General Partnership for Agricultural Producers
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This is a guide to understanding general partnerships.

This publication is designed to help potential partners understand the advantages and disadvantages of a partnership and to guide development of partnership agreements. Primary focus is on agricultural business partnerships, but the issues raised apply to other businesses.

Partnership details appropriate for a specific situation can be obtained from attorneys, accountants or other business advisors. This publication should serve as a guide in understanding partnerships so that a professional can be used more effectively.

We will restrict the discussion here to the general partnership. Although limited partnerships may apply to some farm businesses, their problems are sufficiently unique to require further legal guidance.

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Partnership

A partnership is an association of people who co-own a business for profit.

A partnership is an association of two people or more (may include husband and wife) who co-own a business for profit. Individuals forming a partnership contribute their capital, labor and skills to the business and share with each other the management responsibility, capital growth and returns from the business. Profits and losses may be divided among the partners in any manner which is agreed upon by the partners. There is no set pattern of ownership or operation. The partners determine the terms of the partnership in their partnership agreement.

The business relationship among individuals who are conducting a common business determines whether a partnership exists for tax and liability reasons. A partnership has three basic characteristics that distinguish it from other business organizations. A business association is a partnership when two people or more:

1. share control and management,

2. share profits and losses, and

3. share ownership and control of property.

Any one characteristic in and of itself may not define a partnership, but one characteristic in combination with the others may be sufficient evidence to show the existence of a partnership. For example, a father and son that operate a farm together, share profits and losses and own common assets could be considered partners.* However, the owning of property together in itself doesn't necessarily qualify as a partnership. Nor does the sharing of the crop on a gross receipts basis between a landowner and a tenant indicate a partnership arrangement.

A business partnership is flexible to different situations. To a young person, it may be an opportunity to enter business with parents. To someone with limited capital and a desire to enlarge the business, it is a needed source of capital. Legally, it is a type of business organization. Other types include the sole proprietorship and the corporation.

*For simplicity, all hypothetical cases in this publication assume a father–son partnership. The same result would be obtained if the partnership is a mother-son, mother-daughter or any combination of family members. Partners need not be related, but since most farm partnerships are family operated, we will refer to family members.

There are two kinds of partnerships: general and limited.

A general partnership consists of partners who share management and ownership of the business. Each partner is liable for partnership obligations for the settlement of debts or judgments against the business. A limited partnership is organized with one limited partner or more and at least one general partner. Limited partners are capital investors in a partnership and may not participate in its business management or operation. The general partners must assume all management responsibilities and risk in the farm. The limited partners are liable for partnership obligations only up to the amount of their investment in the partnership. A limited partner who does participate in management becomes liable as a general partner.

Limited partnerships are potentially useful in family businesses when one partner or more wants to retire from active involvement in the farm's operation but wishes to continue the capital investment in the farm. A capital return can be paid to the limited partners to compensate them for their investment. The general partners assume management and active involvement in operating the farm.

When two individuals or more decide to operate a business venture, they are forced to consider business organizations appropriate for multiple owners.

In profit organizations this is called a partnership or a corporation. Sole proprietorship is always an alternative, but it forgoes many advantages. However, partnerships also have some disadvantages. Compare the advantages and disadvantages of a partnership with corporate organizational structure and the sole proprietorship before deciding to form a partnership.

Many of the advantages of a partnership are extensions of the advantages of the sole proprietorship.

Both are characterized by the relative ease of organization and operation. Businesses can be formed and dissolved with few legal restrictions. Flexibility and maximum individual freedom are present. There are no boards of directors, no officers are specified and no formal meetings with minutes are required. The expense of forming and dissolving the business can be held to a minimum.

In certain situations, partnerships have advantages over sole proprietorships. As agricultural businesses grow and become more capitalized and complicated, the management responsibility becomes more critical. A partnership business can pool management abilities into one business and possibly be more profitable as a result. Individuals can combine their skills to strengthen the business to their mutual benefit.

Modernization and labor-saving technology are usually associated with businesses operated by more than one person. For many individuals with limited capital and a desire to avoid hiring labor, a partnership with another individual who has similar objectives may be feasible. If two individuals or more pool their capital resources, economies may be possible that were not present in smaller businesses. Likewise, it may be possible for the partnership to obtain larger loans and a better credit rating than smaller, less efficient operations.

Young people need help to get established in the agricultural business. They may need a business to operate, training and experience in management, and capital. Established farmers often want to be relieved of some of the responsibilities involved in operating the business, or may be looking forward to retirement. A suitable farm partnership can help in achieving these goals. A younger person can benefit from the senior partner's experience and counsel, and the business can gain from the new vigor and ideas contributed by the junior partner.

Tax paid under a partnership arrangement is merely an extension of a sole proprietorship. A partnership pays no income taxes as such—profit is allocated to the partners and the individuals pay the tax. Whether individuals in a partnership pay less tax than under a corporate structure depends upon the business profit level.

Joint Federal return tax rates for individuals in 1988 are 15 percent of the first \$29,750 of taxable income and 28 percent above \$29,750 taxable income. A 5 percent surtax is assessed between \$71,900 and \$149,250 of taxable income. Corporate rates for 1987 are 15 percent of the first \$50,000 taxable income, 25 percent for the next \$25,000, and 34 percent of all taxable income over \$75,000. Corporate income can be split between salaries and corporate profit and each can be taxed as separate entities. Therefore, make tax comparisons for each business situation.

Unlimited liability may be a disadvantage in a partnership.

The partnership is responsible for business debts, actions and mistakes of each partner. The partners prosper or fail together. For the partner with considerable capital assets outside the business, a partnership may make those assets vulnerable to risks not associated with a corporate structure. However, for most family operations with adequate insurance for unexpected disasters, this disadvantage may be worth the risk.

Management of the partnership business is usually shared equally by the partners. For the success of the partnership, it is almost imperative that management be joint to avoid disillusionment resulting from a dominating partner. In some cases, however, sharing management responsibilities results in divided authority and ineffective management. Each is responsible, but no one takes the responsibility to act. Unless a partnership addresses itself to the problem of decisive action, the business may drift with ineffective leadership.

Limited and uncertain business life are characteristic of either a partnership or sole proprietorship. The business is organized and operated for the benefit of the individuals. Once this benefit disappears, through changing goals, death or other circumstances, the business is dissolved. Multiple ownership in a partnership can extend the business life over many generations to transfer capital and management to the younger families. When an agricultural business becomes large enough to operate profitably with hired management, the corporate structure may offer business continuity not possible in a partnership.

Established farmers looking for a partner may have difficulty in finding someone qualified and agreeable. Because a partnership is perhaps the most intimate of all business relationships, a partner must be selected more carefully than an employee.

Every effort should be made to ensure that the partnership will be successful.

Although a partnership's success is not always determined by the partners themselves, they do have the responsibility to use everything in their power to work toward that objective. The following are points to consider and discuss when forming a partnership. They can be divided into three areas: the partnership agreement, the relationship between partners, and the business.

The partnership agreement is a blueprint.

