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General Partnership for Agricultural Producers

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General Partnership for Agricultural Producers

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WHAT IS A PARTNERSHIP?

A partnership is an association of two or more people (may include husband and wife) who co-own a business for profit. There is no set pattern of ownership or operation. Whatever is agreed upon by the partners forms the terms of the partnership. However, a partnership does have three basic characteristics:

1. a sharing of profits and losses,
2. shared ownership and control of property, and
3. shared control and management of the business.

A business partnership is flexible to different situations. To a young man, it may be an opportunity to enter business with dad, or join an established professional practice, such as medicine or law. To someone with limited capital and a desire to enlarge his business, it is a needed source of capital. Legally, it is a type of business organization. Other types include the sole proprietorship and corporation.

WHY A PARTNERSHIP?

When two or more individuals 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 foregoes many advantages. However, partnerships also have some disadvantages. A comparison of the advantages and disadvantages of a partnership with corporate organizational structure and the sole proprietorship should be made before deciding to form a partnership.

Advantages of 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 formation and dissolving 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 man. For many individuals with limited capital and a desire to avoid hiring labor, a partnership with another individual who has like objectives may be feasible. If two or more individuals 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 men need help to get established in the agricultural business. They may need a business to operate, training and experience in management and capital. A father or father-in-law often wants 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 son or son-in-law can benefit from dad's experience and counsel, and father can gain from the new vigor and ideas his son may contribute.

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 corporate structure, depends upon the business profit level. Joint Federal return tax rates for individuals are higher than corporation rates for taxable incomes between $12,000 and $25,000 and above $44,000. However, Michigan income tax is greater for a corporation than for a partnership. Corporate income can be split between salaries and corporate profit and each taxed as separate entities. Therefore, tax comparisons should be made for each business situation.

Disadvantages of a Partnership

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 implied to be shared equally by the partners. For the success of the partnership, it is almost imperative that management be joint to avoid disillusionment resulting from domination by the stronger 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, the partner must be selected more carefully than an employee.

PURPOSE OF THIS PUBLICATION

This publication is designed to help potential partners understand the advantages and disadvantages of a partnership and guide development of partnership agreements. Primary focus is upon the agricultural business partnership, but the issues raised have application for 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.

ESSENTIALS FOR PARTNERSHIP SUCCESS

Every effort should be made to insure that the partnership will be successful. Although its success is not always determined by the partners themselves, they do have the responsibility to use everything in their power to work toward that objective. The following guidelines are offered as points of discussion in forming a partnership. They can be generally divided into three areas: the partnership agreement, relationship between partners and the business.

Partnership Agreement

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. Each party should share in the partnership proceeds according to his contribution of capital, labor and management. Each partner has alternative uses for his resources. Unless each feels his resources are fairly compensated in the agreement in relation to the other partners, he will be dissatisfied with the total operations.

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

ONE OPERATING UNIT

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 owned by each party should be merged into partnership property at the start of the agreement. Each owner no longer owns equipment or livestock in his own name, but holds shares of the personal property in the partnership.

Special problems may be created if a father-son partnership is started too soon. In some cases, the partnership should not be created immediately upon

completion of the son's high school education. It may take time for the father and son to determine if they can, and want to, work together in a common business. Time is also needed for the younger man to determine whether he wants to enter business, complete his military obligation and/or obtain additional education beyond high school. During this interim period, the son probably should work for wages as an employee, or under a wage and profit-sharing arrangement. Both are less formal, and such a relationship is easier to sever than a partnership. During this period, the young man may want to acquire some capital items, but hold them in his own name and receive pay for their use until a partnership can be formed. After deciding to form a partnership, each can contribute his capital to the business.

Relationship Between Partners

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

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

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

A BUSINESS FAMILY

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

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

The less experienced partner needs to be given an increasingly important role in management. He may not be a competent manager when the agreement is started, but there should be a general understanding and plan for him to grow into management responsibility. Also, it should be conceded that each partner may make some mistakes. Through guidance, however, such mistakes may be kept at 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.

Business Success

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

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

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 year of business. 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.

WHY A WRITTEN AGREEMENT?

A written partnership agreement is 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 a common course of action, each partner must understand the other's proposal. Through the drafting process, a more complete accord between the parties can be accomplished 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 source document for evaluating intentions against the results. It is present as a reminder of the commitment of each partner 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 insure a procedure for continuing the business, if the surviving partner(s) choose to do so.

