FATHER-SON FARM OPERATING AGREEMENTS

F. J. Reiss
CONTENTS

INTER-GENERATION TRANSFER PROBLEMS ............................................. 3

ESTATE PLANNING .................................................................................. 4

PARTNERSHIPS AND OPERATING AGREEMENTS ...................................... 5

TYPES OF FARM OPERATING AGREEMENTS ........................................... 6

Joint operatorships .................................................................................. 8

Examples .................................................................................................. 9

Some questions and answers .................................................................... 13

INITIATING THE AGREEMENT ................................................................ 17

SETTING UP THE AGREEMENT ................................................................. 18

OTHER CONSIDERATIONS ...................................................................... 19

ILLINOIS FATHER-SON FARM OPERATING AGREEMENT FORMS

FORM I .................................................................................................... 22

FORM II .................................................................................................. 25

This circular was prepared by Franklin J. Reiss, Professor of Agricultural Economics. It replaces Circular 587, "Father-Son Farm Business Agreements."

Urbana, Illinois


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FARMING HAS BEEN AND USUALLY STILL IS A FAMILY AFFAIR. Farm boys acquire most of their knowledge of farming and their interest in it from their fathers. Well over 90 percent of all new farm operators grew up or worked on farms before starting in farming on their own. It seems natural for a son to succeed the father as operator of the home farm.

The transfer of farm operatorship from father to son is far from being automatic, however, and not without problems. Some of these problems are psychological. Can the two men work together? Will the father insist on being the boss? Farming is an independent way of life, and it is not easy for a father to remember to consult with the son on decisions he has made by himself for many years. Why should he take time to explain to the son that "you can't raise hogs in confinement, and it takes too much money anyway"?

Some of the problems are personal—or they seem to be. The father may feel that he is just now getting his farm business set up the way he wants it and that he does not need the son to help him because he can handle the farm by himself. He may feel that other growing sons can always help if necessary and that the youngest son can eventually take over the farm operation.

Some of the problems are economic. Sometimes the farm is too small for two men. There may be a mortgage on the farm that will require all of the income to pay it off. Or there may be no way for the father to share the farm income with a son and still pay his debts, put the children through school, and save for retirement.

Then there are problems of how to do it. How can the son share in the farm business when he has no money or savings? What is a fair share to each party when the father furnishes all land and capital? Will the arrangement be fair to the other children? And how do father and son settle up each year and file an income tax return?

Of course there are problems in developing a father-son farm operating arrangement. But there may be more problems if one is not developed. For example, who will take over the home farm when the father is ready to retire or becomes disabled?

INTER-GENERATION TRANSFER PROBLEMS

Perhaps it is fortunate that the need for assistance is not all on one side. Fathers, too, face problems in reaching their goals of security in old age, of keeping the farm in the family, of keeping savings invested
in a safe and productive enterprise, and of providing opportunities for children and grandchildren. Without a vigorous, able, and interested son or son-in-law to ensure the continuity of the farm business, the father faces a sequence of undesirable or uninviting steps as he grows older. The pattern is quite familiar. First, rented land is given up and the farm operation is restricted to owned land. Next, the livestock may be given up or reduced, or some or all of the cropland may be rented out and the operation confined to some livestock and a limited acreage in pasture. Machinery becomes old and obsolete; buildings are not maintained; and finally another farm business disappears and the land is absorbed by neighboring farms.

In this process it is not only a farm business that disappears; the value of the estate is reduced and there is the disappointment of seeing a life's work fade away. These things are emphasized to make it abundantly clear that a father-son farm operating agreement is a two-way street with responsibilities, opportunities, mutual assistance, and benefits flowing both ways.

**ESTATE PLANNING**

The possible benefits from a father-son farm operating agreement are not automatic; they must be sought, planned, and worked for. They must be desired enough to compensate both parties for some waiting, some loss of freedom, some sharing, and some willingness to make room for the other party.

If the father is about 45 to 55 years old, he may have many active years ahead. Bringing a son into the business at this time may mean a longer period of joint operation. The farm business must be expanded to efficiently utilize the full-time labor of two men, or supplemental employment for one or both must be found. The father may still be building his estate. He should be in the prime of his management ability, and he may be reluctant to delegate enough responsibility to the son to challenge the son's interest and develop his abilities. The son may resent the domination and limited freedom imposed by his father.

Both father and son, and their wives, should face the problems of working together with full frankness; otherwise small irritations continually repeated and reinforced can become major obstacles to a successful agreement. Perhaps an answer can be found in dividing areas of decision-making and management responsibilities. Major decisions should always be jointly considered, but each party can be placed in charge of certain enterprises or activities. The son may like the hog enterprise and the father may like field work best. They can
still work together, but each is to some extent the "boss" in his particular phase of the business.

Another solution is to make the agreement a temporary one designed to help the son accumulate capital and management experience until he can start on his own on a rented farm. This arrangement is particularly suitable if there is more than one son who may be interested in farming.

If the father is more than 55 years old, the agreement with the son should recognize the problem of transferring the farm and the father's estate, with adequate provision made for the mother's income. At this stage the operating agreement can be more strongly oriented toward ownership by the son. Sale of property to the son may be planned with or without the use of gifts as a part of the transfer plan.

Even when the father is still relatively young, it may be wise to clarify the son's position with respect to the father's estate. Faced with too much uncertainty concerning his future on the home farm, the son may lose interest in farming or even leave the farm and take employment in town. This is particularly true if the son has a college education that qualifies him for either a meaningful role in the farm business or for satisfying employment elsewhere.

PARTNERSHIPS AND OPERATING AGREEMENTS

We have used only the term "farm operating agreements" in our discussion so far. Why not call these arrangements partnerships, as many people do? What is the difference, if any, between a partnership and an operating agreement?

Legally speaking, there probably is no difference where some co-ownership of capital exists, as would be the case under most 50-50 sharing agreements. Where the son contributes labor and management only, the agreement has been called a "labor-share lease" and as such may not meet the legal requirements of a partnership.

Another difference between a father-son farm operating agreement and a formal partnership is in the ownership of capital. Under a formal partnership, title to the operating capital, and possibly to the real estate, may be held by the partnership as a legal entity. Under an operating agreement, the parties to the agreement hold title to the farm business property individually or as co-owners. They make the property available for use under the agreement but do not transfer title.


2 For a complete discussion of formal partnerships see Circular 786, "Partnerships in the Farm Business."
At the end of an operating agreement each party retains his ownership interest in any property involved. At the termination of a formal partnership any partnership property must revert to individual ownership either by purchase and sale or by a distribution of partnership assets.

