Farm Business Arrangements:
WHICH ONE FOR YOU?

Kenneth H. Thomas
University of Minnesota

Michael D. Boehlje
Iowa State University

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TO THE READER

Most discussions of the organizational alternatives for the farm business are oriented to a description of the legal characteristics of various arrangements such as the partnership or corporation. However, the first task of the farm family should be to appraise the situation and determine the economic and management characteristics and dimensions the family wants from a business arrangement. Then the appropriate legal structure or structures with these characteristics can be chosen.

The approach of this bulletin is to develop such an economic and management decision framework for choosing a business arrangement and then to describe how alternative legal structures fit within this decision framework. Certainly, competent legal and tax advice should be obtained in the process of selecting and structuring a business arrangement for your farm.

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About the Authors

Kenneth H. Thomas is Professor and Extension Economist in Farm Management, University of Minnesota.

Michael D. Boehlje is Associate Professor of Economics, Iowa State University.

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FARM BUSINESS ARRANGEMENTS: WHICH ONE FOR YOU?

The family farm is a basic institution in midwestern agriculture. Many parents want their businesses to continue. Thus, their objective is to pass on their farm to the next generation. At the same time, increasing numbers of young people are returning to the farm attracted by higher farm incomes and disillusioned with city life. Because of the high capital and management requirements of modern agriculture, most beginning farmers recognize that they initially will have to "piggyback" on an existing farm operation.

Therefore, a growing number of farm families are confronted with the problem of how best to get a son or son-in-law started and established in farming and to successfully transfer both property and management control to the next generation. The older farmer without relatives to take over the business faces similar problems in bringing an unrelated young man into the business with him as a working manager or partner. To further complicate the present situation, it appears that too many young people are attempting to start farming relative to the number of longer term full-time farming opportunities available.

Selecting a business arrangement under these circumstances is an important decision not to be taken lightly nor done hastily. In most cases the decision involves the economic security of the parents, the future career potential of the farming son or son-in-law, and overall family good will. Thus, it is important that the arrangement meet these needs.

The participants first must recognize that each family and farm situation is different and that each family has a different set of goals and objectives. Thus, a carefully selected business organization plan may differ for each farm. In certain situations relatively simple business arrangements will suffice; in more complex situations, more complex tools will be needed. The farm family will need to appraise their situation and objectives, and make at least a tentative decision about organizing their business. They should also plan to spend some money to secure the necessary professional help of an attorney, accountant, and/or other management advisors as they formalize and carry out their business organization plan.

This bulletin provides farm families and their advisors with an outline of considerations, guidelines, and procedures for selecting farm business arrangements to help solve their entry and exit problems. It is designed to help narrow the range of business arrangements to be considered, not to provide a comprehensive discussion of any particular type of business arrangement. The first section provides a decision framework for choosing a farm business arrangement. Remaining sections provide a more detailed discussion of the selection process. Section II includes the appraisal of the existing situation, the objectives, and the potential for successful joint operation. The importance of starting with a testing stage and the types of arrangements to be considered are covered in Section III. Considerations and arrangements for joint short term operations are discussed in Section IV. Section V outlines considerations and arrangements for longer term joint operations. Reference is made throughout to selected business arrangement aids contained in the appendix.

I. Farm Business Arrangement Decisionmaking: An Overview

Most farm businesses are managed by an individual operator rather than by a management team. The 1969 census of agriculture indicated that 85 percent of U.S. farms were operated as sole proprietorships. Thirteen percent were partnerships, one percent were incorporated, and one percent were in estates and trusts. Growing capital and management requirements of modern farming and the resultant entry and transfer problems mean the number of individually operated businesses will decline while the number of joint family operations involving the use of partnerships and corporations will tend to increase.

This overview first contrasts the life cycle of the traditional individual farm business with that of the emerging multi-management and usually multi-generation joint farming operation. Special emphasis is placed on reasons why each family will require a plan tailored to their situation. A decision framework for selecting a business arrangement is then described which should provide a helpful guide in choosing an arrangement for your situation.

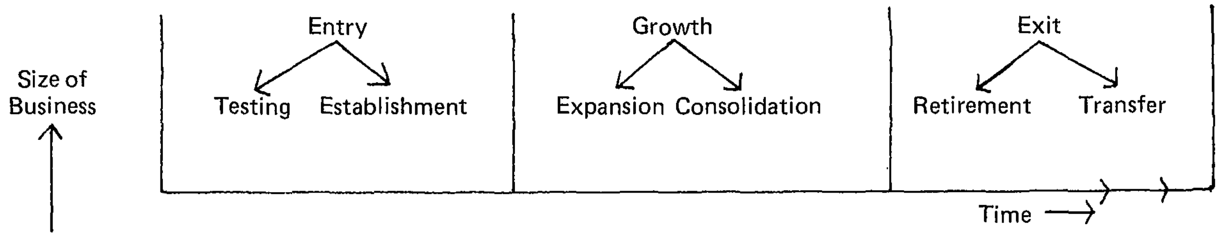

Figure 1. Typical Family/Farm Life Cycle of Individually Operated Business

A. Farm and Family Life Cycles: Traditional and Emerging

The individually-operated farm business has a traditional life cycle paralleling that of the farm operator. The typical farm operator and his firm pass through at least three stages during his farming career: entry, growth, and exit stages (figure 1).

The *entry stage* involves the two major processes of testing and establishment. The operator first evaluates his opportunities in farming and determines whether or not to choose farming as a career. He must then acquire sufficient capital resources and managerial ability to establish a viable economic unit that will generate a competitive income and be capable of growth.

The *growth stage* involves the processes of expansion and consolidation. During this stage the operator first attempts to extend his resource base through purchase or lease. Capital requirements tend to escalate and the operator usually must utilize debt capital. The operator then tends to shift his emphasis from expansion to consolidation of previous gains and stabilization of income.

The *exit stage* involves consideration of retirement and intergeneration transfer. The farm operator attempts to reduce his management responsibilities while maintaining sufficient control of his farm assets to generate adequate retirement income. He should develop estate plans that will implement lifetime or at-death transfers of property and the associated managerial responsibility to the next generation.

The growing capital and management requirements of modern farming, and the resultant increasingly complex and costly entry and exit problems, have caused farm families to look toward the merger of farm businesses and/or farming generations. The emphasis here will be on the merging of generations. The merger of businesses from the same generation should be approached in a similar fashion.

Figure 2 illustrates problems in the process of merging the life cycle of a second-generation farm family with the typical life cycle of the parents. Each situation is different for at least three reasons. One is the *level of achievement of the parents.* Some parents have put together a very substantial business, one that would easily accommodate one or more "next generation" farmers (situation 1, figure 2). Others have provided adequately for their family, but find themselves with a one or a one-and-a-half man business (situation 2, figure 2).

A second reason is the *timing of the son's entrance* into farming relative to the father's stage in his life cycle. The situation of a father with 20 years of active farming ahead of him is not comparable with the situation of a father within two to five years of retirement. A third reason is the *number of children* involved — particularly those interested in farming. The problem is much simpler if there is only one child than if there are eight children and three want to farm.

The merging of the life cycles of two farming generations can be quite simple under the right set of circumstances. Such a case might be the father five years from retirement who has a very good business, and who has only one child — a son on the farm. At the other extreme is the 45-year-old father with a less than two-man business, two sons who want to farm, and five other children.

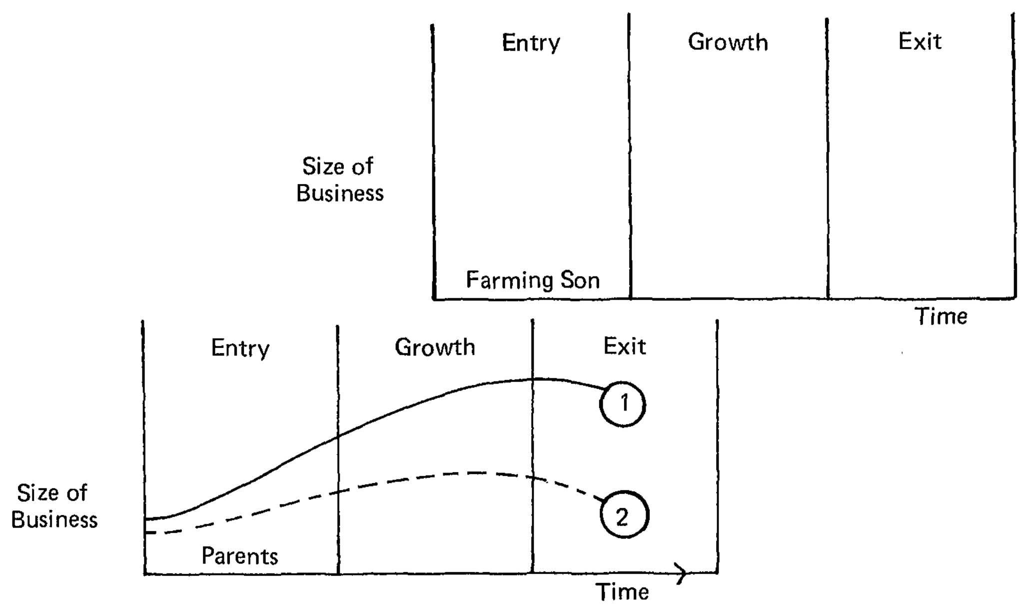

Figure 2. Merging Family/Farm Life Cycles of Parents and Farming Son

B. A Framework for Business Arrangement Decisionmaking

Many other situations could be described. However, it now should be apparent that from a decisionmaking standpoint, the farm family – both generations – should first carefully analyze their *current situation* and identify their objectives. They should also make a preliminary appraisal as to the possibilities of developing a successful joint operation (figure 3).

If it is decided to pursue a joint operation, then the father and son (or son-in-law) normally should enter a so-called *testing stage.* The purpose of this testing stage is twofold: to help the son decide whether he really wants to farm, and to help the parties involved determine whether they can make a joint business venture work from both personal and business points of view. Some families may find that they can jump over this testing stage and go to more complex joint operating arrangements. But these cases are generally the exception rather than the rule.

At the end of the testing period the family must decide what future course they wish to follow. In some cases they may decide to go their separate ways. This may involve the son getting out of farming altogether, or he may move to another farm with no direct ties to the home farm. In cases of a large business and several potential partners, a direct movement toward establishment of a multi-ownership, multi-management firm on a *long-term* basis may be in order.

But probably the most typical move out of the testing stage is toward the formation of an interim or *shorter-term joint arrangement*. Its temporary nature may be caused by the present size of the father's operation, his objectives, his impending retirement from the business or the possible return of other family members to the business. The longer range alternatives under these conditions are (1) a spin-off occurs with the son going off to farm on his own, (2) father retires from the business and rents and/or sells the farm to the son, or (3) a longer-term multi-ownership, multi-management unit is formed.

C. Selecting a Business Arrangement: Considerations, Alternatives, and Guidelines

The factors to be considered in selecting business arrangements now will be outlined; followed by a brief description of the alternative forms of business organization that might be considered as well as suggested guidelines as to where these alternative arrangements tend to fit in the situations just described (figure 3).

1. Considerations in Selecting Business Arrangements

Selection of a form of business organization should be based on what the family wants to achieve. Business development and growth, along with retirement and estate transfer, are key concerns of most farm families considering joint operations. The factors to be considered in choosing a business arrangement differ depending upon which of these motivations is most important.

a. Business development and growth considerations

The concern for business development and growth will vary by family situations, the size of the farm business, the career development stage of the father and son(s), and their longer-term objectives. If this issue is of importance, then the farm family should look for a business arrangement which will enhance business opportunities and/or preserve operational continuity during the transfer between generations.

