The right **ideas**.

The right **results**.

Achieved with the right **firm**.

Do you have a Partnership?

Robert O'Neil, CPA

In starting a business you have to consider what type of entity you want to create based on a variety of factors including: financing, tax, legal, and start-up costs. For these reasons business owners may want to create a joint entity where, under state law, each owner reports their separate share of the business income or loss individually. This sounds easy enough -- each owner reporting their share of the activity on their schedule C, thus eliminating the need to file a partnership return and send K-1s to the individual partners. The only issue is that the IRS may disagree with this treatment, ignore how the business is treated under state law and, instead, treat the entity as a deemed partnership if it meets the IRS's eight factor analysis.

The IRS eight factor analysis, established from the 1967 *Luna* decision, is a list of eight elements that help determine if the individual entities are in reality a partnership for federal tax purposes. The general rule is that, if you meet the majority of the factors, you will typically be deemed to be a partnership. This makes reviewing this list a must, because, if the IRS does change your entity classification, you could face potential accuracy and understatement of tax penalties. The eight factors are as follows:

1. The agreement of the parties and their conduct in executing its terms;
2. The contributions, if any, that each party has made to the venture;
3. The parties' control over income and capital and the right of each to make withdrawals;
4. Whether each party was a principal and co-proprietor, sharing a mutual proprietary interest in the net profits and having an obligation to share losses, or whether one party was the agent or employee of the other, receiving for its services contingent compensation in the form of a percentage of income;
5. Whether business was conducted in the joint names of the parties;
6. Whether the parties filed federal partnership returns or otherwise represented to the IRS or to persons with whom they dealt that they were a joint venture;
7. Whether separate books of account were maintained for the venture; and
8. Whether the parties exercised mutual control over and assumed mutual responsibilities for the enterprise.

The right **ideas**.

The right **results**.

Achieved with the right **firm**.

It is important to note though, that these factors are guidelines, and therefore, can be left to interpretation.

In some cases taxpayers who have a co-ownership agreement and would be treated as partnerships do have the ability to elect out of the partnership status if they can essentially prove that, while they may be co-owners of the property, everything else is kept separate. This means that they have the right to sell their share of the property, they can independently calculate their income, there are no special allocations between the owners and, if they are producing a product, each owner has the right to their share of the produced property. In essence, each co-owner should keep separate accounts, books, and records for their share of the property to help defend their position that the entity is not a partnership.

If you participate in a business activity that you think may be subject to these rules, contact one of the tax professionals at Zinner & Co. LLP for a consultation.