Since the partnership agreement is a blueprint for the organization and operation of the business, it has a central role in total partnership success, and is the mechanism through which each partner relates to the partnership. Unless the partners are satisfied with the agreement, there is a tendency to shift personal resources (money and/or labor) to other uses.

The agreement should be equitable and fair to each party. Parties should share in the partnership proceeds according to their contributions of capital, labor and management. Each partner has alternative uses for contributed resources. Each partner must feel compensated in the agreement in relation to the other partners, or the partner will be dissatisfied with the total operations.

Individuals who own most of the capital resources is a common situation in father-son partnerships. Although the agreement should direct more payments to the largest capital contributor, he should not use his stronger bargaining position to dominate the agreement terms at the expense of the other partner(s). It may be necessary for the partner with the largest capital resources to sell a share of the personal property to the entering partner, and either finance the new partner directly or assist that partner in finding commercial financing. This does not require, however, that all capital from each partner be contributed to the partnership. For example, in a father-son operation, the land need not be included in a partnership. But the partnership should compensate the landowner-partner for capital input and operate the land as a unit rather than as a private business outside the partnership.

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

Furthermore, business personal property should be merged into partnership property at the start of the agreement. Each partner no longer owns equipment or livestock in his own name, but holds shares of the personal property in the partnership.

Special problems occur if a family partnership is started too soon. In some cases, the partnership should not be created immediately upon completion of the high school education. Individuals must determine if they can, and want to, work together in a common business. Also, the younger person must decide whether to enter business or to obtain education beyond high school. It is a good idea for children to work for wages as employees, or under a wage and profit arrangement for a period of time until these decisions can be made. Both of these arrangements are less formal, and such relationships are easier to sever than a partnership. Also during this period, the young person may want to acquire some capital items, but hold them as personal property and receive payment for their use until a partnership is formed. After deciding to form a partnership, each can contribute capital to the business.

Partners must relate well to each other.

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

Older partners tend to be conservative. They have many years and much capital at stake in the business. In these days of rapid changes on the farm, however, one can be too conservative. Some young partners tend to be venturesome, and particularly so when operating with someone else's money. The ability to compromise is essential. Ideally, partners should enjoy operating the business together. But, only conscientious effort by both can achieve this ideal.

In no other occupation are the home and business so closely related as in agriculture production. The spouses must like the business, respect the other partners, and get along with the other partners' spouses. Friction among them contributes to impossible situations. A spouse who is not happy with a situation may complain about the long hours or the low level of spendable income, making both parties dissatisfied. If all parties will be actively involved in the partnership, the spouses should become full partners in the business.

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

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

The less experienced partner may not be a competent manager when the agreement is started. This partner needs to develop management skills so there should be a general understanding and plan for him to grow into management responsibility. Also, it should be conceded that each partner will make some mistakes. Through guidance, however, such mistakes can be kept to a minimum. Partners' qualities may complement each other to offer an opportunity for specialization of responsibilities. Certain areas of management can often be assigned to each party in the agreement.

The partnership will not be successful if business earnings are inadequate.

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

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

A joint business operation requires a careful record of all financial transactions. Inventory records are needed at the beginning as well as at the end of each business year. Good account records lead to increased earnings. Such records are needed not only for monthly and yearly settlements, but also for business improvement. One partner may keep the records, but the other partners should be fully informed on the financial conditions of the business and have ready access to the records at all times.

Agreements

A written partnership agreement is recommended, but not required.

Oral partnership agreements are common and valid if the characteristics of a partnership are clearly present. Likewise, a partnership may be present even without an oral agreement if the actions of the parties meet the requirements of a partnership. Although partnerships may be successfully operated without a written agreement, it is strongly advised that the agreement be in writing.

The ownership and operational terms of a partnership agreement are not inherent to the business structure, but are reached through the consent of the parties involved. To develop common goals, each partner must understand the other's proposal. In drafting the partnership contract, partners can come to a more complete accord by detecting and correcting misinterpretations. Writing out the terms fosters preciseness and clarity. It is the end result of the bargaining process. While the agreement serves as a blueprint for action, the written agreement also serves as a way to evaluate intentions against the results. It is present as a reminder of each partner's commitment and should be reviewed for possible changes as conditions change.

Partnerships should be informal and flexible business arrangements. However, writing and signing a partnership agreement contributes necessary formality and stability. It denotes that a business is being created and fosters a businesslike attitude toward the new association.

Many oral agreements are successful because the partners jointly agree upon the decisions facing the business. But there is no assurance that a partner will always be present. The early death of one partner demands the dissolution of a partnership. But how? One way to convey those wishes is through the partnership agreement. It could save problems and cost for the estate, as well as ensure a procedure to continue the business, if the surviving partner(s) choose to do so.

The partnership agreement is a statement of terms.

A partnership agreement is a statement of terms under which partners bind themselves to organize and operate until the agreement is changed. Because partners are members of a business family, the agreement deals with the intra-family relationship. Litigation over the agreement usually involves only the members of the family. Therefore, the agreement is written for them.

The agreement should serve as a blueprint for the organization and operation of the business. It should be specific enough so each partner knows his rights and obligations, but not so detailed that a business decision cannot be made without reference to the agreement. The agreement should include guidelines for future decision making and cover major aspects of the business organization, operation and dissolution. And as conditions change, the agreement should be amended to reflect these changes.

The agreement should be simple in form and understood by all parties involved. Likewise, it should be legally sound and the terms operationally feasible. To ensure that these points are covered, it is advisable to have an attorney prepare the document.

Professionals, however, cannot decide what the terms of the agreement should be. Only the parties involved can do that. It may be helpful to use Extension Bulletin E-2119S, *Partnership Agreement Worksheet,* to decide and detail terms before contacting a lawyer. Following are highlights of some of the issues, tax considerations and alternative terms of a partnership agreement. Topic headings conform to the headings in the *Partnership Agreement Worksheet.*

How to use the Partnership Agreement Worksheet.

Preliminary Statements: Most agricultural partnerships are not newly established businesses, but continuations of existing businesses with additional ownership. Special problems are created when a new partner with little capital enters an existing business. Will the new partner acquire property from the existing business which in turn will be his capital contribution to the partnership? Property acquired by purchase is property that the present owner sells to the entering partner. Under this alternative, the present owner must report the sale for income tax purposes and pay any taxes due on the sale. The entering partner will have a new cost basis from the property which will be contributed to the partnership. Prices for the sale must be determined and repayment terms and interest rate established, if the seller finances the transaction. If the money is borrowed from a commercial lender, a loan must be arranged for the entering partner. In many cases, it is necessary for the existing owner to co-sign the notes for the beginning partner to obtain the loan.

Property acquired by outright gift from the present owner to the entering partner results in different tax treatment. Neither the donor nor the donee pays income tax on the transaction in this case. The donor's cost basis on gift property is transferred to the new owner and forms the cost basis to the partnership.

Gifts valued over $10,000 in cash or property in any one year to one donee may be subject to a federal gift tax and require filing a federal gift tax return by the donor. The donor pays any tax due. Consult an attorney or accountant for assistance in completing the return and other implications of the federal gift tax law.

Entering partners need not acquire property from the present owner. Previously owned capital may form the only capital contribution by the new partner.