Factors to consider in selecting a form of business organization for business development and growth include: (1) the ease of gaining control of capital, (2) management responsibility and control, (3) limits on business and personal liability, (4) income tax and other cost/benefit considerations, (5) continuity of business existence, and (6) ease of disengagement or dissolution of the business arrangement.

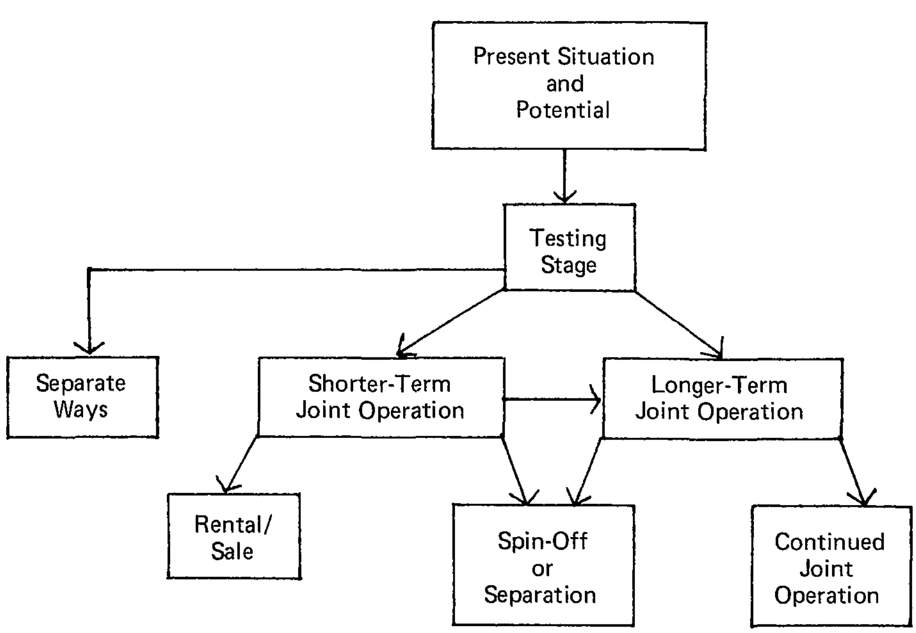

Figure 3. A Framework for Business Arrangement Decisionmaking

b. Retirement and transfer considerations

A sound transfer arrangement should be tested from several points of view: (1) Does it provide the parents with a reasonable degree of security during retirement and old age? (2) Does it provide reasonable security and opportunity for the farming son? (3) Does it provide for equitable treatment of the heirs?

Thus, if retirement and transfer considerations are of key concern, business arrangements should be appraised in terms of: (1) the ability of the parents to control the farm operation for as long as they want, (2) the ease with which property can be transferred, and (3) fair treatment of heirs at transfer and beyond.

Irrespective of the motivation behind the choice of a business organization, the family should attempt to formulate a plan that is as *simple* and *flexible* as possible.

2. Brief Description of Business Organization Alternatives

The major alternatives for organizing a farm business are identified in table 1 and are described as to their business development and growth and retirement and transfer characteristics.

The *sole proprietorship* is a form of business organization in which the farm is operated by one individual and exists until the owner retires or dies. Under current conditions, individual sole proprietorships often become "modified" by various types of contractual arrangements. Such a modified sole proprietorship is often established when a son, son-in-law, or unrelated party is first taken into the business. Wage incentive, wage share, operating and rental agreements and various joint venture arrangements are examples of modified proprietorships.

A *general partnership* is an aggregation of owners. Two or more persons contribute their assets to the business and share with each other the management responsibility, profits, and losses. Each partner pledges faith in the other partners and stands liable for the actions of all partners within the scope of partnership activities.

A *limited partnership* is a special form of partnership permitted by state law in which the liability of one or more partners for partnership debts and obligations is limited to their investment in the business. A limited partner is just an investor; a limited partner who participates in management becomes liable for all partnership obligations as a general partner. A limited partnership must have at least one general partner who handles the management of the business and is fully liable for all partnership debts and obligations.

A *corporation* is an artificial entity created under state law. It is a separate business entity distinct from its owners, who are called shareholders because they own shares or interests in the corporation. The major characteristic of the corporate form of business organization is this sharp line of distinction between the business and the owners. The corporation is a separate legal person as well as a separate taxpayer.

A *tax-option corporation* (sub-chapter S) is a creation of federal tax law. It is a corporation in all respects except that the corporate entity pays no income tax; instead, each shareholder-owner reports a share of corporate income for income tax purposes.

Other arrangements such as the trust can be considered. All of these business arrangements can be *combined* in various ways, such as incorporating part of the business and holding the remainder as a sole proprietorship or partnership.

3. Guidelines as to Where These Business Arrangements Tend to Fit

How each of the above business arrangements tend to fit into the decisionmaking framework described in figure 3 will now be discussed (figure 4). Most farm families will be starting with an individually operated sole proprietorship. As they move to the testing stage, one of the various types of "modified" sole proprietorships, ranging from a wage-share to some type of operating or enterprise type arrangement, will probably be selected. These are simple arrangements, yet they provide the opportunity to test the son's true desires regarding farming and the compatibility of the participants.

Families who then move into a shorter-term joint operation normally should consider some type of joint venture or operating agreement (exchanging labor for machinery, renting some additional land, etc.) or a partnership, depending on the circumstances and the eventual course to be followed. These arrangements likely will be dissolved within a few years, with the son going off on his own, or the father renting the business to the son. The longer-term joint operations usually necessitate the use of a partnership or corporation, or a combination of arrangements.

The next four sections of this bulletin provide a more detailed look at each of the segments of the decisionmaking framework as illustrated in figures 3 and 4.

II. Appraising Your Present Situation, Objectives, and Potential for a Successful Joint Operation

Before beginning any type of joint operation, the parties involved should examine their present situation carefully and make a preliminary judgment of the potential for developing a successful joint operation. Using a form such as FM 221, "Appraising Your Situation, Goals, and Potential for Joint Farm Operation", should prove helpful in making the appraisal (see appendix A).

A. General Description of Present Family and Business Situation

This general description should include a brief statement as to what type of operating arrangement presently is being used and changes under consideration in the arrangement. It also should list all members of the family, their ages, education, marital status, employment, and comments as to special considerations, etc. The interests and future plans of minor children and non-farm heirs should be determined. The size, efficiency, profitability, and financial soundness of the farm business should be described briefly.

B. Present Situation and Objectives — The Parents

The parents first should determine their particular stage in the family farm life cycle — the expansion or consolidation phase of the growth stage, or the retirement phase of the exit stage. The stage will affect the ease and opportunity for a second generation to be integrated into the business.

The parents then should evaluate the size, efficiency, profitability, and financial soundness of the present farm business. Is it large enough for two families? Could transfers or gifts be made easily? What are the opportunities for expansion?

Finally, the parents should put their objectives in writing regarding the future development of the farm business, continuation of the business over time, treatment of the potential farming son and other heirs, etc.

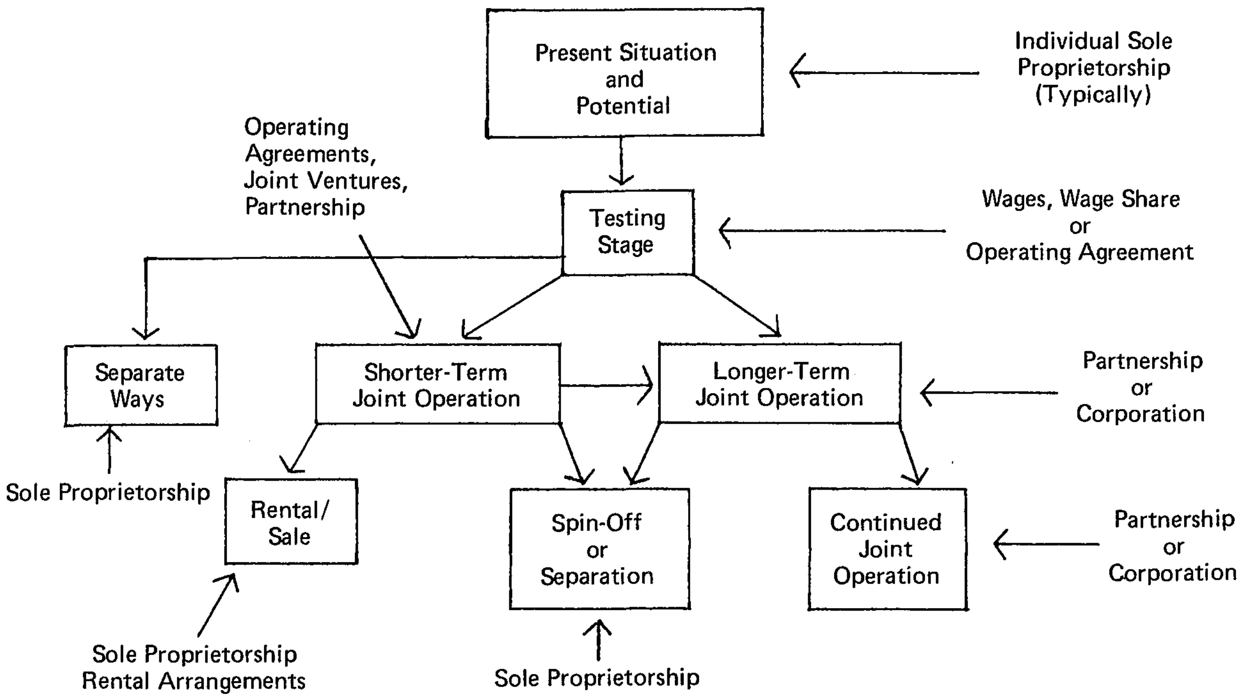

Figure 4. Alternative Business Arrangements and the Decision Framework

Table 1 – Comparison of farm business organization alternatives*

	Sole proprietor	Partnership	Corporation
Nature of entity	Single individual	Aggregate of two or more individuals	Legal person separate from share-holder-owners
Business development and growth considerations			
Source of capital	Personal investment, loans	Partners' contributions, loans	Contributions of shareholders for stock, sale of stock, bonds and other loans
Liability	Personally liable	Each partner liable for all partnership obligations	Shareholders not liable for corporate obligations
Limits on business activity	Proprietor's discretion	Partnership agreement	Articles of incorporation and state corporation law
Management decisions	Proprietor	Agreement of partners	Shareholders elect directors who manage business through officers elected by directors
Income taxes	Income taxed to individual 50% deduction for long-term capital gains	Partnership files an information return but pays no tax. Each partner reports share of income or loss, capital gains, and losses as an individual.	Regular corporation – Corporation files a tax return and pays tax on income; salaries to shareholder-employees deductible. Capital gains offset by capital losses; no 50% deduction for capital gains Rate: 20% on first $25,000, 22% on next $25,000, 48% on excess above %50,000. Shareholders taxed on dividends paid. tax-option corporation – Corporation files an information return but pays no tax. Each shareholder reports share of income, operating loss, and long-term capital gain.
Retirement and transfer considerations			
Life business	Terminates on death	Agreed term; terminates at death of partner	Perpetual or fixed term of years
Effect of death	Liquidation	Liquidation or sale to surviving partners	No effect on corporation. Stock passes by will or inheritance
Transfer of interest	Terminates proprietorship	Dissolves partnership; new partnership may be formed if all agree	Transfer of stock does not affect continuity of business – may be transferred to outsiders if no restrictions

*Adapted from North Central Regional Extension Publication No. 11, The Farm Corporation, revised 1974.

