

# JOINT VENTURE STRUCTURE

## *Joint venture or Partnership?*

Structuring a joint venture, particularly a global joint venture, can have a substantial impact on the its economic success. A threshold decision focuses on the type of joint venture: (i) contractual joint venture; (ii) corporate joint venture; or (iii) unincorporated joint venture. This “joint venture or partnership” decision impacts the joint venture structure. The management of a joint venture, how it is capitalized, and joint venture taxation all play a role in joint venture structures. Additionally, how you exit the business, or joint venture dissolution, can also affect its economic success. Contact Saboor H. AbdulJaami for help structuring your joint venture.

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Your joint venture structure can have a substantial impact on mitigation of [joint venture liability](#) and economic success. As an initial exploration of possible joint venture structures, many businesses engage in a “joint venture or partnership” discussion.

### Joint Venture or Partnership?

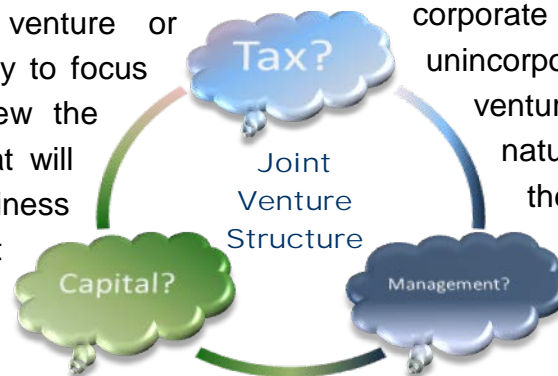
At the outset, the joint venture or partnership discussion is likely to focus on the way co-venturers view the business going forward. What will be the length of the business relationship? How formal will it be? What about the depth of the business relationship, how intertwined will the two businesses become?

The answers to these and other questions will help define the path forward. From a legal standpoint, courts view business joint ventures through the lens of partnership law. What does this mean? A partnership is viewed as a legal unit that is composed of its partners. This means that each partner is personally liable for the debts of the partnership. Each partner has the power to legally bind the partnership. If a partner decides to abandon the partnership, the partnership dissolves. Limiting partnership liability is one of the core benefits of structuring a joint venture. The results of the joint venture

or partnership discussion form the basis of the initial decisions about the joint venture structure and result in a decision about the type of joint venture.

### Type of Joint Venture

This article addresses three types of joint venture: the (i) contractual joint venture; (ii) corporate joint venture; and (iii) unincorporated joint venture. Your joint venture structure will develop naturally once you have selected the type of joint venture.



Contractual Joint Venture. A contractual joint venture may be a good choice for a short-term relationship between two businesses. Particularly if the relationship will be focused on combined service, sales, or marketing, and few if any hard assets are involved, co-venturers may prefer a contractual joint venture. The joint venture or partnership discussion tends to highlight relevant decision points. Unlike a corporate joint venture, you can avoid the time and expense of forming a separate entity. Additionally, a contractual joint venture can be set to terminate at a certain date or upon a certain event. There is no need to institute formal dissolution procedures with secretaries of state or other government agencies that corporate joint ventures require.

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Corporate Joint Venture. A corporate joint venture involves the set-up of a new corporation that is separate and independent from the co-venturers' respective businesses. The new corporation will be the legal and business vehicle through which the co-venturers grow the business joint venture. The decision to form a corporate joint venture begins with the joint venture or partnership discussion and, particularly in the case of a global joint venture, generally reflects joint venture tax concerns discussed below.

Unincorporated Joint Venture. Unincorporated joint ventures are similar to corporate joint ventures in that they involve the set-up of a legal entity that is separate and independent from the co-venturers' respective businesses. They differ from the corporate joint venture in the type of legal entity. An unincorporated joint venture is typically structured as a limited liability company (LLC), or limited partnership (LP), or possibly a limited liability partnership (LLP). With sufficient safeguards, the general partnership may also be employed as a vehicle in lieu of the corporate joint venture. Typically, the type of entity or entities employed in the joint venture is an outgrowth of the joint venture tax analysis.

