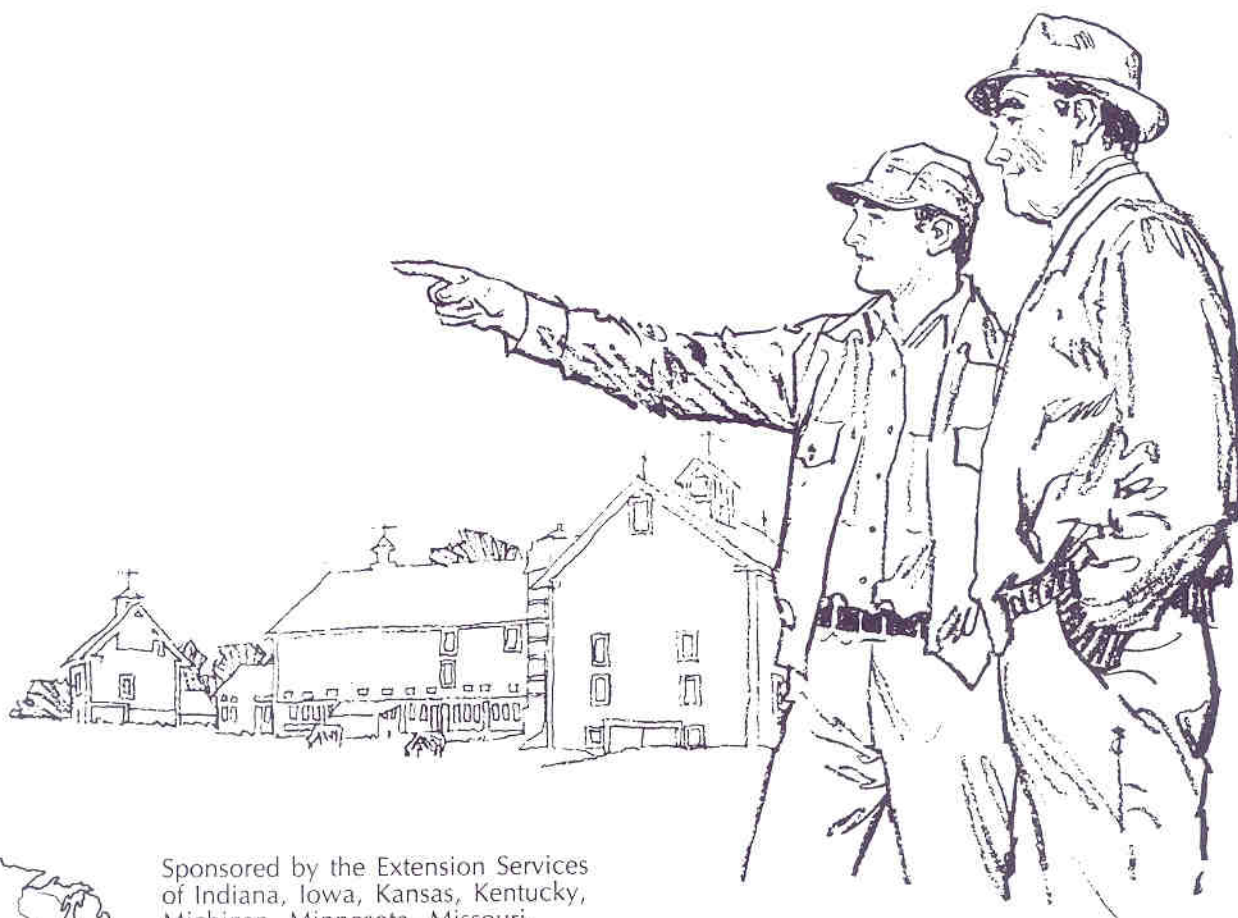


FARM BUSINESS ARRANGEMENTS: Which One for You?

North Central Regional Extension Publication 50—Revised 1982

Kenneth H. Thomas and Michael D. Boehlje



Sponsored by the Extension Services of Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, and Wisconsin, in cooperation with SEA-Extension, USDA.

To the Reader

Most discussions of organizational alternatives for the farm business involve 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 its 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 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.

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 establishment and transfer problems. It is designed to help narrow the range of business arrangements to consider, not provide a comprehensive discussion of any particular type of business arrangement. The first chapter provides a decision framework for choosing a farm business arrangement. Remaining chapters provide a more detailed discussion of the selection process. Chapter 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 consider are covered in Chapter III. Chapter IV outlines possible routes and types of business arrangements that might be considered after the testing stage. Chapter V compares the partnership and corporation as alternative business arrangements for the multi-owner, multimanager farm firm. Reference is made throughout to selected business arrangement aids contained in the appendices.

CONTENTS

Chapter I.	Farm Business Arrangement Decisionmaking: An Overview	3
Chapter II.	Appraising Your Present Situation and Potential for Joint Operation	7
Chapter III.	The Testing Stage: Do You Really Want to Farm? Together?	8
Chapter IV.	Farming Separately or Together: Some Possible Routes and Arrangements	10
Chapter V.	Multi-person Operations: Partnership or Corporation?	11
Chapter VI.	Summary and Conclusions	15
References	15
Appendix A.	Appraising Your Present Situation and Potential for Joint Farm Operation	17
Appendix B.	Farm Employer-Employee and Joint Working Agreements Worksheet	23
Appendix C.	Checklist for General Farm Partnerships	29
Appendix D.	Checklist for Farm Incorporation	30

North Central Regional Extension Publications are prepared as a part of the Cooperative Extension activities of the 12 North Central State land grant universities in cooperation with the Science and Education Administration, USDA. The following states cooperated in making this publication available:

University of Illinois
Urbana, IL 61801

Purdue University
W. Lafayette, IN 47907

Iowa State University
Ames, IA 50011

Kansas State University
Manhattan, KS 66506

Michigan State University
East Lansing, MI 48824

University of Minnesota
St. Paul, MN 55108

University of Missouri
Columbia, MO 65211

University of Nebraska
Lincoln, NE 68583

North Dakota State University
Fargo, ND 58105

Ohio State University
Columbus, OH 43210

South Dakota State University
Brookings, SD 57007

University of Wisconsin
Madison, WI 53704

University of Kentucky
Lexington, KY 40506

Oklahoma State University
Stillwater, OK 74074

For single copies of this and other North Central Regional Publications, write to: Publications Office, Cooperative Extension Service, in care of the university listed above for your state.

If you live outside the North Central Region, write to any of the above universities for single copies. For quantities of any regional publication or general information, write to: NCR Educational Materials Project, 111N Curtiss Hall, Iowa State University, Ames, IA 50011.

About the Authors

Kenneth H. Thomas is professor and extension economist in farm management, University of Minnesota.

Michael D. Boehlje is professor of economics, Iowa State University.

Special thanks are extended to the members of the Estate Planning Task Force for their helpful suggestions and encouragement: Al Bock, Illinois; Gerry Harrison, Purdue; Ralph Hepp, Michigan State; LeRoy Rottman, Missouri; and Richard Weigle, Wisconsin.

CHAPTER I

Farm Business Arrangement Decisionmaking: An Overview

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 have to "piggyback" (join forces with or be aided by parents) on an existing farm operation.

A growing number of farm families are confronted with the problem of how best to get a son or daughter 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 person into the business 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 or done hastily. In most cases the decision involves the economic security of the parents, the future career potential of the farming son or daughter, and overall family good will. Thus, it is important that the arrangement best meet the needs of all individuals involved.

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. Members of the farm family will need to appraise their situation and objectives and make at least a tentative decision about organizing their business. They also should plan to spend some money to secure the necessary professional help of an attorney, accountant, or other management advisors as they formalize and carry out their business organization plan.

Most farm businesses are managed by an individual operator rather than a management team. The 1978 census of agriculture indicated that 85.7 percent of U.S. farms with sales over \$25,000 per year were operated as sole proprietorships, 11.2 percent were partnerships, 2.7 percent were incorporated, and 0.4 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 likely decline while the number of joint family operations involving the use of partnerships and corporations will tend to increase.

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 (borrowed funds). 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 establishment and transfer problems have caused farm families to look toward the merger of farm businesses 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.