C. Present Situation and Objectives — Farming Son and/or Other Heirs

The heirs or children — particularly the farming son — likewise should appraise carefully their present situation and objectives. What has been the son's farming experience to date? What does he have to contribute to the business? What are his objectives regarding the farm business? Does he want to farm with his father for an extended period or just until he gets started? Other family members also should determine their interests in continuing the farm business.

D. Appraising the Potential for a Successful Joint Operation

Every business needs certain characteristics for success. This is particularly true of joint business arrangements because personal relationships as well as business considerations are involved. Before even considering a joint operation, a farm family should appraise their situation in terms of the following partial list of essentials for success.

1. Ability to Live and Work Together *and* Share Management Responsibility

It is essential that the participants in a joint venture relate well to each other in a personal as well as a business sense. All parties (participants and their spouses and families) must be tolerant and understanding as well as have the ability to overlook each other's faults. More business arrangements are dissolved because of disagreements over trivial things than over major issues. The ability to compromise is essential. Many parents are conservative, their children venturesome. Wives must be kept informed, be interested in the business, and be compatible.

All parties should work towards similar *business* objectives to make the business succeed. When goals and values differ, care must be taken to arrive at a reasonable compromise. *Joint participation in managerial decisions is a must.* Most parents understand the importance of transferring property ownership to the operating farm heir. Gradual transfer of management control can be just as vital.

A good check of one's ability to live, work, and manage in a joint business arrangement setting is the test contained in "Test Yourself — Would You Be a Good Partner?" (see appendix B).

2. Business Profitable Enough to Provide Security for Parents and Opportunity for Son

No matter how equitable an agreement may be and how well the parties can get along, a business arrangement will not be successful if business earnings are inadequate. The income must be sufficient to support the owners by providing an adequate standard of living and compensating each individual for his capital resources. This may require (1) an expansion in the business; (2) improvements in production, marketing, and financial skills; and/or (3) shifts in the amounts of resources supplied by the various parties.

It is recommended that the financial feasibility of the proposed plan be tested before the parties enter into a detailed arrangement. This pre-test will force the parties to consider all phases of the proposed operational and business relationship. It also provides an opportunity to determine if the parties can compromise.

3. Provide Opportunity for Junior Partner(s) to Gain Control of Business Over Time and to Be in a Position to Effectively Manage It

The younger generation must have the opportunity to invest and thus increase their equity and control of the business. The sharing of annual income must change over time as relative capital, labor, and management contributions change.

4. Preserve, Protect, and Foster Family Good Will Through Careful Planning and Good Communication

A prime objective of the family should be maintenance of overall family good will. Plans should provide for the fair and equitable treatment of other heirs. A farming son who "gains the whole farm but destroys family good will" is paying an unduly high price. Good communications among all family members is essential, particularly when arrangements are being changed.

If, after closely examining your situation, you decide *not* to develop any type of joint venture, all is not lost. You probably have saved some time and future disappointment. However, if you can pass the above tests, then you and your family should begin exploring how best to start a joint operation.

III. The Testing Stage — Starting a Family Joint Operation

Most existing family farm units are sole proprietorships. Most families have had little or no experience in operating a business together. The son may be uncertain as to whether he really wants to farm. Therefore, it is recommended that the father and his son (son-in-law) first enter a so-called testing stage. The family's objectives at this point should be to determine whether the son really wants to farm, whether the parties can work together, and, if so, what type of joint arrangement would be best.

In this section some alternative arrangements for use during the testing stage are described first, followed by a discussion of the length of the testing stage and the alternative development routes to be considered beyond this stage.

A. Alternative Business Arrangements for the Testing Stage

Business arrangements adapted to the testing stage can be grouped into two broad categories. The first category includes various types of wage, wage-incentive, and wage share arrangements in which the son contributes primarily labor and possibly some management. The second category includes various operating or joint venture agreements that may at times border on being a partnership. With these latter arrangements, the son will be supplying at least some personal property as well as labor and management.

1. Employer-Employee Type Arrangements

First, alternative arrangements in which the son contributes primarily labor and some management are discussed.

a. Wage agreement

Many families find the easiest way to start a son in the business is to pay him wages. This is probably a good place to start the testing process. However, two notes of caution are in order. First, the wage should be a reasonable one. Second, this type of arrangement should be considered very temporary. Since the son does not have a direct interest in the success of the business, he will lose interest in farming if he is forced to work on a wage basis for an extended period of time. One approach is to pay the son well in excess of a hired man's wage. This would keep the son motivated, test the financial adequacy of the business, and insure that the arrangement will not last unduly long.

b. Wage incentive plans

Wage incentive plans often are used to encourage a farming son to take a more active interest, and additional responsibility, in the farm business. For the employee, the compensation should be in addition to his basic wage, not a substitute for a reasonable wage, agreeable working conditions, and adequate housing. It is assumed that the result of an incentive plan will be increased returns to the father as well as the son.

There are basically two types of incentive plans. In the first one, payments are based upon the physical output of one or more of the enterprises regardless of cost. The second plan is a share of profits or gross income arrangement. "Pre-Farm Partnership Arrangements Worksheet," FM 220PFP, provides a procedure and guidelines for setting up various incentive plans (see appendix C).

In a sound incentive program, the son knows that he can influence the size of payment he receives by the work he performs. The payments are sufficiently large and attainable to encourage extra effort. And, a written agreement is developed describing the purpose of the arrangement, employee responsibilities, method of calculating and making the payment, and provisions for arbitration.

c. Wage and income share plans

A wage and income-sharing plan is particularly well-adapted as a beginning agreement when the son is not sure of continuing in business on the home farm, or when he does not want to become too involved financially. From a legal standpoint, a wage and income-sharing, *but not loss-sharing,* plan establishes an employer-employee relationship rather than a partnership. The employee and employer thus would avoid some of the liability aspects associated with the general partnership.

Under this plan the father typically furnishes the farm, the housing for the son, all of the farm personal property, and his own labor and management. He also pays all farm expenses. The son works on the farm full-time and receives a guaranteed monthly wage and a share of net farm income. The wage rate could be comparable to current wages for similar services by hired help in the area. The Farm Partnership Worksheet, FM-220 (see appendix D) can be used in determining a fair wage-share arrangement.

Some of the advantages of wage-based types of business organizations include: (1) determining if the son really wants to farm and if the father and son can get along well when farming together; (2) giving the son experience and "know-how" about farming; and (3) starting and stopping easily as there is no jointly held property, etc. Among the disadvantages are: (1) the son's major interest in the farm may be his monthly paycheck; (2) payment in wages does not encourage savings nor does the arrangement permit the son to gain an equity in the business; and (3) such plans are often kept in force long after the son is ready to become a full-fledged member of the business.

2. Operating or Joint Venture Agreements

The testing period may extend long enough or relationships develop fast enough that the son begins to contribute personal property to the farm business along with his labor and management. Two types of operating or joint venture agreements that can be entered into are the enterprise and the total farm arrangements.

a. The enterprise working agreement

In this arrangement the farming son may furnish some personal property (e.g. livestock and machinery) and some management in addition to his labor. He normally would not make whole farm decisions, but may make most of the major decisions for one enterprise.

The son may buy into a given enterprise such as the dairy herd, cow herd, or hog enterprise on a partial or complete basis. He may either pay the father for the use of feed, buildings, and pasture, or work out a livestock lease arrangement whereby part of the production is given to the father. A form for working out an equitable enterprise working agreement is contained in "Pre-Farm Partnership Agreements Worksheet", FM 220PFP (see appendix). Any resultant agreement should be put in writing and cover such topics as job responsibilities, contributions, distribution of income, method of settling disputes, and dissolution.

Enterprise working agreements should be normally regarded as only temporary. Most farms are too small to be subdivided into separate enterprises. There is a tendency for the son to concentrate on his enterprise at the expense of the overall farming operation with this type of an arrangement. In addition, the son is exposed to considerable risk when he depends on one source of income. Record keeping may be difficult.

b. Total farm operating agreements

The most complex arrangement short of a partnership or eventual split-up of the family arrangement is some type of total farm operating agreement or joint venture. The son contributes personal property and is reimbursed for his labor and management and the use of his capital. There may be situations in which the father and son operate in a joint venture agreement and share labor and machinery but own or rent their own land, livestock, etc. Normally, the family should have made some long-range decisions before entering such agreements and thus would have moved out of the so-called testing stage.

B. Length of Testing Stage?

The length of the testing period depends on the family's situations, objectives, and progress toward deciding which future route to follow. Two to five years normally should suffice for the testing period. Delaying a decision beyond this time should be viewed critically, particularly if the parties still are involved in some type of wage-share arrangement. The purpose of the testing period is to determine whether the son wants to farm and whether the parties can work together. Once these issues have been resolved, they should be prepared to move out of the testing stage.

C. Where to from Here?

At the end of this testing period the family must decide what future course to follow (see figure 3, page 5). A complete separation will occur in some cases. The son will decide against farming as a career or will go off to get established in farming on his own or with another farmer. In other cases, if there is a large business and several potential partners, a direct movement to the establishment of a multi-ownership, multi-management firm on a more permanent basis might occur. This likely will involve formation of a partnership or corporation, or a combination of business arrangements with considerable attention given to business continuity and transfer issues.

The most typical move is toward the formation of an interim, short-term joint arrangement, whether it be a partnership or some type of joint venture. Its temporary nature may be caused by an inadequate size of business, the father's impending retirement, or the possible return of other family members to the business. One of three things eventually may happen: (1) a spin-off, with the son going off and farming on his own, thus forming a second sole proprietorship; (2) the son rents, buys, or inherits control of his father's farm and it once again becomes a sole proprietorship with a new proprietor; or (3) formation of a more permanent multi-ownership arrangement.

The issues and alternatives relating to the shorter-term joint operation will be discussed next since they represent the most common next step for farm families.

IV. Farming Together — For Awhile (Shorter-Term Joint Operation)

This section includes the business development and transfer concerns that families typically face after the testing period, the types of business arrangements that might be considered for use during a relatively short-term period of joint operation, and the considerations regarding the alternative routes that might be followed upon leaving this stage.

A. Business Development and Transfer Concerns

The overriding business development concern at this point is that of finding a way that will permit the son to become established in farming without jeopardizing the longer term financial interests and security of the parents. This often means finding ways of adding resources or intensifying the farming operation without appreciably increasing the father's investment and financial risks. It also may involve one or more of the parties working off the farm to provide adequate income. Transfer considerations are not of primary concern at first. However, they do become of greater importance later on, particularly if a basic goal of the farm family is continuation of the business, and the son's future in farming is dependent upon control over the home unit.

B. Types of Business Arrangements to Be Considered

Joint ventures and partnerships are two types of arrangements well-suited to this shorter-term, interim period of joint operation.

1. Development of a Joint Venture

In cases when the home farm is too small or differences surface between the father and son as to how the business should be developed, a joint venture arrangement might prove desirable. The son might rent or buy a separate farming unit. Machinery might be owned jointly, or owned separately and used jointly. They normally would exchange work, and possibly operate a livestock operation together.

A joint venture can take on many forms and can get a son established in farming without jeopardizing the security the father has built up in his own business. It also permits the son to better exhibit his management know-how and establish his independence because he has a separate business entity. The key to this arrangement is the son's ability to obtain a farming unit sizeable enough to generate enough profits for an adequate standard of living and net worth improvement and which has future business growth potential.

2. Development of a Partnership

When the existing farm business is adequate in size or can be expanded without jeopardizing the parents' financial position, a partnership is often formed. This form of business organization was described earlier in table 1, page 6. Partnerships are commonly used to permit the son with little or no capital to gain gradual control of the business both financially and managerially. The son builds up his equity absolutely and percentage-wise while the father's percentage of total equity of the farm firm declines.

