Two of the more important aspects of estate planning for farmers and ranchers are business planning and family planning.

The business management facets of estate planning include such items as (1) continuity of management, (2) high-quality management, (3) continuous financial flow and (4) continuity of life of the business.

**TYPES OF PARTNERSHIPS**

Continuous management is possible only to the extent it is built into an estate plan. If the business is operated as a sole proprietorship, then contingent plans for operating the farm business by the surviving spouse and/or children are only as sound as the trust, will or other legal instrument in which they are set out. If a trust has been established, then the ability of the designated individual or corporate trustee sets the level of management competency as well as its continuity.

A parent-child partnership can give strength to a high-level, continuous management system by gradually developing the child's managerial abilities. But this continuous management must be built into the business and owner estate plans. It is important that the partners consider such items as ownership of properties and legal transfer instruments and procedures to be followed in case of the death of one of the partners. More specifically, partners need to make sound financial plans and insert specific provisions in their partnership agreement to allow the survivor of the partnership to continue if desired.

In addition to sole proprietorships and partnerships, families may also operate their farms or ranches as corporations. The corporate form of ownership may foster more optimum resource allocation to various interested family members under some circumstances. It may facilitate a planned and orderly transfer of the farm or ranch business as an economic entity over time as the family moves in and out of the business in line with their life cycle. Their operation in the business management facet of estate planning is discussed in more detail in publication L-1341, *Estate Planning — Emphasis on Corporations* (Texas Agricultural Extension Service), available at your county Extension office. (Sole proprietorships, partnerships and corporations are compared on the brief summary chart found at the end of this publication.)

Some of the basic questions which may be asked about partnership include:

1. What is a partnership?
2. How does the partnership operate?
3. What are the advantages and disadvantages?
4. How does the partnership compare with sole proprietorship and with a corporation?
5. Does the parent-child partnership have a place for Texas farmers and ranchers?
6. What are the steps in formation of a parent-child partnership?
7. What will be gained and what type of partnership should it be?

**What Is a Partnership?**

Sometimes a lease agreement or an informal association together in business can unintendedly result in the legal erection of a partnership. Since this may extend one's business liability further than was planned, it is important to ask what a partnership is.

While only an attorney can advise about specific situations, a general partnership can be thought of as an association of two or more persons to carry on a business for a profit. Each partner has the opportunity to contribute to the management and/or capital of the partnership (such as money, property, labor or skill), and each shares in the profits or losses according to the partnership agreement. Liability for obligations and liabilities of the partnership extends to all personal assets of all general partners.

Economic growth of a farming or ranching business may be accelerated or enhanced by combining assets of two or more individuals in a partnership. However, the stability of the firm may be in question because of the possibility of willful termination by a partner or involuntary termination caused by
the death or retirement of a partner. Involuntary termination may be guarded against through specific provisions in the partnership agreement which allow the partnership to continue with the estate as a partner or permit the surviving partner to buy out the interest of the deceased or retiring partner. A partnership may have greater access to equity capital from retained earnings or by contributions of capital by new or existing partners from non-partnership sources.

Specialization of individual effort, division of responsibility and combinations of special talents among the partners can be a real advantage associated with partnership management. Also, with proper planning, labor stability may be built into a partnership.

**Limited Partnership**

A second type of partnership is a *limited partnership*. A limited partnership is a special form of business authorized under state law which permits a person to invest in a business without incurring the unlimited liability associated with sole proprietorships or general partnerships. Rather, his personal liability for partnership debts and obligations is limited to his contractually required contributions to the partnership.

A limited partner may contribute cash or other property but no services or management to a limited partnership. A person can be both a general and a limited partner at the same time, and a limited partner can loan money and transact other business with the partnership. The limited partner is not liable as a general partner unless he takes part in the management and control of the business or otherwise violates some prohibition of state law. General partners in a limited partnership incur all the responsibilities associated with a general partnership as discussed above.

A limited partnership can be formed by two or more persons, for any type of business which can be operated as a general partnership (except banking or insurance), by filing a signed and sworn certificate with the Secretary of State and then paying the required filing fee.

**SOME PARTNERSHIP CONSIDERATIONS**

Some of the established principles of law to which partnerships are subject are:

1. Death dissolves the partnership. For this reason, estate plans for transferring property must be so formulated that continuation of the business is assured. This means the partnership agreement should be written and planned in advance.
2. Each partner is subject to liability for all debts and obligations arising in the partnership business.
3. Partnerships only file an information income tax return, with each partner reporting his share of partnership profits or losses on his personal income tax return.
4. Property can be owned in the name of the partners.
5. A majority of the partners control the business decisions.
6. Profits and losses are divided in accordance with the specified agreement.

Some of the characteristics used to determine whether a particular arrangement legally constitutes a partnership are:

1. Owning assets together.
2. Operating under a firm name.
5. Both parties participating in management.
7. Sharing losses.

An attorney can provide advice about whether a particular arrangement constitutes a partnership. This determination may be critical in cases where, for example, an agreement might be construed to be either a lease or a partnership, because the liability would be expanded if a partnership were unknowingly created.

Parent-child partnerships are often created for one or more of the following purposes:

1. To provide for the transfer of the farm and ranch operation from one generation to the next.
2. To provide a way for the operation to remain a productive, efficient unit.
3. To allow the child, who often has limited capital, entry into the farm business.
4. To allow an orderly shift of the operation from parent to child, with a shift of decision-making responsibility and capability.
5. To allow the parent to move into retirement or semi-retirement while still retaining some responsibility, income and interest.

