

Farm Partnerships - Part I: General Guidelines

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What is a Partnership?

A partnership is an association of two or more persons to carry on, as co-owners, a business for profit. This does not mean that the property used in the business must be co-owned but that the business as a business enterprise must be owned by both parties. The partnership may own all, some, or none of the property used in the business. Partnerships are governed by a code of rules called the Uniform Partnership Act. Additional rules may be adopted in the individual partnership agreement.

General characteristics of a legal partnership are:

1. A partnership is created by an agreement specifying the terms of the arrangement. The agreement should always be in writing. An oral agreement is binding but with this kind of partnership misunderstandings and disagreements often become the rule rather than the exception.

2. Unless specified otherwise in the agreement, each partner has an *equal* voice in management control and a majority of the partners control business decisions.

3. Profits and losses are divided in accordance with the specific agreement; or equally if not agreed upon. Unless specified in the agreement, partners do not normally draw compensation for their services and any withdrawals or "wages" should usually be treated as advances on their share of profits.

4. Both real and personal property may be owned in the partnership name. Unless the agreement expressly states otherwise, each partner has an equal partnership interest and has an equal right to possession and control of partnership property for purposes of carrying on the business of the partnership. Often, individual partners agree to contribute the *use* of their personally owned property to the partnership business. In such cases title to such property remains in the person contributing it. Also, the partnership may lease needed real and personal property as an alternative to the partnership assuming ownership of the assets.

5. Each member is subject to liability for all debts arising in the partnership business. A creditor of the partnership may go against assets of individual partners to collect the money due him. Of course, an individual partner can be held personally liable only for partnership debts and obligations. He cannot be forced to pay the personal debts and obligations of other partners.

6. All partners are jointly and severally liable for the wrongful acts of any partner resulting in personal injury or property damage to one not a member of the partnership. This is true if the partner acting wrongfully was acting in the ordinary course of the business of the partnership or with the authority of his co-partners.

7. A partnership must have its own records, especially for income tax purposes. Although it pays no income taxes, a partnership income tax information return must be filed. The partners then pay individual taxes on their share of the partnership income, as specified in the partnership agreement.

8. A partnership is automatically dissolved upon the death of a partner unless the agreement provides for an orderly method of continuation of the business.

How a Partnership is Created

A partnership is created by an oral or written agreement. In some cases a partnership may be implied without an agreement if the business is being carried on as a partnership. The only legal requirement is that two or more persons combine for the purpose of conducting business. Many times a partnership will be orally created and may simply involve an agreement to divide profits in a specified manner. While this may at first appear acceptable, many problems may arise under such an agreement. If the answers to such questions are provided for in a written partnership agreement, many potential areas of dispute are eliminated.

Determining whether an agreement is a lease or a partnership is sometimes difficult. Some of the characteristics that point to a partnership are as follows:

1. Whether or not each person involved participates in management decisions,
2. Whether assets are owned individually or jointly,
3. Whether or not profits are shared,
4. Whether or not losses are shared,
5. Whether or not the parties have operated under a firm name,
6. Whether or not the parties have a joint bank account for use in business transactions.
7. Whether they keep a single set of business records.

An agreement might provide for one or more of the above characteristics and not necessarily be a partnership. No one factor is controlling. All are applied to the particular arrangement to determine whether in sum it is a partnership.

How to Form a Partnership

The prospective partners should first discuss and plan the arrangement they anticipate creating. They should make decisions regarding the ownership of property, labor and management contributions, management control, profit and loss sharing, record keeping, taxes, partnership termination and transfers of partnership interests, etc. They should obtain expert legal assistance in drawing up an agreement, including all of the plans they have agreed upon. This agreement then becomes their code of operation.

Before an attorney is contacted, an inventory of the value of property to be contributed should be made and some idea of expected returns should be developed. An example of how fixed contributions of partners can be calculated and used as a basis for dividing income in a father-son partnership is shown below.

Table 1. Example of how fixed contributions of partners can be calculated and used as a basis for dividing income in a father-son partnership.