A partnership is based on the following general conditions: (1) each member contributes all, or at least part of, his time to the operation, (2) each individual contributes or rents resources or property to the partnership, (3) management decisions are made jointly by the individuals concerned, and (4) profits and losses are shared according to each individual's contribution to the partnership. Income and expenses can be shared on the basis of fixed contributions or on a 50/50 share of profits after all expenses are paid. The partners should list and value their respective capital, labor, and management contributions when deciding upon the type of partnership arrangement to form. They also should project income and expenses and determine whether the present business under a given share arrangement (fixed contributions or 50/50) would be profitable enough to provide the desired level of living and yet meet debt commitments. The "Farm Partnership Worksheet", FM-220W, provides a form for such an analysis (see appendix D).

The agreement should be put in writing once the desired arrangement has been agreed upon. It should specify who is contributing what to the partnership; how it is to be operated; how profits and losses are to be shared; and the duties, powers, and limitations of the partners. Since transfer and control of a farming operation is so critical today, provision also must be made should the partnership be dissolved because of death, disability, or for other reasons. It should include options-to-buy, buy-sell agreements, and a statement showing that the wives involved agree to the proposed settlement procedures. Property titles, wills, and other documents should be altered where necessary to reflect the desired partnership relationship. Secure legal help in making up the final agreement.

C. Shorter-Term, Joint Operations and Beyond

The primary purpose of the short-term, interim arrangement is to aid the son in getting established in farming while at the same time easing the work load and possibly part of the transfer problem for his father. Another decision point is soon reached. A longer term, more permanent business organization must be developed. Three alternative routes are generally open at this point.

1. Spin-Off — Complete Separation of Operations

The decision may be made to dismantle any joint operations that may have developed and to operate as two separate farm units. Such a separation may be caused by an inability to work together or the father's unwillingness to transfer any property. It may have been part of the plan all along because the original business was too small.

Full and frank communications are important if a spin-off situation is likely to occur. In some cases the parents may have assumed that the son would develop a spin-off firm, but the son was determined to someday own and operate the home farm. The sooner both parties can agree on the eventual disposition of their joint operation, the better.

If it appears that a split is to occur, care should be taken to insure that good records are kept of how much each party has contributed and who owns what property. An answer eventually must be given to the question: Do you wish to keep the home farm in the family in the future?

If the answer is no, then the decision becomes a parental one of whether the farm is to be disposed of before or after death and how. If the farm is to be kept in the family, more complex decisions must be made as to who will eventually own it, how it will be operated, etc.

2. Rental/Sale of Home Farm from Father to Son

The father may be at that stage in his career when he is ready to rent the farm to the son. The father usually wholly or partially retires from the day-to-day work and management of the farm. If there is adequate housing, the father and mother often continue to live on the home farm and receive part of their living, especially food and housing, from it.

Whether the rental arrangement should be a cash or share lease depends on the financial circumstances of the father and son. A cash lease shifts the risk of low prices and yields over to the son. He has to pay the father a fixed rent regardless of price and crop conditions. A flexible cash lease could be developed to minimize some of the risk assumed by the son. With a share lease, the father shares at least part of the financial ups and downs of the farm business.

It usually is recommended that, at the beginning of the rental period, the son acquire full ownership in all machinery and at least a share of livestock, feed, crops, and supplies. The father will be relieved of the worry of managing these assets, and the son will be in a much better financial and managerial position to take the final step towards attaining ownership of the home farm.

The rental arrangement is a fairly satisfactory agreement when the father wants to retire but needs a source of retirement income. The son may find it to his advantage to rent rather than buy at this time. However, it is necessary that the father and son decide on some type of arrangement to eventually transfer ownership, as the son's future in farming may be closely tied to acquiring control of the real estate and other business assets.

3. Continuation of Joint Operation

Family and business relationships may evolve and make it desirable for a short-term, interim arrangement to be continued on a longer-term basis. This alternative will be discussed in detail in the next section.

V. Farming Together — For An Extended Period (Longer-Term Joint Operations)

In numerous cases, business size and family interests suggest the development of a multi-ownership, multi-management firm on a more or less continuing or permanent basis. Business development and transfer concerns become much more complex and important. The nature and extent of these concerns will vary with the current size of the business, the career development stage of the father and son(s), and their longer term objectives relative to the development of the business. The son likely will still be going through the establishment phase (figure 2) and eventually will be entering the growth stage. Whether expansion of the total business or a partial shifting of ownership and control from father to son is required will, of course, depend on the situation. If the farm business is large enough, the chief concern is the protection of the existing unit along with a gradual shift in ownership and eventual control.

A. Business Development and Growth

A number of issues must be considered with respect to the impact of the business arrangement on the growth and development of the farm business, including the availability of capital, the liability of the owners or investors, the management and control of the business, and the costs of alternative business arrangements.

If the owner-operators of the business supply all the capital, no particular business arrangement has a major advantage over the others in terms of capital acquisition. Some differences may occur if an untimely death occurs and the farm is transferred to the heirs. Many non-farm family members who inherit part of the farm business assets do not wish to be involved in a partnership or sole proprietorship. The family member who will operate the business usually inherits the personal property (equipment, livestock, and crop inventories) and the remaining children take ownership of the real estate. The real estate is then leased to the operating heirs. Whether off-farm family members will invest their capital in a farm corporation depends upon the family and business situation. Much of this investment has been somewhat involuntary in that stock was obtained by gift or by inheritance with limited opportunity for resale. Disagreements may arise over dividends, expansion, or management policies. In the future, farm operations will need to make the farm investment attractive to family investors for equity capital to remain available to the corporation.

Limited liability becomes an important issue when the owner-operators have personal investments outside the business. The sole proprietor and general partners risk personal investment when obligations against the business are greater than the value of capital within the business. As a general rule, corporate shareholders and limited partners are not subject to unlimited personal liability. The corporate business organization has an advantage in this regard. However, there is no absolute guarantee of limited liability. Even the corporate shareholder may be subject to liability greater than his investment or his commitment to invest especially when shareholders assume personal liability for debt obligations. This frequently occurs in farming. Adequate liability and property insurance should be carried to protect the business capital.

The corporate structure may have advantages over the partnership in the areas of income tax management and business control from the standpoint of business development and growth. The tax advantage of the corporation occurs because it is a separate taxable entity and thus its tax rates may be lower than that of the individual taxpayer. Through appropriate adjustment of salaries, bonuses, and rents, income can be allocated between the corporation and the individual to reduce taxes. It also should be noted that because the operators become employees of the corporation, certain fringe benefits such as medical expenses, insurance, and retirement plans, may reduce the taxable income. However, the corporation does not have as favorable tax treatment from the standpoint of capital gains and first year depreciation. Part of this advantage can be avoided by keeping certain capital gains property, such as breeding stock, out of the corporation. The partnership's advantages include lower formation and operating costs, lower social security taxes, and easier and lower cost of dismantling should dissolution be necessary.

Management control of a corporation can be regulated more easily than a partnership through proper funding. To maintain control, a person or group of persons needs to control only 51 percent of the stock outstanding. A family can shift more than half of their total resources to the wife or other heirs and still retain control of the farm operation through the use of stock and debentures (interest-bearing securities maturing in 10 or more years). Debentures can be transferred to the wife and non-farm heirs for income purposes. Stock can be transferred to the future managers of the business who must have control.

In a closely-held corporation, majority stockholders, who also may be employees of the organization, can vote against minority stockholders' interests. Most of the profits could be taken as salaries or rent rather than being paid out as dividends leaving little or no cash return on the capital investment of minority stockholders. There may be little or no market value for the stock of a closely held corporation. Therefore, the minority stockholder may not receive any annual income on his stock, nor will he receive anything if the stock is offered for sale. A minority stockholder in a corporation may be locked in unless the articles of incorporation and by-laws are written to specify minority stockholder rights and buy and sell agreements protecting his investment. In a partnership, a minor partner, under the terms of the partnership agreement, can typically sell or dispose of his share if he wants out of the partnership agreement.

Partnerships and corporations have management advantages over other arrangements such as sole proprietorships in certain situations. As agricultural businesses get larger, more capitalized, and more complicated, the management responsibility becomes more critical. A partnership or corporation can pool the diversified management tasks into one business and possibly be more profitable as a result. Individuals with varied management ability and experience can be combined to strengthen their mutual benefit. "Back-up" management or management continuity can be developed more easily in this multi-owner type of business organization. This continuity of organization helps to provide the long-range planning necessary for managers to strive for business growth, efficiency, and profitability and keep pace with the technical advances in agriculture.

From a business development and growth standpoint, tax savings via incorporation will normally far exceed the extra cost of formation, operation, and social security taxes if the farm family has a sizeable income tax problem. The corporation will have additional potential benefits in the areas of business control, continuity, and possibly some advantage in the area of liability.

If you and your advisors decide that farm incorporation is best for you, then the "checklist for Farm Incorporation" should prove helpful in forming a corporation (see appendix E).

B. Retirement and Transfer

After testing and interim arrangements have been in effect for a few years, the son and his wife have a natural desire to gain greater control of the business and to own part of the real estate. Business arrangements such as the partnership or corporation may help to speed the process of building equity, and thus eventual control, or even ease the transfer process. However, there is no substitute for a good estate transfer plan. When should the transfer occur and how should it be implemented?

1. Considerations in Making the Transfer

The issue of transfer of the farm to a younger generation is a difficult one for everyone concerned. The parents have owned the farm for years. They worked hard to build and maintain a viable business. It has become a part of their life and, as such, it is difficult to part with it. A question of security and independence also is involved. As long as the parents have the farm, they have a means of supporting themselves and of being independent of others for their support.

The children, on the other hand, are trying to build a place for themselves and their families. They are seeking opportunities to build a profitable business with a future, and are anxious to try out their wings in farm management decisions.

One of the main objectives of an estate transfer plan is to integrate these different goals into a plan that will meet the needs of all involved.

A sound transfer arrangement should be tested on several different points. First, and perhaps most important of all, does it provide the parents with a reasonable degree of security during retirement and old age? Second, does it provide a reasonable degree of security for the managing son? A third aspect of a sound transfer arrangement is equitable treatment of the non-farm heirs. *And finally,* the arrangement must be based on suitable legal advice. Transfer problems are far too complex for farm families to draw up their own "legal" documents.

When to make the farm ownership transfer depends on the characteristics of both the parents and the farming heir. Age of both parents and the heir are usually key factors. The farm transfer should be made when the father, completely or partially, retires from the day-to-day work and other responsibilities of the farm operation, and/or when the parents have adequate sources of income. The farm transfer should be seriously considered when (1) the farming heir attains maturity with respect to farm experience, managerial competence, and business judgment; (2) is certain he will farm; and (3) has sufficient capital and income to support additional debts and other ownership responsibilities. A cash-flow budget should be prepared to determine whether the son has the potential to take over the farm business.

Continuation of a father-son partnership or corporation with the son purchasing a neighboring farm may be the answer in those cases where the father is not old enough to retire and his income needs are still high, but the son has built a financial reserve for a farm purchase.

Families who are considering an intra-family farm transfer are most likely to achieve their goals and effect a successful transfer if the following conditions exist: (1) the farm is large enough and productive enough to be an efficient unit; (2) income from the farm transfer, or from other sources, can be expected to provide a reasonable degree of financial security for the parents following retirement from the operation; (3) plans to have the transfer, or the actual transfer, of the property occur at a reasonably early period in the life of the son who is to be the future operator and owner of the farm.

With careful planning, transfer of the farm business to the next generation can become a reality under normal circumstances. However, life and circumstances are not always normal. Families also should plan for the unexpected such as premature death of one of the partners or a break-up of a business arrangement. The parties involved should decide how they would want the transfer to occur should something unexpected happen and then specify this in their business agreements and wills. Options to buy, buy-sell agreements, and the funding of such agreements are important issues. The partners, wives, and other heirs should be fully informed as to the nature and implications of these agreements.

