BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ALVADA, INC.)

For Appellant: Monteleone & McCrory a n d
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For Respondent: Crawford H. Thomas
Chief Counsel

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O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Alvada, Inc., against proposed assessments of additional franchise tax in the amounts of $3,288.70, $2,107.52, and $1,390.51 for the taxable years 1958, 1959, and 1960, respectively.

The question to be resolved in this appeal is whether appellant, as an assignee of part of a joint venturer's interest in a construction contract, became a member of a second joint venture or "subventure" with the assignor.

Appellant is a Colorado corporation which qualified to do business in California on June 4, 1958. It is engaged in the tunnel construction business. Its entire corporate stock is owned by Mr. and Mrs. Al Aitken. Mr. Aitken is an expert in tunnel construction.

In June 1958, a joint venture was formed between Kemper Construction Co. (hereafter "Kemper"), a California corporation, and MacDonald & Kruse, also a California corporation. On June 17, 1958, the joint venture was awarded a contract for

the construction of a tunnel. Kemper and MacDonald & Kruse contributed $75,000 and $25,000, respectively, to the capital account of the joint venture and agreed to share in the profits and losses in proportion to their respective contributions. Kemper was designated as the sponsor and was to appoint a project manager and maintain day-to-day supervision,

On July 24, 1958, appellant entered into an agreement with Kemper, titled "Assignment of Interest in Joint Venture Agreement." The pertinent parts of the agreement were as follows:

> 1. KEMPER CONSTRUCTION CO. hereby assigns to ALVADA, INC., Thirty Percent (30%) of the entire Joint Venture so that as between KEMPER CONSTRUCTION CO. and ALVADA, INC. as of the date of this Agreement the interest in. the Joint Venture would be:
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> KEMPER CONSTRUCTION CO. - Forty-five Percent (45%)
> ALVADA, INC. - Thirty Percent (30%)
> MAC DONALD & KRUSE - Twenty-five Percent (25%)
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> 2. ALVADA, INC. shall be entitled through the KEMPER CONSTRUCTION CO. to Thirty Percent (30%) of the profits and is liable for Thirty Percent (30%) of the losses ...
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> 3. ALVADA, INC. agrees to pay to KEMPER CONSTRUCTION CO. Thirty Thousand Dollars ($30,000) as its capital contribution to reimburse KEMPER CONSTRUCTION CO. ... with the same rights and privileges of the return of said capital contribution as KEMPER CONSTRUCTION CO. derives from the Joint Venture Agreement ...
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> 4. If additional capital contribution is required by the KEMPER CONSTRUCTION CO. - MAC DONALD & KRUSE JOINT VENTURE, the KEMPER CONSTRUCTION CO.'S share of said capital contribution shall be furnished by the parties hereto on the ratio as stated in Paragraph 1, to wit: Forty-five Percent (45%) ... by the KEMPER CONSTRUCTION CO. and Thirty Percent (30%) ... by ALVADA, INC.
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> 5. ALVADA, INC. agrees that it derives all of its interest in the Joint Venture of KEMPER CONSTRUCTION CO. and MAC DONALD & KRUSE through this Assignment by the KEMPER CONSTRUCTION CO.

> and that its capacity at the project site will be as an expert advisor to the KEMPER CONSTRUCTION CO., the project sponsor.
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> 6. ALVADA INC. shall be entitled to all of the benefits and liabilities in proportion to its interest as set forth in Paragraph 1 of the KEMPER CONSTRUCTION CO. in said KEMPER CONSTRUCTION CO.-MAC DONALD & KRUSE JOINT VENTURE, except that the management of the project shall continue to reside in the KEMPER CONSTRUCTION CO. ...

The agreement was signed by appellant and Kemper and also bore the signed approval of MacDonald & Kruse.

Pursuant to the above agreement, appellant paid $30,000 to Kemper initially and made an additional contribution of $40,000 during construction. Through Mr. Aitken, appellant actively participated in the construction of the tunnel. The tunnel was completed in 1959.