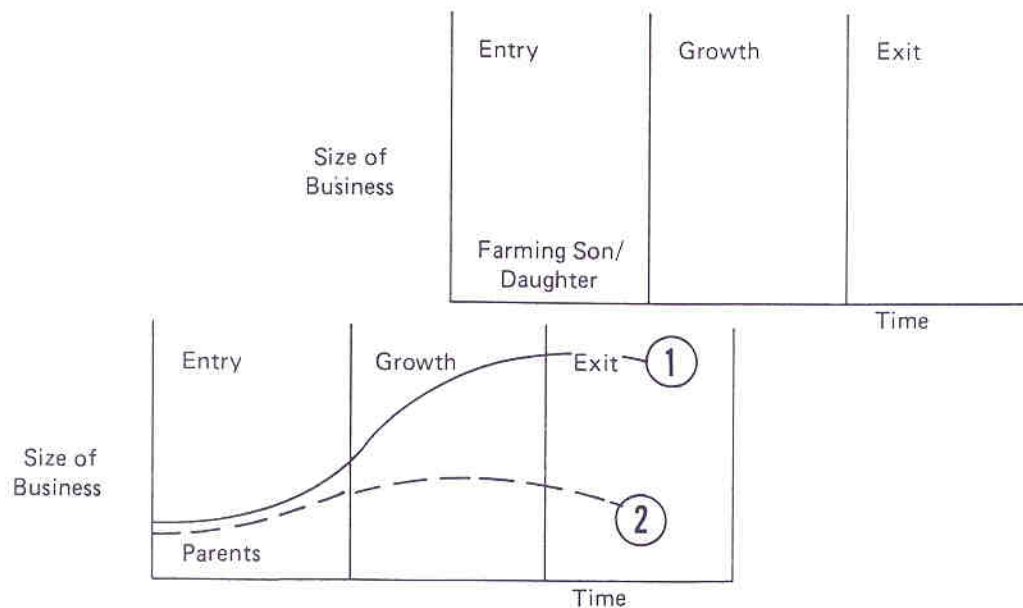


Figure 1. Merging Family/Farm Life Cycles of Parents and Farming Son or Daughter

Merging the life cycle of a second-generation farm family with the typical life cycle of the parents must be approached with caution and candor and explored carefully. Each situation is different for at least three sets of reasons. One reason is the *level of achievement and objectives 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 1). Others have provided adequately for their family but find themselves with a one or a one-and-a-half person business (situation 2, figure 1).

Parents' goals, objectives, values, and priorities also vary. Some may want their businesses to grow and prosper; others may want to consolidate their gains and slow down. Some may want to begin transferring large amounts of property, while others are concerned with enjoying the fruits of their labor. Some will want to favor the farming son or daughter, while others will want to treat all of their heirs "equally."

A second set of reasons relates to the child's managerial ability and the timing of his or her entrance into farming relative to the parent's retirement. Prospective farmers vary widely in their present managerial skills as well as their commitment to a farming career. Also, the timing of their entrance into a farming situation where the parent plans to farm for 20 more years creates a much more complex situation than one where the parent is within five years of retirement.

A third set of reasons relates to the number of other children involved and the degree of interest they have in farming. The situation is much easier to deal with when there is only one child than if there are eight children and three want to farm.

Thus, 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. At the other extreme is the 45-year-old father with a less than two-person business, two children who want to farm, and five other children.

Decision Framework and Business Arrangement Alternatives

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 of the possibilities of developing a successful joint operation (figure 2).

If a joint operation is decided upon, then both parties normally should enter a so-called testing stage. The purpose of this testing stage is twofold: to help the child decide whether he or she 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 child getting out of farming altogether or moving to another farm with no direct ties to the home farm. In other situations the child may establish his or her own separate farming unit but share labor or machinery with the parent in a so-called *spin-off* arrangement. In some cases, the parents may desire to retire from active farming and will *sell* or *rent* the farm to the on-farm heir. Or in cases of a larger business, establishment of a *multi-ownership, multi-management* firm may be in order.

The major business arrangement alternatives for organizing a farm business are defined below, and their general legal complexity is depicted in figure 3.

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 as a modified sole proprietorship established when a son, daughter, or unrelated party is first taken into the business. Wage incentive, wage share, enterprise 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 of 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 entity 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 limited partnership.

How each of the above business arrangements tends to fit into the decisionmaking framework described in figure 2 will now be illustrated (figure 4). Most farm families will be starting with an individually operated sole proprietorship. As they move

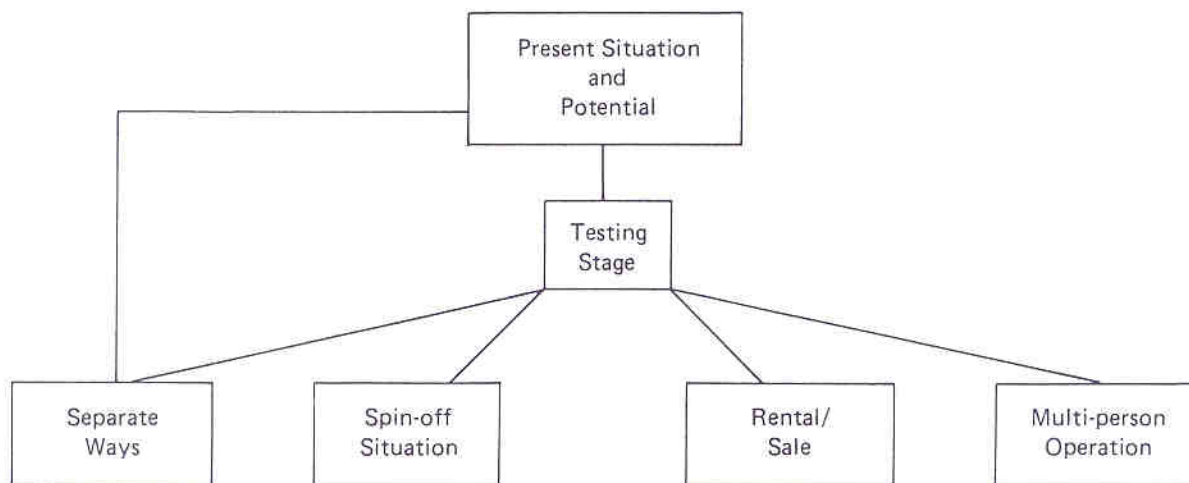


Figure 2. A Framework for Business Arrangement Decisionmaking

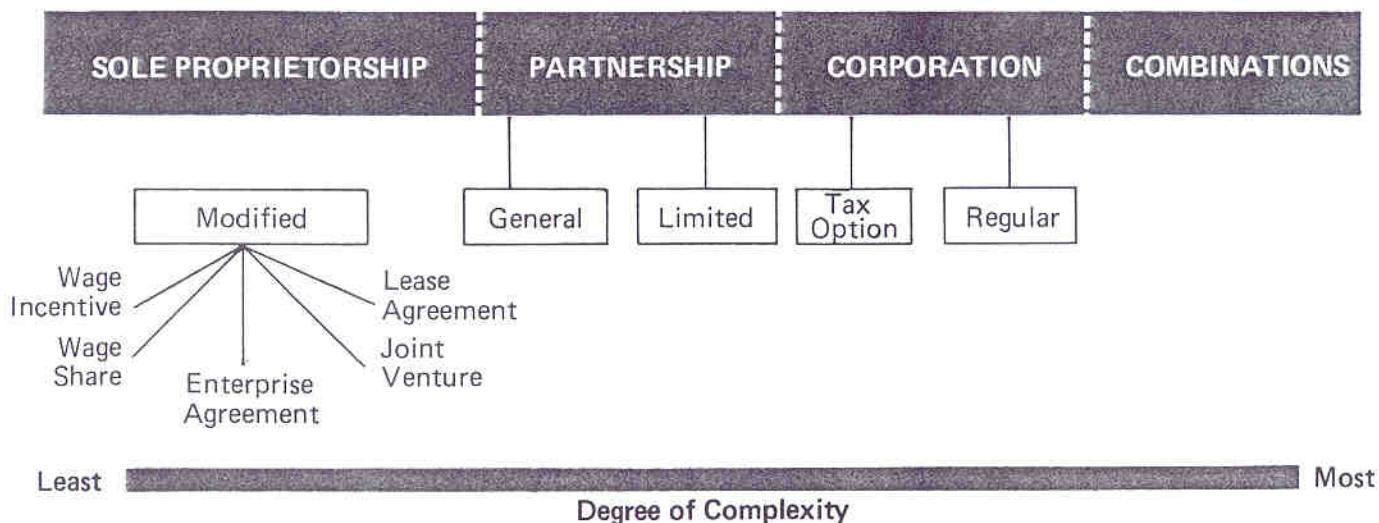


Figure 3. Alternative Business Arrangements Ranked According to Degree of Legal Complexity