2. Alternative Transfer Methods

Methods of transferring the home farm within the family are identified according to when they are implemented:

a. The transfer may be completed during the lives of the parents through sales, gifts, a combination of sales and gifts, or an option to buy.

b. The transfer plans may be made during the lives of the parents, but do not take effect until death, through wills and trust agreements.

c. The transfer may be by the state laws of descent after the death of the parents. As a general rule, the state laws of descent do not provide a suitable farm transfer arrangement. The law spells out how the transfer will be made unless the parents, by will, trust, or some other method, provide for a more suitable transfer plan. Property held in joint tenancy goes to the surviving joint tenant or tenants and is not transferred by the laws of descent.

Changes in the family or farm situation must be reflected in the wills and other estate plans as transfer plans are developed and executed.

3. Business Arrangements for Transfer, Continuity, and/or Disengagement

The type of business arrangement selected can affect the ease with which business transfers, business continuity, and business disengagement can take place. Different arrangements are appraised with respect to these three issues as follows:

a. Transferability of Ownership Interest

The form of business organization should facilitate the transfer of ownership interests, especially when the business has a large capital base. The sole proprietorship is more difficult to transfer; the corporation normally the easiest.

The sole proprietor's interest is transferred only by the sale or gift of the entire business. Certain property within the business can be transferred at various stages. It is possible for a farmer to sell his operating assets and personal property , but retain the real property and lease it to the purchaser. The real property or specific parcels of the real property could be transferred at a later date to the new owner. In any case, the sole proprietorship does not lend itself to easy transferability of ownership interests in the farm business.

The transferability of partnership interests between partners is comparatively easy because the partners own a share of a partnership rather than individual personal or real property. However, a transfer between partners usually requires changes in the partnership agreement unless the original agreement allows for these changes. Interest in any partnership is relatively difficult to dispose of to outside investors.

Shares of stock provide a simple and convenient way to make lifetime and death transfers. The ownership interest is divisable through stock into small units that easily can be transferred. Transfer of shares of stock results in a shift of ownership interest in the business without necessarily disrupting the continuity of the business. The gradual transfer of stock can provide for a progressive shift in ownership and management until final control has been transferred to new owner-operators. In closely-held farm corporations this gradual shift in ownership and management is desirable to maintain efficiency and business continuity. The use of stock and debentures in a corporation also permits management control to be vested in certain property holders (stockholders) and yet permits earnings to flow to other parties (debenture holders).

In most cases, a farmer who wants to attract outside capital will need to incorporate in order to transfer ownership interests. Since the transfer of corporate stock interest often carries with it voting power and indirect voice in management, easy transferability may be obtained at the "price" of admitting outside control. This may be the cost of attracting the outside investor.

b. Continuity of Existence

The partnership and the sole proprietorship are at a severe disadvantage with respect to business continuity because the death or withdrawal of a participant terminates the business organization and many times means liquidation of the business. At best, serious problems of distribution and settlement among the interested parties, and formation of a new business structure can result. Continuation of the business in a partnership structure is possible if the family desires it and the agreement allows it.

The corporation is theoretically much more suitable to business continuity. The death, incapacity, or withdrawal of an owner has no direct effect on the life of the organization as a rule. However, the loss of the personal skills or services of the individual may affect the management of the firm. Ownership of the stock does not affect the operation of the corporation if the business is of sufficient size to hire management and labor services.

The farm business is generally organized for the benefit of the family, not to continue indefinitely. It will generally be dissolved whether the business organization is a corporation or a sole proprietorship when the majority owner dies and if there are no sons or other family members to continue the business. Business continuity depends more on family members who are willing to carry on the business than on the organizational structure.

The perpetual nature of the corporation offers a method of maintaining the business and avoiding the problems of business interruption resulting after the death of a sole proprietor or partner. This continuity of organization helps provide the long-range planning necessary for managers to strive for business growth, efficiency, and profitability and keep pace with the technical advances in agriculture.

The withdrawal of a proprietor or a partner who has considerable capital in the business usually results in that capital being withdrawn as well. The business is then usually capital short. However, the corporate business structure may help retain capital in the business through the sale of stock by the withdrawing shareholder to new stockholders.

c. Disengagement

One essential characteristic of a well-conceived and developed multi-owner, multi-management business arrangement is that it can be dismantled easily. Even in the best of circumstances, a father-son or other multi-owner arrangement may deteriorate if the objectives of the parties change or other personal conflicts arise. The ability to dismantle the organization without further bruising sensitive personal interrelationships and causing further difficulties is important in such situations. A written agreement must be developed and complete *records of capital contributions and income sharing* should be kept to minimize potential problems of disengagement. Details on the title and ownership of specific business assets and/or the changing ownership interests in a partnership or corporation should be documented. This documentation should aid in separating the ownership interests in case of disagreements, spin-off, or parting of the ways. A good multi-owner business arrangement not only facilitates business continuity and development, but also disengagement and separation if that should be necessary.

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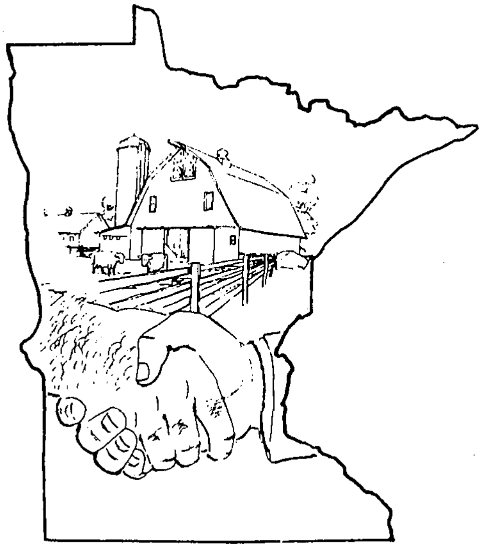
FARM MANAGEMENT SERIES FM 221
12/75

Appraising your situation, goals and potential for joint farm operation



> Use this form to first describe your present farm and family situation and to clarify family goals. Then, appraise the potential of your situation in terms of the five essentials for successful joint operation listed on page 4. This information will be helpful to you and to your advisors as you plan changes in the business organization of your business.

I. Present Situation and Changes Being Considered

- Have you been operating together in the past? If so, describe arrangement.

____

- Describe plans for future and types of business arrangements being considered.

____

____

____

II. Overall Family Situation

A. Family Members

	Name	Age	Education	Martial Status	Present Employment	Comments (special considerations, etc.)
1.						
2.						
3.						
4.						
5.						
6.						
7.						
8.						

B. Interests and Future Plans of Minor Children and Non-Farm Heirs

- If there are minor children, do you think any of them might want to farm? If so, who? When might they start? Would they be brought into the present business?

____

____

- Non-farm heirs: Do any of them have an interest in coming back to the home farm? If so, who and when? ______________________

If it were necessary, would they be willing to leave their inheritance in the business for a period of years in order to keep the farm business intact? ____________

____

III. Farm Business Situation

A. Size of Business and Efficiency

	Acres Operated		Livestock		
	Owned	Rented	Kind	No.	Efficiency
Total	____	____	____	____	____
Crop	____	____	____	____	____

Availability of more land ____ ____

Facilities available ____________

____

Yields on major crops ____________

____

With machinery available we could farm ______ crop acres

Labor Supply

Number of full-time family ________

Number of full-time hired ________

Months of seasonal labor ________

Housing Situation

____

____

____

B. Profitability and Financial Soundness

- Under normal conditions, would income be sufficient for number of families involved? ______ If not, what are your plans for increasing or shifting income? ________

____

- Debt position of father ______________________

son(s) ______________________

IV. Parents' Situation and Objectives

A. Situation

- What stage are you at in your farming career: expansion phase? slowing down? ready to retire? ____________________

- What would you like to see happen to your farm business and what would you be willing to do to make it happen? ____________________

____

____

B. Objectives

Rank each of the following objectives according to their importance to you:

	Extremely Important	Moderately Important	Not Important
To provide sufficient income for my wife and I during our lifetime.	____	____	____
To make provisions for special family needs	____	____	____
To keep farm in family	____	____	____
To help one or more children get started in farming	____	____	____
To treat all children fairly	____	____	____
To reduce my labor contribution	____	____	____
To maintain control of management of business	____	____	____
____________________	____	____	____
____________________	____	____	____

V. Farming Son's Situation and Objectives

A. Situation

- What stage are you at in your farming career? What contributions have you been making to date? ____________________

____

____

____

- What would you like to see happen to the farm business and what would you be willing to do to make it happen? ____________________

____

____

____

____

B. Objectives

Rank each of the following objectives according to their importance to you

	Extremely Important	Moderately Important	Not Important
To make farming my career	______	______	______
To acquire a larger share of business	______	______	______
To assume more management responsibility	______	______	______
To eventually gain control of the home farm	______	______	______
____________________	______	______	______
____________________	______	______	______

VI. Appraising Potential for Joint Operation

Every business needs certain characteristics for success. This is particularly true of joint arrangements because personal as well as business relationships are so important. So before pursuing your proposed change further, appraise your situation in terms of the following five essentials for success.

A. Ability to live and work together and share management responsibility. A good way of checking this is to take the test contained in "Test Yourself--Would You Be a Good Partner?"

B. Business profitable enough to provide security for parents and opportunity for son. Before entering into a detailed arrangement test the financial feasibility of your proposed plan using a form such as FM 220W "Farm Partnership Worksheet".

C. Provide opportunity for junior partners to gain control of business over time and to be in a position to effectively manage it.

D. Preserve, protect and foster family good will through careful planning and good communications. Due consideration must be given to other heirs.

E. Seek out and use competent legal and business management help in planning and carrying out changes in farm business arrangements and related estate plans.

Kenneth H. Thomas
Extension Economist in Farm Management

Mervin L. Freeman
Area Extension Agent in Farm Management

Agricultural Extension Service
Department of Agricultural Economics
UNIVERSITY OF MINNESOTA
U.S. Department of Agriculture

TEST YOURSELF...

Would you be a good partner?

By CLAUDE W. GIFFORD

Partnerships more often stumble over human relationships than over business arrangements.

Here is a farm partnership test that will tell you your chances of success and happiness in a father-son partnership.

After scoring yourself, turn page to see how you rate.

Rating Scale

If your answer to the question is:	Give yourself these points:
A firm "yes"	10
Yes	9
Yes, but barely	8
Maybe, with "conditions"	7
Could live with it	6
Possibly	5
Very difficult	4
Isn't likely	3
Highly improbable	2
A firm "no"	1

Partnership test for fathers:

Points (See rating scale top right):

_____ Are you willing to work up a partnership agreement with your son, or son-in-law—now—and put it in writing?

_____ Can you usually "suggest" advice to your son, or son-in-law, as a business partner—rather than giving him commands or correcting him as a son?

_____ Can you willingly "give in" to your son's, or son-in-law's, wishes when you see that it means a great deal to him, his wife and family? Even though it might cost you money?

_____ Are you willing to turn over definite areas of important responsibility to your son, or son-in-law, for him to make the management decisions? And then live by his decisions without grumbling?

_____ Can you discuss family and business affairs with your son, or son-in-law, without getting emotional, angry or upset?

_____ Are you willing to cut down on your personal spending a bit, or even go deeper into debt to expand your farm, or livestock operation, to provide money for two families?

_____ If your son, or son-in-law, makes a mistake that you might honestly have made at the same age, can you mark it up as a "useful experience" in helping him grow—rather than scold him about it, or brood over it yourself?

_____ Are you willing to have a heart-to-heart talk with your son, or son-in-law, so that he knows fully now what his future is on the farm?