THE PARTNERSHIP AGREEMENT

A partnership agreement is a statement of the 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 can not 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.

As conditions change, the agreement should be rewritten or amended to reflect those changes.

The agreement should be simple in form and understood by the parties involved. Likewise, it should be legally sound and the terms operationally feasible. To insure 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-731A "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 for a partnership agreement. Topic headings conform to the headings in the "Partnership Agreement Worksheet."

Preliminary Statements

INTRODUCTION

Most agricultural partnerships are not newly established businesses, but continuation of an existing business 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 should 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 will have to be determined for the sale and also repayment terms established for the debt payment. If the seller finances the transaction, the interest rate and principal repayment schedule should be established. If the money is obtained from commercial lending institutions, 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 in-

come 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 $3,000 in cash or property, in any one year, to any 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 or cash 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 or more specific enterprises, a more restricted statement can be given.

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 one for a longer period. Usually, the agreement runs indefinitely from one year to the next if no changes are requested by the partners.

Contributions

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 placed upon 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 placed upon each partner's share. If 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 newly acquired property by the entering partner 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. This 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 titled "Future Capital Contributions."

An alternative to the 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, 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, it is also 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 partners' 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 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 land-owning 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, property insurance and minor repairs of improvements — with the payment or larger share of profits going to the land-owning partner to compensate for interest on investment and improvement depreciation. An alternate proposal would make the share of profits higher for the land-owning 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 land-owning 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 non-land-owning 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 or more partners contribute 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 land-owning partner receives the building in addition to this partnership liquidation share, he receives a windfall at the expense of his partners. Or, suppose the land-owning partner dies and the remaining partners purchase the real property from the estate. The non-land-owning 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 upon real property owned by one partner should be paid for by the partner owning the property, who, in turn is compensated for its use. If improvements are paid from partnership funds, they should be treated as partnership assets, and the non-land-owning partners should be entitled to their proportionate shares of the improvement value at the partnership dissolution. 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 land-owning 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 land-owning partner from the rent income.

Under the farm lease arrangement, any net income to the land-owning 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 arrangement would have the partnership pay the real estate fixed costs (real estate taxes, property 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 on 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 initially the partnership is 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 re-investment of business profits at the year-end accounting. Let's examine a father-son partnership started with $100,000 of capital assets, with a 70% contribution by the father and 30% 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-plus 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

Under some partnership situations, it may be desirable for one or more partners 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 contribution 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.

Distributions

Sharing ordinary income (net farm profit) is the essential element for the existence of the partnership relation. Contributions made by partners to the partnership are compensated through distributions, either as salaries, interest allocations or as ordinary income. A partnership is not subject to income taxes. Partners are liable for the payment of the income tax on their shares of income, regardless of whether the actual funds have been distributed to the partners or left in the partnership for re-investing 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. Will salary be paid a disabled partner, and, if so, for how long?

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 re-investment, 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 the 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.

Accounts and Records

Proper partnership accounts must be kept for tax purposes, business evaluation and for partners' information. The fiscal year of the partnership 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 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 and losses, long-term capital gains and losses, 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 re-investment 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 re-affirm 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 which 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 financial affairs between the partnership and the individual partners. Partners may use personal funds while on partnership business, but can be re-imbursed from the partnership account.

Limiting Partners' Power

The partnership agreement may place some limits upon the partners acting individually for the partnership or upon the partner's 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.

Management

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 as-

pects of one enterprise and share this information with other partners before decisions are made, while other partners specialize in other areas.

Dissolution

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

CAUSES OF DISSOLUTION

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 be disbanded at that time. 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 partnership assets.

6. Various other reasons may result in the partnership being dissolved. 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.

Capital gains taxes will be paid by each partner if the selling price of capital assets is above the cost basis. Other assets not classified as capital assets will be taxed at ordinary income tax rates.

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 assets 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 assets. Usually, the situation requires that the departing partner sell all his assets.

2. Values must be placed upon the departing partner's partnership interest. 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 buy-out 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 death of a partner, 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 obtains the cash value when a partner departs for reasons other than death. The individual obtains the cash value if the premiums are paid from personal resources.

Miscellaneous

Various miscellaneous 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.