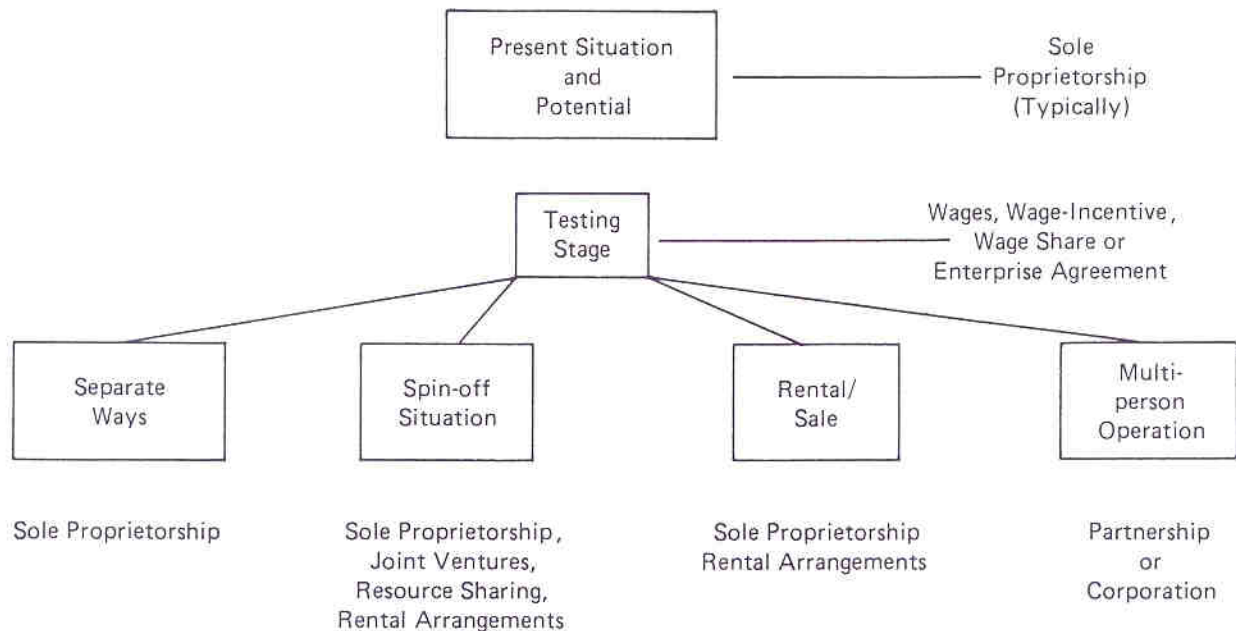


Figure 4. Alternative Business Arrangements and the Decision Framework

to the testing stage, one of the various types of "modified" sole proprietorships, ranging from wages to some type of joint working arrangement, will probably be selected. These are simple arrangements, yet they provide the opportunity to test the heir's true desires regarding farming and the compatibility of the participants.

After this testing stage experience, some families will decide to go their *separate ways*. Dad likely will continue in his sole proprietorship and the son or daughter will establish his or her own operation (sole proprietorship) or farm with someone else. Upon dad's retirement the home farm business will likely be discontinued, with the land rented out or sold. In other cases the son or daughter may desire to establish their own farming unit, but in a *spin-off* situation relative to the home farm. Here, they may end up exchanging labor for machinery and in some

cases becoming involved in a joint venture situation. This may involve joint ownership of machinery, or may mean becoming involved in one or more enterprises together. Dad may rent some of his land to the son or daughter and even co-sign some notes. If dad is at or near retirement, then the plan may call for the establishment of a *rental arrangement*, with dad serving as the landlord and the farming heirs serving as tenants. Eventually, dad may sell part or all of the farm to them. When the business is deemed adequate and the parties can get along well together, then farming together in a *multi-person operation* using either a partnership or corporation becomes the viable business arrangement.

The next four sections of this bulletin provide a more detailed look at each of the segments of the decisionmaking framework illustrated in figures 2 and 4.

CHAPTER II

Appraising Your Present Situation and Potential for Joint Operation

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

On page 18, describe your present family and business situation. This description should include a list of all members of the family, their ages, education, marital status, and employment. Also, make note of any special needs of family members as well as interests of other heirs relative to farming and the home farm. Next, record the present size and organization of the business, as well as its potential for further expansion.

Pages 19 through 22 address the issue of your potential for farming together. The three major questions raised will now be discussed in some detail.

Do You Really Want to Farm? Together?

Here, you are trying to size up the human factor—usually the most important item in successful business arrangements. Some of the key questions to be answered on page 19 include: Is your child and his or her spouse really committed to farming or is it just a passing fancy? If they really want to give it a try, will the family members be able to live, work, and manage together?

It is essential that the participants in a joint operation 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. Spouses 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 check that you might make as to your 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?" (found on pages 21 and 22).

Is the Business Profitable Enough?

Can the business provide security for the parents and opportunity for the child? 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. Space is provided on pages 18 and 19 to make a preliminary estimate of the adequacy of the business, both size- and income-wise. If there appears to be any doubt as to the adequacy of the business, it is recommended that a more detailed financial analysis be made.

Can a Workable Transfer Plan Be Developed?

The younger generation must have the opportunity to invest, thus increasing equity and control of the business as well as taking over management responsibility as time goes by. The question is, can you develop a workable transfer plan? Questions on page 20 include the following:

Is dad willing to shift managerial responsibility over time? Development of the child's management abilities is critical to the future of your business. If the parents are not willing to shift responsibilities on a reasonable timetable, all of the other transfer plans may be for naught. Also, the child will get frustrated and probably leave.

Are the parents able and willing to shift property over time? Here, a careful analysis must first be made to determine whether the parents are in a financial position to shift assets over time. As a guideline, if the value of the parents' estate (in 1982 dollars) is

below \$300,000, then the prospect of their estate being able to transfer much property during their lifetime is not great. Parents in this situation should be concerned primarily with their own welfare, with little or no transfer of property contemplated. Parents with estates between \$300,000 and \$600,000 probably have an adequate estate for their life expectancy needs. However, they should be cautious in terms of transferring property—particularly at this point. Thus, families with either of these two situations should be quite open about the fact that the parents are not in a good position to transfer property and should not be expected to. *Protecting the parents' security is the number one priority in business arrangement decisionmaking, not getting the child established!*

Families with larger estates—\$600,000 or more—are facing a potentially serious estate tax problem. With current inflation

rates, such an estate could grow to \$1 to 2 million in 10 to 15 years. Parents in this situation are usually able to begin the transfer process. The question is, are they *willing* to do so. If not, they should tell the child right away so he or she can make other career plans. You also will have to explore the situation regarding your other heirs. How do they fit into your transfer plans? How can you best treat them fairly?

After answering these questions, you should be able to reach some tentative conclusions about farming together. First, should you even try to farm together? If the answer is no, you can go your separate ways. If you feel very sure of your situation—that it's a definite "go" situation—then you may proceed to read chapters IV and V. If the answer is only a maybe, then you should go through a testing stage—our next topic of discussion.

CHAPTER III

The Testing Stage: Do You Really Want to Farm? Together?

Most existing family farm units are sole proprietorships. Most families have had little or no experience in operating a business together. The son or daughter may be uncertain about farming. Therefore, it is recommended that the parent and child first enter a testing stage. The family's objectives at this point should be to determine whether the son or daughter really wants to farm and whether the parties can work together.

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 child contributes primarily labor and possibly some management. The second category includes various joint working agreements that may at times border on being a partnership. With these latter arrangements, the child will be supplying at least some personal property as well as labor and management. The worksheet, "Farm Employer-Employee and Joint Working Agreements" (Appendix B) is designed to aid you in the development of arrangements for use in this testing stage.

EMPLOYER-EMPLOYEE TYPE ARRANGEMENTS

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

Wage Agreement

Many families find the easiest way to start a child in the business is to pay wages. This plan may also include a year-end bonus and benefits (see page 24, Appendix B). 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 child does not have a direct interest in the success of the business, he or she will lose interest in farming if forced to work on a wage basis for an extended period of time. One approach is to pay well in excess of a hired man's wage. This would keep the child motivated, test the financial adequacy of the business, and insure that the parent will not prolong the arrangement unduly.

