a Loss? Farming usually involves a great deal of risk and uncertainty. An unfavorable growing season or a severe drop in prices sometimes results in a poor year. In the past farmers occasionally have had to live on the interest which accrued to their own equity in the business and sometimes have had to face an actual depletion of the farm capital itself.

Normally, father-son agreements assume that the business will realize income after expenses are met. Such expenses can include withdrawals by both father and son, in lieu of fair wages, for physical labor performed to meet current living requirements. After such expenses are met the balance represents returns to capital and management.

If such balance does not equal a fair return to capital, the two partners should divide whatever balance there is in the same ratio that they furnish capital to the firm. If the balance exceeds a fair return to capital, the excess will be shared in the same propor-

[15]p. 23, Hill, E. B., "Father and Son Farm Partnerships," Mich. Sta. Col. Spec. Bul. 330, Apr. 1944.

tion the parties agreed to share income and expense when the agreement was drawn.

If the father does not participate in day to day management decisions, but the whole burden of such decisions falls on the son, the latter should have a fair management wage before any sharing of balances (after cash expenses) occurs.

Termination of the Agreement: If, for any reason, the agreement needs to be terminated, a settlement of all the business affairs is necessary. While this is seldom anticipated when a father-son agreement is set up, a sufficient notification period should be provided in the agreement in case the two partners find they cannot work harmoniously. It is seldom that a father-son farm business agreement is set up with any provision for terminating the agreement. Yet, even though a father and son do get along together there may be other members of their respective families that become heirs in the case of death and hence need this protection.

Legal considerations and relationships: A father-son agreement sets up a partnership similar to any other business partnership. Each party is liable for all of the obligations of the farm business. However, the majority of fathers and sons would not be working together if they did not have a mutual trust in, and respect for, each other's decisions. Neither would they be working together if either of them was fearful of disputes arising which could not be settled without court action.

With a wage agreement, such as that set up in Plan No. 1, the father and son assume the relationship of employer-employee. In this case the son is not responsible for the liabilities of the business. Yet the father, as the employer, is liable for his son just as he would be for a hired man and, from this standpoint, may obtain insurance against such a liability.

With Plans No. 2, 3, 4, or 5, however, the father and his son assume a partnership and hence, a legal relationship. Sometimes an attempt is made to escape the usual liabilities by inserting a clause in the contract that denies the partnership relationship. The following provisions are included in the contracts recommended by the Pennsylvania State College.[16]

"This Agreement is a contract of hiring and shall not be construed as giving rise to a partnership, and neither party shall be liable for debts contracted by the other." (This statement also could be used in connection with Plan No. 1.)

"This Agreement is for the purpose of carrying on farm business only, and under no circumstances is it to be construed as giving either party authority to contract debts in the name of the other. If, in carrying on the farm business, it becomes necessary to borrow money, this shall be done only with the written consent of both parties."

It is desirable for each partner to have at least a general understanding of the liability of each partner for the acts of the other whenever a father and son partnership is formed. From the legal standpoint. . ."each partner is the agent of the other for the purpose of carrying on the partnership business. As such, he may bind his partner without the partner's consent by incurring debts, entering into agreement, and making sales of crops, livestock, and other property in the course of the business. In actual practice, however, third persons are likely to make inquiries before extending a large amount of credit to either partner. The same is true for any other large transaction. Certain precautions can be taken to protect against these liabilities. The partners may agree to limit the authority of one partner to bind the other. For example, they may provide that sales or purchases of more than a certain amount may be made only by mutual consent, or that one partner may not bind the other in incurring debts or entering into contracts without his written consent. But these limits will protect the partners only against third persons who have been informed of them. Therefore, any limits agreed upon should be made known to those with whom the partners expect to do business. The effectiveness of such limitations may be increased if the partners avoid a joint bank account or place some limitations on its use.

"Each partner is liable to third persons for any torts committed by the other in the usual course of the business. Torts are legal wrong-doings, other than crimes and breaches of contract. Generally, they result either in financial loss to a third person or in injury to his body or property. Negligence resulting in injury to a third person is one example. Most tort liabilities can be covered by insurance of one form or another. For example, farmer's comprehensive personal liability insurance is available as well as auto and truck insurance.

"Contractual and tort liabilities are of an unlimited nature. This means that all of the partners' capital investment in the partnership may be held liable, and

[16] p. 24 and 29, Wrigley, P. I., "Father and Son Farm Business Agreements," Penn. Sta. Col. Exp. Sta. Bul. 492, Jan. 1948.

also their personal assets, including separate property."[17]

Survivor control insurance: On an extremely large farm where there is a large capital investment, and perhaps more than one son in the agreement, a question occasionally is raised concerning the control of the business in case of death of one of the partners. Oftentimes, each of the partners is married, or has relatives who would fall heir to a share of the business. In the event of death, the surviving partners should have first chance at the estate of the deceased. Yet, if the partners who are left are just getting started, it may be difficult for them to finance an additional share of the business. In extreme circumstances, it might become necessary to sell a share in the business to someone outside of the immediate family.

