



Business Entity Comparison Chart



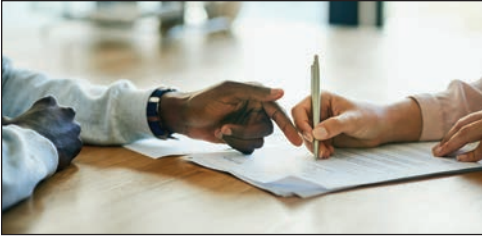
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Entity	Accounting and Recordkeeping	Fringe Benefits	Liability
Sole proprietor, single-member LLC, and spouses-owned business <ul style="list-style-type: none"> Schedule C (Form 1040), <i>Profit or Loss From Business</i> Schedule F (Form 1040), <i>Profit or Loss From Farming</i> Schedule SE (Form 1040), <i>Self-Employment Tax</i> IRS Pub. 334, <i>Tax Guide for Small Business</i> 	<ul style="list-style-type: none"> Accounting is less involved than partnerships and corporations. Double-entry bookkeeping is not required as no balance sheet is needed when filing Schedule C or Schedule F. A non-LLC business owned solely by two spouses may elect not be taxed as a partnership and may file as two sole proprietorships to minimize bookkeeping requirements. Cannot file as a fiscal year business unless owner files Form 1040 under the fiscal year rules. 	<p>Excludable fringe benefits are generally not allowed for the owner.</p> <p>Exceptions: Health insurance is deductible if the spouse is an employee of the sole proprietorship, and the owner is covered as a family member of the employee-spouse. Owners are eligible for dependent care assistance fringe benefits, de minimis fringe benefits, and working condition fringe benefits.</p>	<p>Owner is personally liable for all debts and lawsuits against the business. Exception: If organized as an LLC, liability is usually limited to owner's investment and his or her own malpractice or debt guarantees.</p>
Partnership <ul style="list-style-type: none"> Form 1065, <i>U.S. Return of Partnership Income</i> IRS Pub. 541, <i>Partnerships</i> IRS Pub. 3402, <i>Taxation of Limited Liability Companies</i> IRC Subchapter K, §701 through §761 	<ul style="list-style-type: none"> Small partnerships are not required to provide a balance sheet and can use the same bookkeeping system as a sole proprietor. Larger partnerships must provide a balance sheet with the return, which requires double-entry bookkeeping. A partnership must generally use the same tax year as its partners, but can use a fiscal year if there is a business purpose or an IRC section 444 election was made. Complex books and records are needed when a partner exchanges property, other than cash, for a partnership interest or for special allocations and basis elections. 	<p>Partners are eligible for some excludable fringe benefits. Taxable benefits are reported as guaranteed payments or an adjustment to a partner's distributable share of profits.</p>	<p>A general partner is personally liable for all debts and lawsuits brought against the partnership. Exception: If the partner is a limited partner, or the business is organized as an LLC, liability is generally limited to the partner's investment, plus his or her own malpractice or debt guarantees.</p>
S corporation <ul style="list-style-type: none"> Form 1120-S, <i>U.S. Income Tax Return for an S Corporation</i> IRC Subchapter S, §1361 through §1379 	<ul style="list-style-type: none"> Double-entry bookkeeping may be required depending on income and other factors affecting the need for a balance sheet on the return. Must use a calendar year unless it establishes a business purpose for using a fiscal year, or it makes an IRC section 444 election. 	<p>Shareholder/employees are eligible for some excludable fringe benefits. Benefits added to taxable wages on Form W-2 of more than 2% shareholders include accident and health plans, up to \$50,000 of group health insurance, and meals and lodging furnished for the employer's convenience.</p>	<p>A shareholder's liability is limited to the amount invested, plus his or her own malpractice or debt guarantees.</p>
C corporation <ul style="list-style-type: none"> Form 1120, <i>U.S. Corporation Income Tax Return</i> IRS Pub. 542, <i>Corporations</i> IRC Subchapter C, §301 through §385 	<ul style="list-style-type: none"> Double-entry bookkeeping may be required if the tax return requires a balance sheet. No restriction on use of a fiscal year. Exception: A personal service corporation (PSC) must use a calendar year unless it establishes a business purpose for using a fiscal year or makes an IRC section 444 election. Required to use accrual method of accounting if average annual gross receipts exceed \$30 million. 	<p>Shareholder/employees eligible for excludable fringe benefits, generally to the same extent as any other employee, with exceptions under the nondiscrimination rules. Benefits can include health insurance and reimbursement, education, life insurance, etc.</p>	<p>A shareholder's liability is limited to the amount invested, plus his or her own malpractice or debt guarantees.</p>