Name and Place of Business: A partnership may exist without a name. However, a partnership name gives status or recognition to the business organization. Fewer difficulties are presented if a partnership name is chosen. The partnership name and partner names should be recorded in the county Register of Deeds Office. This gives public notice that a partnership has been formed and operates a business.

Nature of the Business: The nature of the business is usually broad enough to allow for many activities under the agreement. If the partners intend to limit partnership activities to one specific enterprise, or more, a more restrictive statement can be made.

Duration: From a business accounting and tax standpoint, all major changes in the agreement should be made at the end of the business year. The agreement can be for one year or longer periods. However, a one year period provides more flexibility for changes than agreements for a longer period. Usually, the agreement runs indefinitely from one year to the next if no changes are requested by the partners.

Partner contributions to the partnership are capital and personal services.

Capital contributions consist of cash, personal property or real property. Alternative capital contributions can be an outright transfer of property to the partnership or use only, (but not ownership) by the partnership. An outright contribution to the partnership transfers ownership of all the contributed property to the partnership. The contributing partner loses all personal rights to the items contributed. Compensation for the capital contributions is through profit sharing. Contribution of services are labor and management.

Cash Contributions: In some businesses, contributions consist almost entirely of cash. In agricultural businesses, cash contributions usually play a minor part because the partnership is the successor to an existing business. When cash does become part of the contribution, it can be an outright transfer to the partnership or a loan. Rather than contribute property outright to the partnership, each partner has the option to contribute cash directly to the partnership. The partnership, in turn, can purchase the individually owned property from each partner. If property is sold to the partnership, the selling partner must report the transaction as a sale for income tax purposes, and pay the capital gain or ordinary income tax due at the time of transfer. This is the main disadvantage of the procedure. The main advantage is simpler accounting for the partnership, and possibly a higher cost basis for the acquired capital assets.

A partner may also make a loan to the partnership. Due to high capital requirements in agricultural production, partners with adequate resources may lend the partnership money. The partnership usually pays interest on the loan and repays the principal over a stated time period.

Personal Property Contributions: Most agricultural partnership capital accounts are in personal property. The capital consists of feed, crops and supplies, breeding and feeder livestock, and machinery and equipment. When personal property is contributed outright to the partnership, values must be assigned to the property to determine each partner's contribution. The transfer of personal property to partnership ownership does not result in income taxes paid at the time of the transfer. The partnership assumes the cost basis of capital assets from the partner's depreciation schedule.

Outright contribution of personal property in equal shares by each partner is not required. However, experience with agricultural partnerships has shown equal ownership to be a more workable arrangement. The entering partner acquires equal ownership of personal property through purchase or gifts prior to the formation of the partnership. Personal property is inventoried and values are assigned to each partner's share. In a purchase, the entering partner pays for the property through interest and principal payments to a commercial lender or the existing owner, depending upon who finances the purchase. Repayment schedule and interest charged should be detailed in a note. The entering partner's newly acquired property serves as his equal share of outright capital contribution to the partnership.

Unequal contribution of personal property by each partner to the partnership is possible in situations where the entering partner does not want to obligate himself to large debt commitments. The partner with the larger personal property contribution should be compensated for his investment through a larger share of residual profits. The plan also requires the entering partner to acquire a larger share of partnership assets at some future date. Ways to accomplish this are covered in the section entitled "Future Capital Contributions."

An alternative to outright contribution is partner lease of personal property by the partnership, as discussed under real property contributions. The partner owning the property is the lessor and the partnership is the lessee. The lessor receives a payment under the lease from the partnership and reports the income for taxes as ordinary income. Depreciation remains an expense to the lessor. Payment by the lessee would be a business expense.

The lease agreement should detail whether the lessor or lessee purchases replacement property, who owns the offspring (if breeding livestock are leased), lease payments, length of lease and other terms. Not only is the lease agreement a special consideration, but also it requires extra record keeping for separate depreciation schedules, separate accounting of individual pieces of property owned by the lessor and partnership, and the replacement of leased property. Most cases would demand a program for eventual partnership ownership of the leased personal property.

Real Property Contributions: In most agricultural production businesses, real estate accounts for 70 to 80 percent of all capital under business control. Not all capital in real estate is owned, since rented land may be an important source of capital. A partnership may rent land much like any other business. Real estate owned by a partner can be contributed outright to the partnership the same as personal property, and real estate title is transferred into the partnership name. The income tax treatment from this transfer is the same as for personal property.

Agricultural partnerships need not own real property, but can retain the ownership in each partner's name. The partners contribute the "use only" of real estate to the partnership for either a share of the partnership profits or a fixed rental payment. The partnership never owns the real property, but has use of the real estate. The landowning partner is compensated for his larger investment, either as a predetermined figure from profits, or as a larger percentage of profits. In most cases, the partnership pays the real estate fixed costs, such as taxes, insurance and minor repairs or improvements—with the payment or larger share of profits going to the landowning partner to compensate for interest on investment and improvement depreciation. An alternate proposal would make the share of profits higher for the landowning partner, but obligate him to the real estate fixed costs.

Substitute Payment: On farms with real estate debt, some partnerships will substitute interest and principal payments to lenders rather than give the landowning partner a larger share of profits. If this alternative is chosen, the partnership agreement should specify that real estate payments are in lieu of profit distribution so that it is clear that nonlandowning partners have no residual ownership rights in the real estate.

If the real estate contribution for use only is about equal for each partner, partners share equally in residual profit.

Again, the partnership agreement should spell out this arrangement so the partners realize they have no ownership in other partners' real estate. The major difficulty in use only of real estate is the division of partnership profits for a fair and equitable share to all parties concerned.

When property is contributed outright to a partnership or when real estate is owned by the partnership, improvements to the property are owned by the partnership. A difficult question concerning payment and ownership of new improvements emerges when one partner or more contributes realty for use only by the partnership.

For example, if a permanent building is erected on property, the use only is contributed to a partnership and is paid for out of partnership funds. If, upon dissolution, the landowning partner receives the building in addition to this partnership liquidation share, he receives a windfall at the expense of his partners. Or, suppose the landowning partner dies and the remaining partners purchase the real property from the estate. The nonlandowning partners pay for the capital item twice, in effect—once as a share in the partnership and again when the property is purchased from the deceased's estate. Hence, improvements to real property owned by one partner should be paid for by the partner who owns the property and, in turn, is compensated for its use. If improvements are paid from partnership funds, they should be treated as partnership assets, and the nonlandowning partners should be entitled to their proportionate shares of the improvement value at partnership dissollution. To avoid misunderstanding, provision should be made in the agreement concerning disposition of such improvements.

If the real estate is leased to the partnership, a landlord-tenant relationship is established between the partnership and the landowning partner. Rent payments are made from partnership funds. The partners decide whether the payment will be for cash or a crop share. In this case, all ownership expenses on the real estate will be paid by the landowning partner from the rent income.

Under the farm lease arrangement, any net income to the landowning partner is ordinary income from investments, and does not qualify as income subject to Social Security. Because many fathers in a father–son partnership are attempting to increase their Social Security basis, this plan may reduce future Social Security benefits.