Some aspects necessary to make a parent-child agreement work successfully are:

1. A desire to share the farm or ranch business (no forced entries).
2. Income return sufficient for two families, with an equitable division of profits. The division of returns should be prearranged by agreement.
3. Management may be responsibility, control and decision-making ability.

In some cases proportionally more weight could be assigned to one of the partners in one of the resource areas. For example, the parent might have relatively more capital than the child, but the child could offset this by providing more labor, or perhaps by other special skills or knowhow. Or, one partner might take heavier management and operational responsibility in order to equalize input value. In any event, such arrangements should be specifically set out in the partnership agreement.

3. Legal arrangements should be spelled out and carried out with respect to the division of property, equipment, animals etc., in order to have a proper settlement in case of voluntary or involuntary withdrawal of one of the partners.
4. Records should be kept in a definite correct, orderly manner and should be available for inspection by any partner.

5. Agreements need to be spelled out, and a written plan is desirable. Specifically, the written agreement should include:
   - Statement of the contribution of each partner to the business.
   - Definition of expenses and income.
   - A yearly division of profits and income, with periodic withdrawals permitted to meet family cash flow requirements.

6. A separate home is essential when the child is married, and the families need to be compatible.

7. Other children who are not partners need to understand the business in order to avoid family squabbles at a later date.

   Mutual confidence and trust of partners is very important in a successful partnership. All partners need to work closely on decisions and plans and to review such plans periodically.

   There are some disadvantages in having a partnership. Each member is subject to liability for all debts arising in the partnership business if the partnership assets are not sufficient to cover them. In addition, each partner is liable for wrongful acts (torts) arising in connection with the partnership business. An automobile accident negligently caused by one hauling grain for the partnership would be an example.

   To illustrate liability for debts, one partner might buy a new tractor for the use of the partnership without the consent of the other. Both partners may be held liable if partnership assets are not sufficient to pay the debt. Legally, they are said to have “joint and several” liability.

   However, it should be pointed out that the existence of this personal liability is not very important in most parent-child arrangements where essentially all assets of both partners are invested in the business because the business and personal liabilities then become synonymous. Personal liability is just important to those who have other, extensive nonpartnership assets which they wish to insulate. Definite arrangements need to be spelled out for protection in these cases.

   Before creating either a partnership or a corporation, the individual should make sure the form chosen can help meet the desired financial, business, and estate planning objectives. Discussion with others already in partnerships or corporations will help to bring out the major problems they experienced as well as the major benefits they enjoyed. This publication sets out some items to consider, but each individual should be cautious and as well-informed as possible. For a more detailed discussion, see publication MP-1159, Organizing the Texas Family Farm or Ranch Business as a Partnership (Texas Agricultural Extension Service), available at your county Extension office.

   Corporations can provide opportunities for estate transfers that neither the sole proprietorship or partnership allow. These are discussed in publication L-1341, Estate Planning — Emphasis on Corporations (Texas Agricultural Extension Service), available at your county Extension office. A comparison of sole proprietorships, partnerships and corporations is provided in the following summary chart on the back of this publication.
### Comparisons of Farm and Ranch Business Organizations

<table>
<thead>
<tr>
<th>Category</th>
<th>Sole Proprietor</th>
<th>Partnership</th>
<th>Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>Single individual</td>
<td>Two or more individuals</td>
<td>A legal separate entity separate from shareholders (but made up of individual stockholders)</td>
</tr>
<tr>
<td>Life of the organization</td>
<td>Death terminates and there is liquidation; there may be transfer of intent during life</td>
<td>Business terminates with death of partner or at agreed time; sale to surviving partner or partners; liquidation</td>
<td>Forever, or for fixed number of years; in case of death, stock passes by will or inheritance</td>
</tr>
<tr>
<td>Liability</td>
<td>Proprietor liable</td>
<td>Partners are liable for all of partnership obligations</td>
<td>Corporation is liable for obligations; (in some cases, individual stockholders may be asked to sign separate payment notes)</td>
</tr>
<tr>
<td>Capital</td>
<td>Personal investments; loans</td>
<td>Partner contributions; loans</td>
<td>Shareholders' stock, sale of stock and loans</td>
</tr>
<tr>
<td>Management decisions and limits on business</td>
<td>Proprietor fully responsible</td>
<td>Ability and agreement of partners</td>
<td>Directors' decisions, Articles of Incorporation and Texas Law</td>
</tr>
</tbody>
</table>
| Taxes                          | Tax on income of individual and related tax laws | Each partner pays his or her own income tax based on his or her income and related tax laws at tax time; partnership does file IRS Information Report | Regular Corporation: Corporations file a tax return and pay tax on income; salaries to shareholders and employees deductible; Rate: Conform to 1976 legislation.  


Tax-Option Corporation: Each shareholder reports shared income, operating loss and long-term capital gain; IRS Information Report filed by corporation |
| Taxes (estate)                 | Based on value of proprietor's estate, both separate and his or her community part of property and assets | Based on each partner's estate value, considering not only all separate property, but also his or her share of community property; his or her part in the partnership must be included in the above | Based on value on shares of stock and other assets, including other separate and shares of community property |

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