

- the young person has a chance to grow into the business without incurring substantial debt;
- both parties are less confined by farm duties; and
- the older party can retire gradually.

When the younger party joins the business, some form of operating agreement is usually developed. The operating agreement allows the younger party to invest in the business, provide management, and receive a portion of the income from the business. Initially, the younger party may only invest in one enterprise (i.e. hogs, dairy, etc.) while working for a wage on the other enterprises. As the younger party's investment increases, the agreement is changed so his/her share of the income reflects the new investment. If the parties will farm together for several years, a more formal arrangement may be developed, such as a partnership or corporation.

Size of operation

Whether you choose a *spin-off* or *multi-person* arrangement may depend on the size of the parents' operation. Farm families with operations of adequate financial size have a wider array of business arrangements from which to choose.

Multi-person

This approach usually works best when the parent's business is of adequate financial size. Fewer problems arise over the division of income, and everyone is fully employed.

If the business is not large enough but the parents are near retirement, the parties may enter a holding pattern until the parents retire. When the parents retire, the younger party rents the home farm and buys or leases the personal property.

If the business is not large enough and the two parties will farm together for several years, they may develop a multi-person arrangement by expanding the business to meet the income needs of both families. Before doing this, the parents must be sure they are financially strong enough to make such a move and that they do not jeopardize their financial security in retirement years.

Spin-off

Even if the parents' business is of adequate size to support both families, the parties may decide to develop separate farming operations. A typical situation would be a cash grain operation where the parents' business is divided into two separate operations.

A spin-off arrangement is often used when the business is not large enough to support both families. In this situation, the younger party creates and develops a separate business and does not draw resources or income from the parent's business.

Legal arrangements

The major legal alternatives available to you are discussed below. The task is to find the one that best fits your situation.

Sole proprietorship

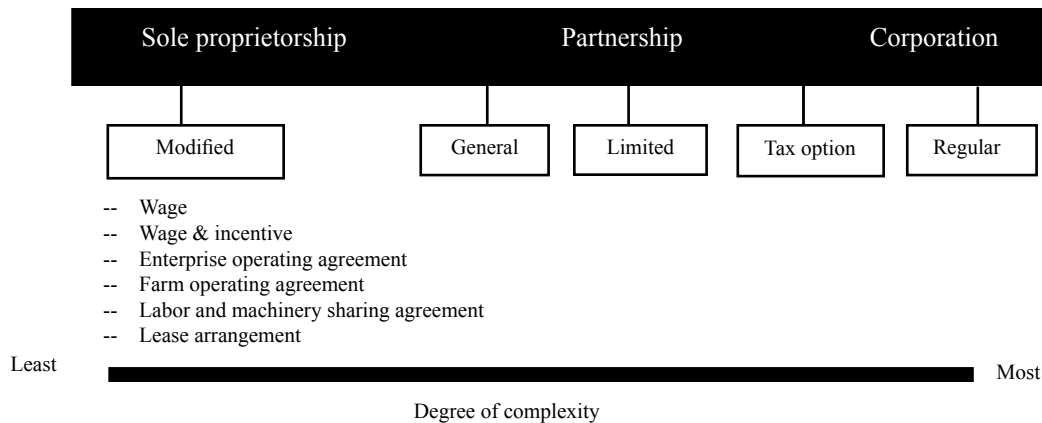
Under a sole proprietorship, the farm is operated by one individual. This legal arrangement continues until the operator quits farming, retires, or dies. Often two or more sole proprietorships are created and linked together with various types of contractual sharing arrangements. Various joint arrangements, such as enterprise and farm operating agreements are examples where two or more proprietorships are used.

Partnership

A partnership is an aggregation of owners. Two or more persons contribute assets to the business and share the management responsibility, profits, and losses. The partnership is not a taxpayer but channels taxable income to the individual partners. A special form of partnership permitted by state law is the limited partnership. A limited partner is an investor and cannot participate in management, but bears no personal risk for the actions of the partnership.

Corporation

The corporation is an artificial entity created under state law. It is a separate business and legal entity, distinct from its owners. There are two types of cor-



porations: (1) the *regular C corporation*, and (2) the *tax-option S corporation*. The regular corporation is a separate tax-payer. The tax-option corporation is a corporation in most respects except that it ordinarily pays no income tax.

Additional information and examples are available in the following files:

File C4-42 - Wage and Incentive Agreement

File C4-43 - Enterprise Operating Agreement

File C4-44 - Farm Business Operating Agreement

File C4-45 - Labor and Machinery Sharing Agreement

AgDM Leasing Section

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Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Jack M. Payne, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.