For this reason, life insurance policies are sometimes taken out on each of the partners with the premiums being paid by the farm business. The farm business (not the wife or children) is the beneficiary, and in case of death, the insurance is used to help purchase that particular partner's share of the business from his estate. In this way, the control of the business is kept within the family, hence the name—survivor control insurance.

Payment of Federal Income Taxes: A father-son farm business partnership as defined in this bulletin, does not pay a federal income tax according to the Revenue Act of 1952. However, an information return (Form 1065) must be made to show the income of the partnership and the method of division between the partners. Form 1040 F may be used on either the cash or the accrual basis for calculating the net farm income of the partnership and a copy of this form should be attached to the Partnership Form 1065.

Each individual partner files his own Form 1040 on which he enters under Schedule C page 2 of that form his share of the farm partnership income as reported by the partnership on Form 1065. It is not necessary for the individual partners to file copies of either Form 1065 or 1040F.[18]

Living Arrangements: As far as living arrangements are concerned, past experience has indicated that, when the son is married, separate living quarters are advisable under practically all conditions. When two families live together there is not only opportunity for occasional disagreement between the father and the son regarding the farming operations, but there is a situation inviting disagreement between the mother and the daughter on household operations. One farm management authority comments that it is easier to heat two families in two houses with the heat from firewood, than it is to heat two families in the same house by friction. A stove can be turned on and off, but the latter is uncontrollable.[19]

There is little doubt but what a home for each family provides more individual freedom and eliminates one source of possible friction. Usually a second house can be rented for a limited period of time and eventually a second dwelling can be built on the farm itself. If a second house is to be built, however, the scale of farming operations should be such that two families will be needed on the farm permanently. Many of the older farm houses in this country are large enough that they can be divided into two separate living units. In these instances, it is advisable for the two families to be separated by a wall rather than by a ceiling. This is because older people usually do not like to climb stairs, and neither does a young couple who may be starting a family of their own and want the children to be able to play out of doors.

What if There Is More Than One Son? Quite often a father-son partnership is set up with two or more sons in the agreement. In fact, some of the most successful father-son arrangements are with several sons. However, where there is more than one son in the family, an additional problem sometimes exists.

Usually the question as to which son should stay at home and help operate the farm depends on which one is interested in the farm business. Not all boys are interested in farming. An example of this was seen by the writer on a farm in central Illinois in 1947 where there happened to be two sons and a daughter in the family. One son became interested in engineering, went through College, and in 1947 was working in the oil fields in Texas. The other son became interested in history and was at that time a history instructor at one of the mid-western universities. Neither of them was particularly interested in farming. However, the daughter was quite interested in the farm business and even helped keep the farm records. She went to college and eventually married an agricultural student. The couple returned to her home where the son-in-law formed a father-son agreement on her family's 520 acre farm. This young man was

[17]The discussion of contractual and tort liabilities has been taken verbatim from page 33, Hill, E. B., "Family Farm-Operating Agreements," Mich. Sta. Col. Epec. Bul. 368, Jan. 1951.

[18]Hart, V. B., and M. S. Kendrick, "1952 Income-Tax Returns: Suggestions for Farmers," Cornell Ext. Bul. 874, Nov. 1952.

[19]S. W. Warren, Professor of Farm Management at Cornell University.

interested in farming. The partnership gave him an opportunity to get started in a successful farm business.

Where there are two sons and they both want to farm, the problem is slightly different. Here the relative ages of the sons play an important role, as far as timeliness is concerned, in setting up a father-son agreement. If it is at all possible, the older son should be taken into the business as soon as it is practical. He should be given the opportunity to gain experience and build up an equity in livestock and machinery. Then, when the younger son is ready to start farming, the older boy may be able to buy or rent a farm of his own. If the age difference between the two sons is such that the older one is able to get started and obtain a farm of his own before the younger one wants to come into the business, then there is little problem.

A similar circumstance also exists when a young man wants to get started in farming before his father is ready to retire. Today, the age of the father is oftentimes such that he still has some of his most active years ahead of him; yet the son may be ready to assume more and more responsibility and perhaps wants a farm of his own. This raises the question of how the father can help his son get established on another farm.