An alternative lease agreement would have the partnership pay the real estate fixed costs (taxes, insurance and minor repairs or improvements), plus allocate a fixed amount of net farm profit for interest on investment and improvement depreciation. In this framework, the interest allocation does qualify as income subject to Social Security.

Future Capital Contributions: The initial agreement determines the capital contribution for each partner at the start of the partnership. Partners may wish to agree at the outset regarding additional capital contributions to the partnership. Upon the mutual consent of the partners, a general statement can be made concerning this contribution, or a certain amount or percentage annual contribution specified. The need for this section arises when the partnership is initially established with unequal capital contributions.

In a father–son partnership, the partners may want to devise a gradual transfer of partnership assets from the father to the son. This will enable the younger partner to acquire, over time, a larger interest in the business. The additional capital contribution by one partner can be through gifts between partners, purchase between partners, or unequal reinvestment of business profits at the year-end accounting.

For example, a father–son partnership started with $100,000 of capital assets, with a 70 percent contribution by the father and 30 percent by the son. If the business has profits of $10,000 each year, shared 70-30, respectively, the father may withdraw all his profits and the son reinvest his share. The father's capital contribution remains at $70,000, but over a 10- to 12-year period at $3,000 or more each year, the son's capital ownership of the partnership equals his father's. If profits are split according to capital contribution and the son's share of capital increases over time, his share of profits should also increase over time.

Withdrawals of Capital Contributions: In some partnership situations, it may be desirable for one partner or more to be able to withdraw part of their capital contribution. In a father–son partnership, for example, the father may want to reduce his capital contribution and let the son increase his share. Usually, businesses increase in size over time and normal growth allows one partner to increase his capital contributions without decreasing another partner's total capital.

Labor Contributions: A partner should devote full time to the partnership. If one partner works for wages outside the partnership or carries on another business, it should be covered in the partnership agreement. The agreement should state how much time can be devoted to other activities and how much partnership salary will be reduced, if any.

Sharing ordinary income (net farm profit) is essential to the partnership relation.

Contributions made by partners to the partnership are compensated through distribution, either as salaries, interest allocations or ordinary income. A partnership is not subject to income taxes. Partners are liable for paying income tax on their respective shares of income, regardless of whether the actual funds have been distributed to the partners or left in the partnership for reinvesting and debt servicing.

Salaries: Periodic distribution of partnership funds can be made to each partner through salaries. Salaries are set at a level to compensate partners for labor and management services devoted to the business. Partners that contribute labor and management equally will generally have equal salaries. Usually, salaries are figured as an expense of the partnership before ordinary income is determined for the partnership tax return.

Drawing Accounts: Rather than distributing funds to partners through salaries, or as a means to make an unequal distribution of funds, "drawing accounts" may be established for partners to withdraw part of the business profits. The profit not withdrawn remains in the partnership for reinvestment and payment of partnership debts. Partners can withdraw money for their personal use during the year or wait until a settlement date. If drawing accounts are desired, a provision for them should be included in the partnership agreement.

Sharing of Ordinary Income: This section of the agreement spells out how ordinary income will be shared among partners. In most partnerships ordinary income should be shared according to contributions, even when contributions are unequal. If salaries are paid to reflect labor and management services, ordinary income should be shared at the same percentage as the partnership capital contribution. Sharing ordinary income according to capital contribution is not required, but each partner will be treated equitably if this principle is followed.

In a father–son partnership, the partners may desire that the younger partner receive periodic increases in his profit share as his capital contributions increase. A planned acceleration of his share in profits can provide incentive for the younger partner to accumulate a larger capital base and stay in the farm business. If a shift in proportion of shares is planned, a schedule showing this shift is necessary. Losses are generally shared in the same proportions as profits. If losses are not to be shared the same as profits, the partnership agreement should contain a provision for this purpose.

Keeping proper accounts and records is essential.

Proper partnership accounts must be kept for tax purposes, business evaluation and partners' information. The partnership's fiscal year must be the same as that of the principal partners unless documentation to the Internal Revenue Service establishes a business purpose for the difference. Likewise, partners may not change their individual tax year to a partnership tax year without a business purpose. Since most individuals file on a calendar year basis, the partnership will also be on a calendar year.

The partnership is the basic accounting unit and must file an annual information return even though it pays no tax. The partnership accounts must be kept so that partnership income having special treatment in the individual return is stated separately. These include short-term capital gains, gains and losses from the sale or exchange of property used in a trade or business, charitable contributions, dividends that qualify for deductions, and tax exempt interest. The partnership accounts may be on the cash or accrual method of accounting.

In addition to income tax records, the business should keep records for management purposes to show the business strengths and areas for business improvement. Capital accounts must also be kept to show each partner's capital contributions, withdrawals and reinvestments of profits. These capital accounts are necessary for equitable distribution of profits or losses, to know each partner's capital in the partnership, and for income tax records when an individual sells partnership property.

The partnership agreement may specify who will keep the records and reaffirm the right of each partner to inspect the partnership books and a full disclosure of partnership business information. It can state the accounting method and the kind of accounts and records that will be kept.

A partnership bank account is highly recommended. All partnership transactions can be handled from this account and all individual transactions handled from personal accounts. This separates the partnership's financial affairs from the individual partners. Partners may use personal funds while on partnership business, but can be reimbursed from the partnership account.

A partnership agreement may limit the partners' power.

The partnership agreement may place some limits on partners acting individually for the partnership or on partners' personal activities. These may be included to fix the rights and liabilities of the partners. The partner who acts contrary to his limited authority may still bind the partnership, but he will be liable to his partner for any loss caused to the partnership. For example, the partnership may limit a partner's ability to purchase major capital items without first consulting with the other partner.

Limitations may be placed on the personal activities of a partner because of the intimacy of the partnership relationship. Through mismanagement of personal affairs, a partner may jeopardize his share of the partnership assets, and indirectly, the property of the individual partners. One such limitation may be on personal debts of any one partner.

Partners share management responsibilities.

Partners characteristically share management responsibilities equally, but they can allocate specific managerial duties by agreement. Partnership business may be carried on most effectively if management duties are divided on the basis of each partner's interests and abilities. They may be divided by crop and livestock enterprises or jobs to be performed. This allows one partner to specialize in the technical aspects of one enterprise and share this information with other partners before decisions are made, while other partners specialize in other areas.

Partnerships dissolve when a partner ceases to be associated with the partnership.

Dissolving the partnership does not necessarily require liquidation of the business. With properly drawn transfer guidelines in the agreement, the business can continue as a new partnership or as a different business form.

Partnerships may dissolve for many reasons. The agreement should provide provisions for the most likely causes of dissolution by outlining procedures for (1) liquidation and distribution of partnership assets, or (2) provisions for purchasing a departing partner's assets.

1. Voluntary Dissolution: a partnership may be dissolved if the partners voluntarily and unanimously agree to do so. The agreement should spell out when this can occur and how partnership assets will be distributed.

2. End of Term: Some partnerships may be organized for a limited term and disbanded at the end of the term. If this procedure is desired, a special provision can guide this dissolution.

