INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
February 12, 1999

Number: **199922014**
Release Date: 6/4/1999
Index (UIL) No.: 761.01-02

CASE MIS No.: TAM-119246-98

Number:
Release Date:

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Years Involved:

Date of Conference: No Conference held

LEGEND:

P	=
Service Group	=
Company	=
Business	=
Professionals	=
Office	=
x	=

ISSUE(S):

(1) Whether P formed partnerships with Service Groups to operate the Offices?

(2) Whether P possesses the benefits and burdens of the ownership of the Office, so as to require P to accrue the accounts receivable earned by the Office as its income?

CONCLUSION:

(1) The contractual arrangements between P and Service Groups do not create partnerships for federal tax purposes.

(2) No conclusion was reached on this issue. This issue is being referred back for further development of the facts and the legal analysis.

FACTS:

P is a publicly traded Company that purchases certain assets of and provides management services to Service Groups. For the years involved herein, P provided management services to x Service Groups. Before providing services to a Service Group, P usually forms a subsidiary that will enter into an asset purchase agreement and a written service agreement with the Service Group setting forth each party's rights and responsibilities.

Under the service agreement, P in return for a service fee agrees to provide Service Group with offices and facilities, equipment, supplies, support personnel, and management and financial advisory services. The facilities P provides to a Service Group under the service agreement include the assets transferred by a Service Group to P under the asset purchase agreement. A sample service agreement was included with the request for technical advice.

Following the execution of a service agreement, P and a Service Group generally enter into an asset purchase agreement which generally requires P to acquire all the assets and properties, tangible and intangible, of and pertaining to or used in the business of a Service Group, assume certain contracts, and purchase equipment, accounts receivable, cash, inventory, and other assets to be used by P or provided for a Service Group's use in accordance with the terms of the service agreement. P purchases only Business equipment and those assets that are necessary to the

performance of its administrative and office management services as provided in the service agreement.

Under a service agreement, P is responsible for providing a Service Group with offices and facilities, equipment, supplies, certain support personnel, and management and financial advisory services. In addition to providing the facilities and offices, P is responsible for all costs of repairs, maintenance and improvements, utility expenses, normal janitorial services, refuse disposal and all other costs and expenses reasonably incurred in conducting operations in the Office. P is specifically reimbursed for such costs. Additionally, P is responsible for paying expenses associated with the facilities such as real or personal property lease or sublease expenses, taxes and insurance. Service Group reimburses P for all operating expenses P incurs in providing these services and facilities. In return for the services provided, P is paid a service fee by a Service Group.

Although a Service Group contracts with P to provide administrative and support services, consistent with state and federal laws, P is prohibited by law from participating in the core component of its business - the provision of Business services - which is the primary income producing activity of a Service Group. A Service Group retains the sole authority to direct the Business, professional, and ethical aspects of its Business practice. A Service Group is responsible for the hiring and firing of Professionals and all issues related to the conduct of its Business practice. Matters involving the internal agreements and finances of a Service Group, including the distribution of professional service income among the individual Professionals in a Service Group, tax planning, pension and investment planning, and expenses relating to internal business matters remain the sole responsibility of a Service Group and the individual Professionals.

Under the service agreement, P and a Service Group form a policy board which is responsible for developing management and administrative policies for the overall operation of the Office. The policy board consists of six members. P and a Service Group each designate three members. The policy board is responsible for decisions on capital improvements and expansions, annual budgets, advertising and other administrative type decisions. The policy board coordinates the services that P provides and manages the contractual relationship between a Service Group and P, but does not control or coordinate the provision of the Service Groups' Business services.

Under the service agreement, P also, typically by the tenth day of each month, acquires a Service Group's outstanding accounts receivable. If after acquiring the receivables, P later collects any amounts in excess of the amount paid for the receivables, or if it cannot collect the entire amount it paid for the receivables, then P accounts for those differences by means of a rolling average computation that adjusts subsequent payments made to a Service Group for the acquiring of next month's receivables. The purpose of the rolling average computation is to credit a Service Group

with all amounts collected on the receivables and to place the entire burden of uncollected accounts on a Service Group.

In general, under the service agreement, P is entitled to a management fee which is comprised of three components. First, P is reimbursed for certain specified expenses which are incurred by P in providing the services delineated under the service agreement. Second, P receives a fee from a Service Group for the benefit of the use of the real and personal property owned by P that is leased by a Service Group. Finally, P receives a fee, which in many, but not all, service agreements is based upon a percentage of net income of a Service Group.

The relationship between each P subsidiary and each Service Group is set forth in a service agreement . The service agreement expressly states that a Service Group and P intend that P will act and perform its services as an independent contractor and not as a partner. Although the agreements between P and the Service Group expressly state that it is the intent of the parties to not form a partnership, some of the promotional literature used by P contains references to “partners” and “partnership”. However, the promotional literature used by P does not reflect an agreement by the parties to form a partnership.