Kemper paid appellant's share of the profits to it in the years 1959 through 1961. Appellant reported these amounts in its franchise tax returns for the income years in which it received the amounts.

The assessments in-question arose from respondent's action in reallocating appellant's profits to the income years 1958 and 1959. The underlying premise for this action is a determination by respondent that appellant's agreement with Kemper created a "subventure," a form of joint venture, and that under rules applicable to joint ventures appellant's distributive share of the income of the venture was returnable without regard to when it was distributed.

Appellant contends that its arrangement with Kemper did not create a joint venture because appellant had no right of management and control. It thus concludes that it was not required to report income from the construction project until it actually received the income. Appellant does not otherwise dispute the correctness of respondent's reallocation of income.

The sole issue which we must consider, therefore is whether appellant and Kemper were--engaged together in a joint venture.

A joint venture is an undertaking by two or more persons jointly to carry out a single enterprise for profit. (Stilwell v. Trutanich, 176 Cal. App. 2d 614, 618 [3 Cal. Rptr. 265]; Tompkins v. Commissioner, 97 F.2d 396, 399.)

It has been stated that the elements of a joint venture are: (a) a community of interest in the subject of the undertaking; (b) a sharing in profits and losses; (c) an "equal right" or a "right in some measure" to direct and control the conduct of each other and of the enterprise; and (d) a fiduciary relation between or among the parties. (Stilwell v. Trutanich, supra, 178 Cal. App. 2d 614, 618 [3 Cal. Rptr. 285]. See also Flanders v. United States, 172 F. Supp. 935, 943.) The authority to manage the enterprise, however, may be placed in one of the members without destroying the nature of the arrangement as a joint venture. (Stilwell v. Trutanich, supra; Sime v. Malouf, 95 Cal. App. 2d 82, 96 [212 P.2d 946, 213 P.2d 788]; Ayrton Metal Co., 34 T.C. 464, 472, rev'd in part on other grounds, 299 F.2d 741.)

If one joint venturer shares his interest in the venture with a third party under an arrangement which itself has the characteristics of a joint venture, then a second joint venture, or what has been characterized as a "subventure" is created. (Ruppole v. Kuhl, 177 F.2d 823; Walsh Construction Co. v. Church, 247 F. Supp. 803; Harry Klein, 18 T.C. 804; Edith W. Abrams, T.C. Memo., Dkt. No. 83704, Oct. 17, 1961.) In Walsh Construction Co. v. Church, supra, subventures were found to exist where a corporate member of several joint ventures engaged in various construction projects assigned portions of its interests to a number of its officers and members of their families. The assignees contributed funds and were to make additional contributions as might be required. The agreements expressly provided that the assignees were to have no voice in the management of the construction projects, although some of them did participate in management as officers of the assigning corporation.

The foregoing authorities support respondent's determination that appellant and Kemper were engaged in a joint venture in the form of a subventure. In order to acquire a portion of Kemper's interest in the main joint venture between Kemper and MacDonald & Kruse, appellant contributed capital and services and agreed to share in the profits and losses. By the terms of the agreement between appellant and Kemper, appellant acquired the same benefits and liabilities in proportion to its interest as Kemper had in the main joint venture, except that Kemper was to continue to manage the construction project. The fact that Kemper was to manage the project did not affect the validity of the questioned subventure between Kemper and appellant any more than it affected the validity of the acknowledged main venture between Kemper and MacDonald & Kruse.

We conclude, in accord with respondent's determination, that appellant and Kemper were engaged in a joint venture.

Appeal of Alvada, Inc.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Alvada, Inc. against proposed assessments of additional franchise tax in the amounts of $3,288.70, $2,107.52, and $1,390.51 for the taxable years 1958, 1959, and 1960, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 27th day of April, 1967, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary