



# Set-Aside Alert™

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## Column: Joint Venture Accounting

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Joint Ventures ("JVs") continue to be a popular vehicle for small businesses operating in the federal government contracting arena. This should be of no surprise, as there are many benefits associated with bidding government contracts as a JV.

One of the most significant benefits is that it allows the joint venturers to stay small longer.

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**...*"One of the most significant benefits (of participating in a joint venture) is that it allows the joint venturers to stay small longer"...***

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Rather than doing the work as a prime contractor, where the small business must account for 100% of the revenues, a JV allows each firm to only account for its proportionate share of the venture's receipts for size purposes.

With that said, if a small business does not adequately document its share of JV receipts, it runs the risk of coming face-to-face with one of every small business' biggest fears—being treated as a large business by the Small Business Administration ("SBA").

For size purposes, the SBA's regulations state that "a concern must include in its receipts its proportionate share of [JV] receipts...." 13 C.F.R. § 121.103(h)(5) (emphasis added).

This, of course, begs the question: How does a small business calculate its proportionate share of JV receipts?

The answer generally depends on whether the JV is populated or unpopulated and whether the JV is structured as an informal business entity (e.g., a partnership) or a formal entity (e.g., a corporation).

Because most JVs are formed as unpopulated partnerships, or limited liability companies ("LLCs"), particular attention should be paid to how such JVs and

their members account for a JV's receipts.

An unpopulated JV has no employees and, instead, relies on the JV partners, as standalone entities, to provide personnel.

A partnership ordinarily flows through all of its income, losses and deductions to its partners and does not receive receipts at the partnership level; LLCs operate along similar lines.

From a contracting standpoint, in an unpopulated JV structured as a partnership or LLC, 100% of the contract work to be performed by the JV flows through the JV, down to the individual JV partners. In this regard, the JV partners are technically subcontractors to the JV.

The effect of the JV partners acting as subcontractors to the JV is that the revenue information for the JV is essentially reported twice. The JV reports all of the receipts earned by the JV on its tax return, and the individual JV partners report their proportionate shares of JV receipts on their respective business tax returns.

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**...*"the SBA is not supposed to double count receipts in determining whether a business is small"...***

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In the context of an unpopulated JV partnership/LLC, a JV partner's proportionate share of JV receipts should be commensurate with the amount of work performed by the JV partner, meaning the JV partner's ownership interest in the JV should be irrelevant for purposes of calculating its JV receipts.

This is an important concept because the SBA is not supposed to double count receipts in determining whether a business is small.

In the context of a small busi-

ness size status protest, the SBA must rely on the tax returns of the protested concern and its JVs in calculating the challenged concern's size.

The SBA—so as to avoid double counting—should recognize that the challenged concern's proportionate share of the revenue information contained in the tax returns of its JVs is included in the revenue information reported on the protested concern's business tax returns.

Because a plain review of a small business' tax returns, and the tax returns of the JV to which the small business is a JV partner, may not depict the true story of the flow of the JV's receipts, the onus is on the small business to produce documentation to substantiate its size.

Therefore, keeping accurate, detailed financial records is of critical importance, especially considering that a small business whose size is at issue has only three business days to respond to a size protest.

Additionally, engaging a CPA or legal counsel, well-versed in contract accounting issues, will surely be of value in the firm's efforts to stay small.

Tony Franco is a partner with PilieroMazza PLLC. Mr. Franco oversees the Government Contracts/Small Business Group. His practice includes all aspects of federal government contracting and administration. He has represented clients before government agencies, and federal and state courts, including the Court of Claims, General Accountability Office, and Board of Contract Appeals. If you have any questions regarding joint ventures, please contact Tony at 202.857.1000.

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