## Partnership

Apartnership is a flexible form of business organization. A summary of the partnership's applications to farming situations is presented below.

In a partnership, both parties have money invested in the business, share management responsibilities, and have some form of sharing of profits and losses.

A partnership is an association of two or more persons to carry on, as co-owners, a business for profit. A partnership may have either a written or oral agreement. In fact, a partnership may be implied without an agreement if the business is conducted like a partnership. The key determinant of whether a partnership exists is if there is a sharing of net income. Although a written partnership agreement is not required, it is recommended. The agreement is the basis for operating the business. Therefore it should be detailed and complete.

## Uniform Partnership Act

General partnerships are governed by a code of rules called the Uniform Partnership Act. Alternative and additional rules may be specified in the partnership agreement.

Unless stated to the contrary in the partnership agreement, the Act provides that:

- A partner is entitled to share equally in the profits and must assume an equal share of the losses.
- Each partner has an equal right in management.
- Any differences arising from ordinary matters connected with the business partnership may be decided by a majority of the partners.
- A partner is not entitled to a salary for management services.


## Property Ownership

A partnership can gain the use of property in three ways:

- Property can be owned in the partnership name. In this case, each of the partners is entitled to an interest in the partnership profits. Generally, property can be transferred into a new partnership in a tax-free exchange without paying income tax on the gain.
- The partnership can lease property from the individual partners or others.
- The individual partners can contribute the use of property to the partnership. The individual partners will often receive an interest in the partnership profits for their contribution of property.


## Sharing Arrangements

A 50/50 partnership agreement is often the preferred partnership arrangement. It facilitates the transfer of personal property to the younger party while permitting them to share in as much of the business profits as possible. Real estate and machinery are often rented or leased to the partnership when it is formed. However, if the younger party owns a portion of the machinery, additional machinery may be given or sold to them so that a 50/50 machinery ownership pattern is established with no lease involved. If financially possible, the younger party may then buy a 50 percent interest in any new machinery acquired by the partners or the partnership. The younger party also would be permitted to acquire 50 percent of the crop and livestock inventories.

If the older party is able and the parties agree, the younger party may receive a larger share of the profits, thus building equity more rapidly. However, the Internal Revenue Service may consider the inequitable sharing of income to be an unreasonable distribution and consider it a gift

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for tax purposes. Also, the question of equity with non-farming children may be a concern.

A farm family may wish to start with a share arrangement that is less than a 50/50 arrangement. Income may be shared according to each partner's relative contributions of land, machinery, labor, and management. For example, the older party may receive 75 percent of the income and the younger party 25 percent. A one-third and twothirds share agreement also may be considered. A process for diving income is provided in Information File C4-16, Dividing Business Income.

## Transferring Property

Partnership shares can be transferred from the older to the younger party, although not quite as easily or conveniently as corporate stock. Transfer of partnership shares to minors poses special problems.

## Dissolution

A partnership is a fragile arrangement. Dissolution of a partnership occurs when the stated term of the partnership is completed, or when a partner or partners decide to dissolve the partnership. Dissolution by law may occur at the death, departure, or bankruptcy of a partner unless there is a provision in the agreement for continuation.

Because the younger party is likely to be concerned with gaining equity in and eventual control of the business, it is a vulnerable position. However, dissolution of the partnership may not lead to a winding-up of the business. When the partnership is dissolved the partners can:

- Terminate the partnership
- Form a new partnership
- Change the form of business organization


## Buy and Sell Agreements

Partnerships may include buy-and-sell agreements where a deceased partner's partnership interest is purchased by the surviving partners. This agreement permits the business to continue
and reduces financial problems at the death of a partner. A buy-and-sell agreement may be funded with life insurance.

## Income Taxes

Generally the partnership pays no income taxes. The partnership files a Form 1065 information return. Income, losses, capital gains, etc. pass through the partnership to the individual partners. The partners report their individual share of income, losses, etc. on their individual income tax returns.

## Employee Benefits

The partners in a partnership are not employees for purposes of participating in employee benefits. However, partners can participate in benefits available to self-employed persons.

## Unlimited Liability

Partners of a general partnership have unlimited liability for the obligations of the partnership. If a general partnership incurs obligations, these obligations can be satisfied first out of partnership assets. If the partnership does not have sufficient assets, the partnership obligation can be satisfied out of the individually owned assets of the partners. Insurance is usually carried to cover liability based on negligence. The other liability is contractual liability.

## Limited Partnership

The limited partnership is a variation of the general partnership. A limited partnership has one or more limited partners. Limited partners have limited liability and cannot participate in management. A limited partnership must have at least one general partner who participates in management and has unlimited liability. Limited partnerships may be structured so that the farming family members are general partners and the off-farm partners are limited partners. In some situations, the limited partnership is used to hold the land, which is then rented to a general partnership, sole proprietorship, or corporation.

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