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Getting Started in Farming: On the Home Farm

Family-operated farms continue to account for most U.S. agricultural production. Taking over the family farm business has long been a beautiful part of the American dream for some farm youth. Similarly, many parents look forward to their farm business being continued in the hands of the children for generations to come. However, those dreams and desires can be shattered quickly if the realities of personal and farm business relationships are not understood by all parties.

The decision to make a living from farming requires much thought. Concrete steps must be taken to give the arrangement the best possible chance for success. A commercial farm business involves considerable quantities of land and capital. Gaining access to these resources can be a major challenge or roadblock for a beginning farmer. Not only is it essential to have physical resources, but one must have the managerial ability to combine those resources into an efficient and profitable farm business.

This publication will address the question of how to get started and established in farming for those who have (1) made the decision to farm for a living and (2) have the opportunity for a beginning on the home farm. The information presented is focused on the younger generation considering whether to enter into a farming arrangement with parents or family. However, the information is also relevant for the older generation preparing to hand down the farm business.

Identify the Situation

The home farm provides several favorable opportunities. The first opportunity is the access to land. Often, the chief factors constraining a beginning farmer are the unavailability and high price of land. The family farm provides access to capital and the opportunity to accumulate additional capital that might otherwise be unavailable. Another appealing aspect offered by the home farm is that farming with the older generations of your family provides the opportunity for gaining managerial experience under their guidance and encouragement. This managerial assistance removes some of the uncertainty and hesitation in borrowing money and entering new enterprises on an efficient scale. Going back to the family farm has a large sentimental value for some people. You are unable to assign a price to farming the land where you were raised.

Even though the home farm provides a viable opportunity to begin farming, several matters need serious attention. Family arrangements are not automatically successful as some may presume them to be. Serious thought, open discussion, and careful planning must take place before an agreement is made to gain the long-term commitment and confidence needed for success. Prior to any agreement, plans must be developed, understood, and agreed upon concerning:

1. What arrangements are made for the new partner to enter the business?
2. How will that person develop a greater role in the management and financial structure of the business?
3. When and under what conditions does the new person gradually assume the managerial reins of the business?
4. How will eventual ownership of the farm be transferred to the younger generation upon retirement or death of parents or family?

Because of the large quantities of resources involved and the total dollar value of these resources, all parties must recognize that a family arrangement has long-term consequences. It is not something to be entered into haphazardly or with less than full confidence by all parties that a successful working relationship is possible. It is unlike many nonfarm jobs at which two weeks notice will terminate employment. Traumatic personal and financial consequences and strained family relationships can result from the failure of a family farming arrangement. Further-

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more, after the arrangement is started, a lot of hard work and considerable "give-and-take" on the part of all participating parties will be necessary to keep the arrangement going.

Before starting a family farming arrangement, it is also essential that serious consideration be given to such matters as:

1. Is there the opportunity for both generations' goals and objectives to be met?
2. Is the business large enough, or can it be made large enough to financially support multiple families?
3. Will the arrangement supply the economic security required by the older generation?
4. Will overall family harmony be maintained?

Identify What is Important

Several aspects of entering a family farm arrangement merit serious consideration. Some of these aspects may be personal, business related, or a combination of both. Making a complete appraisal of all aspects prior to initiating a family farming arrangement is not only the most convenient timewise, but it is also the least costly in terms of dollars, personal heartache, and strained family relations.

Appraising Personal Situations and Goals

The first step in assessing the potential for a successful beginning on the home farm is to evaluate the situation on the home farm as it currently exists. This includes an evaluation of the present situation of the established generation, the entering business partner, and the other potential heirs.

The older generation should carefully consider the following:

1. Do we still have minor children at home to be cared for and educated?
2. What is the likelihood that one or more of these children will want to farm in the future?
3. How much income do we currently spend for family purposes, and how will this likely change in the years ahead?
4. How many more years do we plan to actively participate in the farm business before retirement?
5. How hard do we want to work in the farm business operations in the years ahead? In the next 5 years? In the next 10 years?
6. What goals do we have for the future?
   a. Personal goals – retirement, travel, family, living, etc.
   b. Farm business goals – What do we envision the farm business to be like in the years ahead?
   c. Financial goals – income expectations, future security, providing for children.
7. Are we willing to openly "share" these goals with a new business partner(s)?
8. Is the present farm business large enough to support additional individuals or families?
9. If it is necessary or desirable to expand the farm business, are we willing to incur more debt and thus, perhaps, greater risk?
10. Are we willing to totally disclose and to discuss frankly all financial aspects of the business with our family as we would with a lender or other non-related business partner?
11. Is the present farm business still growing, stabilized in size, or reduced from previous years?
12. How do we visualize our family member's new participation in making farm decisions in the years ahead: making organizational decisions, including land and borrowing more money, and making operational decisions?

The younger generation must evaluate the situation, identify goals, and consider questions such as:

1. Why do I want to farm with my family?
2. What can I bring into the home farm business in terms of interests, experience, education, finances, and other resources?
3. How well do I get along with my family in personal matters?
4. Can I talk openly and frankly with my family?
5. If married, does my spouse like and get along with the rest of my family? How does my spouse feel

about the possibility of farming with my family?