**TYPES OF FARM OPERATING AGREEMENTS**

Farm operating agreements within the family range all the way from very informal oral understandings to rather sophisticated share agreements written and signed by all parties concerned. Such plans can be thought of as forming a series of steps or stages in the son's progress toward the status of an established farm operator either as a tenant, a part owner, or a full owner. Among these steps are:

1. Wage and bonus payments
2. Enterprise share agreements
3. Joint operatorships with the son furnishing no operating capital (labor-share agreements)
4. Joint operatorships with the son furnishing some operating capital
5. Joint operatorships with the son furnishing half of the operating capital

Not all individuals will go through all stages in the above list, nor will any two stages necessarily occur in a given order. Some sons may work on the home farm for wages, and then, possibly after graduating from college, move directly into a joint operatorship with equal ownership of the operating capital. In other cases, where the son is uncertain of his interest or of his ability to get along with his father, it may be advisable to move through the third or fourth step.

**Wage and bonus plans.** There are two specific times in the development of a father-son farm operating agreement when a wage and bonus plan can be most appropriate. The first is when the son graduates from high school. He is not yet ready to take on a share commitment in the total farm business, but he should be given an incentive to use his time and place his interests in something beyond the small livestock projects he may have acquired. If military service lies ahead for the son, the wage and bonus plan may be best until he has fulfilled his obligation.

The other time particularly appropriate for a wage and bonus plan is when the son graduates from college or returns from military service in the middle of the year. For accounting and income tax reasons it may be desirable to begin a share agreement on January 1. Putting the son on a cash wage until the end of the year can solve this problem. Additional information on wage and bonus plans may be found in
Economics for Agriculture TA-20, "Incentive Plans for Farm Workers." This publication is available from your farm adviser or from the Department of Agricultural Economics, University of Illinois.

**Enterprise-share agreements.** This type of agreement may perform a transitional function if, for example, the son has a particularly successful 4-H or FFA project and wishes to continue it. It will be good training for the son if a definite agreement exists concerning his responsibilities for paying the father, in cash or in labor, for farm-grown feeds and for space used for such projects. Such agreements will help clarify the income tax status of the income produced by the projects.

Enterprise share agreements can also be used to develop and encourage a son’s interest in farming, or to test how genuine his interest may be. The son can be given a percentage of the gross sales from a beef cow herd, a swine enterprise, the soybean crop, or any other income source for which he can be given specific responsibility and freedom in making labor and management decisions. His share of the gross income should approximate the share that his direct labor and management are of the total inputs of the enterprise, including land and building rent, machinery costs, and capital depreciation.

Direct labor requirements for crop and livestock enterprises may be estimated on the basis of your own experience, your farm records, or from other sources such as the table below. Labor requirements will vary from farm to farm with the extent of mechanization and suitability of building services.

<table>
<thead>
<tr>
<th>Enterprise</th>
<th>Unit</th>
<th>Average annual hours of direct labor per unita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corn for grain</td>
<td>1 acre</td>
<td>5.0</td>
</tr>
<tr>
<td>Soybeans</td>
<td>1 acre</td>
<td>4.5</td>
</tr>
<tr>
<td>Wheat</td>
<td>1 acre</td>
<td>2.7</td>
</tr>
<tr>
<td>Oats</td>
<td>1 acre</td>
<td>2.5</td>
</tr>
<tr>
<td>Dairy herd</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1–9 cows</td>
<td>1 cow</td>
<td>160</td>
</tr>
<tr>
<td>10–24 cows</td>
<td>1 cow</td>
<td>125</td>
</tr>
<tr>
<td>25 or more cows</td>
<td>1 cow</td>
<td>110</td>
</tr>
<tr>
<td>Beef cow herd, calf sold</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1–14 cows</td>
<td>1 cow</td>
<td>30</td>
</tr>
<tr>
<td>15–39 cows</td>
<td>1 cow</td>
<td>20</td>
</tr>
<tr>
<td>40 or more cows</td>
<td>1 cow</td>
<td>15</td>
</tr>
<tr>
<td>Feeder cattle, long fed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1–39 head</td>
<td>1 feeder</td>
<td>20</td>
</tr>
<tr>
<td>40–79 head</td>
<td>1 feeder</td>
<td>14</td>
</tr>
<tr>
<td>80 or more head</td>
<td>1 feeder</td>
<td>12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Enterprise</th>
<th>Unit</th>
<th>Average annual hours of direct labor per unita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sheep, farm flock</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1–24 ewes</td>
<td>1 ewe</td>
<td>7</td>
</tr>
<tr>
<td>25–49 ewes</td>
<td>1 ewe</td>
<td>5</td>
</tr>
<tr>
<td>50 or more ewes</td>
<td>1 ewe</td>
<td>4</td>
</tr>
<tr>
<td>Hogs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1–14 litters</td>
<td>1 litter</td>
<td>30</td>
</tr>
<tr>
<td>15–39 litters</td>
<td>1 litter</td>
<td>23</td>
</tr>
<tr>
<td>40 or more litters</td>
<td>1 litter</td>
<td>20</td>
</tr>
<tr>
<td>Feeder pigs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1–99 pigs</td>
<td>1 pig</td>
<td>2.2</td>
</tr>
<tr>
<td>100–249 pigs</td>
<td>1 pig</td>
<td>1.6</td>
</tr>
<tr>
<td>250 or more pigs</td>
<td>1 pig</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: AE-3792, "Farm Management Manual."
Joint operatorships

The next step beyond either a wage or an enterprise-share agree­
ment should be an arrangement that extends the son’s interest and
participation into all phases of the farm business. But how can this be
done if he has no savings or property to contribute? Or suppose he is
too young to be ready to commit himself in his choice for his life’s
work. Or perhaps there are other uncertainties such as impending
military service, a younger brother who will want a chance at the home
farm, or a question of how well father and son can work together. All
of these are good reasons for postponing a financial involvement and
commitment to capital ownership in the farm business by the son. How
can the son best be brought into the farm business in such situations?

Labor-share agreements. In this arrangement the son will contribute
only his labor and management. He will, however, be expected to give
attention to all phases of the farm business, and he will share in the
returns from the total farm business. The father remains the owner and
titular head of the business and may also serve as banker for the
business because no separate bank account has to be set up.

Record-keeping is essential under a labor-share agreement because
the division of returns is based on the farm record. Keeping the farm
record can be the special responsibility of the son with cooperation
from the father.

The son’s share in the farm earnings can be (1) a share of the
gross income, (2) a share of the gross income above hired labor or
other selected costs, or (3) a share of the net income, meaning the
residual returns to unpaid factors of production. The next section will
illustrate how these shares may be calculated.

