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Father-Son Farming Agreements * * * * *

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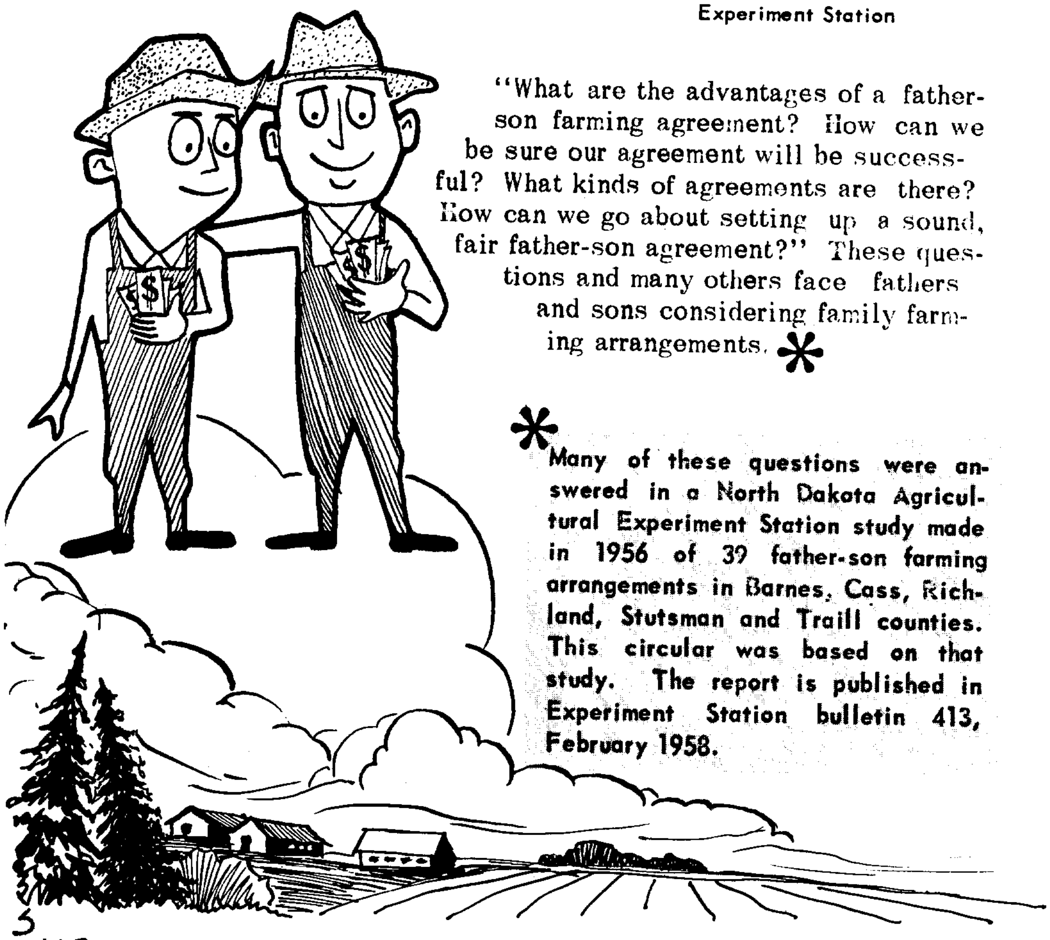

"What are the advantages of a father-son farming agreement? How can we be sure our agreement will be successful? What kinds of agreements are there? How can we go about setting up a sound, fair father-son agreement?" These questions and many others face fathers and sons considering family farming arrangements. *

*Many of these questions were answered in a North Dakota Agricultural Experiment Station study made in 1956 of 39 father-son farming arrangements in Barnes, Cass, Richland, Stutsman and Traill counties. This circular was based on that study. The report is published in Experiment Station bulletin 413, February 1958.

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NORTH DAKOTA AGRICULTURAL COLLEGE

A Good Operating Agre

WHY A FATHER AND SON FARM OPERATING AGREEMENT

A good agreement benefits father, son and farm. Mechanization and larger units have increased the investment needed to start farming. The hired man-tenant-owner era is nearly over. Demand by established farmers for additional land has reduced available land for beginners. Father-son agreements make it easier for many young men to get into farming.

The father profits from the dependable labor his son provides through a joint operation agreement. He is less likely to lose the son's labor before the busy season, since the son's earnings depend upon the farm's production.

The farm's productivity is more likely to be maintained with a father-son arrangement. The lone farmer, at 55 or 60, may lose the desire to keep his farm in top operating efficiency. A son, included in the actual management operation, has the interest and drive to maintain efficiency.

WHAT MAKES A SUCCESSFUL AGREEMENT?

Any father-son agreement must be fair. Sharing of income should be in the proportion both men contribute to the farm business.

A written agreement prevents future misunderstandings. Verbal agreements may be forgotten or remembered differently. Written agreements usually result in more complete discussion of all terms. They protect interest of survivors of either party in case of the other's death.

A farm must be large enough to give full employment and a satisfactory income to both parties. Income can be increased on most North Dakota farms by working more land, producing more and better livestock, or by doing custom work.