6. What are my (our) goals in life? What do I want to accomplish professionally, personally, and financially?
7. Are my intentions to eventually take over the home farm, or is it just a way for me to get experience, land, and financial stability until I can become established on my own?
8. Am I willing to openly share these goals with my family?
9. How do I view my role in the family farm agreement in the years ahead? In 5 years? In 10 years?
   a. Am I willing to gradually mature into acquiring more managerial responsibilities, or do I want to become "boss" immediately?
   b. How do I visualize that we can share responsibilities?
   c. From past personal dealings, do I believe my family business partners will be reluctant to share and/or relinquish managerial responsibilities?
10. Am I willing to invest some of my farm earnings into the farm for growth and expansion?
11. How much income do I believe I will need for family purposes next year, 5 years from now, and 10 years from now? How much, if any, of this will come from nonfarm sources?
12. Is the present farm business large enough to sup port multiple individuals or families?
13. If the farm business needs to be changed or expanded, in what way do I believe this should be accomplished?
14. Am I willing to make the sacrifices, compromises, and extra effort to make the family farm arrangement work?

Due to the complexities of the important decisions that are made when forming a family partnership, it is important to write down the answers to the previous questions in an organized manner. Writing down something forces you to pinpoint your thinking. As the responses are written, they can easily be reviewed as the potential family business partners revise their thoughts. The document can be used later when both parties meet to discuss the decision.

Consideration of Other Potential Heirs

It is essential to know the goals and future aspirations of nonfarming brothers and sisters or other potential heirs. The fact that most parents want to treat all the children equally with respect to inheritance provisions can sometimes be devastating to the farming family member unless provisions are made well ahead of the death of one or both parents.

We have already established it is important to have goals for the new farming business partner. It is equally as important to determine the goals of the separate family members to determine if they conflict. Often, personal goals and the goals of the business are not compatible. The best time to determine the compatibility of goals and thoughts about the future business organization is prior to the formal agreement; it is also the least costly.

Is the Business Large Enough for Multiple Individuals or Families?

Not all farms are suitable for the development of successful multi-family operations. Some farms may be too small, not productive enough, organized in a manner that they cannot support multiple families, or located where they cannot be made into the type of unit upon which family members want to spend the rest of their life working and living. Younger farmers may be disappointed when entering the business if they automatically expect the farm to provide sufficient income and the quality standard of living that it provided growing up. The farm may still be as productive or perhaps even more productive than it was during the young farmer's childhood. It is important to recognize that it could fall short of providing the volume of business necessary to provide sufficient living income and expansion capital for the families of both parties.

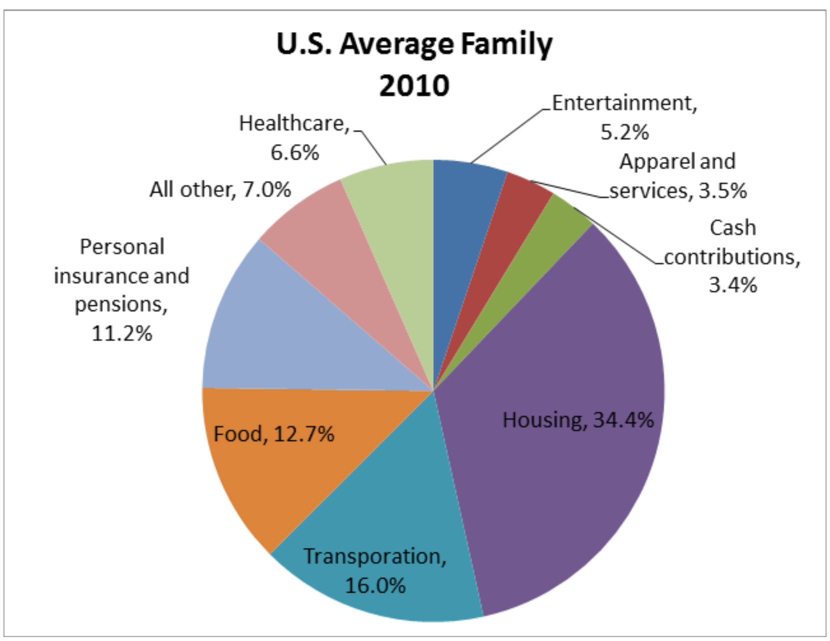
It is extremely difficult to say what amount of income will be needed to provide the standard of living desired by all families involved. Chances are that the older generation will require less income than the younger generation to maintain their respective families. The older generation family members are more likely to only have themselves to support versus having a young family. They may also have little or no housing expenses and savings built up from over the years to live off. The younger generation, on the other hand, may have a spouse and young family and considerably more expense. The younger family members might have the responsibility of making payments on a house, one or more cars, debts that were incurred while in school, and educating their own children.

Managing the Farm Family Finances

No matter what lifestyle you have, creating a family budget is necessary. However, the lifestyle of a farm family can create more challenges, especially for a beginning farmer. Challenges are created by the constant changing nature of farm incomes that fluctuate with many variables, including crop prices, seasonality, and weather.

It has been estimated that living expenses for the average farm family exceed $47,000 per year. Each family budget is going to be different from the next. You can use averages from the United States and Midwest to help as you come up with your own budget. The Midwest is 27 percent rural. Therefore, the spending habits of families more closely resemble a beginning farm family.

The following graph displays the average 2010 U.S. family living expenditures spent on major components.



Iowa State University Extension and Outreach publication “Taking Charge in Changing Times, Managing Farm Family Finances” goes into great detail on setting household, personal, and farm budgets.

Frequently, budgets are generated to evaluate whether a certain investment should be made, such as enterprise expansions or farm land purchases, without recognition of the fact that principal repayment must be taken from the same funds as living expenses. Thus, investments may be made and debts incurred that cannot be repaid after family living expenses have been met.