Wage Incentive Plans

Wage incentive plans often are used to encourage a farming child to take a more active interest, and additional responsibility, in the farm business. For the employee, the compensation

should be in addition to his or her 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 parent as well as child.

Space is provided on page 24 for developing a wage-incentive plan. Example incentive plans for various types of employees and enterprises are provided on page 25. In a sound incentive program, the workers should be able to influence the size of payment received by the work performed. Payments should be sufficiently large and attainable to encourage extra effort. A written agreement should be developed describing the purpose of the arrangement, employee responsibilities, method of calculating and making the payment, and provisions for arbitration.

Wage and Income Share Plans

A wage- and income-sharing plan is particularly well-adapted as a beginning agreement when the child is not sure of continuing in business on the home farm, or 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 parent typically furnishes the farm, housing for the child, all farm personal property, and his own labor and management. He also pays all farm expenses. The child works on the farm full-time and receives a guaranteed monthly wage and a share of net farm income. The wage rates could be comparable to current wages for similar services by hired help in the area. Space is provided on page 26 for determining a fair wage-share arrangement.

Some of the advantages of wage-based types of business organizations include: (1) determining if the child really wants to farm and if the parent and child can get along well when farming together; (2) giving the child 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 child'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 child to gain an equity in the business; and (3) such plans are often kept in force long after the child is ready to become a full-fledged member of the business.

JOINT WORKING AGREEMENTS

The testing period may extend long enough or relationships develop fast enough that the child begins to contribute personal property to the farm business along with his labor and management. Similarly, a so-called holding pattern maybe in order in those cases where the parent is very close to retirement. Rather than expanding the business, establishing a partnership, etc.,

the parties may decide to extend the testing stage and become involved in some type of joint working agreement. Two types of joint working agreements will be explored at this point, though there obviously could be many others.

Enterprise-type Joint Working Agreement

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

The child may buy into a given enterprise such as the dairy herd, cow herd, or hog enterprise on a partial or complete basis, either paying the parent for the use of feed, buildings, and pasture or working out a livestock lease arrangement whereby part of the production is given to the parent. A form for working out an equitable enterprise working agreement is contained on page 27. 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 normally should be regarded as only temporary. Most farms are too small to be subdivided into separate enterprises. There is a tendency for the child to concentrate on his or her enterprise at the expense of the overall farming operation with this type of an arrangement. In addition, the child is exposed to considerable risk when he or she depends on one source of income. Record keeping may be difficult.

Joint Venture-type Working Agreements

There may be situations in which the parent and child operate in a joint venture agreement and share labor and machinery but own or rent their own land, livestock, etc. A worksheet is provided on page 28 for calculating the values of the contributions of labor and machinery between a parent and child. 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 into the spin-off stage, etc.

Length of Testing Stage

The length of the testing period depends on the family's situation, objectives, and progress toward deciding which future route to follow. Two to three 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 a wage-type arrangement. Remember, the purpose of the testing period is to determine whether the child wants to farm and whether the parties can work together. Once these issues have been resolved, be prepared to move out of the testing stage.

CHAPTER IV

Farming Separately or Together: Some Possible Routes and Arrangements

This section discusses some possible routes and types of business arrangements to consider after the testing stage.

Going Your Separate Ways

You may decide to dismantle any joint arrangements that may have developed during the testing stage and go your separate ways. Such a separation may be caused by an inability to work together or the parent's unwillingness to transfer property. Or, it may have been part of the plan all along because the original business was too small.

Full and frank communications are important if such a separation is likely to occur. It is unfortunate when parents have assumed the child would eventually farm on his or her own, but the child was under the impression that he would operate the home farm. The sooner both parties can agree on their future course, 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 about who will eventually own it, how it will be operated, etc.

Spin-off Situation

In cases where the home farm is too small or differences surface between the parent and child about how the business should be developed, a spin-off situation might prove desirable. The child 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. Such joint working arrangements can take on many forms and can get a child established in farming without jeopardizing the security the parent has built up in his own business. It also permits the child to better exhibit management know-how and to establish independence because he or she has a separate business entity. The key to this arrangement is the child's ability to obtain a farming unit sizable enough to generate profits for an adequate standard of living and net worth improvement, and which has future business growth potential.

Rental or Sale of Home Farm From Parent to Child

The parent may be at that stage in his career when he is ready to rent the farm to the child. The parent usually wholly or partially retires from the day-to-day work and management of the farm. If there is adequate housing, parents 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 parent and child. A cash lease shifts the risk of low prices and yields over to the child, who has to pay the parent a fixed rent regardless of price and crop conditions. A flexible cash lease could be developed to reduce some of the risk assumed by the child. With a share lease, the parent shares at least part of the financial ups and downs of the farm business. (See list of land rental bulletins in references at end of publication.)

It usually is recommended that at the beginning of the rental period the child acquire full ownership of livestock, feed, crops, and supplies. The parent will be relieved of the worry of managing these assets, and the child will be in a much better financial and managerial position to take the final step towards attaining ownership of the home farm. Ownership of the machinery should be worked out with your accountant to avoid investment credit recapture.

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

Multi-person Operation

When the parties involved can get along well together and the existing farm business is adequate in size or can be expanded without jeopardizing the parents' financial position, then farming together in a formal multi-person operation seems in order. This usually involves the use of a partnership or corporate type of business arrangement. Where these arrangements best fit and how to go about forming them will be discussed in the next chapter.

CHAPTER V

Multi-person Operations: Partnership or Corporation?

When it appears the parties involved are ready for a multi-person operation, two questions remain. First, should we be in a partnership or corporation? Second, how do we go about forming such arrangements? We shall discuss each of these questions in this section.

Should We Be in a Partnership or Corporation?

Of course, there is no perfect form of doing business, nor is there likely to be one that will meet all your needs. As you can see in table 1, both the partnership and corporation have their advantages and disadvantages, their costs and benefits. Therefore, you will need to work closely with your accountant, attorney, or management consultant in deciding which arrangement can best meet your specific needs. The following discussion is designed to give you a general feel of where each of these tools tends to best fit.

CORPORATION

When one looks to the business world it appears that the corporation is the ultimate form of business organization. Just as most major businesses are organized as corporations, a similar pattern appears to be emerging in farming. The corporate structure tends to be utilized in those situations where: (1) there is a large, growing business with continuing income tax problems and (2) where continuity, control, and transfer of the business are of key concern to the owners. Let us explore each of these points further.

The corporate form has several characteristics which make it attractive from an income tax management standpoint. As you can see in table 1, the corporation is a separate legal entity, which means that another taxing unit has been created. This permits a splitting of income between the corporation (retained earnings) and the individuals (salaries, rents, interest). Also note that the corporate form has very favorable tax rates relative to those available to individuals at similar income levels.

To take advantage of these features, however, the after-tax earnings of the corporation must be retained in the corporation and reinvested there. Otherwise, they will be subject to an accumulated earnings tax or double taxation if distributed as dividends. Thus, it is generally recommended that the corporation be considered in those situations where there is a relatively severe tax problem (\$25,000 to \$30,000 or more of taxable

income) and a growing business where retained earnings can be reinvested for an acceptable business purpose.

Tax-wise, it should also be noted that since the corporation is a separate legal entity, the owner/operators of the corporation become employees of the corporation. As a result, they become eligible for a wider range of fringe benefits than would be true under the self-employed status of the partnership. However, the corporation does not have as favorable tax treatment from the standpoint of capital gains. Part of this disadvantage can be avoided by keeping certain capital gains property, such as breeding stock, out of the corporation.

Two key estate planning features of the corporation are the ease with which property can be transferred (shares of stock versus property items) and the fact that control of the business can be exercised as long as the parents (or later the farming child) retain at least 51 percent of the voting stock. Therefore, a key concern in its formation is what property should be put into the corporation—particularly, should land be included? If considerable land is kept outside of the corporation (for tax and other reasons) the ease of transfer benefit is reduced markedly. A second concern is how the corporation is structured financially. For example, if the corporation were capitalized with preferred stock or debentures (interest-bearing notes due in 10 or more years) going to the parents or to the off-farm heirs, this would reduce the amount of common stock the farming child would have to own to control the business. It would also "freeze" that portion of the parents' estate, saving future estate taxes or the cost of acquiring the property by the farming child. However, a carefully structured limited partnership, combined with a general partnership, can to a marked degree accomplish the same estate planning features.