Contribution	Father			Son		
	Value	Rate	Value of Annual Contrib.	Value	Rate	Value of Annual Contrib.
LAND AND BUILDINGS						
1. Interest (5-6% of valuation)						
2. Real Estate Tax						
BUILDINGS, WATER SYSTEMS, FENCES, AND OTHER PERMANENT IMPROVEMENTS						
3. Depreciation (2-4% of replacement value)						
4. Repair (1-2% of replacement value)						
5. Insurance						
POWER AND MACHINERY						
6. Interest (6-8% of new cost plus salvage value ÷ 2)						
7. Depreciation (10-14% of replacement cost less salvage value)						
8. Repair (3% of new cost)						
9. Insurance						
LIVESTOCK						
10. Interest (6-8% of current value)						
11. Depreciation, if any (breeding stock only)						
12. Insurance						
PERSONAL PROPERTY TAX, LABOR, AND MANAGEMENT						
13. Partners, number of mos. x no. of dollars						
14. Family help						
15. Hired labor						
16. Management (10% of expected gross)						
17. CASH RENT						
18. TOTAL						
19. PERCENT OF CONTRIBUTIONS TO EACH						

Things to Include in a Partnership Agreement

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

1. A short introduction containing the date, the names of the parties and the fact that it is a partnership agreement.

2. The name of the partnership, the location of the principal place of business, the general nature of the business, and the duration or length of partnership.

3. Capital contributions, cash, real and personal property, special assets and service, provisions for capital accounts of the partners and for withdrawal of money by partners, and a provision setting out procedures for loans to the partnership by a partner, if contemplated.

4. A provision regarding management by the partners, their responsibilities regarding property and debts, salary payments, and a general statement of the partner's rights and obligations in connection with operating the partnership business.

5. A statement regarding the sharing of profits and losses including the composition of farm expenses, rate of depreciation on farm improvements, a definition of farm receipts, inventory changes, and a procedure for year-end settlement.

6. Provisions for records, accounts, banking and other financial matters including tax considerations.

7. A statement regarding termination and voluntary dissolution of the partnership including provisions for continuation of the business after the retirement, incapacity or death of a partner.

8. Other provisions might include those for living arrangements, arbitration of disputes, vacation arrangements, additional partners, maintaining improvements, and any additional ideas applicable to a given set of resources or a particular problem.

9. A closing statement to the effect that the parties to the agreement know its contents and intend to bind themselves to it. This statement is followed by the signatures of the partners.

Relationship Between Partners

It is essential that the partners relate well to each other and are able to live with, and overlook, each other's faults. Both need to be tolerant and understanding and have the ability to forgive. Harsh words should be avoided. *Father and son farming programs are more often divided because of disagreements over trivial things than over major issues.*

Some fathers tend to be conservative. They have many years and much capital at stake in the business. In these days of rapid changes on the farm, however, one can be too conservative. Some sons

tend to be venturesome, and particularly so when operating on someone else's money. The ability to compromise is essential. Ideally, a father and son enjoy operating the business together. But, only conscientious effort by both can achieve the ideal.

In no other occupation are the home and business so closely related as in agricultural production. The wives must like the business, respect the other partners, and get along with the other partners' wives. Friction among them contributes to impossible situations. A wife who is not happy with her situation may complain about the long hours her husband works or the low level of spendable income, making her husband dissatisfied. Usually, if she has a voice in the agreement and fully understands its conditions, she is more likely to be satisfied.

A Business Family

Because a partnership is an intimate business relationship, the partners are members of a business family. They should be working towards similar objectives to make the business succeed. Problems frequently appear in partnerships because the goals and values between the families are divergent. It is doubly important that partners respect and honor each other's opinions. And, as these goals and values affect the business, a suitable compromise should be worked out in the agreement.

Joint participation in managerial decisions is another "must". If the business is a partnership, one partner is not "in charge of" the business and the other simply a worker. Both are in charge. For example, in a father-son agreement, the father's tie-breaking vote on the basis of seniority can become particularly disturbing to a son. It is suggested that the partners and wives set time aside each month for a "business conference" to study business progress and openly discuss any problems. Communications may break down when time is not planned for open discussion.