The son owns some capital. In this case the agreement may be essen­
tially the same as a labor-share except that the son’s annual contribution
will include interest on his capital. The more capital he contributes the
larger will be his share of the earnings.

A labor-share agreement can grow toward a 50-50 ownership of
operating capital by allowing the son to take some of his earnings each
year in the form of an ownership claim on the operating capital. This
means that the shares to father and son must be recalculated each year
to give the son credit for the extra capital input in the ensuing year.

Questions on such capital contributions by the son include the fol­
lowing: What about depreciation on his machinery, or death losses
among his livestock? Both of these items are a cost to the farm busi­
ness as a whole and they should be borne by the business and not by the
son alone. There are two ways to handle these costs: (1) either the
son is paid each year by the farm business for depreciation and death loss in his contribution, or (2) his contribution is allowed to remain at a constant number of dollars regardless of depreciation or death loss. Under the first method, his annual contribution and his claim at the end of the agreement would be his remaining capital value. Under the second way, at the end of the agreement the son would present a claim for the original value contributed even though the items were long since gone.

**The 50-50 share agreement.** Under this plan the father and son each own half of all operating capital and each gets half of all income above expenses, including as expenses payments for use of the father’s farm and payments to the son for labor he put in that was not matched by the father. This plan is closest to being an equal partnership.

If the farm is rented from a third party, the land does not enter into the operating agreement. The land rent will be paid by the farm business as an expense to come out of undivided income. Similarly, if the father owns all or part of the land, he will be paid an allowance or net rent for the use of his land. Or if father and son each contribute some land, only the difference in annual value will be paid to the party with the larger contribution. The rest of the land return will be received by each party as part of his half share of the income.

**Examples**

Let us illustrate the different joint operatorship agreements by assuming a farm situation. The father owns 320 acres. He rents an adjoining 80 acres on a cash lease from a sister, and he rents 220 acres, a mile down the road, on a crop-share-cash lease. The total acreage, 620 acres, is operated as a two-man, hog-cattle feeding farm. Of the 620 total acres, 530 acres are tillable land. See Table 1 on the next page.

**Son contributes labor and management only.** The son graduated from college in June and then completed the year as a replacement for the hired man on a wage and bonus plan. Now he wants to start January 1 on an operating agreement with his father. He, at 21, is the eldest of three children. He has an 18-year-old sister and a brother, 16, who is interested in the home farm. The elder son is not married and is eligible to be drafted for military service. Both he and his father feel there are too many uncertainties for him to buy into a share of the farm operating capital at this time. What share of the farm earnings should he get if he contributes only his labor and management?

The information needed to answer that question can be taken from Table 1, but the exact answer depends on what income, gross or net, is
Table 1.— A Financial Summary of a 620-Acre Farm as It Is Expected to be Operated Under a Father-Son Agreement

<table>
<thead>
<tr>
<th>Input items</th>
<th>Market values</th>
<th>Annual input values</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital items</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>320 acres land and buildings</td>
<td>$144,000</td>
<td>Interest @4%: $5,760</td>
</tr>
<tr>
<td>Machinery and equipment</td>
<td>18,000</td>
<td>Interest @6%: 1,080</td>
</tr>
<tr>
<td>Inventory of livestock, feed, grain, seeds, and supplies</td>
<td>32,000</td>
<td>Interest @6%: 1,920</td>
</tr>
<tr>
<td>Operating cash (bank balance)</td>
<td>3,000</td>
<td>Interest @6%: 180</td>
</tr>
<tr>
<td><strong>Depreciation or capital replacement</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings and fences</td>
<td>800</td>
<td></td>
</tr>
<tr>
<td>Machinery and equipment</td>
<td>4,750</td>
<td>4,750</td>
</tr>
<tr>
<td><strong>Operating expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Seed, fertilizer, and crop expense (omit landlord's share)</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Feed, breeding stock, and livestock expense</td>
<td>6,500</td>
<td></td>
</tr>
<tr>
<td>Taxes, insurance, building repairs, and others (omit landlord's share)</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>Hired labor</td>
<td>800</td>
<td></td>
</tr>
<tr>
<td>Gas, oil, electricity, machinery repairs, custom work, and supplies</td>
<td>5,600</td>
<td></td>
</tr>
<tr>
<td>Cash rent on 80 acres</td>
<td>2,150</td>
<td></td>
</tr>
</tbody>
</table>

| Operating expenses |           |                     |
| 24 months unpaid labor and management (12 months for the father and 12 months for the son) | 400/mo. | 9,600 |
| Total annual inputs |                     | $46,640 |
| Assumed gross farm income |           | 48,500 |

to be the basis for sharing. The guiding principle is that the son is to share in the income in the same proportion as he contributes to the business. If his labor and management are valued at $4,800 (12 months at $400 per month) and total inputs (exclusive of landlord's inputs on rented land) are $46,640, then his share of the total inputs, and hence of gross income, would be 10.3 percent ($4,800 ÷ $46,640 = .103). If the gross income is $48,500 (exclusive of share rent given to landlords on rented land), then the son's share would be $4,995.50 ($48,500 × .103 = $4,995.50). Thus under a profit-sharing agreement the son would receive almost $200 more than he would receive under a simple wage and bonus agreement.

Putting the son's share on a gross income basis is the simplest arrangement. He would get 10.3 cents out of every dollar received (after adjustment for changes in inventory). But this arrangement does not give the son any incentive to hold down costs. A better arrangement is to share the net income.

The son's share of the net income is also based on the principle of proportional sharing. The net income to be divided is that which remains after all expenses except unpaid labor, management, and inter-
est on capital have been paid. The son's share of this net income should be the same share as his labor and management are of the unpaid contributions.

In Table 1 we see that the annual input values on capital items, all contributed by the father, amount to $8,940. When the father’s $4,800 worth of unpaid labor and management is added, his total annual contribution comes to $13,740. The son contributes only his labor and management valued at $4,800. Thus the father contributes 74.1 percent of the $18,540 ($13,740 + $4,800) total annual inputs and the son 25.9 percent. Consequently the son should receive 25.9 percent of the net income. These calculations are summarized in Table 2. When the $5,550 worth of depreciation and the $22,550 worth of operating expenses and cash rent is subtracted from the assumed gross income of $48,500, we get a net income of $20,400. The son’s share of this would be $5,283.60 ($20,400 × .259 = $5,283.60). Note that this is a little more than the $4,995.50 he would get as a gross income share.

The son’s share of inputs can be calculated without knowing what the gross income might be and without knowing what the operating expenses might be (Table 2). Thus the shares to each party can be estimated rather easily, but the settlement at the end of the year requires a good record of income and expenses.