PRETESTING THE PROPOSED PLAN

Partners need to test their proposed plan, to 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 for increasing the total income. A pretest also forces parties to consider all phases of their proposed operation and business relationships before an agreement is concluded.

EXAMPLE 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.

Forming the Partnership

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, but contributes its "use only" 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 is his cost basis in 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, not on his share of the partnership cost basis.

Table 1 (p. 13) 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.

Purchased breeding livestock currently on the father's depreciation schedule have a fair market value of $20,000 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 ½ the livestock — $4,000 — ½ 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.

Table 1. Example of Differences 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

The raised breeding livestock have an $18,000 market value. The sale of a ½ interest 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 prior owner'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 at a fair market value of $10,000 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 ½ 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 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 formation of the partnership ($6,000 feed, crops, etc.; $2,000 purchased feed and seed, and $2,000 gain on livestock purchased for resale) and capital gains of $15,000 ($6,000 gain on purchased breeding livestock and $9,000 gain on raised livestock). The tax impact of these sales on the father can be reduced by electing to treat the transaction as an installment sale, thereby spreading the taxable income over future years as the note is paid.

The contributed basis of the machinery is equal. 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. 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 is considerably lower.

Annual Taxation

Annual income and expenses of a farm partnership are reported on a single Schedule 1040F for the total partnership. A single depreciation schedule is set up using the adjusted basis of the assets, as contributed by each of the partners. In an equal partnership, the tax benefits and burdens are 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 would 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.

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 C as an offset to the depreciation on his real estate. Fixed expenses on the real estate, such as property taxes, insurance and minor repairs, are 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 line 9 of a Form 1065 — U.S. Partnership Return of Income. Any payments to partners for salaries or an interest allocation for use of real estate are deducted on line 14. The ordinary income from line 26 is then allocated to the partners in Schedule K of Form 1065.

Capital sales, if any, are reported on Form 1065, Schedule D, and the distribution to partners is shown in Schedule K. The holding period of the partnership also includes the period during which the partner held the property.

The single 1065, Schedule D, and one partner's tax return are filed with the Internal Revenue Service. Partners report their share of partnership income and losses as shown on Schedule K in their personal Form 1040 and Schedule D, together with any other income they may have.

Tables 2 and 3 illustrate Schedules K and N of a Form 1065 for a partnership tax return with a $28,000 net farm profit. Each partner received a $7,000 annual salary. Partner A (father) received, in addition, a $6,000 interest allocation for the use of his real estate. The partnership ordinary income was, therefore, $8,000 to be distributed equally. In addition, the partnership sold $2,400 of breeding livestock for a long term capital gain and claimed $700 of additional first year depreciation on the purchase of a new forage chopper for $3,500. Additional first year depreciation was not claimed on the other capital purchases.

Partners' Basis

It is necessary to maintain individual partners' capital accounts in the partnership. These accounts are necessary, since they 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 capital account 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 and property from the partnership, or his share of partnership losses.

These accounts are maintained in Schedule M of the Form 1065. Schedule M of the partnership shown in Table 1 would look like Table 4 (p. 16) if the partnership had $8,000 of taxable income and no withdrawals or distributions were made to the partners.

A Schedule L (Balance Sheet) must be maintained on the cost basis of partnership property to support the capital accounts included in Schedule M. The balance sheet for this operation might look like Table 5 (p. 16). It has been assumed that $20,000 was paid for feeder cattle purchased for sale during the year and are on inventory. Also, $12,000 worth of new machinery was purchased and $5,000 is currently owed on it.

Termination of a Partnership

A partnership terminates if an aggregate of 50 percent or more of the capital and profits interests are sold within a 12 month period, or if no part of the partnership is carried on in the form of a partnership. The termination can result from death of a partner, buyout of one partner by another, sale of partnership assets and distribution of the proceeds to the partners, or the outright distribution of partnership assets to the partners. In any case, the tax basis of the proceeds of the sale, or of the assets distributed, is the individual partner's basis in the partnership and 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 taxable year of the partnership closes as of the date of termination of the partnership.

The sale of a partnership interest is generally viewed as the sale of a capital asset which will produce capital gain or loss. There are two exceptions, however, which 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 partner A was bought out at the end of the year, for example, his valuation or adjusted basis in the partnership is $51,000. This must be allocated over the partnership assets to determine his ordinary and capital gains on the sale.