How Can the Father Help His Son Get Established on Another Farm? Actually, the primary purpose of a father-son agreement is that of providing the son an opportunity whereby he may obtain experience and accumulate capital. A father-son agreement is often the first step in helping a young man to accumulate capital and get established on a farm of his own. In this respect, the father can aid the son by helping him establish a good credit rating in the local community so he can obtain capital from the local bank or other credit agency. The son may start as a tenant and then buy a farm later. The father can help him select a farm in the local community, either to rent or to purchase. Most of the established farmers can anticipate in advance when a good farm will be available. In this way the father makes it possible for a young man to obtain a more productive unit. Furthermore, if the son starts out on a farm near the home unit, the father can help him in a number of ways, such as exchanging work or machinery, or by buying farm supplies (or selling farm products) in larger quantities than would otherwise be possible.

Summary

1. Increased difficulty in getting started in farming because of the large investment now required has led to the development of several types of father-son farm business agreements.

2. The three primary objectives of these agreements are: (1) To provide the opportunity for a young man to get started in farming, (2) to allow the older, more experienced man to retire from the heavy farm work, and (3) to provide economic security and social stability in present-day agriculture by maintaining the productivity of the farm unit.

3. This bulletin is concerned primarily with the development of the annual agreement for operating the farm business. Hence, a father-son agreement has been defined as a mutual understanding between father and son, or in some instances between other members of the family, to supply the various elements—land, labor, capital, and management—which are essential to the operations of a successful farm business.

4. "Breaking the ice" is oftentimes the most difficult problem in getting a father-son agreement started. The father and son must sit down and talk things over in a businesslike manner. The son, of course, must make the decision that he wants to be a farmer. This is a big decision, as farming is a lifetime job and the capital requirements are high.

5. If the agreement is to be a success, an adequate volume of business and a high level of operating efficiency are necessary. Otherwise, there will not be sufficient income to provide a satisfactory level of living for two families.

6. The agreement should be written.

7. A good set of farm records—a farm inventory and farm cash account—must be kept if the division of income is to be made correctly and the ownership of the capital is to be kept clear.

8. The partners to the agreement should decide at the beginning of the year the value of the different types of farm property, the interest rate which will be used, the value of each partner's labor and management contribution, and the value of the prequisites, if any, furnished by each party. The agreement should be based on first-of-the-year inventory values. The value of all farm property as well as the value of the labor and management contributions should be fairly conservative.

9. A farm bank account is probably the simplest and easiest method of keeping track of all farm receipts and farm expenses. With each partner withdrawing a monthly allowance for living expenses, a settlement need to be made only at the end of the year. The final settlement at that time, however, should include inventory adjustments as well as the cash income, if each partner is to know just where he stands.

10. An agreement based on an "enterprise split" is not advisable from the standpoints of practical record keeping, sharing of the income, or getting established in farming. The most practical agreement is set up on the entire farm business.

11. A number of different methods may be used for sharing the income from the farm business. Among those presented in this bulletin are:

a. Regular wages plus a bonus or share of the profits.
b. A father-son agreement set up on a landlord-tenant basis.
c. Sharing income in proportion to the total contributions.
d. Sharing income equally after paying all contributions.
e. Sharing income in proportion to the labor and management contributions.

12. The agreement should be flexible in order that year-to-year adjustments can be made.

13. When the son is married, separate living quarters are recommended under all circumstances.

Appendix

FARM NO. 1. YEAR 1951. CALLAWAY COUNTY, MISSOURI. ACRES OWNED, 301; RENTED, 120; OPERATED 421. SOIL TYPE, PUTNAM SILT LOAM AND LINDLEY LOAM. TOPOGRAPHY, LEVEL TO ROLLING. HEREFORD CATTLE, DUROC HOGS. CROP SHARE-CASH LEASE ON 120 ACRES AND A FATHER-SON AGREEMENT ON THE ENTIRE FARM.

MACHINERY AND EQUIPMENT

Item	Beginning Value	Ending Value
Auto (f.s.)	$ 687	$ 625
Tractor	0	1,600
Tractor	450	400
Baler	1,200	1,050
Mower	175	150
Plows (2)	210	185
Wagons (5)	350	350
All other	2,121	2,559
Total	$5,193	$6,919

REAL ESTATE

	Beginning Value	Ending Value
Land, 301 acres @ $50.00	$15,050	$15,050
Buildings	12,545	12,825
Improvements	1,470	2,182
Total	$29,065	$30,057

FEED AND SUPPLIES

Item	Beginning Amount	Beginning Value	Ending Amount	Ending Value
Corn	1600 bu.	$2,400	1750 bu.	$3,150
Oats	350 bu.	315	600 bu.	600
Wheat	100 bu.	200	100 bu.	200
Hay	50 t.	1,000	50 t.	1,000
Other		1,302		1,168
Total		$5,217		$6,118