What about depreciation and unpaid family labor other than the father’s and son’s? These items can be added to the father’s unpaid contributions or they can be treated in the farm record as if they were cash expenses. Adding them to the father’s contributions will increase his share of the net profit and decrease the son’s share, but it also removes them as expenses, thus making the net to be divided a larger figure. The son’s smaller percentage share of a larger net will give him about the same total income for his contributions.

Son contributes some capital. The son can begin the process of capital accumulation by taking part of his earnings as a claim against

<table>
<thead>
<tr>
<th>Table 2.— Unpaid Contributions by Father and Son Operating the Farm Summarized in Table 1 Under a Labor-Share Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unpaid contributions                                      Total annual value (interest)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Land and buildings: $144,000                               $5,760</td>
</tr>
<tr>
<td>Machinery and equipment: $18,000                           1,080</td>
</tr>
<tr>
<td>Inventory items: $32,000                                 1,920</td>
</tr>
<tr>
<td>Operating cash                                             180</td>
</tr>
<tr>
<td>Labor and management.                                      9,600</td>
</tr>
<tr>
<td>Totals                                                    $18,540</td>
</tr>
<tr>
<td>Proportions (percent)                                      100</td>
</tr>
</tbody>
</table>
the business at the end of the year rather than have the father pay him his share in cash. For example, if the son had received a cash advance of $300 per month against his total share of $5,283.60, he might ask the father to credit him with a capital contribution of $1,683.60 toward the next year's business ($5,283.60 − $3,600.00 = $1,683.60). By repeating this process he will gradually build up a capital equity in the business.

From the father's standpoint this is the same as selling a part of the operating capital to the son. The son now has a claim on the ownership of the capital because the father keeps the money he would otherwise have paid to the son as income. It is as though the father had borrowed this amount from the son. In any final settlement the son must be paid in full for his capital claim or be given capital items worth that amount.

Suppose we change the way the contributions shown in Table 2 are shared by assuming that the son owns $3,000 worth of the machinery and equipment and $2,400 worth of the livestock. The result is that the son's share of the income increases in line with his contributions. This not only allows him to accumulate capital in the business, but it also gives him a larger share of any profits.

The total annual value of the son's $5,400 investment would be $180 on the machinery and equipment and $144 on the livestock. If these are added to the son's $4,800 worth of labor and management, his annual contribution becomes $5,124, or 27.6 percent of the $18,540 total annual contributions. These calculations are summarized in Table 3. Under this arrangement the son should receive $5,630.40, which is 27.6 percent of the net income of $20,400.

Table 3.—Unpaid Contributions by Father and Son Operating the Farm Summarized in Table 1 With the Son Contributing Some Capital

<table>
<thead>
<tr>
<th>Unpaid contributions</th>
<th>Total annual value (interest)</th>
<th>Contributed by</th>
<th>Proportions (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Father</td>
<td>Son</td>
</tr>
<tr>
<td>Land and buildings: $144,000</td>
<td>$5,760</td>
<td>$5,760</td>
<td>0</td>
</tr>
<tr>
<td>Machinery and equipment</td>
<td></td>
<td>900</td>
<td>0</td>
</tr>
<tr>
<td>Father: $15,000</td>
<td></td>
<td>180</td>
<td>0</td>
</tr>
<tr>
<td>Son: $3,000</td>
<td></td>
<td>0</td>
<td>180</td>
</tr>
<tr>
<td>Inventory items</td>
<td></td>
<td>1,776</td>
<td>0</td>
</tr>
<tr>
<td>Father: $29,600</td>
<td></td>
<td>144</td>
<td>0</td>
</tr>
<tr>
<td>Son: $2,400</td>
<td></td>
<td>180</td>
<td>0</td>
</tr>
<tr>
<td>Operating cash</td>
<td></td>
<td>9,600</td>
<td>4,800</td>
</tr>
<tr>
<td>Totals</td>
<td>$18,540</td>
<td>13,416</td>
<td>5,124</td>
</tr>
<tr>
<td>Proportions (percent)</td>
<td></td>
<td>72.4</td>
<td>27.6</td>
</tr>
</tbody>
</table>
Father and son as 50-50 partners. This plan requires the son to become the owner of half of the operating capital. This step may be approached gradually, as we noted above, or it can occur all at once by the son buying a one-half interest in the father's operating capital.

Taking the farm described in Table 1 as an example, the son would have to buy one-half interest in the $18,000 worth of machinery and equipment, the $32,000 worth of livestock, feed, and other inventory items, and the $3,000 bank balance. This is a total operating capital of $53,000 and the son's share would be $26,500.

Some questions and answers

1. Q. The sum of $26,500 is a lot of money. How can a young man just out of school finance that much capital? A. By giving his father a promissory note or notes in payment.

2. Q. Is the son expected to pay off such notes? A. The son is expected to pay off the notes he gives to his father. Just how this is done is a matter of agreement. Payments may be set up to amortize the debt in a stated number of years, or the son can make variable payments according to his share of the earnings at the end of each year. Of course, gifts of part or all of the principal may be made to the son by the father as part of his estate planning. See Question 7 below.

3. Q. Is the son expected to pay interest on the amount of the notes to his father? A. Yes. The rate of interest charged is a matter of agreement. If the rate is too low, a gift is implied. We suggest that if the father wants to make gifts, he do so explicitly in the form of reductions in the amount of principal owed rather than as a reduction in interest.

4. Q. What is a fair way to price the father's machinery when the son buys a one-half interest? A. We suggest that the remaining cost on the income tax depreciation schedule be used, if possible. This avoids capital gains or losses and a split depreciation schedule. Accelerated depreciation formulas may mean that the remaining cost on some items is considerably below their market value as used machinery. The difference can be overtly recognized as a gift. Other heirs can be given fair treatment in other ways.

5. Q. Suppose the son owned some machinery before the agreement. How is this handled? A. Let's go back to Table 3 in which we assumed that the son owned $3,000 in machinery (remaining cost) and $2,400 in livestock. If the son's property can be used efficiently in the farm business, he will be credited with a capital contribution of $5,400 against his $26,500 one-half share. He would then give his father a
note, or notes, for $21,100. In other words, if the total operating capital to be used in the business is $53,000, including the son's $5,400 capital items, then the father would be furnishing $47,600 worth of capital and the son $5,400. The father uses $5,400 of his $47,600 to match the son's $5,400, leaving $42,200 of the father's capital unmatched. Therefore, the son buys a one-half interest in this amount for $21,100.