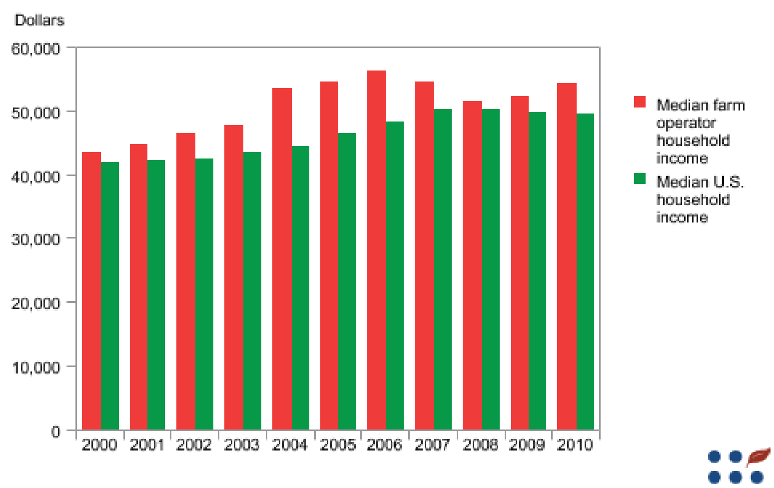
Next question: How much gross income will be needed to produce net farm income of $40,000-50,000?

Farm records across the country indicate that it takes roughly $5 gross income to generate $1 net farm income. For simplicity, assuming the 5:1 ratio, a potential family arrangement would require $200,000–250,000 gross income to be generated annually to be viable.

Budgeting expected returns based on actual farm records is by far the best method of evaluating the farm business potential. If a possible family farm agreement is anticipated 2 to 3 years in the future, and comprehensive farm business records are not currently being kept by the older farming generation, the younger generation should strongly encourage that this be initiated immediately. It is far better to determine prior to entering a family farm arrangement that there is going to be insufficient income generated than to find out a year into the venture. If it is determined that there will not be sufficient income generated from the home farm as it now exists, expansion of the business or alternative supplemental sources of income must be considered.

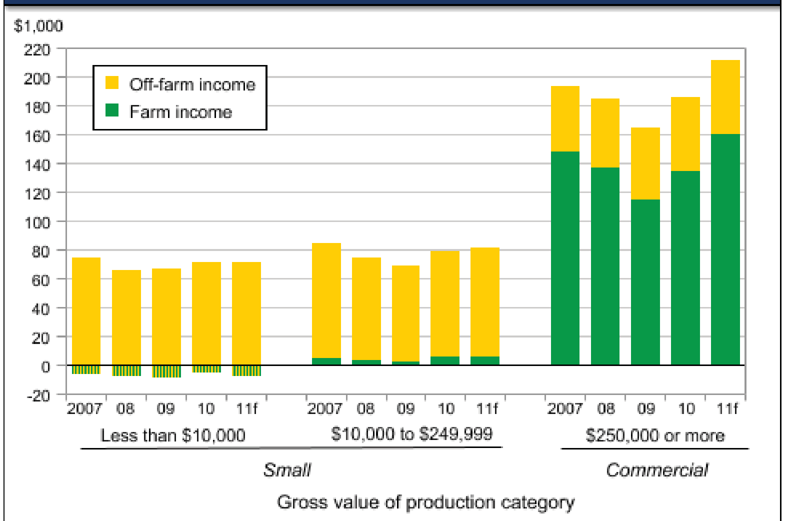
Increasing the efficiency of the business, including better yields, improved timeliness, and better management, will help increase necessary income in some situations, but that usually is

Median farm operator household income compared with median U.S. household income, 2000-2010



Source: Agricultural Resource Management Survey, ERS and NASS, USDA and the Current Population Survey, U.S. Bureau of the Census.

Average household income of family farms, by size of farm, 2007-11f



Source: Agricultural Resource Management Survey, ERS and NASS, USDA.

not enough. Bringing another person into an existing business usually necessitates expansion of the business. This expansion can take many forms. On some farms, expansion of the land base may be feasible, but for others it may not. The opportunity to expand various livestock enterprises or intensify cropping programs is available on many farms. In the short run, the best alternative may be for one or more members of the family operation to seek nonfarm employment. Each farm situation is different; therefore, each situation must be analyzed to determine the means that provide the most potential for successful expansion.

While future conditions, opportunities, and problems can never be fully anticipated, it is important to agree on the basic format of needed business expansion prior to initiating an arrangement.

Sharing Management Responsibility

It is essential that not only the farm business partners be able to relate well to each other in personal as well as business matters, but other members of the families also must be able to do so. All parties (father, son, spouses, and other family members) must be kept aware of the business matters and be understanding and tolerant of each other's idiosyncrasies. More business arrangements are dissolved because of disagreements over trivial matters than over matters of real consequence.

When starting a family farm arrangement, the older generation must be sufficiently wise and open-minded to recognize the younger generation's maturity and increasing ability. The older generation, who may have views that are typically more conservative, need to recognize the younger generation's drive and desire to get ahead. On the other hand, the younger generation must recognize that older business partners have had years of experience in making managerial decisions and, thus, should have confidence in and show respect for their ideas.