Business Entity Comparison Chart

Entity	Organization and Ownership	Taxation of Profits and Losses
Sole proprietor, single-member LLC, and spouses-owned business <ul style="list-style-type: none"> Schedule C (Form 1040), <i>Profit or Loss From Business</i> Schedule F (Form 1040), <i>Profit or Loss From Farming</i> Schedule SE (Form 1040), <i>Self-Employment Tax</i> IRS Pub. 334, <i>Tax Guide for Small Business</i> 	<ul style="list-style-type: none"> One individual carrying on an unincorporated trade or business. A qualified joint venture whose only members are spouses may elect not to be taxed as a partnership and file as two sole proprietorships. An LLC may not make this election (except in community property states). Easiest business to organize with minimal legal restrictions. The entity does not exist apart from the owner. Business starts and ends based on the owner's involvement. The owner has complete freedom over business decisions and is entitled to 100% of the profits. The owner is limited by his or her own ability to raise capital and obtain financing. Outside investors cannot be part owners. Transfer of ownership consists of selling the business assets. A single-member LLC is taxed as a sole proprietorship unless the election is made to be taxed as a corporation. 	<ul style="list-style-type: none"> The owner is self-employed and pays self-employment (SE) tax on net profits. Net profits are subject to income tax in the year earned and cannot be deferred by retaining profits. Losses offset other income in year incurred, such as Form W-2 wages, interest, dividends, and capital gains. Exceptions: Losses cannot be used to offset income from activities subject to passive loss, at-risk loss, and hobby loss rules. Owner may qualify for the 20% qualified business income deduction (QBID).
Partnership <ul style="list-style-type: none"> Form 1065, <i>U.S. Return of Partnership Income</i> IRS Pub. 541, <i>Partnerships</i> IRS Pub. 3402, <i>Taxation of Limited Liability Companies</i> IRC Subchapter K, §701 through §761 	<ul style="list-style-type: none"> Two or more owners conducting an unincorporated trade or business. Easy to organize with minimal legal restrictions. Multi-member LLCs are taxed as partnerships, unless the election to be taxed as a corporation is made. No limitations on the number of partners or partner entities. More flexibility than a corporation in dividing up profits, losses, ownership of capital, and making special allocations to partners. Contributing property in exchange for a partnership interest is a tax-free event (except for the receipt of cash). Liquidating a partnership interest in exchange for property is generally tax-free, unless the liquidation is in cash only. Getting out of a partnership may be more complicated than starting one. A partnership agreement can restrict selling or transferring of a partnership interest. State law may limit an LLC's life. 	<ul style="list-style-type: none"> The partnership pays no income tax. Profits pass through to partners for individual payment of tax. Tax to partners cannot be deferred by retaining business earnings. Pass-through items retain the same character to the partner as they had to the partnership. A general partner's distributive share of profits is subject to self-employment (SE) tax. Limited partners' share of profits not subject to SE tax unless in the form of guaranteed payments. Payment for partner services to the partnership is not Form W-2 income, but may be guaranteed payments, profits, or special allocations. Losses flow through to partners and can be used to offset other income such as Form W-2 wages, interest, dividends, and capital gains. Exceptions: Losses cannot be used to offset income from activities subject to passive loss, at-risk loss, and hobby loss rules. Partner may qualify for the 20% qualified business income deduction (QBID).
S corporation <ul style="list-style-type: none"> Form 1120-S, <i>U.S. Income Tax Return for an S Corporation</i> IRC Subchapter S, §1361 through §1379 	<ul style="list-style-type: none"> A corporation that has elected to be taxed as an S corporation by filing Form 2553, <i>Election by a Small Business Corporation</i>. Ownership is through owning shares of stock. Limited to 100 shareholders. (Spouses and their estates and all members of a family, as defined in IRC section 1361(c)(1)(B), and their estates can be treated as one shareholder for this test.) Stock is limited to one class of stock with equal rights to distributions and liquidation proceeds. Shareholders are limited to individuals, estates, certain trusts, and certain charities. Corporations and certain partnerships are ineligible to own stock. Other ownership and organization issues are the same as a C corporation. 	<ul style="list-style-type: none"> An S corporation generally pays no tax. Profits flow through to the shareholders. Pass-through items retain the same character to the shareholder as they had to the corporation. Distributions are not subject to self-employment tax. Shareholders who perform services are paid as employees and income is reported on Form W-2. Losses flow through to shareholders and may be used to offset other income, subject to passive, at-risk, and hobby loss exception rules. Shareholder may qualify for the 20% qualified business income deduction (QBID).
C corporation <ul style="list-style-type: none"> Form 1120, <i>U.S. Corporation Income Tax Return</i> IRS Pub. 542, <i>Corporations</i> IRC Subchapter C, §301 through §385 	<ul style="list-style-type: none"> A legal association carrying on a trade or business organized under state law. Ownership is through owning shares of stock, and there is no limit on number of shareholders, or type of taxpayer or entity. Forming a corporation may require complex and expensive legal procedures. Corporations must hold board meetings, shareholder meetings, and keep corporate minutes. Corporations are subject to federal and state regulations. The life of a corporation is perpetual. Transfers of ownership can be as easy as selling or inheriting stock. Liquidating a corporation is usually a taxable event, and contributions in exchange for stock may be taxable. Raising additional capital can be as easy as issuing new shares of stock. 	<ul style="list-style-type: none"> Shareholders who perform services are paid as Form W-2 employees subject to payroll taxes and reporting rules. Reasonable wages must be paid and not inflated to reduce corporate tax liability. Net profits are subject to tax at the corporate 21% rate. Profits distributed as dividends are taxed again on the shareholder's tax return. Tax to the shareholders can be deferred by retaining earnings for business purposes. Losses do not pass through to shareholders. Business losses must be carried over to a year with profits. Capital losses must be carried over to a year with capital gains. At-risk limitations, hobby loss, and passive loss rules do not apply.