6. Q. If the son now owns one-half of the operating capital, how is his property identified? A. The son and the father each own an undivided, one-half interest in all operating capital items including any items the son may have contributed. There is no need to identify ownership of a particular piece of machinery or breeding animal unless the agreement is being terminated. In this case one party can buy out the other party's interest without physically dividing the property, or, if a physical division is necessary, one party can divide the property into two lots of equal value and the other party can choose the lot he wants. The son can be given the prerogative, in the original agreement, of including in his share the original items he contributed or any offspring thereof.

7. Q. Which is better, the son giving his father a single note for his total obligation or a series of notes for lesser amounts each? A. This depends upon the objectives in mind and the expected repayment program. Payments can be set up on a fixed dollar payment annually, large enough to cover interest and retire the principal in a given number of years. Any good compound interest table should include the factor for calculating the desired annual payments.

Some families may agree to have the son make extra or irregular payments on principal with interest due annually on the unpaid balance. Others may want to make gifts from the parents to the son. If the son has given a series of small notes with progressive maturity dates, the parents can make a gift by simply marking one of these notes paid and presenting it to the son at Christmas or some other appropriate time.

Fixed principal payments with interest on the unpaid balance will mean higher initial payments because the interest declines each year with the principal payment remaining the same.

8. Q. Under a 50-50 share agreement, how are the income tax returns filed? A. It is advisable for the two parties to file a partnership return on Form 1065. This is merely an information return. There is no tax to be paid by the partnership. Form 1065 shows the earnings of each party. These earnings should then be reported by each party on his individual Form 1040. A single form 1040F should accompany the partnership return to show the farm earnings.
9. Q. How are money matters handled? A. We strongly recommend a separate bank account for the farm business. All farm income should be deposited in this account and all farm expenses and disbursements, including the shares of earnings to father and son, should be made by check on this account. The farm bank account will then be an important part of the farm business records.

Each party should have his own personal bank account separate from the farm business. Both parties can be authorized to sign checks against the farm bank account, but checks above a stated amount can be required to have both signatures.

10. Q. If the father has a mortgage against the farm, are the interest and principal payments on the farm a business expense to be charged to the farm business account? A. No. As long as the father retains ownership of the land, the mortgage payments are his personal obligation. Such payments would have to be made by the father out of his own income.

11. Q. How can the father give half of the farm income to the son and still have enough left to make mortgage payments and meet family living costs? A. This is a question that disturbs many fathers. What these fathers forget is that while they, in a sense, give up half of the farm income, they will receive other money returns in addition to their one-half of the farm income. Suppose we turn back to the example in Table 1 on page 10. Before bringing the son into the farm business the father got all of the $48,500 gross income. Now he gets only $24,250. But the real question is how this has affected his total net income.

Against the $48,500 gross income, the father had operating expenses and depreciation totaling $28,100, not including what he paid the hired man who was replaced by the son. If this was $3,000, then the father had $17,400 remaining ($48,500 - $31,100 = $17,400) out of which he would have to pay any interest and mortgage payments and family living expenses.

After the operating agreement goes into effect the father's gross income drops to $24,250, but his share of the expenses also goes down from an estimated $31,100 to $16,930 (one-half of $28,100 plus one-half of $5,760 for use of the father's land). His net farm income would thus be $7,320 ($24,250 - $16,930 = $7,320). But the farm business also pays him $5,760 for the use of his land (a net rent), and the son pays him interest on the $26,500 note he owes on half of the operating capital. At 4 percent this amounts to $1,060. Thus the father has a total net income of $14,140 ($7,320 + $5,760 + $1,060 = $14,140),
not much less than the previous $17,400, out of which to meet his financial obligations. This does not take into account any living or educational expenses he was previously paying for the son, or any payments the son will make on the $26,500 principal.

12. Q. How would the son make out financially under the 50-50 share agreement if he owes the father the full $26,500? A. His net farm income would be $7,320, the same as the father's. However, he would have to pay $1,060 interest to the father, thus leaving $6,260 out of which to make principal payments and meet family living expenses.

13. Q. What about the 16-year-old son; how can he be brought into the business? A. It depends partly upon what the father wants to do at the time the second son wants to join the operating agreement. If the father is near retirement age, he may sell his share of the operating capital to the second son and let the two brothers operate as a two-man partnership. This might also occur if the father is ill or otherwise incapacitated. Or, he may be in a position to devote most of his time to off-farm activities.

A big problem in bringing in a second son while the father is still active in the farm business is how to get enough volume for three men. If they can rent or buy more land or expand livestock enterprises, they may be able to achieve a three-man operation, but this should be determined before commitments are made.

If the volume problem can be solved, the father may initially sell only a one-third interest in operating capital to the older son, and thus hold a one-third interest for the second son. If the younger son's desire to farm is not positive, then the 50-50 share with the elder son is advisable. The younger son can buy a one-third interest from each of the two parties if and when he is ready to join the operation.

14. Q. How long should father and son operate under a given agreement? A. No longer than necessary. Many operating agreements are carried on much beyond the time when a change should have been made. This particularly tends to be the case where the experience has been most successful. Both father and son are happy with the arrangement and don't want to make a change. The son should be the one who should anticipate changes that will allow him to make progress toward capital ownership and the independent tenure of a tenant or part-owner.

The requirements of qualifying for Social Security benefit payments may force the father to give up his operating interest in the partnership and assume the role of a landlord receiving rental income. The son should plan ahead for this change.
INITIATING THE AGREEMENT

Communications between father and son are often notoriously poor. Neither one may really know the real hopes and aspirations of the other. The father would like to have his son as a business partner but doesn't want to force him into it. The son may hesitate to raise the subject because he feels a strong need to achieve a status, independent of his father, in which he is not beholden. At the same time he would welcome a chance to step into an operating arrangement where he could be his own man and carry his share of the load.

In such a situation a third party can be helpful. The farm adviser, vocational agriculture teacher, farm record fieldman, and many others may be approached by either party with a plea or an implied wish to speak to the other party. Such tactics have "broken the ice" in a number of cases, but there is much merit in an open and forthright question by either father or son to the other. What the father may forego in not waiting for the son to take the initiative he can make up in noting the degree of interest in the son's response. Likewise, the son can have a measure of pride and independence restored through the father's willingness to develop a businesslike agreement with him.

Once the two parties have reached the communication stage, there remains the very real question of whether they can work together and whether they have mutually compatible ideas and goals, particularly with respect to the farm business. Initially this is still a communications problem. What ideas does the son have about what can be done with the farm business? What role would he like to play in it? What goals does the father have for the near future and in the longer run?

Open discussion may not be the best way to start. A better approach may be to have each party independently set down on paper what his goals and aspirations are. The result may look like the example below.