In some situations, business partners may arrive at slightly different solutions to a problem. The different parties must discuss the differences and listen to one another's point of view without implying negative feelings toward the other to come up with the best solution. Sometimes this may result from one party convincing the other that a course of action is the best option, and sometimes, by discussion, the best decision is really a compromise. Good family business arrangements should never imply that one party or the other is right or wrong. The words "I told you so" should never be used if a decision proves to be wrong. The key to the matter is willingness by both parties to discuss openly and honestly all aspects of the decision to be made. Open and honest communication includes both talking and listening. In most instances, the parties cannot do both simultaneously.

To have a successful arrangement, there has to be a genuine desire by all parties and their families to make it work. Everyone should be dedicated and willing to work toward similar business objectives to make the business successful. When values and goals appear to differ, care needs to be taken to arrive at a reasonable compromise. The ability to compromise is essential.

There may be times when it seems that an acceptable compromise is impossible. For these instances, it is extremely valuable to have a predetermined procedure for arriving at a decision. It may mean calling on a third party such as the county extension agent, extension specialist, vocational agricultural teacher, lender, or other mutually respected individual for advice. A plan for facilitating the negotiation process might even be necessary. Most of the time the mere fact that such a plan for arbitration exists is sufficient to alleviate the occurrence of the problem. If not, you have already agreed upon a mutually acceptable plan for settlement.

Joint participation in major managerial decisions is a must. Typically, the older generation understands the importance of transferring property ownership to the farming heir, but may fail to realize the importance of gradually transferring management.

In addition to working together and sharing management, appraisal should be made of the "living together" aspect of the arrangement. From the outset of the joint venture, there must be an understanding that multiple distinct families are involved.

There must be separate living facilities. This is desirable even if the older generation is not married. If the older generation is married, it is an absolute necessity. The significant others of family business partners may feel additional pressure from other family members if they are all living under the same roof. There also needs to be a general understanding of working hours, weekend responsibilities, and time off to help foster smooth family living conditions.

Will the Arrangement Facilitate Change?

The family farm arrangement has to be considered beyond the first year or two of operation unless it is specifically designed as a temporary or short-term venture. The first step in making these decisions is to recognize that there will be changes – in the people involved, goals, financial needs, financial positions, and the farm business. It should be designed so that smooth adjustments can be made when changes occur.

When a family farm agreement is initiated, the older generation is often still in the prime of working life and capable of long hours of hard work. As time passes, they will be less able and probably will not want to work as hard before retirement.

Current cash income needs of the older generation typically decline and interests and goals change. Security in their retirement years becomes much more important. On the other side, younger generations will most likely have increasing income demands, especially if they have a family or plan on starting one.

The management experience and competency of younger generations also increase, along with the desire to assume more responsibility and become "master of their own destiny." If the business is profitable, their equity in the farm business will also be growing.

Adjusting to these changes cannot be left to chance. Before starting a family farm arrangement, it is vital that definite written plans be agreed upon that will provide: (1) security for the older generation after retirement, (2) transfer of managerial control of business to the younger generation, and (3) transfer of farm ownership to the younger generation, with appropriate compensation to other members of the family. Let's briefly examine each of these.

Security for older generation – After working hard for years to build up the farm business and buy the home farm, older generations are entitled to enjoy the rewards of their long efforts and have security in their retirement years. Security and the wish not to be a burden on their children or the younger farm generation during retirement are strong desires parents have.

Provisions must be included in the family farm agreement to provide security for the older generation after managerial control has passed down. While this basically involves arriving at an agreement that is equitable to both parties, there is one thing that must be clearly recognized. Security must be built up over the years. Thus, the farm business must be efficiently managed and big enough to provide adequate income for the multiple families so that security can be obtained.

Some may be afraid to turn over the managerial control and ownership of their business to the younger generation. They love and trust them but are also aware of cases where the ungrateful children or heirs have turned their backs on parents in the parents' twilight years.

Management control for younger generation – One of the most important matters to be resolved in a family farm agreement involves managerial responsibilities. While specific responsibilities should be agreed upon at the start of the arrangement, the responsibilities must change over time in a definite manner. Typically, the older generation, who controls most of the land and capital resources at the start of the arrangement, has the primary managerial role. But as contributions to the business from younger generations increase, they assume more managerial responsibilities until the time when they take over complete managerial control (perhaps at the time of the older generation's retirement). The share of business income received by the younger generation should change in a similar manner.

It is very important that younger generations know prior to entering the arrangement when or under what conditions their managerial responsibilities will change –particularly when they will assume managerial control. This cannot be left to the whim of the older generations because too often they are hesitant to give up control and continually put off handing over the reins. This uncertainty is unfair to the younger generation and is likely to lead to personal and business problems that could destroy the arrangement. Older generations may not know exactly when they will retire and have no way of knowing if or when illness will curtail their participation in the business. This entire matter must be openly and thoroughly discussed and an agreement must be reached. The agreement must be put into writing prior to a long-term arrangement. If setting specific dates for turning over managerial responsibilities is unrealistic for your situation, then at the very least write in specific conditions under which managerial changes are to be made.

Transfer of farmer ownership to younger generation – Many young family members entering a family farm arrangement want to eventually own the home farm. If the young family member is the only child or heir, agreement as to when ownership will be transferred can usually be worked out without much difficulty. Security and living provisions for the older generation during retirement and tax considerations are primary factors to be considered in the decisions.