Neither P nor a Service Group holds itself out to third parties as a partner in a partnership. After a service agreement is signed, an Office retains the name of a Service Group. Moreover, even though P employees interact with clients in the Office, the clients are not told that these individuals are P employees. Additionally, P handles all collection actions, such as client billing, on behalf of a Service Group and in a Service Group name. The P name does not appear in any correspondence with clients, other companies, etc. In all correspondence, a Service Group is listed as the provider of the Business services. Moreover, under the service agreement, the individual Professional remains the employee of a Service Group and a Service Group remains solely responsible for the compensation of the Professionals for the services they render to the clients of a Service Group. The Professionals are paid by a Service Group from the money received from P for the accounts receivable.

P and a Service Group have and maintain separate books and records; however, consistent with the bookkeeping aspect of the service agreement, an employee of P typically maintains a Service Group books and records.

LAW AND ANALYSIS:

Section 761 of the Internal Revenue Code provides 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 corporation, trust or estate.

Section 1.761-1(a) of the Income Tax Regulations, as in effect for the tax years here under consideration, provided that a joint undertaking merely to share expenses is not a partnership. For example, if two or more persons jointly construct a ditch merely to drain surface water from their properties, they are not partners. Mere co-ownership of property that is maintained, kept in repair, and rented or leased does not constitute a partnership. For example, if an individual owner or tenants in common of farm property lease it to a farmer for a cash rental or a share of the crops, they do not necessarily create a partnership. Tenants in common, however, may be partners if they actively carry on a trade, business, financial operation, or venture and divide the profits thereof. For example, a partnership exists if co-owners of an apartment building lease space and, in addition, provide services to the occupants either directly or through an agent.

The determination of whether a partnership exists is to be made by considering whether, in view of the parties' actions, the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise. Commissioner v. Culbertson, 337 U.S. 733 (1949), 1949-2 C.B. 5. A list of factors relevant to such a consideration is provided in Luna v. Commissioner, 42 T.C. 1067 (1964).

The factors provided in Luna, none of which are conclusive, are:

> The agreement of the parties and their conduct in executing its terms; the contributions, if any, which each party had made to the venture; the parties' control over income and capital and the right of each to make withdrawals; 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; whether business was conducted in the joint names of the parties; whether the parties filed federal partnership returns or otherwise represented to respondent or to persons with whom they dealt that they were joint venturers; whether separate books of account were maintained for the venture; and whether the parties exercised mutual control over the assumed mutual responsibilities for the enterprise.

The determination of whether parties intended to join together in a partnership "is a question of fact to be determined from testimony disclosed by their agreement, considered as a whole, and by their conduct in execution of its provisions." Commissioner v. Tower, 327 U.S. 280, 286-287 (1946). The best evidence of the intent of parties is any written document signed by the parties that defines their relationship.

The service agreement expressly states that the parties do not intend to create a

partnership relationship and that P will perform its services as an independent contractor. There is no reference to a partnership anywhere in the service agreement or the purchase agreement. The terms of the agreements are consistent with the intent to establish an independent contractor/principal relationship.

Neither P nor a Service Group represents to third parties that the P-Service Group affiliation is a partnership arrangement. The parties did not establish a joint name. The parties did not file a federal partnership return or otherwise represent to the IRS or to persons with whom they dealt that they were a joint venture. Although P uses the words “partner” and “partnership” in its sales literature, this does not reflect the intent of the parties to form a partnership.

Under the service agreement, P, acting on behalf of a Service Group, bills clients and collects the fees for Professional services rendered by Service Group in the Office, and for all other professional and Office services. Service Group appointed P for the term of the agreement to be its true and lawful attorney-in-fact, for the purposes specified in the agreement.

Under the service agreement, Service Group has complete control of and the responsibility for the hiring, compensation, supervision, evaluation and termination of its Professional employees. Service Group is responsible for the payment of such Professional employees’ salaries and wages, payroll taxes, Professional employee benefits and all other taxes and charges applicable to them.

The facts presented indicate that P and Service Group did not intend to join together in a joint venture. Although the parties had a contractual arrangement regarding the operation of the Office, P and Service Group each conducted a separate business activity with P providing services for Service Group, as an independent contractor in exchange for a fee paid by Service Group. The Service Group provided Business services to the public. In contrast, P was in the business of providing administrative services to numerous Service Groups, each party keeping its own books and records. The business was presented to the public as an Office owned by Service Group. The parties did not hold themselves out to the government as a joint venture. There was no arrangement for a sharing of the profits and losses of the activity between P and Service Group. The agreements between P and Service Group reflect the intent of the parties to not form a joint venture. Therefore, based upon an application of the standards set forth in Culbertson and Luna, the relationship between P and Service Group was not a partnership for federal income tax purposes.

CAVEAT(S)

Except as specifically ruled upon above, no opinion is expressed or implied as to the federal tax consequences of the transaction described above under any other

provision of the Code.

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.