CROPS RAISED

Kind	Acres	Yield	Total Production	Amount Sold Quantity		Price	Value
Corn for grain 1/	65	69 bu.	4,485 bu.	550 bu.	@	$ 1.67	$ 918
Soybeans 2/	36	29 bu.	1,044 bu.	1,040 bu.	@	2.60	2,704
Wheat	29	21 bu.	609 bu.	550 bu.	@	2.12	1,166
Oats	45	41 bu.	1,845 bu.				
Red Clover hay 3/	31	2.2 t.	68 t.	22 t.	@	19.85	437
Timothy-lesp. hay	33	1.2 t.	40 t.				
Total cropland	(239)			Farm total			$5,225
Pasture 4/	120			Landlord's sales			1,433
Woods	43			Operator's total			$3,792
Farmstead and waste	19						
Total farm acres	421						

1/ 20 acres, 50-50 crop-share; 55 bu. per acre; landlord sold his half at $1.67 per bushel.
2/ 18 acres, 50-50 crop-share; 22 bu. per acre; landlord sold his half for $2.60 per bushel.
3/ 25 acres bought standing @ $20.00 per acre
4/ 30 acres rented @ $12.00 per acre.

LIVESTOCK

	Av. No.	Beginning No.	Beginning Value	Purchased No.	Purchased Value	Sales No.	Sales Value	Ending No.	Ending Value	Died or Eaten No.	Died or Eaten Value
Dairy	2	2	$ 400			1	$ 184	2	$ 400		
Dairy heifer	1	1	100								
Veal calves	2					2	100				
Sub-total			(500)				(284)		(400)		
Beef cows	26	22	$ 5,500		$	3	$ 1,035	27	$ 6,750		$
Yearlings	18	20	4,000			12	3,240	17	3,400	1	150
Calves	25	18	2,700			5	675	23	3,450		
Bull	1	1	750	1	800	1	600	1	750		
Sub-total			(12,950)		(800)		(5,550		(14,350)		(150)
Brood sows	13	14	980			10	810	10	700		
Stock hogs	109	109	1,090			99	4,395			4	150
Spring pigs	103					103	4,079				
Fall pigs	105							105	1,134		
Sub-total			(2,070)				(9,284)		(1,834)		(150)
Chicks					15						
Total			$15,520		$ 815		$15,118		$16,584		$ 300

LIVESTOCK PRODUCTS SOLD

Butter and Cream	$ 70
Poultry and eggs	102
Total	$172

MISCELLANEOUS RECEIPTS

Custom baling	$ 420
Government payments	279
Other	314
Total	$1,013

FARM NO. 1 -- CONTINUED

CASH FARM EXPENSES[1/]

Son's labor, 12 months	$1,500	Fertilizer	$ 1,300
Other hired labor	552	Crop expense	400
Feed purchased	2,686	Veterinary	161
Hay bought	500	Livestock purchased	1,549
Tractor expense	149	Pasture rent	360
Equipment repair	366	Buildings and fence upkeep	476
Gasoline, oil and grease	360	New buildings and improvements	699
Truck expense (farm share)	164	Taxes, real estate	215
Auto expense (farm share)	96	Taxes, personal	105
New Machinery	2,686	Insurance	114
Machine hire	495	Miscellaneous	178
		Total	$15,111

1/ Does not include landlord's expenses on 120 acres.

FAMILY LABOR
2 1/2 months, $250

VALUE OF OPERATOR'S LABOR
10 months, $1,380

SUMMARY

FARM INVENTORY

Item	Beginning	Ending	Change
Land	$15,050	$15,050	$ 0
Blgs. and imp.	14,015	15,007	992
Beef cattle	12,950	14,350	1,400
Hogs	2,070	1,834	-236
Other livestock	500	400	-100
Machinery	5,193	6,919	1,726
Feed, supp.	5,217	6,118	901
Cash on hand	2,000	2,000	0
Total	$56,995	$61,678	$4,683
Average	$59,336		
Interest on Average Capital		$2,967	
Interest on Beginning Capital		2,850	

CASH ACCOUNT AND FARM INCOME

Cash Receipts	$
Crop sales	$ 3,792
Livestock sold	15,118
Livestock products	172
Miscellaneous	1,013
Total cash receipts	20,095
Total Cash Expenses	15,111
Cash Balance	4,984
Unpaid family labor	250
Increase in inventory	4,683
Farm Income	9,417
Interest	2,967
Labor Income	6,450
Operator's Labor	1,380
Return to Capital	$ 8,037
Percent return	13.5%

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