The son's goals and aspirations:

**Over the next 5 years**
- Finish college
- Get married
- Start a home of my own
- Be my own boss
- Buy a new car
- Get started in farming
- Make money
- Buy modern machinery

**In the long run**
- Be a leader in my community
- Raise a family
- Have a modern home
- Keep the home farm in the family
- Improve and expand the farm business
- Be a farm leader
The father's goals and aspirations:

*Over the next 5 years*
- Put children through college
- Get new furniture
- Go on vacation trips
- Put up new grain-storage facilities
- Raise more hogs
- Farm more land

*In the long run*
- Build a new house
- Spend time with grandchildren
- Provide for retirement
- Pay off the mortgage
- Keep the farm in the family

It is not difficult to see how the common elements in such an exchange can lead father and son to turn to each other in a spirit of mutual respect and cooperation to work out an agreement in which they pool their resources for greater effectiveness.

**SETTING UP THE AGREEMENT**

Does one have to go through the tedious problem of calculating inputs and contribution shares and of drawing up a formal agreement? No, you don't have to go through these steps, but something important will be missing if you don't. The son won't have quite as much authority, and there will always be some uncertainty about how settlements are to be made and about who owns what.

For example, if the father wants his son to stay on the farm, he can make a very simple offer of whatever income he thinks it will take to keep the boy interested. If the gross income from the farm business is about $40,000 and if it will take $6,000 to keep the son at home, the father can offer the son a 15-percent share of the gross income from the business. It can be as simple as that.

Obviously such an arrangement leaves much to be desired. It will work only if there is no problem with other children, if the son is willing to take an easy answer to the question of how to make a living, and if the father and mother have the means to give the son more than his contribution to the business may be worth.

The task of drawing up a formal agreement can be made easier by using a standard form that can be adapted to fit individual cases by filling in blank spaces. Two such forms are reproduced at the end of this circular, starting on page 22. These forms may be used directly or typed copies can be made from them. You may also obtain additional copies of these forms from your farm adviser or from the College of Agriculture, University of Illinois, Urbana 61801. It is suggested that three copies be used: one, perhaps the one printed in
this circular, as a work sheet in arriving at a mutually acceptable agree­
ment, and the other two to be duplicate, signed copies of the final
agreement for the files of the two parties. The work sheet copy may be
kept in a handy location for easy reference when questions arise.

OTHER CONSIDERATIONS

Management responsibilities. Unless the agreement specifies other­
wise, it is intended that all parties have an equal voice in making man­
agement decisions. This is desirable in order to develop the ability and
competence of the son to eventually assume major responsibility for
the home farm or a farm business of his own. This will usually not be
an automatic result. The son should make special efforts toward
making informed contributions to the management of the farm busi­
ness. The father should help by creating opportunities for the son to
take management responsibility. This can be done by delegating major
responsibility for certain enterprises or by placing the son in charge
while the father is away on vacation or engaged in other activities.

Fathers who complain that the son lacks aggressiveness and initia­
tive should remember that it is not easy for the son to shift from the
status of a dependent minor, subject to parental discipline, to an equal
partner. It is a wise parent who knows how to confer enough freedom
to allow the son to learn by mistakes he will make, but who helps him
avoid making disastrous ones.

Living arrangements. Housing can be a problem. Should the resi­
dence be included and maintained by the partnership as a business
asset? A good rule is that the farm business should either furnish
housing for both parties or for neither one. In the latter case, the
farmhouse would be omitted from the value of the father’s capital con­
tribution and all costs on the residence such as taxes, insurance, and
repairs would be charged to the father’s personal account and not to
the farm business.

If the son is married and there are two houses on the land being
farmed, then the farm business may well include both houses as a busi­
ness expense. Furnishings and utilities, however, should be treated as
personal expense. Separate housing, whether paid for by the farm
business or not, is highly desirable.

If the son is not married and lives at home with his parents, it is
a good idea to expect him to make at least some financial contribution
toward his room and board if he has been given a financial status in­
dependent of the family. Expecting him to reckon with such costs is
realistic and good discipline. Furthermore, it enhances his independent
status and can add to his self-confidence in contributing to the management of the farm business.

Military service. The possibility of the son being drafted for a tour of military service is a contingency that should be considered before a father-son farm operating agreement is developed. An extended absence on the part of the son can work a hardship on the father. It may be better to delay an agreement until after the son has fulfilled his obligation. Some fathers have expressed a wish to involve the son before his military service as an inducement to assure his return to the farm afterwards. Such a move may prove unwise if it leads the son into choices he is not making wholeheartedly.

If an agreement has been developed and then the son is drafted, there is a question of what to do. If the father is willing to temporarily resume full management responsibility, the son may replace his labor contribution by paying a hired man out his own pocket. In this case, the agreement could continue uninterruptedly, with perhaps some added compensation to the father for his management. If a good hired man cannot be found to replace the son, it may be necessary to terminate the agreement or to reduce the volume of business to a size which the father can handle alone.

College education. Many farm boys complete their high school training with sizable FFA or 4-H Club projects in the form of livestock enterprises, or with inventories of machinery and equipment. Going to college creates an interruption similar to that of military service and may be dealt with in a similar manner. In many cases the son may find it necessary to sell his accumulated property to help finance his college education. If valuable breeding animals are involved, the father may take care of such animals, or their progeny, until the son can come into the business on a personal contribution basis.

Some boys may choose to forego a college education in favor of an operating agreement with the father. Such young men may well be encouraged to participate in winter short-courses, adult evening school classes, and agricultural extension programs. If other children in the family are given a college education, the parents should consider capital gifts or other offsetting arrangements in favor of the son who remains on the farm.

If the farm-operating son does go to college, his training should prepare him to go directly into a full 50-50 partnership with the father.

Buying land. When should the son attempt ownership of farmland? Actually, the more relevant question is under what circumstances should the son attempt to buy land while in a farm-operating agreement
with the father? The answer depends on how favorable the price may be and how the purchase would have to be financed.

Most young men starting out in an operating agreement with their fathers would have little or no down payment to make on the purchase of land. An installment land contract would, therefore, be the only way they could attempt it. The son should carefully budget his expected income and expenses, including those from the operation of (or rental income from) the land to be bought. If his expected net income is large enough to meet living expenses and make both interest and principal payments, then the purchase may be a wise move.

In some cases father and son are faced with the choice of buying a tract they have been renting or lose it entirely. If such a tract cannot be bought on contract, the father may be able to mortgage other property to make the down payment for mortgage financing. If the son is to become an equal co-owner of such tracts, he may be faced with the same problem of 100-percent indebtedness on his share. Again, careful budgeting is called for to see if he can pay interest on the value of his entire share and have enough remaining to make payments on the principal.