Separate housing for both families is desirable. It allows more freedom and eliminates a possible source of friction.

A complete record of all receipts and expenses avoids disputes at settlement time and is helpful as a guide for improving operations and preparing tax returns.

ement Benefits Father, Son

TYPES OF AGREEMENTS

There are four general types of father-son agreements. Their value varies with the son's age and his participation in the farm business.

Indefinite allowances are usually effective only when the son is very young. The father provides all clothing, housing and groceries, plus a small allowance. This plan creates little interest for older sons in the farming operation.

Project agreements usually involve a 4-H or an FFA project. These projects help teach good farming and often are the start of successful father-son agreements covering the entire farm. Project agreements are recommended for school age sons.

Enterprise agreements give the son the income from one enterprise and are used frequently during transition from a project agreement to an income-sharing agreement. Enterprise agreements tend to develop specialization which may result in low return due to crop failure, disease, bad weather or low prices.

Income-sharing agreements, allowing the son to share in the entire farm income, are suitable when he is ready to give full time to the farm. Each party shares in the net returns in proportion to his contribution of labor, management and capital. The agreement should be reviewed and changed yearly to meet contribution changes. This agreement gives the son an interest in the entire farm business. The division of net income is based on the contributions of each, so the agreement is more likely to be fair. The son's risk is less because he receives a share of the income from all farm enterprises.

HOW TO FORM A FATHER-SON AGREEMENT

The "fixed-expense" method is one of the many approaches to forming a father-son farming agreement. It is based on sharing the gross income and out-of-pocket expenses in the same proportion as the fixed expenses are shared. Fixed expenses include ownership costs of interest, taxes, depreciation, insurance on assets and labor contribution of the operators. Figuring ownership costs of assets owned by each party calls for appraisal of land, buildings, machinery and livestock.

After appraisal, ownership cost rates can be applied to the assets to determine the contributions of each party. The following form makes calculating these contributions and the percentage contribution of each party easy.

	FATHER			SON		
	Appraised value of asset	Ownership cost rate	Contribution	Appraised value of asset	Ownership cost rate	Contribution
Land	$	5%	$	$	5%	$
Buildings		10%			10%	
Machinery		15%			15%	
Livestock		15%			15%	
Taxes on assets						
Insurance on assets						
Labor & management			3,600			4,300
Total contribution of each party			$			$
Percentage contribution of each party			____%			____%

The suggested value for labor is based on the findings in the 39 cases studied. The amount of labor performed by the father should be considered and valued accordingly when this cost is estimated.

ADVANTAGES OF THE FIXED-EXPENSE APPROACH

The fixed-expense approach gives both father and son an interest in the entire farm business. This equal interest is desirable in father-son agreements. If one man receives a greater proportion of income from one enterprise than from another, he may tend to spend extra effort on it, sometimes to the neglect of other operations.

To simplify accounting, fathers often sell part of their assets to their sons to get a 50-50 farming agreement. This usually is satisfactory if the father is approaching retirement, but not for fathers who plan to farm for another 10 or 15 years. If the agreement should end, jointly-owned machinery may create settlement problems. In many cases the father must retain ownership of his assets to earn a satisfactory living for his family. With the fixed expense approach, the father can retain full ownership of his assets.

It is easy to determine fairness of the agreement when gross income and variable expenses are shared in the same proportion. An error made in estimating contributions will affect net cash income less than an error in an agreement in which gross income and variable expenses have to be estimated to determine fairness.

The fixed expense approach to father-son agreements is adapted to the familiar "cash basis" accounting system. All that is necessary for settlement is a record of gross income from the sale of the production and of variable expenses. These records are kept for income tax purposes, anyway. To simplify accounting, a separate bank account is often used for making deposits of income and paying variable expenses.

KEEPING THE AGREEMENT EQUITABLE

Contributions of each party may change from year to year. The son may buy new machinery. Some of the assets owned by the father will depreciate, decreasing his contributions unless replaced. When such changes occur, it is only fair that adjustments be made in the sharing of the net cash income.

TIME AND METHOD OF SETTLEMENT

"Settling up"--once a month or once a year--depends upon the banking system used for making deposits and paying expenses.

A monthly settlement is almost a necessity when each party draws from a personal bank account to pay farm expenses.

If a separate bank account is used for the income sharing arrangement, settlement can wait till the end of the year. The bank balance, plus the advances received by each party, is divided according to a predetermined agreement. If taxes and insurance on assets are paid out of this bank account, they should be regarded as an advance to the party paying them, as the payee has received credit for these fixed expenses in the contribution calculation.

ENDING THE AGREEMENT

If the agreement is called off, the part of the production not sold before the termination date should be divided when the sale is made. Similarly, each party should be charged for his share of expenses that are not paid on or before the termination date.

KEEP THESE RECORDS

1. A written contract covering terms of the agreement.
2. An inventory indicating ownership of the real and personal property used in the business.
3. An annual record of the receipts and expenses to be used in calculating the annual income of each party in the agreement.

Sample forms of the fixed-expense type agreement can be obtained from your local county extension agent.

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