## Joint Venture Tax

To recap, the joint venture or partnership discussion results in the initial selection of the type of joint venture based on considerations such as the extent of the business relationship and how to best limit your legal liability for co-venturer's actions. This selection is refined after completion of the joint venture tax analysis. You may be able to limit joint venture taxation by analyzing the type of entity or entities employed, the assets that will be contributed to the joint venture, and how you will exit the joint venture.

If your joint venture vehicle is a corporate joint venture, you will need to factor two levels of taxation into your joint venture tax analysis. Corporations pay taxes on profits at the entity level. When the corporate joint venture distributes earnings to shareholders, each shareholder must pay taxes at the applicable rate. This results in two levels of taxation: (1) corporate joint venture level; and (2) co-venturer level. Unincorporated joint ventures, which use pass-through entities as the joint venture vehicle (e.g., LLC, LP, general partnership), do not pay federal tax at the joint venture level. To the extent distributions are made, untaxed earnings flow-through the entity to co-venturer's. Each co-venturer then pays taxes at the applicable rate. Unincorporated joint ventures enjoy other joint venture tax benefits including the ability to allocate losses, deductions and tax credit to the co-venturers.

Your joint venture tax analysis should also review the type of assets that will be contributed to the joint venture. Contributing appreciated assets to a corporate joint venture is likely to result in a tax event, unless the contributor "controls" the corporate joint venture within the meaning of applicable tax rules. In general, assets may be contributed to unincorporated joint ventures without triggering a tax event.

Another area of joint venture taxation concern is the tax treatment upon exiting the business. If the venture is successful, joint venture dissolution may result in the distribution of cash or assets. A corporate joint venture dissolution will result in tax at both the entity level and at the co-venturer level. Dissolution of an unincorporated joint venture is likely to result in more favorable joint venture taxation due to the flexibility of the entity and the joint venture's pass-through tax status. On the other hand, if instead of a joint venture dissolution you plan to exit through a sale of the equity, the incorporated joint venture may be the preferred joint venture structure inasmuch as the sale of stock should avoid joint venture level taxation. Alternatively, you may be able to take advantage of a tax-free reorganization.

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Your joint venture structure may be significantly influenced by the results of your joint venture tax analysis. In the context of a global joint venture, additional things to consider include any foreign co-venturer's exposure to U.S. taxes, including 30% mandatory withholding. Another consideration may be whether a global joint venture that will sell products outside of the U.S.A. is able to include offshore entities or tax treaty planning to further reduce joint venture tax liability.

## Joint Venture Structure

Limiting liability is one of the core benefits of structuring a joint venture. Depending on the particulars of your business joint venture, either a corporate joint venture or an unincorporated joint ventures can be a good choice. However, due to inherent legal formalities, improper use of the corporate joint venture option can result in illusory protection. Corporate joint ventures that are inadequately capitalized, or that commingle assets and liabilities with co-venturer entities, or that do not adhere to statutory formalities (i.e. annual meetings), may result in each co-venturer being fully liable to the joint venture's creditors. Unincorporated joint ventures that are structured as LLC's are similarly vulnerable. Joint venture structures reliant on LPs or LLPs may lose their limited liability protection if limited partners become too involved in the management of the business. Finally, the joint venture structure may be vulnerable to securities laws, bankruptcy laws, or environmental laws that impose liability on controlling persons and parent entities.

As can be seen above, structuring a joint venture involves many considerations that impact the economic success of the business. Any joint venture structure will also address management structure and regulatory structure. Regarding management structure, corporate joint ventures must have a board of directors and executives as mandated by statute. In this regard, corporate joint ventures have the least flexible management structures. Unincorporated joint ventures, such as LLCs and LPs, enjoy greater flexibility. Joint venture structure may also be shaped by regulatory requirements. In particular, global joint ventures that contemplate operating in U.S. telecommunications or any industry that touches on national security may need to adjust their structure accordingly.

Ultimately, your joint venture or partnership discussion will shape your approach to your joint venture structure. The simplicity of a general partnership is appealing – no filing requirements, ability to do business in most states without additional filing – make this form appealing. Contractual joint ventures best exemplify this choice. However, additional considerations, such as joint venture taxation, may cause another type of joint venture to be preferable.

**For more information** about structuring your joint venture, contact Saboor H. AbdulJaami using the information provided below.

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