In many families, there are other children or members involved, and the matter of transferring farm ownership can become complex. A primary family objective should be maintenance of overall family goodwill and equitable treatment of all heirs. Accomplishing this while maintaining security during retirement, transferring the farm to the younger generation in the most expeditious manner, and protecting the rights of the farming family member (in the partnership) takes careful thought in planning. Estate planning is beyond the scope of this publication. Several points should be emphasized here:

1. Good estate planning is not done at the time of the older generation's death. If planning is not completed before then, all that can be accomplished is to pick up the pieces.
2. Strange things sometimes happen to heirs when an estate is settled. Brothers and sisters, even those who may have been close in early life, can become jealous and greedy. Thus, it is very important, if one person is to acquire ownership of most or the entire farm, that the estate plan clearly specify provisions for equitable treatment

of all heirs.

3. Communication is extremely important in this matter. All family members, including those not part of the family arrangement, must be informed of the nature and intent of the family farm agreement at the time it is initiated. This should include intentions for changes in managerial control, farm ownership transfer, and inheritance. Bringing these things into the open now can prevent major personal family problems later.
4. Younger generations will be building up their own share of the total farm equity over time. Accurate records of the young farmer's investments should be maintained to facilitate an equitable settlement when farm ownership is transferred. This also protects their rights if the older generation's estate must be settled prior to ownership transfer.

While the preceding discussion is not exhaustive of items that need to be considered prior to entering the farming business by way of the family farm, it offers a guideline. The home farm does provide a unique opportunity for getting started in farming; however, for the attempt to be successful, much thought, open discussion, and thorough consideration of the items mentioned above (and others) must precede actual initiation of any family agreement.

Selecting the Best Family Arrangement

The most important step, appraising all aspects of the situation, has been completed. Now it is time to focus on how the younger generation actually enters the home farm business. The initial arrangement will vary with each specific situation. Have younger generations already been working on the home farm for a while, or have they been away from the farm for several years?

One situation may have the following characteristics: younger generations have been away from the farm for several years (college, military, or nonfarm employment); they have little capital accumulated with which to buy into the home farm business and limited managerial experience in farming; and the older generation has operated the farm as a sole proprietorship for years and has grown accustomed to making all management decisions without having to discuss them with a partner.

Another situation may be younger generations working with older generations while finishing their education. They have some capital already accumulated, and the older generation has already been sharing some minor management decisions, permitting the younger generation to gain some managerial experience. In this situation, the initial business arrangement may be a more sophisticated and long-lasting one than an employer-employee arrangement. A joint operating arrangement or even a partnership-type arrangement may be desirable. The individual situation will dictate what the initial business arrangement will be.

Employer-Employee Arrangements

In an employer-employee relationship, the younger generation will start as an employee of the current business for a wage agreed upon by both parties. This method is the least complicated way of starting the younger generation on the farm. It serves as a trial period enabling the younger generation to mature into the business, leading to a more long-lasting arrangement to determine if working with the family is possible. In an employer-employee arrangement, the younger generation's decision not to continue with the family farm would cause minimum disruption in the business. However, if no further steps are taken, this arrangement will provide little or no direction for the family farm in the future, and the younger generation may become dissatisfied.

In the employer-employee arrangement, the younger generation usually has a little more to contribute to the business than solely labor. They might be able to share some of the management responsibilities and possibly some capital, depending upon individual circumstances.

Wage Agreement

Several modifications of this basic wage agreement may serve as the initial form of business or as a means of maturing into a more complex, joint arrangement. One such arrangement is the combining of a wage incentive plan with the basic wage. This serves to stimulate more direct interest in the business as well as permits younger generations to realize that the amount and quality of their efforts will directly affect their earnings.

It is not the intent to discuss incentive plans in depth here, but a few fundamentals need to be presented. An incentive must be payment in excess of the basic wage and not mere substitution for a living wage, adequate housing, or working conditions. The incentive should be large enough and achievable to encourage the extra effort desired. A token incentive, one that is either a poor substitute for a living wage or one that is totally out of reach, will surely guarantee disaster.

A sound incentive plan is likely to result in increased income for both generations. The incentive payment should be based on performance over which the younger generation has direct control or influence. Once an acceptable incentive plan has been developed, like any other business arrangement, it should be written down. It should describe the purpose, the responsibilities of both generations, the method of calculation and time of payment, and provide a method of settling disputes.

Another approach is to pay the younger generation well in excess of what a hired person would typically earn. This accomplishes several different objectives. It displays faith in younger generations and their potential contribution to the business; it serves to keep them motivated and more genuinely interested in the business; it provides an indication as to whether the business will be able to generate enough income to ultimately satisfy the needs of both generations; and it will also help to ensure that this type of wage agreement (rather than some joint sharing of costs and income) will not last too long.

Wage and Income Sharing Agreement

Another modification of the basic wage agreement is the wage and income sharing agreement. Under this kind of agreement, the younger generation is paid a wage (approximately equal to a hired man's wage) plus a share of net farm income. This share of net income could be in the form of livestock, equipment, or cash. Thus, it provides a means of building the younger generation's capital involvement in the business. With this type of arrangement, younger generations have reason to take added interest in the business, and it encourages them to take the point of view of the manager rather than simply the hired man.

Because of their interest in keeping the net income as high as possible, they will likely become more aware of and have more interest in the cost side of production. As a result, income for both generations will be increased. It is very important, however, that as net income can be calculated different ways (and have quite different results), that a specific definition of what net income is must be agreed upon.

Under the wage and income sharing agreement, generations must be aware that as long as the arrangement is income sharing and not loss sharing, an employer-employee relationship exists. This implies that the younger generation, as an employee, is not responsible for the liabilities and losses of the business. It also implies that the younger generation has authority to do only the things that the older generation authorizes. If it becomes obvious that losses are also being shared, then legally a partnership exists and the problem of unlimited liability and other partnership responsibilities must be faced.