_____ Are you willing to accept the fact that your son's wife and his family—and his future—are rightfully his No. 1 concern?

_____ Are you willing to make a contract now that protects your son's, or son-in-law's, investment of time and money in the farm in case of an untimely death for you?

=====

Your total score

For mothers:

Points:

_____ Can you accept the fact that your son or daughter has married a person of his or her choice and that this partner and their future together is his or her No. 1 concern?

_____ Can you willingly accept the fact that it may be necessary for you and your husband to go deeper into debt in order to provide more income for two families?

_____ Are you willing to go along with your husband now in giving your son, or son-in-law, and his family, a clear picture of their future on the farm?

_____ Can you take pride in your daughter's, or daughter-in-law's, clothes and her home furnishings for the pleasure it brings her and her family—rather than comparing them with what you have or being upset when yours are not as new?

_____ Can you refrain from giving advice to your daughter, or daughter-in-law, about raising her children—yet enjoy them as your grandchildren?

_____ Can you accept the fact that young couples are likely to be more carefree, spend money more lavishly and be more irresponsible than couples of your age?

_____ Can you willingly compliment your son or daughter about his or her married partner's good qualities once in a while—and refrain from dwelling on their shortcomings?

_____ Can you let your young "in-laws" have their own life—with couples their own age—and be free to come and go without comment while you stay a reserved distance away, even though they live on the same farm (or even in the same house)?

_____ Do you believe that a farm partnership is a business arrangement with advantages to both families—rather than a favor for the young family?

_____ As you strive to get along in the partnership would other people say that you are kind and considerate; that you are discreet about what you say; and that you are a person who controls her anger?

=====

Your total score

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Rating Scale

If your answer to the question is:	Give yourself these points:
A firm "yes"	10
Yes	9
Yes, but barely	8
Maybe, with "conditions"	7
Could live with it	6
Possibly	5
Very difficult	4
Isn't likely	3
Highly improbable	2
A firm "no"	1

If you find that you don't score as high as you thought you might, don't despair. The couples who helped set up the test say that a good partnership doesn't just happen—it is developed by people who "put themselves out" to make it work.

If you decide after the test that a farm partnership isn't for you, there's nothing wrong with that. After all, not everyone is cut out to be a business partner. Many successful farmers would be unhappy in a partnership.

Your chances for success as a good farming partner

Total points	
91-100	You're a fine partner
81-90	You should make it go
71-80	It may be rough
61-70	Barely „passable"
51-60	Think of another setup
41-50	You'll be very unhappy
31-40	You couldn't stand it
21-30	Please don't do it
10-20	Not a chance in the world

If the combined total points reach 320 or more for the four people (two couples) in the partnership, it should be a success. If the combined total is 240 or less, the partnership will have major troubles.

For sons and sons-in-law:

Points: (See rating scale top left):

Can you accept advice from your father, or father-in-law, with an open mind—believing that it might have merit? Are you willing to "give it a try" when it is important to him, even when you think the advice might not work?

Are you patient enough to take time to "grow into" the farm business that your father, or father-in-law, has spent a lifetime building up?

Since you have the advantage of youth, strength and stamina, are you willing to do more than your share of the physical work on the farm without complaining or feeling resentment?

Can you appreciate with understanding that your father, or father-in-law, may have spent many years running the farm, making the decisions, perhaps even dealing with you as a boy—and that it will take some time for him to get used to your coming in as a decision-making business partner?

Can you feel that you may be getting a much faster start in life, with much more certainty, as a result of the partnership—and that this "debt" is something you owe to the partnership?

In return for the advantages that the partnership offers you, are you willing to take on the prospect that maybe you will be primarily responsible for caring for your parents or "in-laws" in later years?

Can you refrain from pressing your advice on your parents or "in-laws" regarding their personal or family affairs—keeping in mind that they may enjoy things that you wouldn't?

Can you willingly reserve for your father, or father-in-law, an important area of responsibility in the farm business, even in his advancing years? Can you avoid imposing your will on him, in this area, even though he may "hold back" the farm business some?

Are you willing to keep a good set of record books of partnership expenses and income so that you and your father, or father-in-law, can see what is making money and what isn't?

In situations that call for judgment affecting the partnership and your father, or father-in law, can you willingly lean over backward so that others would judge you as being calm, fair and considerate?

Your total score

For daughters and daughters-in-law:

Points:

_____ Can you accept without resentment the fact that your mother, or mother-in-law, has spent a lifetime raising a family and making the farm go, and that she is entitled to rest, travel, good furniture—things that you may not be able to afford at this stage of life?

_____ Can you appreciate the faster start in life that you may be getting as a result of the partnership; and be truly thankful without resenting your dependence on the older couple?

_____ Can you "make do" with the house you have, the furniture, the car, the conveniences—without complaining that the older couple is responsible?

_____ Can you accept the fact that married "spats" are normal and then keep them to yourself without burdening the older couple or expecting them to take your side; and without blaming them or "taking it out" on them because of the partnership?

_____ Can you use good judgment in not imposing too much on your mother, or mother-in-law, to take care of the children, prepare meals, baby-sit, and the like?

_____ Can you teach your children to enjoy the grandparents' attention and their home when the grandparents want the children; but otherwise keep the children from "having the run" of the grandparents' house?

Can you be discreet around your children so they aren't "carrying stories" between the two homes?

_____ Are you willing to make and keep a budget of household expenses that will help you plan and get along on what may be "short funds" due to two families living on the same farm?

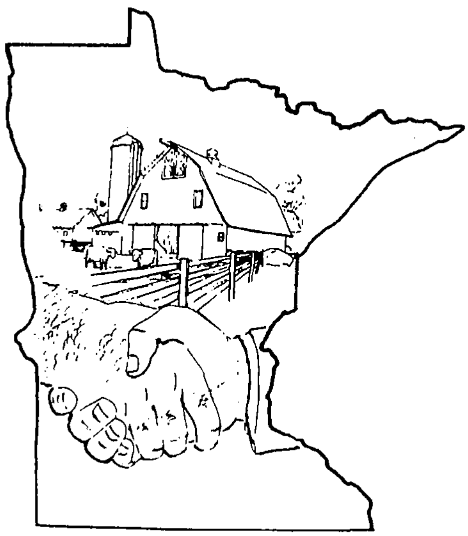
_____ Can you refrain from "egging" on your husband to get him to make more of the farm decisions, ask for a bigger share of money, or do less of the work or chores—when this makes the partnership more difficult and your husband more uncomfortable?

_____ If you're a daughter-in-law of the older farm couple, are you willing to take time to "grow into" your husband's family? If you are a daughter of the older farm couple, can you make your husband the "confidant" of your thoughts; work out your "troubles" with him; and not lean on your daughter-family relationships so that your husband feels like an outsider?

Your total score

FARM MANAGEMENT SERIES FM-220PFP
MAY 1975

Pre-Farm Partnership Arrangements WORKSHEET



The success of a farm partnership depends upon the partners' ability to get along together on both business and personal matters. Therefore, we believe that most potential partners should work together for two or three years in some type of pre-partnership arrangement before they formalize their working arrangement into a partnership. Getting to know one another is very important. The business and personal relationships that develop require each person to make compromises and to be tolerant of the other person's mistakes. The aspirations each person has for the growth and development of the farm business over time must also be acceptable to the other potential partner.

Two common types of pre-farm partnership arrangements are illustrated in this worksheet.

Arrangement #1 - Wage-Incentive Program
This is an employee-employer arrangement where the employee furnishes only labor. The employee typically receives cash wages, some fringe benefits and possibly bonuses for the labor contributions.

Arrangement #2 - Enterprise Working Agreement
The employee in this arrangement may furnish some personal property (i. e. livestock and machinery) and some management in addition to labor. The employee would not normally make whole farm decisions, but may make most of the major decisions in one enterprise. This agreement should be in writing and be signed by all parties involved. Be sure the written agreement covers such topics as: (a) job responsibilities of each party, (b) a clear description of all assets owned by each party, (c) settling disputes and (d) conditions under which this agreement can be dissolved.

A third type of pre-partnership agreement, the Wage-Share Arrangement, can best be developed using the Farm Partnership Worksheet, FM-220W.

Kenneth H. Thomas
Extension Economist, Farm Management

Mervin L. Freeman
Area Extension Agent, Farm Management

Agricultural Extension Service
Department of Agricultural Economics
UNIVERSITY OF MINNESOTA
U. S. Department of Agriculture

WAGE INCENTIVE PROGRAM

		Example		Your Situation	
I. What are some production goals expected of this employee?		13,500# milk sold/cow			
		500,000# milk sold/man			
II. Proposed method and amount of payment for an employee who is able to attain these levels of performance?		Per Month	Per Year	Per Month	Per Year
A. Cash wages (include social security)	(1)	$450	$5,400	$	$
B. Prerequisites (fringe benefits)					
Housing, room and board	(2)	$120	$1,440	$	$
Utilities (electricity and phone)	(3)	$ 20	$ 240	$	$
Meat, milk, other produce	(4)	$ 25	$ 300	$	$
Insurance (health, accident & life)	(5)		$ 400	$	$
Other (gasoline, car, etc.)	(6)	$ 10	$ 120	$	$
C. Incentives for achieving or exceeding goals (see page 4)					
Whole farm incentive: (example: 20% of profits as defined in Incentive Guide)	(7)	xx	$ 540	xx	$
	(8)	xx	$	xx	$
	(9)	xx	$	xx	$
Livestock incentive: (example: $.40/cwt. milk sold over 12,000#/cow)	(10)	xx	$ 60	xx	$
	(11)	xx	$	xx	$
	(12)	xx	$	xx	$
Crop incentive:					
	(13)	xx	$	xx	$
	(14)	xx	$	xx	$
D. Total wages:					
Yearly wage (total lines 1 thru 14)	(15)	xx	$8,500	xx	$
Monthly wage (line 15 ÷ 12 months)	(16)	$708	xx		xx
III. What could this prospective employee earn working somewhere else? In town? On another farm?		$600/mo. or $7,200/yr. in town		$ /mo.	$ /yr.

ENTERPRISE WORKING AGREEMENT

		Example	Your Situation
I.	General description of working agreement	Employee will be herdsman and will contribute 25 cows, 25 heifer repl.	