Other legal features which may or may not be an advantage of the corporation include business continuity and limited liability. The corporation can be set up for a perpetual life, whereas the partnership must be reformed at the departure of any of the partners. However, remaining corporate members must have the managerial skills and financial wherewithal to control and operate the business for it to continue, regardless of the form of business organization.

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

Table 1. Comparison of Farm Business Organization Alternatives*

	<i>Sole proprietor</i>	<i>Partnership</i>	<i>Corporation</i>
Nature of entity	Single individual	Aggregate of two or more individuals	Legal entity separate from owners
<i>Business establishment and growth considerations</i>			
Source of capital	Personal investment, loans	Partners' contributions, loans	Contributions of share holders for stock, sale of stock, bonds, and other loans
Liability	Personally liable	Each partner liable for all partnership obligations.	Shareholders may not be liable for corporate obligations.
Limits on business activity	Proprietor's discretion	Partnership agreement	Articles of incorporation and state corporation laws
Management decision	Proprietor	Agreement of partners	Shareholders elect directors who manage business through officers elected by directors.
Income tax	Income taxed to individual; 60% 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 60% deduction for capital gains. 1982 tax rates: 16% on first \$25,000, 19% on next \$25,000, 30% on third \$25,000, 40% on fourth \$25,000, 46% on excess above \$100,000. 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.
<i>Transfer considerations</i>			
Business life/continuity	Terminates on death; business liquidates	Agreed term; terminates at death of partner. Liquidation of sale to surviving partners.	Perpetual or fixed term of years. Death may have little 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 1979.

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 liability issue should be checked carefully with your attorney, as well.

The corporation also has some negative characteristics in comparison to the partnership. Generally, it costs more to set up and maintain a corporation. There are also some possible adverse tax costs in the formation, operation, and dissolution of the corporation. At formation there may be a tax liability if a tax-free incorporation is not possible. There also may be a possible recapture of investment credit if part of the real estate or other property is withheld from the corporation. During operation,

social security taxes will be higher with the corporation. Also, a corporation gets no deduction for capital gains and must have a net income in excess of \$50,000 before this disadvantage is overcome. Retained earnings also can be a problem if the business is not growing fast enough to provide a place to reinvest earnings. Since incorporation usually is made as a tax-free exchange, termination holds the potential for a large capital gains tax.

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 of the stock of a closely-held corporation. Therefore, the minority stockholder may not receive 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-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 to get out of the partnership agreement.

PARTNERSHIP

A general partnership is the simplest form of business association of two or more persons. In structure, it can be likened to an "over-grown" sole proprietorship. It is easy to create, as no written agreement is required. With few exceptions, the arrangement can become whatever the partners agree to. Therefore, it can range from very simple to complex. Other key characteristics of the partnership are noted in table 1.

As a result, the general partnership tends to fill the gap between the sole proprietorship and the corporation. It can represent a stepping stone to incorporation, remain a continuing means of doing business, or revert to a sole proprietorship upon the retirement, death, etc., of one of the partners. It serves a useful role for many mid-sized businesses where taxes are not a problem. When combined with a limited partnership it can overcome much of the advantage of the corporation as far as estate transfer is concerned.

Forming a Partnership or Corporation: Some Checklists

A partnership is based on the following general conditions: (1) each member contributes 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. Many state extension services have worksheets available for this purpose.

The agreement should be put in writing once the desired share 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 spouses involved agree to the proposed settlement procedures. Property titles, wills, and other documents should be altered where necessary to reflect the desired partnership relationship. The "Checklist for General Farm Partnerships" (Appendix C) should prove helpful as you develop your partnership agreement. Secure legal help in making-up the final agreement.

Forming a corporation involves considerations similar to those discussed for a partnership, but the structure by law is required to be more formal. If you decide that a farm corporation is best for you, then the "Checklist for Farm Incorporation" should prove helpful in forming the corporation (Appendix D).

Two key issues which can have a major impact on future tax burdens and the ease with which property and control are shifted to the heirs must be faced at the time of corporate formation. These are: (1) what property should be put in the corporation and (2) what type of capital structure should be used? Therefore, you should not try to form a corporation unless you can secure the services of an accountant and attorney skilled in the formation process. You must also have a business orientation and a willingness to become a student of corporate operation.

Transferring the Farm to the Next Generation

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've worked hard to build and maintain a viable business. It has become a part of their lives and, as such, 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, 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 child? A third aspect of a sound transfer arrangement is equitable treatment of 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 parent or parents, completely or partially, retire 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 or she 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 child has the potential to take over the farm business.

Continuation of a parent-child partnership or corporation with the child purchasing a neighboring farm may be the answer to those cases where the parent is not old enough to retire and his income needs are still high, but the child 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 at least part of the transfer, of the property occur at a reasonably early period in the life of the child 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 circum-

stances. However, life and circumstances are not always normal. Families also should plan for the unexpected, such as premature death of one of the parents 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 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, spouses, and other heirs should be fully informed of the nature and implications of these agreements.

CHAPTER VI

Summary and Conclusions

This publication has been designed to aid you in answering two basic questions: (1) should we try to farm together and (2) if so, what type of business arrangement(s) would best fit our situation?

It was emphasized that every family and farm business situation is different, thus calling for a different farm business arrangement plan. After reading this publication, three things should be evident to you: (1) there is no shortage of legal tools to work with; (2) any business arrangement will work if you have good family relationships, a profitable business, and a workable operating agreement and transfer plan; and (3) some arrangements will work better than others in a given situation.

You will need to spend some time and money to get the job done right. You will have to study this material and your situation carefully to determine where you are, where you want to be, and how you might get there from here. You should seek out some good help—an accountant, attorney, management consultant—to help you in selecting and developing your business arrangement. Then, you should communicate your plan to the rest of your family and be prepared to revise it as needed.

REFERENCES

Regional

Bennett, M., *Livestock-Share Rental Arrangements for Your Farm*. North Central Regional Extension Bulletin No. 107. Lease form, North Central Regional Extension Bulletin No. 108.

Harl, N.E., et al., *The Farm Corporation*. North Central Regional Extension Publication No. 11, Rev. 1979.

Henderson, P.A., *Fixed and Flexible Cash Rental Arrangements for Your Farm*. North Central Regional Extension Bulletin No. 75. Lease form, North Central Regional Extension Bulletin No. 76.

Irrigation Crop-Share or Crop Share-Cash Farm Lease. North Central Regional Extension Bulletin No. 106.

Levi, D.R., and J.B. Grover, *Federal Income Tax Savings Possibilities by Incorporating*. Southern Extension Farm Management Committee, Publication 16, 1975.

Prötzer, D.D., *Crop Share or Crop Share Cash Rental Arrangements for Your Farm*. North Central Regional Extension Bulletin No. 105. Lease form, North Central Regional Extension Bulletin No. 77.

Pretzer, D.D., *Pasture Rental Arrangements for Your Farm*. North Central Regional Extension Bulletin No. 149. Lease form, North Central Regional Extension Bulletin No. 109.

Smith, R.S., and R.N. Weigle, *Taxmanship in Buying or Selling a Farm*. North Central Regional Extension Bulletin No. 43, September 1975.

Illinois

Krausz, N.G.P., *Installment Land Contracts for Farmland*. Extension Circular 823, 1971.

Indiana

ID-68 *Farm Planning and Financial Management*

EC-473 *Farming Together*

EC-438 *Flexible or Sliding Scale Cash Rents*

EC-282 *Indiana Father-Son Wage, Income Sharing Agreement*

EC-285 *Indiana Income-Sharing Contract with Guaranteed Wage*

Iowa

Harl, N.E., *Farm Estate and Business Planning*, Agri-Business Publications, Glenview, Illinois, 6th ed., 1980.

Harl and Halbrook, *Organization of Feedlot Operations*, PM-598, Iowa State University Cooperative Extension Service, 1974.

Schwenk and Ver Ploeg, *Your Family Business Affairs*, Pm-575. Iowa State University Cooperating Extension Service, 1973.

Kansas

Pretzer, Don D., *Business Organization of the Family Farm*. MF 279, Oct. 1980.

Pretzer, Don D., *Multi-Operator Farm Business Arrangements, Part I*. C-589, Jan. 1978.