Joint Operating Arrangements

It may be obvious, because of the younger generation's personal situation (farming experience, capital accumulation, desire to invest in the business, or managerial experience and ability), that a more sophisticated joint venture type arrangement is desirable. If this arrangement is viewed as "the next step" in the family farm business, an enterprise working agreement may be suitable.

An enterprise agreement usually implies that the younger generation will be given primary responsibility for a specific enterprise within the business. Generally, in addition to labor, the younger generation will furnish some of the livestock and/or machinery, as well as some management.

They will have major decision-making authority in decisions affecting the total farm. As younger generations gain more experience and display ability to handle more responsibility, they can be given a larger share of the responsibility for the total business.

The enterprise agreement should be viewed as only a temporary arrangement. If this arrangement lasts too long without shifting more total business responsibility to younger generations, they may become so preoccupied with "their" source of income (their enterprise) that they neglect some of their total farm obligations. This form of written agreement should include such points as job responsibilities, contributions by both generations, sharing of income, methods of settling disputes, and ultimate graduation into more of a total farm joint operating agreement.

If the joint operating agreement is not considered to be a next step in the family farm relationship, but rather to serve as the initial form of business partnership (for example where the younger generation has the necessary ability, experience, and desire), a total farm operating agreement may be desirable. A total farm operating agreement is a complex form of organization for a beginning farmer. If the situation is right, a total farm operating arrangement can be developed where initially the younger generation's investment in the business can be minimal for the first few years. Thus, some of the advantages of attesting or trial period can be realized. Before entering this type of an arrangement, the family should have made some long-range decisions and thus, may be far beyond the "testing" phase. If this is the case, this should be considered a more permanent type agreement.

Reappraise the Situation

Once initial entry into the farming business has been accomplished, either as an employee or as a junior member of a joint operating agreement (and some time has been spent in a testing or trial period), an evaluation of the question "where to go from here?" must be made. This evaluation could lead to three different basic conclusions. One might be that a permanent partnership will not work, and the younger generation decides to move into a nonfarming occupation. A second conclusion might be that the younger generation's goal of "getting started in farming" has been accomplished, and it is now time for the younger generation to start farming alone. Possibly the older generation is at or near retirement age and may want to let the younger generation assume total control of the home farm by either buying or renting the farm. The third conclusion could be that the family farm agreement has proven successful and all parties want to continue farming together. This third conclusion means that consideration should be given to a more formally organized, long-term, joint farming arrangement. This could be a partnership or a family corporation.

Long-term Family Business Arrangements

When more formally organized joint operating arrangements are contemplated, more emphasis needs to be placed on consideration of long-range goals for both parties. Since these types of arrangements imply a more complex sharing of management as well as capital investments, attention needs to be given to the detrimental effects that would result if it became necessary to discontinue the joint operation. Also, as these arrangements are considered, some definite plans for ultimate transfer of managerial control and eventual transfer of property ownership from the older to the younger generation become extremely important.

The two common business arrangements that fall under this heading are partnership and corporation. While the advantages and disadvantages of these business arrangements merit comprehensive discussions, only a brief overview of their relation to the family farm situations will be presented.

Partnership as an Alternative

A partnership permits the combining of assets, sharing of the management responsibilities, and the sharing of both profits and losses of the business. A partnership tends to facilitate the gradual transfer of both management control and ownership among the generations. As younger farmers build equity, their contribution to the business increases both in total dollars and percentage compared to the older farmer. As older generations reach the stage in their farming career where they wish to start phasing out of the business, more management and ownership can be conveniently transferred to the younger generation.

Ownership of property prior to the formation of a partnership sometimes causes concern. Not all assets owned by both parties have to be contributed to the business. However, once property is contributed, it is no longer yours and mine; it becomes ours (i.e. the partnership's).

When establishing a partnership, corporation, or even a landlord-tenant arrangement, the problem of inventory and the estimation of fair value of individual contributions becomes of utmost importance. Partners should list and value the capital, labor, and management each one contributes to the partnership. Even though the partnership may pay a salary to each for labor contributed, business profits should be ultimately shared on the basis of contribution.

The formation of a partnership, while providing a means of transferring management and ownership, places great importance on record keeping and written agreements. This is true, not only for income sharing and income tax reasons (while a partnership pays no income tax, an information tax return must be filed), but also for reasons associated with possible dissolution and/or death of one of the partners. A severe financial burden can be placed on the remaining partner if, at the death of either party, no records are available to determine ownership of property or no plans have been agreed upon as to the disposition of the business. The partnership can be set up to provide for continuation after the older generation's retirement or after the death of a partner. These arrangements should be set forth in the written partnership agreement.

Another item that merits consideration when contemplating formation of a family farm partnership is the unlimited liability feature. Each partner is an agent for the partnership. Therefore, the acts of either partner while carrying out partnership business can bind the partnership. Both partners and their assets are liable for acts committed and obligations incurred by either partner in the course of conducting partnership business. The possible consequences of this feature, as well as others, emphasize the extreme importance of careful and thorough consideration prior to establishing a partnership.

If it is decided to form a partnership, the written document should address issues such as, but not limited to: (1) respective contributions made by each party; (2) how profits and losses are to be shared; (3) duties, powers, and limitations of the partners; (4) provisions for the continuation of the business at death of a partner, if so desired (including purchase options, buy-sell agreements, and the agreed-upon funding of same); and (5) statements showing that the wives involved agreed to the proposed settlement procedures. To insure that everyone's estate planning goals will be fulfilled and the partnership intentions honored, property titles, will, and other documents may need to be altered. While it is not a requirement that an attorney draft the partnership agreement, it is strongly encouraged.