			Example: Employer	Example: Employee	Your Situation: Employer	Your Situation: Employee
II.	Fixed contributions to enterprise by each party.		Employer	Employee	Employer	Employee
	Livestock, number and value*		75 cows @ $600	25 cows @ $600		
			75 heifers @ $150	25 heifers @ $150		
	Building + equipment depreciation	(1)	$ 8,000	$ 0	$	$
	interest	(2)	$ 4,800	$ 0	$	$
	repairs	(3)	$ 1,200	$ 0	$	$
	Taxes and insurance	(4)	$ 300	$ 0	$	$
	Labor + management charge or wage	(5)	$ 0	$10,000	$	$
	Other labor hired	(6)	$ 3,000	0	$	$
	Total fixed contribution	(7)	$17,300	$10,000	$	$
	Grand total fixed contribution**	(8)	$27,300		$	
	Value home grown feed fed*	(9)	$48,000		$	
	Sub-total (8 + 9)	(10)	$75,300		$	
	Desired share arrangement (percent)	(11)	75%	25%	%	%
	Allocated fixed + feed contrib. (10 x 11)	(12)	$56,475	$18,825	$	$
	Total fixed contribution (line 7)	(13)	$17,300	$10,000	$	$
	Value home grown feed contrib. (12 - 13)	(14)	$39,175	$ 8,825	$	$
III.	Other enterprise costs* (share in desired percent: line 11)					
	Purchase feeds		$ 4,500	$ 1,500	$	$
	Breeding costs		$ 900	$ 300	$	$
	Veterinary, medicine		$ 1,800	$ 600	$	$
	Production testing		$ 630	$ 210	$	$
	Marketing costs and commission		$ 1,800	$ 600	$	$
	Other enterprise costs		$ 1,200	$ 400	$	$
	Total other enterprise costs	(15)	$10,830	$ 3,610	$	$
IV.	Expected income and debt servicing capacity of enterprise (share in desired percent: line 11)		12,000 cwt. @ $7.60/cwt.			
	Milk		$68,400	$22,800	$	$
	Cull sales		$10,500	$ 3,500	$	$
	Total income, each party	(16)	$78,900	$26,300	$	$
	Less selected expenses (3+4+6+14+15)	(17)	$54,505	$12,435	$	$
	Approximate spendable income (16 - 17)	(18)	$24,395	$13,865	$	$
	Sched. principal + interest payment	(19)	$ 8,000	$ 3,600	$	$
	Amount left for living, etc. (18 - 19)	(20)	$16,395	$10,265	$	$

		Example	Your Situation
V.	Guaranteed wage and fringe benefits	Employee guaranteed $1,000/mo. plus house + (1) 1,000# steer/year	

* Livestock and other enterprise cost contributions and enterprise income will be shared in desired percentages (line 11). Adjustment of home grown feed contribution by each party will be made to make arrangement equitable (lines 12 thru 14).

** Total employer and employee fixed contributions.

INCENTIVE GUIDE

The following examples of incentive payment programs are meant to serve only as a guide. Any plan should be adjusted to fit your particular situation. For example, payment rates on a large, productive, highly mechanized farm, employing several men, should be different than those on a small, unproductive, poorly mechanized farm. Incentive payments should be tied to work responsibilities carried out by the employee and over which he has some control.

WHOLE FARM

Percent of Gross Income
* 1/4 - 1% of all gross receipts (adjust to size and type of farm)

Percent of Net Income
* 1 - 4% of returns left after all cash operating expenses are deducted from gross income

Percent of Taxable Income
* 2 - 10% of taxable income as computed on form Schedule F

Percent of Profits
* 10 - 40% of profits derived by: subtracting from the taxable income a labor and management charge for the operator, and a return on the operator's equity in the business. Adjust this amount by the inventory change that took place in the farm's personal property during the last taxable year.

Wage Adjustments and Bonuses
* End of year bonus of 1 - 10% of cash wages
* Paid vacation of 2 - 4 weeks per year during the low labor load periods.
* An annual increase in cash wages of 3 - 10% per year if the employee stays

LIVESTOCK

HOGS

Feeder pigs purchased and fed out
* 25 - 50¢/feeder pig bought and fed out.
* 1/4 - 1% of hog sales less cost of feeder pigs.
* If death losses are less than 4%, the employee receives 25 - 40% of the market value of these market hogs saved. (Example: 98% of feeder pigs purchases live to be sold on the market. The employee receives 25 - 40% of the market value of 2% of all market hogs sold.)

Feeder pigs produced (for sale or fed out on the farm)
* 25 - 50¢/pig weaned
* $1 - 3/pig weaned above 7/litter
* $3 - 5/sow that weans more than 8 pigs/litter
* 1/4 - 1% of gross income from hogs, including inventory changes

Complete hog program
* 25 - 50¢/hog marketed during the year if employee stays until end of year
* $2 - 5/market hog sold above 7/litter
* 1/4 - 1% of gross income from hogs--including inventory changes

PUREBRED LIVESTOCK
* 1/4 - 1/3 of premiums when purebred livestock are exhibited

DAIRY
* 1/2 - 2% of milk sales, paid monthly
* Start at 1/2% of milk check and increase pay by gradually moving up to 2% of milk check
* 5¢/cwt. milk sold, and rate is increased by 2¢/yr. employee stays, up to a maximum of 25¢
* 1 - 3% of returns above feed cost based on DHIA records
* 25 - 50¢/cwt. milk sold above 10,000 lbs./cow & 50 - 75¢/cwt. milk sold over 15,000 lbs./cow
* $5 - 10 for each calf saved over an 85% calf crop at the end of the year
* 15 - 25¢ for each one thousand pounds of milk sold per worker over 300,000 pounds

BEEF

Cow herds (calves sold at weaning)
* $1 - 3 for each beef calf weaned
* 10% of gross income above $160/cow
* $10 - 20 for each calf weaned over 90% calf crop

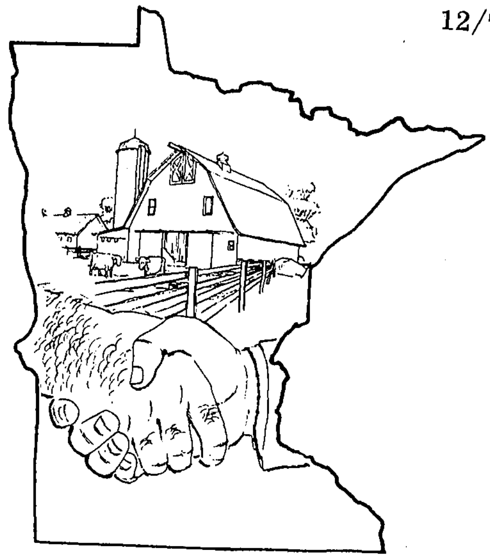
Feeder cattle purchased
* 25¢ - $1/head of fed cattle marketed
* 1/8 - 1% of beef sales less cost of purchased feeders
* 10 - 20% of return over all cash costs including home-grown grain fed

CROPS

* 1/4 - 1% of small grain produced, including grain equivalent in silage
* 5¢/bu. corn produced over 100 bu. per acre
* 10¢/bu. of soybeans produced above 30 bu./acre
* $1 - 3/ton of alfalfa that yields over 3.5 ton/acre
* 1/8 - 1% of gross crop sales
* $100 bonus if corn and soybeans are planted without a single row missed. Hired man gets bonus if he catches and replants missed rows on his own.

FARM MANAGEMENT SERIES FM-220W
12/75

Farm Partnership Worksheet



Business Profitable Enough?
Type of Share Arrangement?

One of the keys to a successful farm partnership is that the business be profitable enough to provide a sound economic future for all the partners involved. The purpose of this worksheet is to provide you with a means of testing the financial feasibility of your proposed farm partnership arrangement. Two types of share arrangements can be analyzed--the fixed contributions approach and the so-called 50/50 arrangement (equal shares approach).

Three steps must be taken to complete this worksheet:

Step #1 - Estimate the value of the capital, labor and management contributions of each partner under the fixed contributions approach (page 2) and under a 50/50 arrangement (page 3). Describe details of arrangement on page 4.

Step #2 - Project the expected long-term net cash income of the partnership (page 5).

Step #3 - Determine profit and debt servicing position of each partner under the two types of share arrangements being analyzed (page 6).

If, after completing these three steps you find that the situation is not financially attractive to all partners, four possible alternatives might be considered: (1) altering the contributions of each of the partners, (2) changing the business to increase overall-profitability, (3) one or more of the partners supplementing their earnings with nonfarm employment and (4) you can forget about trying to form a partnership at this time.

Kenneth H. Thomas
Extension Economist in Farm Management

Mervin L. Freeman
Area Extension Agent in Farm Management

Agricultural Extension Service
Department of Agricultural Economics
UNIVERSITY OF MINNESOTA
U.S. Department of Agriculture

Step #1a - Estimate the value of capital, labor and management contributions of each partner, using the fixed contributions approach (describe nature of arrangement on page 4).

			Amount Contributed by:		
		Total Value of Contribution	Partner ______ (name)	Partner ______ (name)	Partner ______ (name)
I. Capital Contribution					
A. Real Estate (conserve. mkt. value)					
Land ______ acres @ $______/acre		$______	$______	$______	$______
Land ______ acres @ $______/acre		______	______	______	______
Land ______ acres @ $______/acre		______	______	______	______
Total Real Estate	(1)	$______	$______	$______	$______
B. Personal Property					
Machinery (mkt. value)		$______	$______	$______	$______
Livestock inventory (mkt. value)		______	______	______	______
Feed & seed inventory (mkt. value)		______	______	______	______
Cash for operating expense		______	______	______	______
Other property ______		______	______	______	______
Total Personal Property	(2)	$______	$______	$______	$______
C. Total Capital Contributions (1 + 2)	(3)	$______	$______	$______	$______
II. Labor and Management Contribution					
Months of labor provided	(4)	______	______	______	______
Percent of management supplied	(5)	100%	______%	______%	______%
III. Annual Use Charge for or Value of Contributions					
A. Use Charge for Capital Contribution					
Interest on real estate @ ______% x line 1		$______	$______	$______	$______
Interest on pers. prop @ ______% x line 2		______	______	______	______
Total Interest on Capital	(6)	$______	$______	$______	$______
* Depreciation on machinery	(7)	______	______	______	______
* Depreciation on new buildings	(8)	______	______	______	______
* Taxes & insurance	(9)	______	______	______	______
* Repairs & maintenance	(10)	______	______	______	______
Total Capital Use Charge (6+7+8+9+10)	(11)	$______	$______	$______	$______
B. Value of Labor and Management Contribution					
Labor @ $______/mo. x line 4		$______	$______	$______	$______
Mgt. (4-7% of cash income x line 5)		______	______	______	______
Total Value of Labor & Management	(12)	$______	$______	$______	$______
C. Total Value of Labor & Mgt. & Capital Use Charge (11 + 12)	(13)	$______	$______	$______	$______
IV. Percentage of Total Contribution by Each Partner					
Total capital, labor & mgt. contributed (line 13)	(14)	100%	______%	______%	______%

* These expenses are often included on page 5 as a partnership expense.

Step #1b - Estimate the value of capital, labor and management contributions of each partner, using the 50/50 approach (describe nature of arrangement on page 4).

			Amount Contributed by:		
		Total Value of Contribution	Partner ______ (name)	Partner ______ (name)	Partner ______ (name)
I. Capital Contribution					
A. Real Estate (conserve. mkt. value)					
Land ______ acres @ $______/acre		$______	$______	$______	$______
Land ______ acres @ $______/acre		______	______	______	______
Land ______ acres @ $______/acre		______	______	______	______
Total Real Estate	(1)	$______	$______	$______	$______
B. Personal Property					
Machinery (mkt. value)		$______	$______	$______	$______
Livestock inventory (mkt. value)		______	______	______	______
Feed & seed inventory (mkt. value)		______	______	______	______
Cash for operating expense		______	______	______	______
Other property______		______	______	______	______
Total Personal Property	(2)	$______	$______	$______	$______
C. Total Capital Contributions (1 + 2)	(3)	$______	$______	$______	$______
II. Labor and Management Contribution					
Months of labor provided	(4)	______	______	______	______
Percent of management supplied	(5)	100%	______%	______%	______%
III. Annual Use Charge for or Value of Contributions (normally, should be supplied equally)					
A. Use Charge for Capital Contribution					
* Interest on real estate @ ______% x line 1		$______	$______	$______	$______
Interest on pers. prop @ ______% x line 2		______	______	______	______
Total Interest on Capital	(6)	$______	$______	$______	$______
** Depreciation on machinery	(7)	______	______	______	______
** Depreciation on new buildings	(8)	______	______	______	______
* Taxes & insurance	(9)	______	______	______	______
** Repairs & maintenance	(10)	______	______	______	______
Total Capital Use Charge (6+7+8+9+10)	(11)	$______	$______	$______	$______
B. Value of Labor and Management Contribution					
Labor @ $______/mo. x line 4		$______	$______	$______	$______
Mgt. (4-7% of cash income x line 5)		______	______	______	______
Total Value of Labor & Management	(12)	$______	$______	$______	$______
C. Total Value of Labor & Mgt. & Capital Use Charge (11 + 12)	(13)	$______	$______	$______	$______
IV. Percentage of Total Contribution by Each Partner					
Total capital, labor & mgt. contributed (line 13)	(14)	100%	______%	______%	______%

* These expenses are usually entered as part of rent charge on lines 23 and 24, page 5.