Pretzer, Don D., *Partnerships as a Farm Business Arrangement, Part II*. C-590, Jan. 1978.

Thomas, W.B., *Business Organization of the Family Farm*. MF-279, December 1972.

Michigan

Field Rental Rates in Michigan. Extension Bulletin E-683, July 1980.

Hepp, R.E., and Kelsey, *General Partnership for Agricultural Producers*. Extension Bulletin E-731, Rev. September 1975.

Hepp, R.E., and Kelsey, *Partnership Agreement Worksheet*. Extension Bulletin E-731A, January 1972.

Rates for Custom Work in Michigan. Extension Bulletin E-458, July 1980.

Minnesota

Tiffany, D.G., K.H. Thomas and P.R. Hasbargen, *Land Rental Arrangements for Minnesota Farmland*. Econ. Report 80-3, 1980.

Thomas, K.H. and M.L. Freeman, *Farm Partnership Inventory and Net Worth Form*. FM 223, 1979.

Thomas, K.H. and M.L. Freeman, *Farm Partnership Worksheet*. FM 224, 1980.

Missouri

Bennett and Looney, *Farm Lease Agreement*. Guide Sheet 426, 1975.

Looney and Rottmann, *Farm Partnerships—Part I: General Guidelines*. Guide Sheet 510, 1972.

Looney and Rottmann, *Farm Partnerships—Part II: Legal Considerations*. Guide Sheet 511, 1972.

Looney and Rottmann, *Farm Partnerships—Part III: An Example*. Guide Sheet 512, 1972.

Matthews and Hagan, *Should You Incorporate Your Farm?* Guide Sheet 400, 1975.

Matthews and Rottmann, *Partnership Taxation (Sub S) For Farm Corporations*. Guide Sheet 506, 1976.

Matthews and Rottmann, *Installment Land Sales in Missouri*. Guide Sheet 507 (forthcoming).

Nebraska

Henderson, P.A., *Suggestions for Making Family Farm and Ranch Operation Agreements Work*. G77-381, 1977.

Perry, R.E., *Incentive Pay for Farm-Ranch Workers*. G76-311, 1976.

Perry, R.E., *What are Good Labor Relations*. G76-312, 1976.

Ulrich, J.R., P.A. Henderson and J.D. Aihen, *Guidelines for Articles of Incorporation and By-Laws*. EC78-869, 1978.

North Dakota

Anderson, R.A., *Examples of Father-Son Farm Operating Agreements*. Extension Mimeograph, 1974.

Anderson, R.A., *Father-Son Farm Operating Agreements*. Extension Mimeograph, 1973.

Johnson, J.E., *Suggestions on Father and Son Farming Agreements*. Ag. Econ. Bulletin No. 457 (revised), 1976.

Rice, B.B., *A Complete Farm Budget: Steps in Planning and Reorganizing the Farm Business (Worksheet), Section III, No. 2, Farm Management Planning Guide*. North Dakota Extension Service, 1973.

Staroba, Johnson, and Rice, "Farm Leasing in North Dakota." Section IX, No. 4, *Farm Management Planning Guide*. North Dakota Extension Service, 1975.

Staroba, Johnson, and Rice, "Lease Equity in Crop Share Leases." Section IX, No.5, *Farm Management Planning Guide*. North Dakota Extension Service, 1975.

Ohio

Moore, J.E., et al., *Should You Form a Partnership*. Extension Bulletin 550.

Moore, J.E., et al., *Guidelines for Forming a Partnership*. Extension Bulletin 551.

Moore, J.E., et al., *A Farm Partnership Agreement*. Extension Bulletin 552.

Moore, J.E., *Considerations to Help Assure Farm Partnership Continuation*. E.S.O. 292.

Moore, J.E., "Should You Incorporate Your Farm?" (Mimeo).

Moore, J.E., *Farm Business Organization Considerations*. E.S.O. 206.

Oklahoma

Maynard and Laughlin, *The Oklahoma Farm-Ranch Corporation*. Extension Circ. E-814.

Maynard and Laughlin, *Farm Partnerships*. Extension Circ. E-710.

Maynard and Boehlje, *Retirement Planning for Farmers*. Extension Circ. E-817.

Wisconsin

Luening, R.A., *Multi-Person Farm Operating Agreement Worksheet*. A2664.

Huber, L.F., R.A. Luening and A.R. Allen, *Cash Farm Lease*. A2850.

Huber, L.F., R.A. Luening and A.R. Allen, *Livestock Share Lease*. A2851.

Huber, L.F., R.A. Luening and A.R. Allen, *Crop Share Lease*. A2852.

APPENDIX A*

Appraising Your Present Situation and Potential for Joint Farm Operation

This form is designed to aid you in assessing your present situation to determine whether you should try to farm together. It is divided into two major parts.

Part I. Description Of Our Present Situation

Space is provided for you to provide a brief description of your family, your business, your present business arrangement and future plans. This information will be particularly useful to those advisors you choose to work with--such as your attorney, accountant, management consultant, etc.

Part II. Our Potential For Farming Together

Every business needs certain ingredients for success. This is particularly true of joint family arrangements because personal as well as business relationships are so important. Three key questions come to fore in appraising your potential for farming together successfully:

- * Do you really want to farm?/together? - Here you will need to be frank with yourselves. Is your child (and his or her spouse) really committed to farming? Can family members live, work and manage together?
- * Is the business profitable enough?/have growth potential? - Is your farm business profitable enough to provide financial security for the parents and farming opportunity for a family member? Is there potential for business growth over time?
- * Can an effective transfer plan be developed? - Will there be opportunity for the farming child to gradually assume management control of the business? Will he or she be able to acquire ownership of sufficient property in a reasonable time period without jeopardizing the parents' financial security?

After answering these questions, you should be in a better position to decide whether you should try to farm together and, if so, what route you should follow.

Kenneth H. Thomas
Extension Economist
Farm Management

Mervin L. Freeman
Area Extension Agent
Farm Management

Agricultural Extension Service
UNIVERSITY OF MINNESOTA
St. Paul, Minnesota 55108

*See Chapter 2 for information on how to fill out forms in Appendix A.

DESCRIPTION OF OUR PRESENT SITUATION

A. Family Situation

1. Father - Name _____ Age _____
 Years to Retirement _____ Health _____

2. Mother - Name _____ Age _____
 Work Outside Home _____ Health _____

3. Children

<u>Name</u>	<u>Age</u>	<u>Education</u>	<u>Marital Status</u>	<u>Present/Future Employment</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

4. Special Needs Of Any Family Members _____

5. If any of the other heirs want to farm, when might they start? Would they be brought into the present business?

B. Farm Business Situation

	<u>Acres Operated</u>		<u>Livestock Program</u>		
	<u>Owned</u>	<u>Rented</u>	<u>Kind</u>	<u>No.</u>	<u>Efficiency</u>
Total	_____	_____	_____	_____	_____
Tillable	_____	_____	_____	_____	_____
Avail. of more land	_____	_____	_____	_____	_____

<u>Machinery/Capacity</u>	<u>Facilities: Condition/Capacity</u>
Full-line yes ___ no ___	_____
Custom work hired _____	_____
Custom work done _____	_____

Additional acres we could operate with present machinery: _____ acres

<u>Labor Supply</u>	<u>Housing Situation</u>
Number of full-time family _____	_____
Number of full-time hired _____	_____
Months of seasonal labor _____	_____

OUR POTENTIAL FOR FARMING TOGETHER

A. Do You Really Want To Farm? Together?

1. Is the child (spouse) really committed to farming?
 - a. Do you really want to farm? _____
 - b. Do you want to farm with your parent for an extended period or just to get started? _____
 - c. What would you like to see happen to the farm business and what would you be willing to do to make it happen? _____

2. Can family members live, work and manage together?
 - a. Test yourself: would you be a good partner?
(See pages 21 and 22.)
 - b. Have you worked and managed together before? If yes, describe and evaluate. _____

B. Is The Business Profitable Enough?

1. Will it provide income sufficient to provide financial security for parents and opportunity for the child?

- a. Make a rough estimate (from schedule F)

Normal gross income	(1)	
Operating expenses (excluding depreciation) . . .	(2)	
Net cash farm income	(1 - 2) (3)	
Net nonfarm income	(4)	
Cash available for debt servicing, living, replacement	(3 + 4) (5)	
Family living and income taxes	(6)	
Real estate principal payment	(7)	
Cash available for non RE & replacement (5 - 6 - 7)	(8)	
Annual non RE payment	(9)	
Annual machinery replacement	(10)	
Surplus/deficit	(8 - 9) and (8 - 10) (11)	

- b. For more detailed analysis, use University of Minnesota extension publication FM 224.

