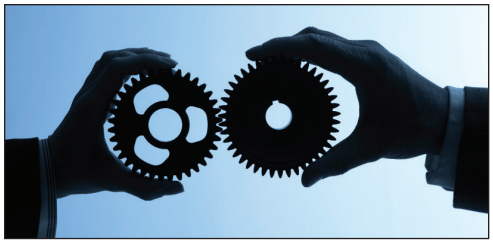

Partnerships

US Tax Help
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Tax Preparation/Planning for Expats

What You Need to Know About Partnerships

A partnership is the relationship existing between two or more persons who join together to carry on a trade or business. Each person contributes money, property, labor, or skill and expects to share in the profits and losses of the business.

A partnership must file an annual information return to report the income, deductions, gains, or losses from its operations, but it does not pay income tax. Instead, it passes through any profits or losses to its partners. Each partner includes his or her share of the partnership's income or loss on his or her tax return.

Partners are not employees and should not be issued a Form W-2 (nor a Form 1099). The partnership must furnish copies of Schedule K-1 (Form 1065) to the partners by the date Form 1065 is required to be filed, including extensions.

A partnership or individual partner may find the following information helpful to determine some of the forms which may be required to be filed.

Partnership Forms

Annual Return of Income—Form 1065, *U.S. Return of Partnership Income*

Every partnership that engages in a trade or business, or has gross income, must file an information return on Form 1065 showing its income, deductions, and other required information.

A partnership is not considered to engage in a trade or business and is not required to file a Form 1065 for any tax year in which it neither receives income nor pays or incurs any expenses treated as deductions or credits for federal income tax purposes. However, a partnership not currently engaged in a trade or business may want to file Form 1065, even though not technically required to do so, in order to avoid unnecessary correspondence from the IRS.

Employment Taxes

- Social Security and Medicare taxes and income tax withholding—Form 941, *Employer's Quarterly Federal Tax Return.* Generally, each quarter, all employers who pay wages subject to income tax withholding or Social Security and Medicare taxes must file Form 941 by the last day of the month that follows the end of the quarter.
- Federal unemployment tax (FUTA)—Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return.* Generally, the FUTA tax applies to the first $7,000 paid to each employee during a calendar year after subtracting any payments exempt from FUTA tax.
- Depositing employment taxes. Employers must deposit federal income tax withheld, plus both the employer and employee portion of Social Security and Medicare taxes, plus or minus any prior period adjustments to tax liability. All taxpayers must use the Electronic Federal Tax Payment System (EFTPS) to make federal tax deposits.
- State payroll tax requirements. The partnership should check with each state in which it conducts business or has employees to ensure the state requirements are met.

Partnerships

Information Returns, Form 1099

The partnership may have to file information returns if, in the course of its trade or business, it makes payments of rents, commissions, or other fixed or determinable income totaling $600 or more to any one person during the calendar year. Generally, Form 1099-MISC, *Miscellaneous Income,* is used.

Excise Taxes/State Sales Taxes

Excise taxes are taxes paid when purchases are made on a specific good, such as gasoline. There are also excise taxes on activities, such as on wagering or on highway usage by trucks. Sales taxes are imposed by states on sales of particular merchandise or services. The partnership needs to be aware of when these taxes may need to be collected and/or remitted to the proper authorities.

Individual Forms

Income Tax—Form 1040, *U.S. Individual Income Tax Return,* and Schedule E, *Supplemental Income and Loss*

Schedule E is used by the partner to report income or loss from the partnership as provided to the partner on Schedule K-1. Losses from partnerships are limited to the partner's basis. Other separately stated items from Schedule K-1 are reported on various forms and schedules of the partner's Form 1040.

Unreimbursed business expenses paid by a partner are deductible if the expenses were required to be paid under the partnership agreement.

Self-Employment Tax—Schedule SE (Form 1040), *Self-Employment Tax*

A partner's distributive share of partnership income is included in figuring his or her net earnings from self-employment.

Estimated Tax—Form 1040ES, *Estimated Tax for Individuals*

Estimated tax is the method used to pay tax on income that is not subject to withholding, such as partnership income.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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Partnership Advantages/Disadvantages

Advantages	*Disadvantages*
• *Flexibility.* A partnership can make special allocations or distributions among partners for non pro-rata shares of income and deductions. • *Simplicity.* For tax purposes, a formal partnership agreement is not required. A verbal agreement is generally all that is required to form a partnership, although a written agreement is recommended. • *Flow-through income.* Income and deductions from a partnership flow through to the partners on Schedule K-1.	• *Liability.* A general partner is liable for debts of the partnership, including debts that have been incurred by another person. An LLC formed under state law can shield partners from liability. • *Self-employment tax.* The distributive share of income from a partnership is subject to SE tax for general partners. • *Commitment.* It is often said that a partnership is easier to get into than to get out of. Written partnership agreements should contain an escape clause.

General and Limited Partners

- ***General partner.*** A general partner is a partner who is personally liable for partnership debts. A general partner is subject to SE tax on guaranteed payments and on the distributive share of partnership income.
- ***Limited partner.*** A limited partner is liable only for the amount of money or other property that the partner contributed, or is required to contribute, to the partnership. A limited partner is subject to SE tax on guaranteed payments but is not subject to SE tax on the distributive share of income.
- ***LLC members.*** An LLC with more than one owner is treated as a partnership by default, unless the LLC elects to be taxed as a corporation. Members of an LLC are subject to SE tax on guaranteed payments, but confusion exists as to whether and when LLC members are subject to SE tax on the distributive share of income.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.