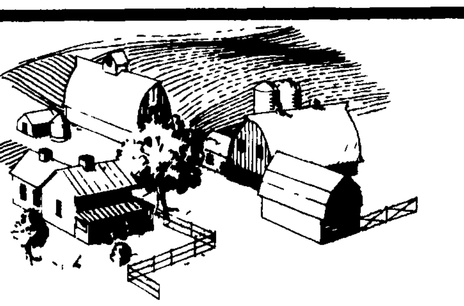
FARM MANAGEMENT



Drafting A Partnership Agreement

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This time of year many farmers are thinking about and planning for future changés in the business structure of their farm to reap all possible tax benefits. We do this with the use of rental, lease, joint venture, family security, and but-sell agreements. We also use benefits from installment sales, gifting programs, partnerships and corporations. Some of the options available are:

a.) transfer of farm assets
b.)change earned income to unearned income
c.) simplify the operation
d.) pool available resources
e.) start building equity for the next generation
f.) provide more flexibility in personal scheduling
g.) limit the liability of certain individuals
h.) redefine management responsibilities
i.) provide a continuous supply of labor and/or management
j.) include non-farming individuals in the profits and ownership of the operation.

Let's look at the partnership agreement. It is important to put the agreement in writing because there are many situations which may arise. Putting the agreement in writing can eliminate future disagreements and arguments that may destroy the partnership as well as the personal relationship.

The partnership agreement may be divided into the following eight sections:

1.) Introduction
2.) Contributions
3.) Labor, management and vacations
4.) Distribution of profits
5.) Financial records
6.) Partners Limits
7.) Dissolution or termination
8.) Miscellaneous.

Certain topics should be addressed in each section.

Introduction

This section should include the partnership name and address, name and address of the individuals involved, type of business, term of the partnership, and location of the partnership. Usually this is short and states the basics of the agreement.

Contributions

This section should detail the specific land, buildings, trees, machinery, livestock, supplies, feedstuffs, and/or cash contributions of each partner initially to the partnership. It should also discuss the recording procedures for tax and fair market capital accounts for each partner and how they relate to ownership of the partnership. It may also refer you to other rental or lease agreements.

This section should also state that all assets purchased or grown by the partnership after the partnership's formation will be considered partnership assets.

Labor, management and vacations

This section is **critically** important. Labor and management contributions and responsibilities should be spelled out explicitly unless they will be equal in all ways.

Almost always the business will operate more smoothly if one partner is acknowledged as the primary decision maker in a specified area. It should state which management decisions will be made strictly by joint agreement. This section should also state whether each partner will devote their undivided time and attention to the business and if side line businesses of any type will be allowed.

The time off and vacation limits should be stated in this section. Be sure to allow for vacations as this can be a major reason to form a partnership.

Distribution of profits

This section should be very detailed. The term "net profit" should be defined. Detail how the profits will be distributed which include the exact amounts of monthly draws for each partner.

You may consider the use of a guaranteed draw for a younger partner who will be putting more time and energy into the business than the senior partner. Using the guaranteed draw will give the junior partner more money to survive on, but yet not decrease his ownership of the business. This guaranteed draw will be a tax deduction, just like any wage for the operating partnership.

The effect of a substantial increase or decrease in farm profits on partners' draws should be discussed as well as the effect of a prolonged vacation, pursuit of other interests, illness or disability.

It is critically important that you spell out the payment for services of the spouses and children here, especially if the contributions are not nearly equal. The relationship of spouses to each other can often make or break the partnership.

Financial records

The financial records are the lifeblood of the partnership and need serious attention. The following are important points to address:

•Who will post the records, file the invoices, and see that the taxes are filled?
•What bank will the partnership use?
•Who can sign partnership checks?
•What is the maximum any one partner can spend without the other partners consent?
•What, if any, personal expenses (taxes, fuel, vehicle repairs, utilities, etc.) will the partnership pay.
•Will the partnership operate on a fiscal or calendar year tax basis?
•How often will the partners meet to review the financial records of the partnership?
•How soon after the end of the business year must the books be finalized and reviewed by all parties?

Partners' Limits

Limits should be set on the amount that an individual partner