3. Withdrawal of a Partner: A partnership cannot function effectively without the consent of all partners. If one partner wants to be disassociated from the partnership, provisions in the agreement can outline the procedure for making the division with limited family friction. The agreement can specify proper motive, time of division and procedure for buying out or liquidating the departing partner's assets.

4. Retirement of a Partner: Retirement is a planned withdrawal from a partnership. Provisions can specify when the partner can retire under normal conditions, and how the retiring partner will be compensated for his share of partnership assets.

5. Death of a Partner: Appropriate buy and sell agreements or liquidation procedures can direct the payment to the estate for the partnership interest of the deceased partner.

6. Various other reasons may result in partnership dissolution: Some of these would include incapacity of a partner, expulsion of a partner, and admission of a new partner. Appropriate provisions may cover these situations.

Liquidation: Partners may prefer to liquidate upon dissolution rather than to continue the business. Liquidation can result from a sale of partnership assets or a division of assets to partners according to their proportional ownership share. Any special provisions for evaluating partnership assets or dividing certain property should be given.

Each partner will pay capital gains taxes if the selling price of capital assets is above the cost basis. Capital assets and other assets not classified as capital assets will be taxed as ordinary income. Depreciation recapture on depreciable assets or investment tax credit recapture will need to be considered.

Buy and Sell Agreements: In most situations, dissolving a partnership will not result in business liquidation. The remaining partners will buy out the departing partner's partnership interest and form a new business organization. The buy and sell agreement should cover at least three major areas.

1. When a partner leaves the partnership, it can be mandatory or optional for the remaining partners to purchase the departing partner's business interests. Usually, the situation requires the departing partner to sell his entire partnership interest.

2. Values must be placed upon the partnership interest held by the departing partner. Various methods are available to establish this value at the time of departure through appraisers, book values or by agreement. Because prices change rapidly, market values are usually used. The partnership could annually determine (by mutual agreement) a fixed buyout value. An advantage of this procedure is that values are certain and determined by the partners themselves. The major disadvantage, in practice, is that values change rapidly and partners fail to update the agreement to reflect these changes.

3. Financial arrangements must be established for payment to the departing partner. Cash settlement is usually preferred but generally the remaining partners do not have enough savings to follow this alternative. Remaining partners could borrow the money from commercial lenders, but this might put them deeply into debt, or make it impossible for them to borrow the desired amount. Reimbursing the departing partner in installments may be preferred. The terms of the settlement, interest rates, payment period, number of payments and security should be spelled out. Liquidation of some assets may be required to purchase the ownership from the departing partner.

In case of a partner's death, partnership life insurance may serve as a method to finance the purchase. The insurance would provide liquidity at death to make the purchase. If life insurance is used, the agreement should specify the kind and amount of insurance, who pays the insurance premium, what happens to the insurance policy if a partner departs other than through death, and who receives the insurance benefits. Usually, partners insure each other with the purchaser being the beneficiary. If partnership funds are used to pay the premiums, the partnership receives any cash values when a partner departs for reasons other than death. The individual receives any cash values if the premiums are paid from personal resources.

Other provisions may be important in an agreement. These may include partner housing and vacation, admitting new partners, length a partner may continue to draw a salary, and share of profit, if incapacitated.

Partners need to test their proposed plan.

Pretesting the proposed plan will determine if the financial terms are feasible before the agreement takes effect. This may be done by making an estimate of the receipts, expenses and net returns for a typical year under the plan of operation they propose to follow. If such estimated results reveal any kind of disappointments, it is not wise to complete the agreement unless adjustments are made or plans can be developed to increase the total income. A pretest also forces parties to consider all phases of their proposed operation and business relationships before an agreement is concluded.

Taxation

There are two theories of partnership taxation.

Two general theories of the taxation of a partnership have evolved, the aggregate theory and the entity theory. Both theories are recognized in taxing a partnership and its partners. In the aggregate theory, the partnership is viewed as a collection of taxable individuals with a business relationship. The partnership itself has no existence distinct from its members and, therefore, is said to be an aggregate of its members. This theory is reflected in the partnership tax return which requires a partner to include in his personal tax return his share of specified gains, losses, deductions and credits of the partnership.

The entity theory views the partnership as a separate organization from the partners. This theory is reflected in the partnership tax return which allows a partner to be treated as if he were an outsider conducting business with the partnership, such as renting property to the partnership or receiving a cash wage from the partnership.

The partnership agreement is very important in determining how partnership transactions will be allocated and taxed. In general, allocations of partnership income, deductions, capital gain, loss or credit to the partners will be controlled by the partnership agreement. In the absence of a provision in the agreement, the allocations will be made according to the manner in which general profits and losses are shared by the partners.

A partnership is formed by having partners contribute assets, services and, possibly liabilities.

A typical father–son partnership involves 50 percent ownership by each in the partnership personal property assets. To achieve this, the son purchases enough assets from his father, so that (combined with whatever livestock and machinery he may already own) it will equal his father's contribution. The father continues to own the real estate, and leases it to the partnership.

The income tax cost basis to the partnership (of the assets contributed) is the cost basis in the hands of the contributor. The contributor's cost basis in the partnership is the cost basis of the assets he contributed to the partnership, which is adjusted each year in the partnership tax return to reflect the net profit, withdrawals and operating losses.

When a partner sells his interest in the partnership, he is taxed on his individual cost basis in the partnership, which is not always the same as his share of the partnership cost basis.

Table 1 (p. X) is an example of the differences that can occur in the tax basis of partners' contributions of property to a farm partnership when a son purchases 50 percent ownership at market value in his father's business. The son then contributes his purchased assets to the partnership and the father contributes the other 50 percent. The tax ramifications of this example should be checked for any recent changes in the tax law.

Purchased breeding livestock currently on the father's depreciation schedule have a fair market value of $30,000 and an undepreciated cost basis of $8,000. The son's acquisition of $10,000 worth of livestock results in a $6,000 gain to the father ($10,000 purchase price for half the livestock—$4,000—half of his $8,000 basis). The son's contribution to the partnership carries a $10,000 basis, but the father's $10,000 market value contribution, only a $4,000 basis. The $4,000 is the undepreciated value left on the $10,000 market value retained.

The raised breeding livestock have an $18,000 market value. The sale of a half interest to the son results in a $9,000 gain to the father and a contribution by the purchasing partner to the partnership of a $9,000 basis, which is depreciable by the partnership. The father's $9,000 contribution of raised livestock has a zero basis.

Some feeder cattle had been purchased for resale by the father. The son's acquisition of half at a fair market value of $5,000 results in a $5,000 basis contribution to the partnership. The purchase price to the father was $6,000, so he has $2,000 of ordinary income ($5,000 minus ($6,000 ÷ 2)). His contribution of half the cattle, or $5,000, at fair market value contributes $3,000 of basis.

The 50 percent ownership of machinery and equipment was sold to the son at the undepreciated value to the father. Consequently, the fair market values and basis of

Table 1. Example of difference in basis of partners' contributed property to a partnership.

