Office of Chief Counsel
Internal Revenue Service
Memorandum

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date: September 20, 2005

to:

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from:

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subject: Existence of a Partnership

This Chief Counsel Advice responds to your request for assistance dated June 27, 2005. This advice may not be used or cited as precedent.

LEGEND

X =

Y =

Z =

Product =

Year 1 =

Year 2 =

Country =

Date =

ISSUE

(1) During the pre-check-the-box years at issue, did a partnership exist between the entities?

CONCLUSION

(1) Based on the materials submitted and representations made within, no partnership existed between the entities during the pre-check-the-box years in question.

FACTS

During the years in question (Year 1- Year 2), X was a U.S. importer of foreign-produced Z. Among the different brands X imported was Product, produced by Y. Under the terms of its distribution agreement with Y, X purchased Product from Y for its own account resale with in the U.S., with title and risk of loss passing to X at the port in Country. The agreement required X to pay Y an initial amount equal to Y's cost to produce Product and a further amount equal to one-half of X's "profit" on resale of Product. In addition, the agreement required Y to reimburse X for one-half the marketing expenses incurred by X in relation to the marketing and promotion of Product. The distribution agreement between X and Y was terminated by mutual agreement effective as of Date.

LAW AND ANALYSIS

Section 761and 7701(a)(2) provide, in part, that the term partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not a trust, estate, or corporation.

Prior to January 1, 1997, the classification of any particular entity was determined under tests and standards set out in § 301.7701-3 and § 301.7701-4. Old § 301.7701-2(a)(1) set forth six major characteristics ordinarily found in a pure corporation which, taken together, distinguish it from other entities. These characteristics are: (1) associates; (2) an objective to carry on business and divide the gains therefrom; (3) continuity of life; (4) centralization of management; (5) liability for corporate debts limited to corporate property; and (6) free transferability of interests. Old §301.7701-2(a) provided that whether an organization is to be classified, for federal income tax purposes, as a partnership or as an association, depends upon the extent to which the organization possesses the following characteristics ordinarily found in a corporation: (1) centralization of management; (2) continuity of life; (3) free transferability of interests; and (4) limited liability. Thus, an entity which possesses three or four of these corporate characteristics will be treated as an association taxable as a corporation. An entity which is determined to possess two or fewer of the above characteristics will generally be classified as a partnership for federal income tax purposes.

A partnership is created for income tax purposes when persons join together their money, goods, labor, or skill for the purposes of carrying on a trade, profession, or business and when there is a community interest in the profits and losses. *Commissioner v. Tower*, 327 U.S. 280 (1946). Whether a partnership exists depends on whether the taxpayer and others intended to join together in order to carry on a business for joint economic gain. *Commissioner v. Culbertson*, 337 U.S. 733 (1949). The following factors, none of which is conclusive, are evidence of this intent: (1) the agreement of the parties and their conduct in executing its terms; (2) the contributions, if any, which 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 his services contingent compensation in the form of a percentage of income; (5) whether business was conducted in the joint names of the parties; whether the parties filed federal partnership returns or otherwise represented to respondent or persons with whom they dealt that they were joint venturers; (6) whether separate books of account were maintained for the venture; and (7) whether the parties exercised mutual control over and assumed mutual responsibilities for the enterprise. *Luna v Commissioner*, 42 T.C. 1067, 1077-78 (1964).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The Field asserts that a partnership or joint venture existed between and . The primary argument in support of the partnership characterization is that there was a sharing of profits and losses between the parties. The Field argues that the distribution agreement is unique, and therefore rises to the level of creating a partnership, as a result of there being a requirement for sharing of percent of the net profits and, in addition, a reimbursement of percent of the marketing costs to . In addition, the Field points to the degree of involvement that had in the handling of . The Field argues that there were requirements of monthly reports to , pricing input from , and the requirement that obtain prior approval from in the case of a change in vendors.

argues that their agreement was consistent with most distribution agreements in the industry at that time. They have produced other agreements that also possessed the shared gross profit feature that were not considered to be partnerships by the Service, or at least are not being challenged by the Service. However, the feature of sharing the marketing expenses appears to be unique to this distribution agreement. argues that it does not make sense from a policy perspective to categorize this distribution agreement as a partnership in light of the numerous other agreements that exist today. Furthermore, argues that even if it shared in net profits, it did not have a proprietary interest in the profits of and no obligation to share in the losses. funds associated with the sale of the were not segregated, but rather, flowed into general account along with other sources of revenues. had no control over or access to any of funds from the sale of the . merely makes payments to and there is not necessary correlation between these payments and actual receipts. Furthermore, argues that they had an interest in protecting their proprietary interests in the brand and were involved in operations and decision making only to the extent required to protect the integrity of the brand name.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-3050 if you have any further questions.

/s/

By: ______________________________

Dianna K. Miosi
Chief, Branch 1
(Passthroughs & Special Industries)