** These expenses are usually included on page 5 as a partnership expense on lines 25, 26 and 28, or as part of rent (lines 23 and 24).

Description of Arrangements on Pages 2 and 3

I. Fixed Contribution Approach (page 2)

A. List changes from present property ownership required to bring about contribution pattern noted on page 2.

B. What items will be leased or cash rented?

C. Debt to be serviced by each partner; annual payment. (principal & interest)

II. 50/50 Approach (page 3)

A. List changes from present property ownership required to bring about contribution pattern noted on page 3.

B. What items will be leased or cash rented?

C. Debt to be serviced by each partner; annual payment. (principal & interest)

III. Other Comments

Step #2 - Project the long-run net cash income of proposed partnership plan
(The projected partnership income should be based upon expected long-run prices, costs, crop yields and livestock production.)

I.	Projected Partnership Income			
	Livestock Sales			
	Hogs	$____		
	Beef	____		
	Milk	____		
	Dairy cattle	____		
	____	____		
1.	TOTAL LIVESTOCK SALES		$____	
	Crop Sales			
	Corn	$____		
	Soybean	____		
	____	____		
2.	TOTAL CROP SALES		$____	
3.	Custom work done		____	
4.	Agricultural program payments		____	
5.	Patronage dividends		____	
6.	Federal and state gasoline tax refund		____	
7.	Other income ____		____	
8.	TOTAL CASH INCOME		$____	

		Type of Arrangement	
II.	Projected Partnership Operating Expenses	Fixed Contributions	50/50 Approach
9.	Labor hired	$____	$____
10.	Feed purchased	____	____
11.	Seed purchased	____	____
12.	Fertilizer and lime	____	____
13.	Herbicides and insecticides	____	____
14.	Machine hire	____	____
15.	Supplies	____	____
16.	Livestock purchases	____	____
17.	Breeding fees	____	____
18.	Veterinary, medicine	____	____
19.	Gasoline, oil and grease	____	____
20.	Marketing charge	____	____
21.	Utilities	____	____
22.	Interest on operating and partnership debt	____	____
23.	Rents paid for real estate (optional)	____	____
24.	Other rents and leases paid (optional)	____	____
25.	Machinery replacement allowance (optional)	____	____
26.	Bldgs. & equip. replacement allowance (optional)	____	____
27.	Taxes and insurance (optional)	____	____
28.	Repairs and maintenance (optional)	____	____
29.	Other cash expenses ____	____	____
30.	TOTAL CASH OPERATING EXPENSE	$____	$____
III.	Projected Partnership Net Cash Income (Line 8 - 30)	$____	$____

Step #3 - Determining the profit generating ability and debt servicing capacity of the business for each partner. Under fixed contributions and 50/50 approach.

		Individual Partners		
		Partner	Partner	Partner
Arrangement #I - Fixed Contributions Approach	TOTAL	(name)	(name)	(name)
	(Use Fixed Contributions Column, Page 5)			
A. Profit Generating Ability				
1. Percentage contribution (line 14, page 2)	100%	%	%	%
2. Projected net cash income (line III, pg. 5, x line 1)	$	$	$	$
3. Total labor, mgt., + capital use charge (line 13, pg. 2)				
4. Ability to pay desired resource use charges (2 - 3)	$	$	$	$
B. Debt Servicing Capacity				
5. Projected net cash income (line 2, above)	$	$	$	$
6. Net nonpartnership income (estimated)				
7. Total cash available (line 5 + 6)				
8. Family spending & income tax (estimated)				
9. Cash available for debt servicing (line 7 - 8)*				
10. Scheduled annual principal & interest pay (page 4)				
11. EXCESS DEBT SERVICING CAPACITY (line 9 - 10)		$	$	$

Arrangement #II - 50/50 Approach				
A. Profit Generating Ability	(Use 50/50 Partnership Column, Page 5)			
12. Projected net cash income (line III, page 5, divided equally)	$	$	$	$
13. Total labor, mgt., + capital use charge (line 13, pg. 3)				
14. Ability to pay desired resource use charges (12 - 13)	$	$	$	$
B. Debt Servicing Capacity				
15. Projected net cash income (line 12, above)		$	$	$
16. Cash rent for real estate, to be paid partners (line 23, pg. 5)				
17. Other cash rents & leases to be paid partners (line 24, pg. 5)				
18. Net nonpartnership income (estimated)				
19. Total cash available (line 15+16+17+18)				
20. Family spending and income tax (estimated)				
21. Cash available for debt servicing (line 19 - 20)*				
22. Scheduled annual principal and interest payments (page 4)				
23. EXCESS DEBT SERVICING CAPACITY (line 21 - 22)		$	$	$

* If taxes and insurance, and/or repairs and maintenance have been included as a capital use charge in lines 9 and 10, page 2, they should be subtracted from cash available.

CHECK LIST FOR FARM INCORPORATION*

1. **Name.** What is to be the corporate name? Consider application to reserve corporate name.

2. **Duration.** Is the corporation to be organized to exist perpetually? Or for a term of years?

3. **Purpose.** What are to be the purposes of the corporation? Narrowly defined or broadly stated?

4. **Stock and debt capital structure.**
   a. How many classes of stock to be authorized? How many shares of stock to be issued? What are characteristics of each class as to –
      (1) Voting rights – voting stock, non-voting stock, proxy voting, cumulative rights.
      (2) Dividend rights.
      (3) Preference on liquidation.
      (4) Conversion rights, if any.
      (5) Par value – consider low par value to minimize annual fee on stated capital.
      (6) Fair market value on issuance.
      (7) Pre-emptive rights.
   b. Is debt capital to be used? (Watch tax-free incorporation limitation).
      (1) Type of debt security (note, bond, debenture) and amount.
      (2) Time of maturity.
      (3) Conversion to stock.
      (4) Interest rate.
      (5) Priority on liquidation.

5. **Stock transfer restriction.** What type of restriction to be used (consent, first option, buy-sell agreement)? Method of stock valuation (book value, appraised value, periodically re-negotiated fixed value)? Arrangements for payment by purchasers?

6. **Shareholders.** Names and addresses? Date of annual meeting? Place of annual meeting? Voting requirements? Quorum requirements? Pooling agreements? Voting trusts? Shareholders' agreements? For minor shareholders, consider using Uniform Gifts to Minors Act custodianship. Custodian should be someone other than donor.

7. **Board of directors.** Number of directors on board? Names of first directors?. Voting requirements? Quorum requirements? Arrangements for meetings. Director fees? Is preincorporation agreement desirable?

8. **Officers.** What offices are to be authorized? Who is expected to be elected to each office? What salary is to be authorized for each officer? Is corporation to pay entire social security tax or only one-half? Is a bonus policy to be authorized? What authority are officers to have in terms of borrowing money, signing negotiable instruments, executing contracts, or signing other documents? Explain proper format for signatures on corporate documents.

9. **Other employees.** What individuals are to be employed by the corporation in addition to the officers? What are terms of employment? Is an employment contract to be drafted? Arrangements for compensation? Is corporation to pay entire social security tax or only one half?

10. **Assets to be owned by corporation.** What property is to be transferred to the corporation?
    a. Prepare inventory for each transferor and list each item by name of owner, description of asset, income tax basis, fair market value, indebtedness and holding period. Preserve copies to be submitted with income tax returns. Watch gifts between and among transferors of property. Note insurance carried on assets and assets under special registration.
    b. Is transfer to be tax-free or taxable? Check eligibility requirements for one desired.
    c. Who is to value assets?
    d. Have property taxes been paid by transferors to date of incorporation?
    e. Documentary stamp taxes on land transferred?
    f. Abstracts of title?
    g. Prepare deeds and bills of sale.

11. **Assets to be leased by corporation.** What property is to be leased to the corporation? List each item by name of lessor, description of property and rental to be charged. Prepare leases.

12. **Bank.** What bank is to be the depository bank? Resolution of officer authority to borrow money and sign negotiable instruments to be prepared and sent to bank.

13. **Income taxation.** What method of income taxation to be followed?
    a. Regular. File Form 1120 annually.
    b. Subchapter S – review eligibility requirements for election; prepare Form 2553; if corporation has operated previously as regular corporation, check operating loss carryover, investment credit carryover, and recapture of investment credit. File Form 1120-S annually.

14. **Identification number.** Prepare and submit Form SS4, "Employer's Application for Identification Number."

15. **Registered office.** What is the address of the registered office of the corporation?

16. **Registered agent.** Who is to be the registered agent of the corporation?

17. **Notice of incorporation.** If required by state law, as in Iowa, prepare notice of incorporation, forward to publisher of eligible newspaper and, where required, send affidavit of publication to secretary of state.

18. **Incorporation kit.** Order corporate kit, specifying type of seal, if any; number and type of stock certificates (have stock transfer restriction printed thereon or type restriction on certificate when received); minute book.

19. **Loans, mortgages.** What loans or mortgages are to be assumed or taken subject to by corporation? Give special attention to Federal Land Bank, Production Credit, Farmers Home Administration loans.

20. **Basis.** Determine corporation's income tax basis of assets for purposes of depreciation and sale. Calculate and make a record of shareholders' basis for stock and securities received. Because of "galloping basis," repeat every year for Subchapter S corporations.

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*Prepared by Neil E. Harl, Professor of Economics, Iowa State University, Member of Iowa Bar.

21. **Fiscal year.** What is to be the corporation's fiscal year? Consider fiscal year other than calendar year for Subchapter S corporations.

22. **Method of accounting.** Is the corporation to be on the cash or accrual basis? How are inventories to be valued?

23. **Special elections.** Check on elections for treatment of commodity credit loans, soil and water conservation expenses, and land clearing expenses.

24. **Residences.** All houses to be transferred to corporation? Reasonable rental to be paid by occupants? Or occupants to report value of occupancy as additional income? Or rely on I.R.C. § 119?

25. **Motor vehicles.** What vehicles to be transferred to corporations. Insurance arrangements? Title transfer? What vehicles to be individually owned? Rate of compensation for business use? Insurance coverage for accidents involving employee-owned vehicles within scope of employment?

26. **Recapture.** If corporation is not a mere change in form of doing business, will depreciation and investment credit be recaptured? If Subchapter S taxation is elected after operation as a regular corporation, file shareholder consent to be responsible for recaptured investment credit with last Form 1120.

27. **Fringe benefits.** What fringe benefits are to be provided? Check health and accident plan, group term life insurance (10 of more employees or "baby group" plan), sick pay and deferred compensation for retirement.

28. **Doing business in other states.** Will the corporation be doing business in another state? How much? Necessary to qualify to do business as a foreign corporation?

29. **Monorities.** Is stock to be permitted to pass to off-farm shareholders? Consider assuring management rights, current income , and market for stock in planning for protection of minority shareholders.

30. **Wills.** Do wills and estate plans of shareholders need to be updated by codicil or completely rewritten? Consider provisions to direct executor to consent to Subchapter S election and to comply with restrictions on stock transfer. For holders or potential holders of Subchapter S of corporation stock, consider substitute provisions in lieu of trusts — for example, legal life estate rather than marital deduction trust.

31. **Memberships.** What about memberships in cooperatives? Farm organizations? Breed associations?

32. **Insurance.** Check on casualty insurance, liability insurance, workmen's compensation election, and motor vehicle liability.