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Op. 58-150

TERRITORY OF HAWAII
DEPARTMENT OF THE ATTORNEY GENERAL
HONOLULU

August 27, 1958

Honorable Earl W. Fase
Tax Commissioner
Territory of Hawaii
Honolulu, Hawaii

Attention: Mr. John A. Bell
Deputy Tax Commissioner

Dear Sir

This is in response to your letter of May 9, 1958 in which you ask our advice concerning the general excise tax liability of X, Y and Z each of which is a Hawaiian corporation, under the following circumstances:

X is engaged in the business of engineering, Y in civil engineering and Z in surveying, engineering and photogrammetric engineering or surveying by means of photography. X and Y share certain office accommodations but each has its own employees. Z has its own and separate offices and employees. Each corporation has been issued a license under the provisions of section 117-10, R.L.H. 1955, and has been reporting under such license those fees which it considers to be part of its taxable gross income under the general excise tax law. None of these corporations provides comprehensive engineering services; accordingly, when an engineering contract calls for services which cannot be provided by one corporation alone, two or three of them, the number depending on the nature of the services to be performed, are parties to the contract.

Illustrative of a contract involving all three corporations is that which was made with the City and Country of Honolulu. The contract recites that the three corporations are engaged thereunder as joint adventurers and are collectively referred to as the "Contracting Engineers:" All three corporations are signatory parties thereto. Subsequently, among themselves, the corporations made a written agreement called "Joint Venture Agreement" which, after reciting that "there being no uncertainty between themselves as to which services are to be rendered by a particular firm" and "they desire to agree between themselves as to what portion of the contract proceeds will be received by each firm." states:

> "The joint venture will pay gross income taxes on the entire proceeds. [Z] Corporation for its survey and map work will receive $15,400. [Y] for its project management and coordination will receive such reasonable amount as may be mutually agreed with [X], and [X] and [Y] for the remaining services required by the contract will receive the balance of the contract proceeds to be apportioned as follows: each firm will receive 210% of the compensation paid their respective employees for work on the contract, after payment of any agreed expenses to others, and if there is not sufficient to make such payments to each firm, the deficit shall be shared in proportion to the amounts otherwise payable to them. Any balance after such payments will be shared in proportion to the amounts each has expended for labor and materials in completing their respective services."

A contract to which only X and Y were signatory parties was that made with the United States of America. The corporation are referred to therein as a "joint venture." with respect to this contract the two corporations executed a "Joint Venture Agreement" identical to that made in connection with the City and County contract, except that Z is not concerned therein.

Your question is whether that portion of the fees each corporation receives under such contracts as those mentioned above is part of such corporation's taxable gross income.

Under the General Excise Law a joint adventure is a taxable entity. See section 117-1, R.L.H. 1955.

That parties to an agreement have styled their relationship a joint adventure does not necessarily result in their being treated as joint adventurers in their legal relations inter sese. Whetstone v. Purdue, 107 Ore. 86, 213 P. 1014 (1923); Petition of Williams, 297 F. 696 (C.A. 1, 1924); Schumacher v, Davis, 1 F.Supp. 959 (1932). Nor does the fact that each of the parties may be jointly and severally liable to a third party with respect to the performance of the subject matter of the adventure. Herbert v. Callahan A. Baker, 35 No. App. 498 (1889).

A joint adventure is an association of two or more persons who combine their resources to undertake jointly a single business transaction for joint, and not several, profit. Ford v. McCue, 163 Ohio St. 498, 127 N.E.2d 209 (1955); Fedderson v Goode, 112 Col. 38, 145 P.2d 981 (1944). It is necessary, generally, that there be an agreement to share losses as well. Kienitz v. Sager, a.k.a. Kienitz, 40 Haw. 1, Eline Realty Co. v. Foeman, 252 S.W.2d 15

(Ky., 1952); Kasiske v. Baker, 146 F.2d 113 (C.A. 10, 1944). Essential also is an agreement providing for joint proprietary interest in and mutual control over the subject matter of the adventure. Howard v. Societa Di Unione E. Beneficenza Italiana, 62 Cal.App.2d 842, 145 P.2d 694 (1944); Baker v. Billingsley, 126 Ind.App. 703 132 N.E.2d 273 (1956); Chislolm v. Gilmer, 81 F.2d 120 (C.A. 4, 1936), affirmed 299 U.S. 99, 81 L.Ed. 63, 57 S.Ct. 65, rehearing denied 299 U.S. 623, 81 L.Ed. 458, 57 S.Ct. 229; In re taxes Gay & Robinson, 40 Haw. 722. The right of mutual control and management, however, may be placed by agreement wholly in the hands of, or may be delegated to, one of the joint adventurers. United States Fidelity & Guar. Co. v. Dawson Produce Co., 200 Okla. 540, 197 P.2d 978 (1948) Joint adventures and partnerships, being similar in character, are usually tested by the same rules. Eastern I. & M. v. Patterson et als., 39 Haw. 346; Kienitz v. Sager, a.k.a. Kienitz, supra. No different are the rules because the existence of a partnership is questioned for purposes of taxation. Commissioner v. Tower, 327 U.S. 280, 90 L.Ed. 670, 66 S.Ct. 571 (1946).

Applying the foregoing rules governing the existence of joint adventures to the facts presented with respect to the City and County contract, we are of the opinion that the joint adventure consisted of X and Y but that Z did not stand in the relation of a joint adventurer. The profit to be made by Z is several, not joint; it would not share in any losses which might be suffered by the other two corporations in the performance of the adventure. Any profit which it might make or any loss which it might incur would be dependent upon whether its expenditures in performing its portion of the contract is less than or exceeded the allocated sum of $15,400. Between X and Y, however, there was a sharing of both profits and losses.

The relationship between Z and the joint adventure is analogous to that between a subcontractor and a prime contractor on a construction contract in which the former agrees to do, for a sum certain, a portion of the work on the structure which is the subject matter of the contract. In that situation there is no sharing of profits and losses.

The joint adventure is subject to a tax of 3 1/2% on the total amount of the fees received under the contract with the City and County as it is not a contractor within the meaning of section 117-7, R.L.H. 1955, who is allowed subcontractual deductions under section 117-14(c)(2), R.L.H. 1955. And being a subcontractor, but not one within the purview of sections 117-7 and 117-14(c)(2), Z should return the fee of $15,400 as part of its taxable gross income.

The joint adventure is also liable for the full amount of the fees received under the contract with the United States.

However, being joint adventurers, and receiving their respective portions of the proceeds under both the City and County and the United States contracts as such adventurers, neither X nor Y need return such proceeds in its indivual capacity.

Respectfully_,

NOBUKI KAMIDA
Deputy Atttorney General

APPROVED:

HERBERT Y. C. CHOY
Attorney General