Incorporation as an Alternative

The corporate form of business organization is by far the most sophisticated. A corporation is a legal entity, distinct and separate from the individuals who own, manage, or work for it. The corporation is owned by the shareholders who may or may not be actively involved in the day-to-day operation of the business. The major characteristic of the corporate form of business is this distinction between the business and the owners.

As the corporate business is a separate legal being, it can own property, sue and be sued, enter into contracts, and must pay income tax. Because of the legal and definite manner in which corporations must be formed and dissolved, it is of extreme importance that farmers and their respective families give thorough consideration to the advantages, disadvantages, and possible consequences of this form of conducting the farm business.

Advantages of a Corporation

A corporation provides the opportunity for the older and younger generations to contribute some or all of their assets to the business in return for which each is provided shares of stock equal to their contribution. Thus, the actual property owned by each party after incorporation is stock and not the specific piece of property contributed. This makes possible the convenient transfer of business ownership from the older generation to the younger generation by merely transferring shares of stock. Young farmers can acquire more of the business as they accumulate dollars to invest, or when the older generation decides to phase out and transfer stock to the younger generation.

Another advantage of the corporate structure and having assets represented by shares of stock is that the business can continue virtually uninterrupted after the death of a shareholder. The corporation exists as long as the shareholders desire it. It is able to withstand ownership changes caused by one generation replacing another because shares of stock rather than physical property pass to the next generation.

Farmland owned by either party may or may not be transferred to the corporation in return for shares of stock. There are advantages and disadvantages to both alternatives. If the land is, in fact, left out of the corporation, the family corporation can rent the land from the older generation and/or the younger generation. Thus, as discussed in relation to partnerships, the older farmer may, in effect, assume the role of a landlord and the corporation the role of the tenant.

Family farm members can be full-time salaried employees of the corporation as well as owners. Therefore, as older generations reach their retirement age, they can conveniently withdraw from the actual labor and management of the business but still remain as an owner. Thus, the corporation provides a lot of flexibility in terms of turning the management over to the new farmer.

One of the major advantages of the corporate structure is the limited liability feature. Shareholders are liable for the debts of a corporation only to the extent of the shares of stock they own unless they have signed personally, as well as an agent of the corporation, as surety for a corporate debt. If, on the other hand, a corporation becomes insolvent, shares in it are worthless. Thus, farmers whose assets are all in shares of stock have lost all of their property.

The income tax advantage of a corporation may be of major interest if the business income is sufficiently large. Tax advantage to the business and shareholders should be identified before a corporation is decided upon. Because a corporation is a legal entity, unlike the partnership, it is also a taxpayer. However, the corporate tax rate schedule is such that there may be sizable tax savings available with sufficient planning.

There may be other advantages of the corporation as a form of family business arrangement. Some of these include possible increased efficiency over time, possible increased credit status, added flexibility in estate and retirement planning, and possible fringe benefits that are available only to corporations.

Disadvantages of a Corporation

Disadvantages must also be considered. The first might simply be the initial costs of incorporation. These initial costs may include filing fees, preparation of the articles of incorporation (this document describes the contract with state and defines the scope and organization of the corporation), and attorney fees. In addition, annual fees and taxes are required for the privilege of conducting business within the state. These fees are not required of other types of businesses.

Some consider the strict requirements of formal organization and accurate record keeping a disadvantage. A corporation is required to keep complete and accurate records of accounts, minutes of its shareholder and board of directors meetings, and a record of its shareholders with the number and class of shares held by each. Reports must be filed when certain changes take place in the capitalization or issuance of shares. Annual reports of the business must also be made to the state. While this is considered a disadvantage by some, it may well be one of the major improvements over other forms of business.

While there are obvious income tax advantages discussed above, there can also be tax disadvantages. As the family members are employees of a corporate business, social security taxes will be higher than they would be if self-employed. Also, the corporation does not receive the favorable tax treatment on capital gains items or first-year depreciation that is available under other forms of business arrangements. There is also the possibility of double taxation of some of the income. This occurs when the corporation pays corporate income tax on income, which is retained in the business and distributed to shareholders as dividends. The dollars are taxed as income to the corporation and the dividends are taxed as income to the shareholders. In addition, there is an intangible personal property tax associated with owning shares of stock in some states.

Another feature that may be overlooked is that other than member shareholders, there may be few individuals who want to buy shares of stock from a minor shareholder. If members do not want to buy minority shares at the fair value, the minority shareholder will either be "locked in" or forced to sell at less than fair value.

It should be obvious that while there are many advantages to the corporate form of business for a family business, there are also disadvantages that must be considered. In most cases, a corporate form of business structure should be "matured into" rather than be the initial form of a family business. It is essential to consult legal counsel for detailed discussion of all facets of corporations and advice before deciding on the corporate form of business.

In-depth information regarding farm estate and business planning can be found in Neil E. Harl's book titled "Farm Estate and Business Planning 16th Edition."

Final Consideration – Put It in Writing

Regardless of which form of arrangement the family initially chooses, or which permanent form eventually results, the agreements should be written. As a part of the initial agreement, there should be discussion of how the arrangement will be dissolved or discontinued. Even in the most ideal situation, parties change, objectives change, and personal conflicts may arise, resulting in a decision to discontinue the joint farming arrangement.