Planning ahead. A father-son operating agreement is not intended to be a permanent tenure arrangement. In developing such an agreement both parties should therefore look ahead and prepare for the next steps to be taken. They should consider such questions as these: When will the son be ready to go from a labor-share to a share based partly on the ownership of operating capital? How long will the father want to remain active in the farm business? What arrangements can be made to carry out the eventual transfer of the farm business to the next generation? When and how should the partnership be terminated and the son take over as a tenant?

A careful blending of gifts and installment contract sales from the father to an operating son, or sons, cannot only keep the business intact across the generation transfer but it can help to minimize estate and inheritance taxes without impairing the financial security of the parents. Social Security and Medicare programs may now make it feasible to make earlier transfers of some of the family property to the next generation. This can do much to preserve the operating integrity of a family farm business across generation lines.

On the following pages, the two forms are shown. If you use a form printed in this circular, we suggest a ball point pen for filling in the blanks since ink may spread on this paper. Additional, separate forms of the leases may be obtained from your farm adviser or from the College of Agriculture in Urbana.
FORM 1
ILLINOIS FATHER-SON FARM OPERATING AGREEMENT

The son contributes only his labor and his share of the management. Annual settlement is made on the basis of the cash balance and the inventory and capital changes.

Date and names of parties
This agreement is entered into the .......... day of ............... , 19....., between
.................................................................................., the father, and ................................................................
.................................................................................., the son.

Description of land
This agreement is entered into for the purpose of operating a farm business on the following described real estate:
..............................................................................................................
..............................................................................................................
..............................................................................................................
situated in the County of .................................., in the State of ..................................; and on any other land which the father may add to the operating unit.

Length of term
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 to terminate is given by either party to the other at least .......... months before the end of the agreement year.

Extent of agreement
The terms of this agreement shall be binding on the heirs, executors, administrators, and assigns of both father and son in like manner as upon the original parties, except as shall be provided by mutual agreement otherwise.

No partnership created
This agreement shall not be construed as giving rise to a partnership; and neither party shall be liable for debts or obligations incurred by the other without written consent.

Section 1—Division of income and related stipulations
Clause A. Division of net farm returns. The net farm returns at the end of the contract year shall be divided on the basis of ..........% to the father and ..........% to the son. For subsequent years under this agreement the shares shall be calculated on or before ................. each year and entered below:

19..... ..........% to father, ..........% to son
19..... ..........% to father, ..........% to son
19..... ..........% to father, ..........% to son
19..... ..........% to father, ..........% to son
**Clause B. Calculating net farm returns.** In calculating net farm returns, the records of the farm business, kept in the book, shall be used.

The net farm returns shall be the sum of net cash income (cash balance or cash income minus cash expense) and inventory and capital change, except as hereinafter provided. *(List any items to be excluded, such as gains and losses of capital items—for example: sales of machinery for more than their value in the depreciation schedule (gain) or for less than their value (loss); or insurance collected on destroyed buildings for more or less than the value in the depreciation schedule. List also any limitations to be placed on depreciation.)*

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**Clause C. Accounting methods and procedures.** Recordings in the farm account book shall be made by ; but both parties shall cooperate in setting up inventories and depreciation tables and in summarizing and interpreting the records.

**Depreciation.** The beginning-of-year and end-of-year values of capital items (machinery, buildings, soil improvements, and farm share of auto) shall be based on the cost of such items less reasonable depreciation for the years they have been used.

**Inventory values.** Feed, grain, seeds, and supplies, and market livestock (including all hogs and poultry) shall be valued at market price at the farm. Breeding, dairy, and work stock shall be listed at conservative values (considering cost for animals purchased) and at a fair price from year to year for animals of similar quality, condition, and age.

Summary of capital and inventory values at the beginning of each year and the son's claim against this capital if he elects to accumulate such an equity instead of receiving all of his share of the net income as a cash payment:

<table>
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<tr>
<th>Year</th>
<th>Total farm value</th>
<th>Son's accumulated share at the beginning of each year</th>
<th>Added equity claims in lieu of cash income</th>
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**Clause D. Wage guarantee.** The son is guaranteed by the father a cash income of $ per month, the income for each month being due on or before the day of the following month. Such compensation shall be considered advance payment against the son's share of the net farm returns at the end of the year. If the son's share of the net farm returns is not equal to the total amount paid above, he shall nevertheless be entitled to retain the above amount, and shall not be required to make any refund. The amount advanced to the son shall not be considered a part of the cost of hired labor when determining farm expenses.
Section 2 — Other farm business considerations

Clause A. Receipts and disbursements. Since the father owns all or the major portion of the operating capital, he shall accept all income and pay all expenses except small expenses not exceeding $............., which may be paid by the son. For such expenses the father shall reimburse the son at the end of each month upon presentation of receipted statements.

All farm purchases and sales amounting to more than $............. shall be made only with the knowledge and consent of both parties.

Clause B. Management. General operating plans shall be discussed and agreed upon by both parties.

Clause C. Living arrangements. Living arrangements shall be provided for both parties as follows: .................................................................

........................................................................................................

If either party boards the other, the party receiving board shall pay the party providing the board $............. a month for his laundry and his share of the cash cost of food and fuel.

Clause D. Ownership. Capital replacements or additions, such as new buildings or machinery and equipment shall be furnished by the father. Inasmuch as the father furnishes the investment in the farm business, ownership of farm property shall remain with him at the termination of this agreement, except as stipulated below and as noted in the capital and inventory summary in Clause C of Section 1:

........................................................................................................

........................................................................................................

Clause E. Additional agreements. .................................................................

........................................................................................................

........................................................................................................

Section 3 — Arbitration

If differences should arise between the parties to this agreement, 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 decision: The father and son shall each select one arbitrator; the two arbitrators so selected shall jointly select a third; and the three shall determine the bases of settlement which to them seem equitable.

Signed ........................................................................................., 19....

........................................................................................................

(Father)

........................................................................................................

(Son)
FORM 2

ILLINOIS FATHER-SON FARM OPERATING AGREEMENT

The son contributes half the operating capital, his own labor, and his share of the management. Annual settlement is on a cash income and disbursement basis. Inventory and capital changes are considered only in final settlement.

Date and names of parties
This agreement is entered into the ........ day of .................., 19........, between ........................................, the father, and ........................................
........................................, the son.

Description of land
This agreement is entered into for the purpose of operating a farm business on the following described real estate: .................................................................

.................................................................

.................................................................

situating in the County of ........................., in the State of .........................; and on any other land which the father or son may add to the operating unit.