2. If the income is not sufficient, how are you going to supplement it? _____

3. Parents, what would you like to see happen to your farm business and what would you be willing to do to make it happen? _____

C. Can A Realistic Transfer Plan Be Developed?

1. Is the parent willing to shift managerial responsibility?
 - a. Gradual shift of responsibility to the child while the parent is farming?

 - b. Will the child be able to handle the total managerial responsibility upon the parent's retirement?

2. Are parents willing/able to shift property ownership over time?
 - a. Analysis: are parents in a financial position to shift assets over time? Or, do they need them for their own income/security needs?

 - (1) Net worth position _____ (For a more detailed analysis, see University of Minnesota extension publications FM 223 and 224)
 assets _____
 debts _____
 net worth _____
 - (2) Income position - now? _____ retirement? _____
 - b. Conclusions: are parents willing/able to transfer property on a reasonable timetable?

<u>Personal Property</u>	<u>Able</u>	<u>Willing</u>
Sell portion while farming together?	_____	_____
Sell balance to child upon retirement?	_____	_____
Help finance sale?	_____	_____
<u>Real Estate</u>		
Give child favorable buy/sell options?	_____	_____
Sell portion while farming together?	_____	_____
Sell whole/portion of farm upon retirement?	_____	_____
Sell whole/portion of farm while living?	_____	_____
Help finance sale? Gifts?	_____	_____

3. What about other heirs?
 - a. How equitably have they been treated?

 - b. What is their attitude toward their sibling's gaining ownership in business?

 - c. Would they be willing to leave portion of their inheritance in the business for a period of years in order to keep the farm business intact?

D. Conclusions

1. Should we try to farm together?

2. If so, should we go into a testing stage to see if the child really wants to farm and whether we can farm together?

3. If we are beyond the testing stage, is the business big enough?

 - a. If not, should we expand the business or work around it?

 - b. If large enough, should we be in a partnership or corporation?

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

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.

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.

Your chances for success as a good farming partner

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

APPENDIX B*

Farm Employer-Employee and Joint Working Agreements Worksheet

This worksheet is designed to aid you in developing effective business agreements between farm operators and their hired employees as well as between farm family members. It includes the development of employer-employee type arrangements as well as more complex joint working agreements.

Arrangements developed with hired employees should reflect their capabilities and role in the business. For example, wages and incentive payments for a semi-skilled worker should be different than for a supervisory-management type worker. Similarly, the type of arrangements developed between family members should vary according to what phase they are in the so-called testing stage. Three such phases are identified below.

Entry Phase #1 - Wage or Wage-Incentive (pages 24 and 25)

Starting point for most situations, with focus on entrant's interest in farming and family's ability to work together. Opportunities to acquire production skills and assume some managerial responsibilities should be provided. Arrangements may range from cash wages only at the beginning, with incentives/bonuses added when entrant is ready to assume more responsibility. Incentive programs should be based on production/management areas over which entrant can influence outcome.

Entry Phase #2 - Wage-Profit Share (pages 25 and 26)

By this time the entrant should have accumulated considerable production skill and be relatively committed to a career in farming. Entrant should be ready to assume some overall management responsibility and be consulted on important business decisions. Arrangements may range from a fixed percentage of gross earnings to a sharing of net profits.

Entry Phase #3 (optional) - Joint Working Arrangements (pages 27 and 28)

This is an optional phase for use when it appears desirable for the entrant to enter a "holding pattern" for one of the following reasons: (1) to await the parents' retirement to take over the farm, (2) to build equity prior to spinning-off on one's own, or (3) to await a final joint decision to either expand operations and/or enter into a partnership or corporation situation. The entrant will normally be contributing some personal property as well as labor and management (and in some cases real estate). Arrangements usually include joint working agreements involving one or more crop or livestock enterprises or farm businesses.

Kenneth H. Thomas
Extension Economist
Farm Management

Mervin L. Freeman
Area Extension Agent
Farm Management

Agricultural Extension Service
UNIVERSITY OF MINNESOTA
St. Paul, Minnesota 55108

*See Chapter 3 for information on how to fill out forms in Appendix B.

ENTRY PHASE #1 - WAGE OR WAGE-INCENTIVE ARRANGEMENT

Example Your Plan

Employee's Responsibilities:

Son, John age 21, contributing only labor to the farm business. Provide labor where needed.

Cash Received Per Year

Value Other Benefits Per Year

Cash Received Per Year

Value Other Benefits Per Year

Cash Wages

7,200

Bonus/Incentive Payments

Crop

Livestock

Other/bonus

200

Fringe Benefits

- Housing, room and board
- Utilities
- Meat, milk and other produce
- Other (car, gasoline, etc.)
- Insurance (health, accident and life)
- Social security paid by employer
- Workman's compensation paid by employer

1,800

100

300

500

Total Cash/Benefits Received

7,400

2,700

Grand Total

\$10,100

BONUS / INCENTIVE / SHARE GUIDE

The following examples of incentive programs should be used only as guides and be adapted to your situation. They should be tied to work responsibilities carried out by the employee and over which he/she has some control.

Suggested Incentives	TYPE OF EMPLOYEE STATUS		
	Semi-Skilled	Skilled	Supervisory/Management
Normal Incentive Should Equal To:	2-5% of cash wages	4-10% of cash wages	5-15% of cash wages
General Farm	End of year bonus = \$100 - \$400 per year plus \$50 for each year of service	End of year bonus = \$200 - \$600 per year plus \$75 for each year of service	End of year bonus = \$300 - \$1,000 per year Plus \$100 for each year of service
Small Farm	Weekly bonus of 1½ times cash wage rate for each hour worked over 60 hours per week		2-5% of net cash income
Large Farm	Weekly bonus of 1½ times cash wage rate for each hour worked over 48 hours per week		1-4% of net cash income
Crop Farm	\$1-2/hour tractor driven after 7:00 p.m. (paid weekly) \$2-3/hour tractor driven after 11:00 p.m. (paid weekly)	\$1-3/hour tractor and/or combine driven after 7:00 p.m. (paid weekly) \$2-5/hour tractor and/or combine driven after 11:00 p.m. (paid weekly)	2-6 cents per bushel of corn produced over county average 5-15 cents per bushel of soybeans produced over county average
Dairy	\$1-3 for each cow detected in heat \$3-5 per calf weaned if death loss kept below 15% \$5-10 per calf weaned if death loss kept below 10%	<u>Calving interval</u> \$ 50 = 14 months \$150 = 13.5 months \$300 = 13 months \$500 = 12.5 months	<u>Herd milk production avg.</u> 12,000# = \$100/year 14,000# = \$400/year 16,000# = \$800/year 18,000# = \$1,600/year
Hogs	\$0.50-1.00 for each sow detected in heat	<u>Pigs saved per litter</u> 6.5 = \$ 50 7.0 = \$150 7.5 = \$300 8.0 = \$500 8.5 = \$900	<u>Feed conversion farrow to finish</u> 450# = \$100/year 400# = \$200/year 350# = \$400/year 300# = \$700/year 250# = \$1,100/year
Beef	\$5-10 for each feeder detected sick, treated and recovered	<u>Calf crop sold</u> 80% = \$100 85% = \$200 90% = \$400 95% = \$700 100% = \$1,100	Same as other two categories