The ability to dissolve or dismantle the business without additional injury to personal and family relationships is very important in such situations. A complete record of capital contributions and income sharing from the outset can minimize difficulty at this point. Plans for arrangement of property titles, the division of specific business assets, and determining final interests in the partnership or corporation should be documented. Equally as important as providing for the continuation of the business is providing for final settlement if the need should arise.

Execute Strategies and Arrangement

A successful family farm arrangement has to be measured in terms of whether the goals of both generations are accomplished. As these are long-run considerations, success cannot be measured at the end of one or two years. Even though careful consideration regarding all major aspects of the arrangement is given prior to establishing an agreement, total success is not guaranteed. As noted earlier, changes will occur that necessitate adjustments. In all arrangements, there will be some tough spots that will have to be worked out. To have a successful arrangement, all parties must be dedicated to the arrangement and continually strive to make it work.

The following items are very important in keeping problems from arising and in minimizing the effects of those that do. Most of these have been mentioned earlier.

1. Keep the farm business and family matters separated. Have specific living facilities for the different families.
2. Have an understanding regarding working hours, weekend responsibilities, and time off.
3. Outline specific areas of individual and joint responsibility and adjust these as the situation warrants.
4. Communicate! Discuss decisions to be made and things that are bothering you openly, honestly, and regularly. Remember that communication involves both talking and listening by both parties.
5. When decision making involves two or more parties, some give-and-take is necessary. Compromises are often the best solutions.
6. Recognize that because future events cannot be seen with certainty, wrong decisions will be made by even the best managers. The words "I told you so" should never be used by either party in a family agreement when decisions turn out to be wrong.
7. Set up a regular schedule for discussing problems, reviewing business progress, and making decisions. This does not mean you shouldn't discuss things at other times, but it does force you to

regularly stop long enough to communicate. This should be done even during the busiest times of the year.

8. All major agreements should be put down in writing. This is not an indication of lack of trust; it merely protects both parties in case something happens to one of them.
9. Follow through on all agreements made unless both parties agree that adjustments of past agreements are advisable. This is particularly true in matters of managerial responsibilities and farm ownership transfer.
10. Keep complete and comprehensive records on the farm business. This is vital for accurate business analysis, which is the basis for sound decision making, and the distribution of business income. Accurate records must also be kept of the capital investments made in the business by each party.
11. There may be times when it seems that a compromise between parties is impossible. Set up a predetermined procedure for arriving at a decision. A third party to give advice or plan for binding negotiation could prevent a small problem from becoming insurmountable.
12. Set up an insurance program that will protect the business and both parties from financial disaster. The program should contain appropriate amounts of health, liability, property, mortgage, and life insurance. Life insurance can be used to fund buy-sell agreements, which should be an integral part of the partnership agreement.

Farming today is running a business – a much bigger business than most people realize. The size of many farm businesses in the United States has increased greatly in the past decade. Family business partners must recognize that the increase will likely continue in the years to come. This means that they will have to develop into a progressive, efficient management team. To be successful, they must not only keep current with and utilize improved crop and livestock technology, they must stress the business aspects of their arrangement. They must keep and analyze their farm business records and, in their decision making, they must use the best planning techniques available. Their management "tool kits" must contain the latest budgeting techniques, including cash flow analysis and other financial management tools. Descriptions of these tools can be obtained at your county extension office. A family farm business must be efficiently managed and sufficiently large to provide a living income for both families.

A family farm business can be one of the most rewarding types of farm business organizations possible. However, it can be a sad situation, too, because both business and family issues are involved. Thorough prior planning, continued open communication, and a genuine concern for each other will certainly go a long way to ensure success.

Resources

Evaluation of the diversity of crop and livestock enterprises among agro-biodiversity farmer field schools (ABD-FFS) and Non-ABD-FFS households in Bondo District, Kenya - www.m.elewa.org/JABS/2011/38/9.pdf

Farm Aid Annual Report - www.farmaid.org/site/c.qlI5IhNVJsE/b.2750725/k.946A/Annual_Report.htm

Iowa State University Extension and Outreach - Managing Family Farm Finances - www.extension.iastate.edu/Publications/PM1173.pdf

Montana State University - Transferring Your Farm or Ranch to the Next Generation - msuextension.org/publications/FamilyFinancialManagement/EB0149.pdf

Penn State Cooperative Extension - Will Your Family Farm Continue? - agmarketing.extension.psu.edu/Business/passonfarm/WillYourFarmContinue.pdf

Sustainable Agriculture - www.sustainabletable.org/issues/familyfarms/

USDA Economic Research Service
***America's Diverse Family Farms: Assorted Sizes, Types, and Situation* -** www.ers.usda.gov/publications/aib769/aib769.pdf
***Commodity Costs and Returns* -** www.ers.usda.gov/data/CostsandReturns/testpick.htm
***Farm Household Income* -** www.ers.usda.gov/briefing/wellbeing/farmhouseincome.htm
Growing Farm Size and the Distribution of Farm Payments - www.ers.usda.gov/publications/EB6/EB6.pdf

U.S. Department of Labor, Bureau of Labor Statistics - Consumer Expenditures - 2011 - www.bls.gov/news.release/pdf/cesan.pdf

U.S. Environmental Protection Agency - Ag 101 Demographics - www.epa.gov/agriculture/ag101/demographics.html

What It Costs To Live Well: Midwest - www.forbes.com/2005/07/01/realestate-livingwell-midwest-cx_sc_0701home.html

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