Property	Son		Father		Partnership	
	Tax Basis	Fair Market Value	Tax Basis	Fair Market Value	Tax Basis	Fair Market Value
Breeding livestock						
Purchased by father	$10,000	$10,000	$ 4,000	$10,000	$14,000	$20,000
Raised by father	9,000	9,000	—0—	9,000	9,000	18,000
Market livestock purchased for resale by father	5,000	5,000	3,000	5,000	8,000	10,000
Basis of machinery and equipment	15,000	15,000	15,000	15,000	30,000	30,000
Raised feed, crops and market livestock	6,000	6,000	—0—	6,000	6,000	12,000
Purchased feed and crops by the father	2,000	2,000	—0—	2,000	2,000	4,000
TOTAL	$47,000	$47,000	$22,000	$47,000	$69,000	$94,000

contribution of each partner are identical. There is no taxable gain or loss to the father on the sale.

The $12,000 worth of feed, crops and raised market livestock were on inventory in the prior business. A purchase of 50 percent ownership from the father results in $6,000 of ordinary income to him. Contribution to the partnership provides a $6,000 basis for the purchasing partner's contribution and a zero basis for the father's contribution.

The result of these transactions is $10,000 taxable income to the father in the year of partnership formation ($6,000 feed, crops, etc.; $2,000 purchased for resale) and capital gains of $15,000 ($6,000 gain on purchased breeding livestock and $9,000 gain on raised livestock). If there is any depreciation recapture on breeding livestock or machinery it is ordinary income and must be reported in the year of sale. The tax impact of these sales on the father can be reduced by electing to treat the breeding livestock as an installment sale, thereby spreading the taxable income over future years as the note is paid. The sale of the feed, crops and market livestock in a casual sale of this type would be eligible for an installment sale.

The contributed basis of the machinery is equal to its cost. The basis of the son's contribution of feed and crops is a deductible operating expense of the partnership in its first year of operation.

For ordinary expense items in inventory, such as feed, seed, fertilizer and purchased livestock, partnership expense deductions can be larger by having the partnership purchase the ordinary expense items from the prior business. The income, however, is taxable to the prior business owner. The tax impact on the prior business owner needs to be weighed against the results of the potential business deduction for the partnership.

To make adjustments in this situation, the purchasing partner could acquire the full value of specific assets from the prior owner (making the immediate tax impact less) and contribute these assets to the partnership. Such assets might be the machinery, equipment and purchased livestock.

However, the specific asset selection must be done carefully to avoid investment tax credit and depreciation recapture. This maneuvering reduces the father's taxable income on the sale, but he is likely to run into a more difficult tax situation when he sells his interest in the partnership, since his basis in the partnership will be considerably lower.

Annual income and expenses of a farm partnership are reported on a single Schedule 1040F for the total partnership.

A single depreciation schedule can be set up using the adjusted basis of the assets, as contributed by each of the partners, or each partner's share of the capital assets can be depreciated separately. In an equal partnership, the tax benefits and burdens can be shared equally, regardless of any inequity this may cause between the partners. For example, depreciation on the cows that the son purchases from the father could be shared with the father who contributed raised cows with a zero basis, and, therefore, were nondepreciable. If equal sharing is not desired, a provision can be included in the partnership agreement to allocate depreciation from specific assets to a partner. New regulations as a result of the 1984 Tax Reform Act may change the flexibility of depreciation allocations.

For example, the father receives a payment equal to the real estate depreciation for recovery of his investment in buildings and other real estate improvement. The payment is an expense to the partnership and income on the father's Schedule E as an offset to the depreciation on his real estate. Fixed expenses on the real estate, such as property taxes, insurance and minor repairs, can be paid by the partnership. An interest allocation to the father completes the payments by the partnership for the use of his real estate.

The net farm profit from Schedule F is carried to page 1 of a Form 1065—U.S. Partnership Return of Income. Any payments to partners for salaries or interest allocation for use of real estate are deducted as guaranteed payments. The ordinary income is carried to appropriate lines in Schedule K of Form 1065.

Capital sales, if any, are reported on a Form 4797 and Schedule D, and the net gain or loss is shown in Schedule K. The holding period of the partnership also includes the period during which the contributing partner held the property.

The Form 1065 Schedule shows the total partnership, income, capital gains and losses, credits and other items that are allocated to individual partners. A very similar form, The K-1, is completed in triplicate to show the individual's amount of each item. One copy of the K-1 for each partner is filed with IRS with the 1065; a second is filed by the partner with the individual's return and the third is retained with the partnership records. The individual partner then combines the items allocated to him on the K-1 in his individual tax return with any other income, capital gains and losses, and credits he may have.

Table 2 illustrates Form 1065 Schedule for a partnership tax return with a \$44,000 net farm profit. Each partner received a \$15,000 annual salary. Partner A (father) received, in addition, a \$6,000 interest allocation for the use of his real estate, also as a guaranteed payment. The partnership ordinary income after the above allocations was \$8,000 to be distributed equally. In addition, the partnership sold \$2,400 of raised breeding stock for a long-term gain and claimed a \$5,000 direct expense deduction on the purchase of a new forage chopper for \$12,000. The calculation of net earnings from self-employment includes the \$44,000 net profit less the \$5,000 direct expense deduction.

It is necessary to maintain individual partner's capital accounts in the partnership.

Individual partners' capital accounts provide the taxable basis of a partner's ownership in the business when he disposes of his share of the partnership or the partnership is dissolved. A partner's beginning count is the total of the adjusted basis of the property he contributes to the partnership. This is reduced to the extent that other partners assume any liabilities he contributes to the partnership. The basis of the partnership interest of each of the other partners is increased by their share of the assumed liabilities.

The capital account of a partner is increased annually by his share of the taxable income from the partnership. A decrease is required for distributions or withdrawals of money or property from the partnership, or his share of partnership losses.

These accounts are maintained in the Form 1065 section entitled "Reconciliation of Partner's Capital Account" and in each partner's Schedule K-1. The partnership illustrated in Table 1 and Table 2 would look like Table 3 (p. 22) if the partnership had \$44,000 of taxable income and \$21,000 was withdrawn by the father and \$15,000 by the son.

A Schedule L (Balance Sheet) must be maintained on the cost basis of partnership property to support the capital accounts for each partner. The balance sheet for this operation might look like Table 4 (p. 23). It has been assumed that $20,000 was paid for feeder cattle purchased for sale during the year and not sold at year end. Also, $12,000 worth of new machinery was purchased and $5,000 is currently owed on it. If the partnership meets certain requirements outlined in the instructions, the balance sheet items do not have to be completed. However, a partnership return must still be filed.

A partnership is terminated in two ways.

A partnership terminates if an aggregate of 50 percent or more of the capital and profits interest are sold within a 12 month period, or if the partnership business is discontinued. The termination can result from death of a partner, buyout of one partner by another, sale of partnership assets and distribution of proceeds to the partners, or the outright distribution of partnership assets to the partners. In any case, the tax basis for a partner of the proceeds of the sale, or of the assets distributed, is not the partnership's basis in the property. The partner's basis in the partnership must be allocated over the property or funds received.