ENTRY PHASE #3A - JOINT WORKING AGREEMENT - ENTERPRISE

General Description	Example			Your Plan		
	Total	Frank (name)	John (name)	Total	(name)	(name)
72 dairy cows; 14,000# milk desired share - 1/3-2/3						
Expected Income						
Milk @ \$13.00	\$131,040					
Culls @ \$240 per cow	17,160					
Total Income	(1) <u>148,200</u>					
Operating Expense						
Crops, if any	0					
Livestock, if any	16,200					
Total	(2) <u>16,200</u>					
Net Cash Income (1 - 2)	(3) <u>132,000</u>					
Annual Value Other Contributions/Profit Share						
Land/rent	0	0	0			
Machinery & equipment	4,680	0	4,680			
Home raised feed	61,480	61,480	0			
Buildings & equipment	12,240	12,240	0			
Labor & management	21,600	7,200	14,400			
Total Contributions	(4) <u>100,000</u>	<u>80,920</u>	<u>19,080</u>			
*Calculated Share (%)	(5) <u>100%</u>	<u>81%</u>	<u>19%</u>	<u>100%</u>	<u>%</u>	<u>%</u>
or *Desired Share (%)	(6) <u>67%</u>	<u>2/3</u>	<u>1/3</u>	<u>%</u>	<u>%</u>	<u>%</u>
Livestock: owned in same % as calculated share (line 5), or desired share (line 6)						
Annual Settlement						
Net farm income (3 - 4)	(7) <u>\$32,000</u>			\$		
% share of net (line 5 or 6)	(8)	<u>67%</u>	<u>33%</u>		<u>%</u>	<u>%</u>
Distribution of net (line 7 x 8)	(9)	<u>\$21,330</u>	<u>\$10,670</u>			
Total other contributions (line 4)	(10)	<u>80,920</u>	<u>19,080</u>			
Sub-total (9+10)	(11)	<u>102,250</u>	<u>29,750</u>			
Interest adjustment, if any (see below)	(12)	<u>+1,425</u>	<u>-1,425</u>			
Total annual settlement (11 ± 12)	(13)	<u>103,675</u>	<u>28,325</u>			

*Interest Adjustment: With desired share arrangement, the participant whose desired share (line 6) is higher than the calculated percentage (line 5) actually owes the other participant an interest amount on the difference in contribution between the two share arrangements. Calculate as follows:

Calculated contributions (line 4)	(a) <u>\$100,000</u>	<u>\$80,920</u>	<u>\$19,080</u>			
Desired share % (line 6)	(b)	<u>67%</u>	<u>33%</u>		<u>%</u>	<u>%</u>
Appropriate contribution under desired share (total line a x b)	(c) <u>100,000</u>	<u>66,670</u>	<u>33,330</u>			
Cont. discrepancy (a - c)	(d)	<u>+14,250</u>	<u>-14,250</u>			
Interest adjustment (d x interest <u>10%</u>)	(e)	<u>+1,425</u>	<u>-1,425</u>			
(insert total line e at line 12, above)						

APPENDIX C

Checklist for General Farm Partnerships

PRELIMINARY STATEMENTS

1. What are the names and addresses of the partners?
2. What name (if any) has been selected for the partnership?
3. Where will the partnership have its principal place of business?
4. In what farm (nonfarm) activities will the partnership be permitted to engage?
5. When will the partnership agreement take effect? How long will it run? Will it be automatically renewable?
6. When and how must termination be given?
7. An annual review of the agreement will be held _____.

CAPITAL CONTRIBUTIONS—CASH, PERSONAL PROPERTY, REAL ESTATE

1. A schedule indicating the initial capital contribution of each of the partners should be prepared, indicating its value and how contributed—whether outright, use only, or by lease.
2. Under what conditions can a partner make additional contributions to the partnership? Leave profits or annual use charges in the partnership?
3. If major improvements are made on a given partner's property, who will own them? How will they be paid for?
4. Under what conditions can a partner withdraw part of his contribution?

CONTRIBUTIONS OF LABOR AND MANAGEMENT; DUTIES AND LIMITS

1. Indicate the amount and value of each partner's labor and management contribution to the business.
2. What non-partnership work, if any, may a partner engage in?
3. Under what conditions will the partners not have an equal voice in management, and what will the arrangement be?
4. How will disagreements be settled?
5. How will management responsibilities be divided?
6. What will happen if a partner is unable to perform duties assigned to him?

7. What limitations will be placed on the partners relative to the use and disposition of existing property? The acquisition of property and debt? The management of personnel and dealings with other parties?

RECORDS AND ACCOUNTS

1. Where will the partnership establish its checking account? Who will be empowered to sign the checks?
2. What accounting system will be used? Who will keep the accounts? Will they be paid?
3. Who will do the tax work? Develop the capital account?
4. What periodic and annual financial statements will be provided to the partners?

PARTNERSHIP INCOME, EXPENSES, ANNUAL SETTLEMENT

1. Except for the following, all other income shall be considered partnership income: _____
2. Except for the following, all other business related expense shall be paid by the partnership _____
3. Cash withdrawals—what amounts will each partner be able to withdraw monthly for living expenses, debt servicing, etc? How can this amount be changed?
4. Are inventory changes to be considered on an annual basis or for the period of the agreement?
5. How will profits and losses be shared?
6. When are wages, salaries, rents, interest, or other types of compensation to partners to be paid?

PARTNERSHIP DISSOLUTION; BUSINESS LIQUIDATION OR CONTINUATION

1. What will happen to the partnership business if the partners agree to dissolve the partnership or the term of the partnership expires?
2. What will happen to the partnership business if a partner withdraws or retires? What limitations or penalties shall be placed on a withdrawing partner?

3. What will happen to the partnership business if one of the partners becomes incapacitated or dies?
4. If the business is liquidated, how will the person be selected to handle the winding up of the partnership assets? What will be the priorities for distributing partnership assets? How will assets in the capital account be shared?
5. If the business is to continue, what agreement has been reached as to the buy-out of the departed partner's interest by the remaining partners? Will the buy-out be mandatory or voluntary?
6. How will the value be established and payments made to execute the buy-out provision? Will life insurance be used to

fund part or all of the buy-out? Who will own and pay for the insurance?

ARBITRATION AND MISCELLANEOUS PROVISIONS

1. How will disagreements be arbitrated?
2. How will partners' housing be provided?
3. How will partners' vacations and time-off be handled?
4. Is provision for admitting a new partner desired?
5. Have the spouses been involved in developing the agreement? Do they understand it and consent to it?

APPENDIX D

Checklist for Farm Incorporation*

1. *Name.* What is to be the corporation name? Consider application to reserve corporate name.
2. *Duration.* Will the corporation be organized to exist perpetually? Or for a term of years?
3. *Purpose.* What are the purposes of the corporation? Narrowly defined or broadly stated?
4. *Stock and debt capital structure.*
 - a. How many classes of stock will be authorized? How many shares of stock will 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.
 - (2) Time of maturity.
 - (3) Conversion to stock.
 - (4) Interest rate.
 - (5) Priority on liquidation.
 - b. Is debt capital to be used? (Watch tax-free incorporation limitation.)
 - (1) Type of debt security (note, bond, debenture) and amount.
5. *Stock transfer restriction.* What type of restriction will 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 Minor 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 pre-incorporation agreement desirable?

*Prepared by Neil E. Harl, professor of economics, Iowa State University, and member of Iowa Bar.

8. *Officers.* What offices will be authorized? Who is expected to be elected to each office? What salary will be authorized for each officer? Is corporation to pay entire social security tax or only one-half? Will a bonus policy 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 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 will 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 will 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 will be the depository bank? Resolution of officer authority to borrow money and sign negotiable instruments should be prepared and sent to bank.
13. *Income taxation.* What method of income taxation will 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.
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 will be transferred to corporations? Insurance arrangements? Title transfer? What vehicles will 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 recapture 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 or 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. *Minorities.* Will stock 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.

North Central Farm Management Extension Committee:

Illinois	Duane Erickson
Indiana	David Bache
Iowa	William Edwards
Kansas	Don Pretzer
Kentucky	Charles L. Moore, Sr.
Michigan	Myron P. Kelsey
Minnesota	Fred Benson
Missouri	Herman E. Workman
Nebraska	Larry L. Bitney
North Dakota	Billy B. Rice
Ohio	Allan E. Lines
Oklahoma	Ted Nelson
South Dakota	Wallace Aanderud
Wisconsin	Robert A. Luening
SEA-Extension	Buel Lanpher
Farm Foundation	Walter J. Armbruster
Administrative Advisor	Paul B. Crooks (Purdue University)

Produced at the University of Minnesota.

Editor: Sharon Farsht. Designer: Dianne Swanson.

This publication is a revision of Extension Bulletin 401, Agricultural Extension Service, University of Minnesota.

In cooperation with NCR Educational Materials Project

Issued in furtherance of Cooperative Extension work, Acts of Congress of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture and Cooperative Extension Services of Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. Norman A. Brown, Director of Agricultural Extension Service, University of Minnesota, St. Paul, MN 55108.

Programs and activities of the Cooperative Extension Service are available to all potential clientele without regard to race, creed, color, sex, national origin, or handicap.