The less experienced partner needs to be given an increasingly important role in management. He may not be a competent manager when the agreement is started, but there should be a general understanding and plan for him to grow into management responsibility.

Business Success

No matter how equitable an agreement may be and how well the partners get along, the partnership will not be successful if business earnings are inadequate. The income must be high enough to support multiple owners and compensate individuals for their capital resources. Often it may be necessary to buy or rent more land. It may mean a larger livestock enterprise. But growth and expansion usually involve more debt to finance the capital expenditures and larger interest and principal payments.

Size of business, however, is not the only criterion for operating a profitable business. Favorable price relationships, the application of proven technical practices, efficient production and marketing, and skill in handling finances and investments are all essential elements.

And, as already pointed out, a complete farm record system, particularly important in a partnership, is essential.

Essentials for Partnership Success

Once a family has decided to form a partnership, every effort should be made to insure that the business will be successful. Although its success is not always determined by the partners themselves, they do have the responsibility to use everything in their power to work toward that objective.

What are some of the possible stumbling blocks?

Individuals who own most of the capital resources in a partnership have a stronger bargaining position than those with little or no capital resources. This is commonly the situation in a father-son partnership. Although the agreement should direct more payments to the largest capital contributor, he should not use his stronger bargaining position to dominate the agreement terms at the expense of the other partner(s). It may be necessary for the partner with the largest capital resources to sell a share of the personal property to the entering partner, and either finance the new partner directly or assist him in finding commercial financing. This does not require, however, that all capital from each partner be contributed to the partnership. For example, in a father-son operation, the land need not be included in a partnership. But the partnership should compensate the landowner-partner for his capital input and operate the land as a unit rather than as a private business outside the partnership.

The partnership should usually combine all income-producing enterprises into one operating unit. Failure often results when the business is divided so that each party receives income from the particular unit or units he manages. There is a tendency, under split operations, for each partner to favor his part of the business and neglect the rest.

Special problems may be created if a father-son partnership is started too soon. In some cases, the partnership should not be created immediately upon completion of the son's formal education. The father and son may need time to determine if they can, and want to, work together in a common business. During this interim period, the son probably should work for wages as an employee, or under a wage and

profit-sharing arrangement. Both are less formal, and such a relationship is easier to sever than a partnership. During this period, the young man may want to acquire some capital items, but hold them in his own name and receive pay for their use until a partnership can be formed. After deciding to form a partnership, each can contribute his capital to the business.

How to Dissolve a Partnership

A partnership may be terminated by agreement between the partners or by operation of law. Dissolution under a partnership agreement generally occurs when the term or business in the agreement is finished. If no duration is fixed by the agreement then either partner may terminate the partnership at will. Dissolution by operation of law occurs in the event of death, bankruptcy, or incapacity of any partner or by any event which makes the continuation of the business unlawful. If a court is shown that the partnership cannot continue without loss, the court may dissolve the partnership.

After a partnership is dissolved the next step is to discharge the liabilities and to distribute the assets if any remain. The assets of a partnership are distributed as follows: **First**, to creditors other than partners. **Second**, to partners for their advances and loans made to the firm. **Third**, capital and investments to partners who made the contributions. **Last**, any profits left after all other liabilities are distributed to the partners on the basis of the agreement for sharing profits.

If the firm is insolvent, the debts of the firm may be satisfied from the personal sources of the partners in accordance with the agreement for sharing losses. When one member of the partnership dies, becomes incapacitated or otherwise disabled, the law gives the remaining partners the power to wind up the partnership affairs. They, of course, must exercise reasonable business judgment on behalf of all partners and creditors.

Once a partnership is dissolved it is important that notice be given to outsiders, especially those who have previously done business with the partnership. This would involve notice by publication to all except outsiders who have done business with the firm. Such parties should receive actual notice so that they will have no basis for believing the firm still exists. This avoids the possibility of partners continuing to be liable for indebtedness owing to such outsiders after the firm is dissolved.