The sale of a partnership interest is generally viewed as the sale of a capital asset that will produce capital gain or loss. There are two exceptions, however, that affect the sale of a farm partnership. Substantially appreciated inventory and unrealized receivables (i.e., cooperative revolving funds or crops and market livestock sold for which all the income has not yet been received) will be treated as ordinary income. Inventory items are substantially appreciated in value if their fair market value exceeds: (1) 120 percent of the partnership's basis in them; and (2) 10 percent of the fair market value of all partnership property other than money. Inventory in a farm partnership would include feed, seed, fertilizer, crops and market livestock. The basis of feed, seed, fertilizer and crops is zero, even when purchased by a cash basis partnership, since the items are included in cash expenses. The basis of market livestock would be cost, the same as for income tax purposes.

It appears that it would be difficult to obtain capital gain treatment for all of a partner's interest in a farm partnership unless at the time of sale the inventory is reduced to a very low valuation (less than 10 percent) of the fair market value of total partnership property including machinery and equipment, breeding livestock and real estate.

If the son was bought out at the end of the year, for example, his valuation or adjusted basis in the partnership is $49,700 . This must be allocated over the partnership assets to determine his ordinary income and capital gains on the sale.

Table 2. Schedule K, Form 1065—Partners' Shares of Income, Credits, Deductions, Etc.

Schedule K Partners' Shares of Income, Credits, Deductions, etc.		Partnership		Father's K-1		Son's K-1	
	(a) Distributive share items		(b) Total amount		(b) Total amount		(b) Total amount
Income (Loss)	1 Ordinary income (loss) from trade or business activity(ies) (page 1, line 21)	1	8,000	1	4,000	1	$4,000
	2 Net income (loss) from rental real estate activity(ies) (Schedule H, line 17)	2		2		2	
	3a Gross income from other rental activity(ies) 3a $						
	b Minus expenses (attach schedule) 3b $						
	c Balance net income (loss) from other rental activity(ies) ▶	3c		3c		3c	
	4 Portfolio income (loss):						
	a Interest income	4a		4a		4a	
	b Dividend income	4b		4b		4b	
	c Royalty income	4c		4c		4c	
	d Net short-term capital gain (loss) (Schedule D, line 4)	4d		4d		4d	
	e Net long-term capital gain (loss) (Schedule D, line 9)	4e		4e		4e	
	f Other portfolio income (loss) (attach schedule)	4f		4f		4f	
	5 Guaranteed payments	5	36,000	5	21,000	5	15,000
	6 Net gain (loss) under section 1231 (other than due to casualty or theft)	6	2,400	6	1,200	6	1,200
	7 Other (attach schedule)	7		7		7	
Deductions	8 Charitable contributions (attach list)	8		8		8	
	9 Expense deduction for recovery property (section 179)	9	5,000	9	2,500	9	2,500
	10 Deductions related to portfolio income (do not include investment interest expense)	10		10		10	
	11 Other (attach schedule)	11		11		11	
Credits	12a Credit for income tax withheld	12a		12a		12a	
	b Low-income housing credit (attach Form 8586)	12b		12b		12b	
	c Qualified rehabilitation expenditures related to rental real estate activity(ies) (attach schedule)	12c		12c		12c	
	d Credit(s) related to rental real estate activity(ies) other than 12b and 12c (attach schedule)	12d		12d		12d	
	e Credit(s) related to rental activity(ies) other than 12b, 12c, and 12d (attach schedule)	12e		12e		12e	
	13 Other (attach schedule)	13		13		13	
Self-Employment	14a Net earnings (loss) from self-employment	14a	39,000	14a	22,500	14a	16,500
	b Gross farming or fishing income	14b		14b		14b	
	c Gross nonfarm income	14c		14c		14c	

Table 3. Form 1065—Reconciliation of Partners' Capital Accounts.

Schedule M Reconciliation of Partners' Capital Accounts

(Show reconciliation of each partner's capital account on Schedule K-1 (Form 1065), Question I.)

(a) Capital account at beginning of year	(b) Capital contributed during year	(c) Income (loss) from lines 1,2, 3c, and 4 of Sch. K	(d) Income not included in column (c), plus nontaxable income	(e) Losses not included in column (c), plus unallowable deductions	(f) Withdrawals and distributions	(g) Capital account at end of year
$69,000	0	$44,000	$2,400	$5,000*	$36,000	$74,400

*Specially allocated direct expense deduction

Schedule K-1 for the Son.

I Reconciliation of partner's capital account:

(a) Capital account at beginning of year	(b) Capital contributed during year	(c) Income (loss) from lines 1, 2, 3, and 4 below	(d) Income not included in column (c), plus nontaxable income	(e) Losses not included in column (c), plus unallowable deductions	(f) Withdrawals and distributions	(g) Capital account at end of year
$47,000	0	$19,000	$1,200	$2,500	$15,000	$49,700

Schedule K-1 for the Father.

I Reconciliation of partner's capital account:

(a) Capital account at beginning of year	(b) Capital contributed during year	(c) Income (loss) from lines 1, 2, 3, and 4 below	(d) Income not included in column (c), plus nontaxable income	(e) Losses not included in column (c), plus unallowable deductions	(f) Withdrawals and distributions	(g) Capital account at end of year
$22,000	0	$25,000	$1,200	$2,500	$21,000	$24,700

Table 4. Schedule L—Balance Sheets.

Schedule L **Balance Sheets**

(See the Instructions for Question M Before Completing Schedules L and M.)

Assets	Beginning of tax year (a)	Beginning of tax year (b)	End of tax year (c)	End of tax year (d)
1 Cash		-0-		$9,400
2 Trade notes and accounts receivable				
a Minus allowance for bad debts				
3 Inventories FEED CROPS, MARKET LIVESTOCK		16,000		20,000
4 Federal and state government obligations				
5 Other current assets (attach schedule)				
6 Mortgage and real estate loans				
7 Other investments (attach schedule)				
8 Buildings and other depreciable assets MACHINERY, EQUIPMENT	30,000		42,000	
a Minus accumulated depreciation	-0-	30,000	11,000	31,000
9 Depletable assets BREEDING LIVESTOCK	23,000		23,000	
a Minus accumulated depletion	-0-	23,000	4,000	19,000
10 Land (net of any amortization)				
11 Intangible assets (amortizable only)				
a Minus accumulated amortization				
12 Other assets (attach schedule)				
13 **TOTAL** assets		$69,000		$79,400
Liabilities and Capital				
14 Accounts payable				$5,000
15 Mortgages, notes, bonds payable in less than 1 year				
16 Other current liabilities (attach schedule)				
17 All nonrecourse loans				
18 Mortgages, notes, bonds payable in 1 year or more				
19 Other liabilities (attach schedule)				
20 Partners' capital accounts		$69,000		$74,400
21 **TOTAL** liabilities and capital		$69,000		$79,400

General Partnership Sample Form

This general partnership agreement is entered into this __________ day of ____________________ 19 _______,
by and between ______________________________________ and ____________________________________

____

ARTICLE I: Name and Place of Business

A. The name of this partnership is ____

B. The principal place of business shall be at ____,
county _______________________________________ and at such other places within or without the State
of __________________________________ as may be agreed upon by the partners.

ARTICLE II: Nature of Business

This partnership shall engage in ____ business including the growing, purchasing and marketing of crops, livestock and other products and in such other business as shall be agreed upon by the partners.

