



You Could Have a Partnership

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Because the size of farming operations has grown, many farmers have entered into agreements with other farmers or family members. For convenience sake, they treat these operations as joint ventures. Each party files their own Schedule F. Each reports their share of income and expense. They each report their share of depreciation of jointly owned equipment on their individual depreciation schedules. However, the IRS could determine that this was not a joint venture but a partnership. Consequently, partnership tax rules come into play.

Internal Revenue Code Section 7701(a)(2) defines a "partnership" as including a joint venture through or by means of which any business, financial operation, or venture is carried on, and which is not a trust, estate, or corporation. The term "partner" includes a member in such a joint venture.

The issue is whether there are two separate and distinct operations that share some assets or is it one operation that divides profits and files separate income tax returns? The answer to this question can have major tax consequences. Even if the individuals file separate returns, the IRS could consider them a partnership and apply partnership taxation rules.

Depreciation

The IRC §179 expensing provision allows an entity to write off \$500,000 of qualifying purchases in 2011. However, beginning in 2013 this is reduced to \$25,000 plus an inflation factor. If the operations are separate, each individual has the \$500,000 limitation. For 2011 however, if the operation is a partnership, the limit is split to \$250,000 each. While this might not be a problem in 2011, it could be a big problem in 2013 with the reduced limitation.

Elections

Many tax elections are made on an entity basis. For example, in 2011 100% bonus depreciation applies to all new qualifying purchases. If a taxpayer does not want to use the 100% deduction, they must elect out. If the IRS determines the operation is a partnership, the election will apply to all parties.

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Another election that could be troublesome is the election to defer the taxation of crop insurance proceeds to the following year.

IRS Authority

In a 2010 Tax Court case (*William F. Holdner v. Commissioner*, U.S. Tax Court, T.C. Memo 2010-175, Aug. 4, 2010); the judge cited other cases as precedent in determining that Mr. Holdner and his son had a partnership. Consequently, the income and expenses were reallocated between the partners. The language from these rulings included:

“Mere coownership of property does not create a partnership for Federal tax purposes, but co-owners of property may become partners if they carry on a business activity for profit.”

“The existence of a partnership for Federal income tax purposes is a question of Federal law and does not depend on whether an enterprise is recognized as a partnership under local law.”

“A partnership is created for Federal income tax purposes when persons join together their property, labor, or skill for the purpose of carrying on a trade, profession, or business and there is a community of interest in the profits and losses.”

Solution

There is less likelihood the IRS will deem a joint venture to be a partnership if there is a written agreement between the parties. This agreement should specifically state the venture is not to be construed as a partnership. Each venture should maintain a separate bank account as opposed to a joint account that receives all income and pays all bills with a distribution of profits at year end. Vendors should also be aware this is not a partnership and invoice and make payments to each separately.