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

1 Give name, address, and social security number of each partner. (Designate nonresident aliens, if any.) If return of partner is filed in another Internal Revenue Service Center, specify service center.		2 Percentage of time devoted to business
Partner A	Partner A, R.F.D. #1, Anytown, Michigan SS #123-45-6789	100%
Partner B	Partner B, R.F.D. #1, Anytown, Michigan SS #123-45-6788	100%

Partner's Share of:		Partner A	Partner B	Partner C	Partner D	Total
3 Ordinary income (loss) (line 26, page 1)		$ 4,000	$ 4,000			$ 8,000
4 Additional first-year depreciation (line 1, Schedule I) Schedule F, line 53		350	350			700
5 Payments to partners--salaries and interest (line 14, page 1) . . .		13,000	7,000			20,000
7 Net short term gain (loss) from sale or exchange of capital assets (line 3, Sch. D).						
8 Net long-term gain (loss) from sale or exchange of capital assets (line 7, Schedule D) . .		1,200	1,200			2,400
9 Net gain (loss) from sale or exchange of property under section 1231 (line 19, Sch. D) . .						
10 Net gain (loss) from involuntary conversions under section 1231 (line 22, Schedule D).						
11 Net earnings from self-employment (line 10, Schedule N).		17,000	11,000			28,000
14 Cost or Basis of Investment In Property:						
Life Years	Property					
a) 4 or more but less than 6	New--enter basis					
	Used--enter cost	3,600	3,600			7,200
b) 6 or more but less than 8	New--enter basis	1,750	1,750			3,500
	Used--enter cost	650	650			1,300
c) 8 or more	New--enter basis					
	Used--enter cost					

Table 3. Schedule N — Computation of Net Earnings from Self-employment. (See Instructions for Schedule N.)

1	Ordinary income (line 26, page 1)		$ 8,000
2	Add: Payments to partners--salaries and interest (line 14, page 1) . .	$20,000	
3	Net ordinary loss (line 10, page 1)	-0-	20,000
4	Total		$28,000
5	Less: Portion of line 4, page 1, which does not constitute net earnings from self-employment	-0-	
6	Nonqualifying dividends (line 5, page 1)	-0-	
7	Interest (see instruction for Schedule N)	-0-	
8	Net rentals from real estate (see instruction for Schedule N) . .	-0-	
9	Net ordinary gain (line 10, page 1)	-0-	-0-
10	Net earnings from self-employment. Enter in line 11, Schedule K		$28,000

Table 4. Schedule M — Reconciliation of Partners' Capital Accounts.

Partner	1. Capital Account at Beginning of Year	2. Capital Contributed During Year	3. Ordinary Income (Loss)	4. Income Not Included in Column 3	5. Losses Not Included in Column 3	6. Withdrawals & Distributions	7. Capital Account at End of Year
A . . .	$47,000	-0-	$4,000	-0-	-0-	-0-	$51,000
B . . .	22,000	-0-	4,000	-0-	-0-	-0-	26,000
C . . .							
D . . .							
Totals	$69,000		$8,000				$77,000

Table 5. Schedule L — Balance Sheets.

Assets	Beginning of Taxable Year		End of Taxable Year	
	(A) Amount	(B) Total	(C) Amount	(D) Total
Cash and checking account		-0-		$ 7,000
Feed, crops and market livestock		$16,000		20,000
Breeding livestock	$23,000		$23,000	
Less accumulated depreciation	-0-	23,000	4,000	19,000
Machinery and equipment	30,000		42,000	
Less accumulated depreciation	-0-	30,000	6,000	36,000
Buildings and other fixed depreciable assets	-		-	
Less accumulated depreciation	-	-	-	-
Land		-		-
Other assets		-		-
Total assets		$69,000		$82,000
Liabilities and Capital				
Accounts payable		-		$ 5,000
Mortgages payable		-		-
Other liabilities		-		-
Partners capital accounts		$69,000		$77,000
Total liabilities and capital		$69,000		$82,000

Sample General Partnership 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 property 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 re-imbursed 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 deceased 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_____.

____

____

____

Issued in furtherance of cooperative extension work in agriculture and home economics, acts of May 8, and June 30, 1914, in cooperation with the U.S. Department of Agriculture. George S. McIntyre, Director, Cooperative Extension Service, Michigan State University, E. Lansing, Mich.
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