ARTICLE III: Duration

The term of this agreement shall be from the __________ day of __________________________ 19 _______, to the __________ day of ____, 19 _______, and from year to year thereafter unless written notice of termination is given by either party to the other at least __________ months before the end of the agreement year.

ARTICLE IV: Contributions and Capital Withdrawal

	Partners' name (below)			
A. Original cash contributions by each partner:				
1. Outright cash contribution				
2. Cash loans to the partnership				
a. Interest rate payable				
b. Principal repayment terms				
B. Original personal property contributions by each partner:				
1. Market value of outright contributions				
a. Income tax cost basis				
2. Property leased to the partnership				
a. Annual lease payment				
b. Date lease ends				
c. Replacement property to be assumed by				
C. Original real property contributions by each partner:				
1. "Use only" of property				
a. Market value of contribution				
b. Fixed real estate expenses paid by				
c. New improvements paid by				
d. Compensation paid to owner for property use				
2. Market value of outright contribution				
a. Income tax cost basis				
3. Property leased to the partnership				
a. Annual lease payment				
b. Fixed real estate expenses paid by				
c. New improvements paid by				
d. Date lease ends				

D. Each partner shall leave in the business as additional contributions to partnership capital the profits not distributed to him at each annual accounting. Though neither partner shall be required to make additional capital contributions, other than profit distribution, each partner may make additional capital contributions to the partnership at such times, and in such amounts, as the partners may agree.

E. The capital contributions of the partners shall not be subject to withdrawal except upon dissolution.

F. Each partner shall contribute his full-time labor to the partnership and shall not engage in non-partnership work for profit.

G. Improved real property, the "use only" of which contributed herein, shall remain individual property and shall not become partnership property. All other contributed property shall be partnership property. All property to be contributed by the partners shall be contributed on, or before, the __________ day of ____________________ 19 ________ .

H. Improvements upon real property owned by a partner, the "use only" of which is contributed herein, shall be paid by the owner, unless there is special agreement otherwise in writing. Each partner agrees to improve his separate property in the best interests of the firm. In the event any improvements are made (with partnership funds) upon the separate property of the individual partner who contributes its "use only", it shall be partnership properrty and the individual partner shall be responsible to the partnership for the undepreciated income tax valuation of the improvements, when use of the property by the partnership is terminated.

ARTICLE V: Distribution of Salaries, Profits and Losses

A. The partnership shall pay each partner an annual salary of $ ______________ to be paid ______________ (date). The salary shall be treated as partnership expense in determining partnership ordinary income. The partners may alter the amount of this salary as they agree.

B. The partnership shall pay ______________ , who owns real property and has contributed the "use only" to the partnership, compensation from partnership funds of $ ______________ to be paid ______________ . This compensation shall be treated as an interest allocation to the partner and partnership expense in determining partnership ordinary income. The partners may alter the amount of compensation as they agree.

C. Each partner's share in ordinary income of the partnership shall be in the same proportion that the value of his capital contribution bears to the value of all capital contributions in the partnership business. Ordinary income shall remain in the partnership business account for re-investment and payment of partnership debts, unless a partial or complete distribution is agreed upon by the partners at the annual accounting.

ARTICLE VI: Accounts and Records

A. ______________________________ shall have the responsibility and duty to establish and maintain the account books and records of this partnership for the purpose of showing partnership income and expenses, each individual's capital and income status, the financial condition of the business and other information necessary for good management of the business. At the close of each fiscal year, he shall make a full accounting. The books shall be open to inspection by the partners at any reasonable time.

B. The partnership accounts shall be kept on a calendar year cash basis.

C. A capital account shall be maintained showing the ownership interest of each partner. The capital account of each partner shall consist of his original contributions plus any additional contributions, including any part of his share of partnership profits not withdrawn from the partnership, minus his share of partnership losses and capital distributions made to him.

D. There shall be a partnership bank account into which all partnership receipts shall be deposited, and from which all partnership expenses shall be paid by check except small items amounting to less than $ ____________, which may be paid by either party. For such cash expenditures, the parties to this agreement shall be reimbursed at the end of each month. Checks drawn on the partnership bank account may be signed by any one of the following persons:

______________________________ ______________________________

______________________________ ______________________________

ARTICLE VII: Partners' Powers and Limitations

A. Without consent of the other partner, no partner shall:

(1) Make, execute, or deliver an assignment of partnership property for the benefit of creditors.

(2) Contract to sell or lease all or substantially all of the property of the partnership.

(3) Submit a partnership claim or liability to arbitration.

(4) Confess a judgment against the partnership or any of his partners.

(5) Do any act that would make it impossible to carry on the ordinary business of the partnership.

(6) Admit a new member to the partnership.

(7) Act as surety, guarantor, or accommodation party to any obligation in the name of the partnership.

(8) Sell or mortgage, lease or assign, any partnership real property.

(9) Borrow or lend money on behalf of the partnership.

(10) Compromise any claim due the partnership.

(11) Hire or dismiss any employees.

(12) Contract or incur expenses or indebtedness on behalf of the partnership in any transaction involving more than $ ____________.

ARTICLE VIII: Management

A. Partners shall have equal voice in the management of the partnership business.

B. Each partner shall devote his full time and best efforts to the partnership business.

ARTICLE IX: Voluntary Dissolution

A. The partnership may be dissolved at any time by unanimous agreement. Upon dissolution, no further business shall be transacted by the partners, except that necessary for the orderly winding up of the affairs of the partnership and distribution of its assets.

B. Upon the termination of this agreement, an ending inventory of partnership property shall be taken and appraised jointly by the partners to determine the market value.

C. The partners shall share in the value of partnership property in the same proportion as the capital account shows the ownership interest of each partner.

D. If at the termination of this agreement actual division of the property owned in common is not possible or desirable, settlement may be made by auction sale or by one partner (or partners) buying out the share of the other partner (or partners), within a ______________ day period, at the value arrived at by joint appraisal.

ARTICLE X: Retirement, Incapacity or Death of a Partner

1. Any partner may retire from the partnership at the end of any calendar year after ______________ years following the formation of the partnership, by giving written notice to the other partner at least ______________ days prior to the time of retirement.
2. The partnership shall be dissolved on the death, insanity, or other total legal or physical disability of a partner.
3. Upon the retirement, incapacity, or death of a partner, the remaining partners shall have the option to purchase the retired, incapacitated, or decreased partner's interest in the partnership at market value, as determined by the remaining partners, and the departing partner or his representative.
4. The remaining partners shall have full authority to manage partnership affairs during liquidation, and shall make an accounting to the other partner, or his legal representative, when the partnership affairs are concluded.

ARTICLE XI: Arbitration

If differences should arise between the partners, they may elect to arbitrate a settlement. If they elect to arbitrate, they agree to use the following procedure and to abide by the resulting decisions. Each partner, or his representative, shall each select one arbitrator and the arbitrators shall determine the bases of settlement which to them seem equitable.

In witness whereof, the parties hereto have set their hand this __________ day of ______________ 19 ________.

____

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7:88-1.5M-New-SDC/UP-$2.00, For sale only. FILE: 17.241 (Operating Agreement-Partnership)

O-17622