Length of term
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 to terminate is given by either party to the other at least ................ months before the end of the agreement year.

Extent of agreement
The terms of this agreement shall be binding on the heirs, executors, administrators, and assigns of both father and son in like manner as upon the original parties, except as shall be provided by mutual agreement otherwise.

No partnership created
This agreement shall not be construed as creating a partnership entity. Neither party shall be liable for personal debts or obligations incurred by the other.

Section 1 — Contributions
The father and son agree that the contributions to the farm business shall be as specified in Clauses A, B, and C, of this section, and in accordance with the following further provisions:

.................................................................

.................................................................

Clause A. Labor and management. Each party shall contribute a part or all of his labor and management to the farm business. If the contributions are not essentially
the same, they may be equalized by payments to the father or the son out of the undivided farm receipts for labor and management put into the farm business in excess of that contributed by the other party. In making such settlement, labor and management shall be valued at the following rates per month for the months worked: father $.................., son $..................

_Clauses B. Real estate._ Excess contribution of land, land improvements, and buildings by either the father or the son shall be paid out of the farm account at the end of the year. _Payment may be in the nature of interest, the amount calculated as shown below, or as a cash rent. Choose the method desired and cross out the other._

**Method 1. Cash rent**

\[
\text{acres contributed by the father at } \text{\$} \cdot \text{per acre} = \text{\$} \cdot \\
\text{acres contributed by the son at } \text{\$} \cdot \text{per acre} = \\
\text{Difference to be paid to father, son (cross out one) } \text{\$} \cdot 
\]

**Method 2. Interest charge**

Father: acres ........; value with improvements ........ at ........\% = ........ Son: acres ........; value with improvements ........ at ........\% = ........

\[
\text{Difference to be paid to father, son (cross out one) } \text{\$} \cdot 
\]

_Clauses C. Farm personal property._ The son shall furnish a half interest in the livestock, machinery and equipment, feed and grain, and the farm bank account (if any) at the beginning of the agreement. The total conservative value of the farm personal property at the beginning of this agreement is $.................. Of this total amount the father owns $.................. and the son owns $.................. In order to make the son's share equal to one-half of the total, the son agrees to pay or give his note to the father for $..................

_Clauses D. New capital._ New capital items, such as farm buildings, fences, livestock equipment, and machinery, shall be paid out of undivided income or financed by additional money contributed equally by each party. Any such improvements to real estate shall become the property of the party who owns the land on which they are located, but subject to compensation of one-half of the appraised value to the other party at the end of the agreement in harmony with the consideration of capital changes in Clause C of Section 2. The party owning the real estate in question shall have the option of making improvements at his own expense. If he does so, the interest or cash rent in Clause B shall be adjusted accordingly, and no claim shall be made by the other party to any value in such improvements at the end of the agreement.

**Section 2 — Division of income**

The father and son agree that division of income shall be as specified in this section except as follows:

After each party is paid for his excess labor, management, and real estate capital contributions to the farm business, and payments for capital changes have been made in accordance with Clause C of this section, the resulting net farm income is to be divided equally between the father and the son.
Clause A. Farm receipts. Farm receipts shall include all farm income from all sources, including such items as livestock, livestock products, crops, government programs, and custom work.

Clause B. Farm expenses. Farm expenses shall include livestock purchases; livestock expenses; feed purchases; crop expense; wages and cash cost of board for hired labor; taxes and cash rent; capital and maintenance expenses for buildings and land improvements and for machinery and equipment; farm share of telephone and electricity; and, in short, all farm expense items of whatsoever nature which are commonly listed and recorded in farm record books used by the University of Illinois farm account projects. See Clause A of Section 4.

Clause C. Inventory and capital changes. Changes in inventory and capital shall not be considered until 19___, or until the end of this agreement, when all property shall be appraised jointly by both parties under the same plan as was used in establishing conservative values when this agreement was started. The differences between beginning and ending values of all inventory and capital items—including livestock, feed and grain, buildings, land improvements, machinery and equipment, and other operating and fixed capital—shall be considered inventory and capital gains or losses for the entire period of the agreement. In making settlement, the farm personal property or the net proceeds from the sale of the farm personal property shall be divided equally between father and son. The father shall pay the son for the son’s share of any capital gain in the father’s buildings and land improvements, and receive pay from the son for the son’s share of any capital loss in these items. The son shall make to or receive from the father similar payments due on buildings and land improvements owned by the son. Otherwise the settlement at the end of the agreement shall be similar to the settlement at the end of the year provided for in Clause D below.

Clause D. Annual settlement. Annual settlements shall be an equal division of the cash balance, after payments for excess contributions have been made.

Section 3 — Banking arrangements

The parties to this contract agree that the banking arrangements shall be as outlined in this section except as follows:

Joint checking account. There shall be a joint farm checking account into which all cash farm receipts shall be deposited, and from which all expenses shall be paid by check, except small items amounting to less than $___________, which may be paid by either party and charged against the farm bank account. For such expenditures the father or son shall be reimbursed at the end of each month. The annual settlement will be made by balancing the personal withdrawals by each party for living expenses, debt payments, and emergency needs during the year and by paying the following from the joint checking account: (a) interest or rent to the party with the larger real estate investment (see Clause B, Section 1); and (b) by paying the party contributing the most labor and management for the excess above that contributed by the other party. Checks may be signed by the father or son, but checks in excess of $____________ must be signed by both.
Section 4 — Other farm business considerations

In addition to the foregoing articles of agreement, the father and son agree that they will perform and carry out the stipulations represented in Clauses A, B, C, and D, of this section; and in addition thereto they jointly agree to the following provisions:

**Clause A. Farm records.** The son shall keep a strict record of the farm business in the .............................................................................................. (insert name of the book that is to be used).

**Clause B. Living arrangements.** Living arrangements shall be provided for both father and son and their families as follows:

If either party provides living facilities (room, board, laundry) for the other, the party receiving these services shall pay $.............. a month to the other party.

**Clause C. Management.** General operating plans shall be discussed and agreed upon by father and son. All farm purchases and sales amounting to more than $........ shall be made only with the knowledge and consent of both parties.

**Clause D. Term life insurance in the amount of $................. on the father and $............... on the son shall be taken out by the other party with annual premiums paid out of undivided income. Proceeds of such insurance shall be payable to the surviving party and shall be used to buy out the deceased party’s interest in operating capital from his heirs.

**Arbitration**

If differences should arise between the parties to this agreement, 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 decision: The father and son shall each select one arbitrator; the two arbitrators so selected shall jointly select a third; and the three shall determine the bases of settlement which to them seem equitable.

Signed .........................................................................................., 19.....

(Father)

(Son)