Business Entity Pros and Cons



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Business Entity Pros and Cons

Sole Proprietorship

Pros	<ul style="list-style-type: none"> • No formal creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • No double taxation of profits.
Cons	<ul style="list-style-type: none"> • No liability protection, except through insurance. • Self-employment tax is assessed on entire net profit of the business. • Transfer of ownership can be complex. • Limited access to fringe benefits for owners.
Good Fit	<ul style="list-style-type: none"> • Seasonal or part-time businesses. • Businesses with little liability. • Home-based businesses. • Businesses intended to operate for the owner's life only.

Single-Member LLC

Pros	<ul style="list-style-type: none"> • Simple creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • Liability protection for member, except for malpractice. • No double taxation of profits.
Cons	<ul style="list-style-type: none"> • Self-employment tax is assessed on entire net profit of the business. • Transfer of ownership can be complex. • Limited access to fringe benefits for owners. • Laws regulating LLCs vary widely among states. • Failure to follow statutory requirements can result in loss of LLC status.
Good Fit	<ul style="list-style-type: none"> • Businesses with potential liability in operations. • Businesses intended to operate for the owner's life only.

Multi-member LLC

Pros	<ul style="list-style-type: none"> • Limited liability for all members, except for malpractice or debt guarantees. • Unlimited number of members. • Separate entity from members, allowing for greater flexibility in operations. • Ownership is in the form of membership interest and can be transferred more easily than ownership in a single-member LLC. • No double taxation of profits.
Cons	<ul style="list-style-type: none"> • Requires a separate tax return. • Laws regulating LLCs vary widely among states. • Failure to follow statutory requirements can result in loss of LLC status.
Good Fit	<ul style="list-style-type: none"> • Businesses requiring equity capital. • Businesses with potential liability in operations. • Businesses intended to exist beyond the lives of the members. • Businesses expecting changes in ownership over time.

General Partnership

Pros	<ul style="list-style-type: none"> • No limit on partner number or type. • Can be used to hold investments in other businesses and consolidate multiple lines of business. • Flexible allocation of profit, loss, and distributions. • Favorable tax treatment when liquidated. • No double taxation of profits.
Cons	<ul style="list-style-type: none"> • Requires a separate tax return. • Unlimited liability for all partners. • Difficult to dissolve or change ownership without substantial planning. • Requires tracking of basis for partners, both inside and outside the partnership. • Individual partner's share of income is subject to self-employment taxes.
Good Fit	<ul style="list-style-type: none"> • Two established businesses who wish to work as one. • Partners wishing to consolidate multiple entities into one entity.



Business Entity Pros and Cons

Limited Liability Partnership

Pros	<ul style="list-style-type: none"> • Liability protection for limited partners. • Separate entity from partners. • Ownership can be transferred within the rules of the partnership agreement. • Limited partners' liability is limited to their investment in the business. • Limited partners pay self-employment tax on guaranteed payments only. • No double taxation of profits.
Cons	<ul style="list-style-type: none"> • Must have one general partner with unlimited liability. • Limited liability status for damages can be lost for a variety of administrative reasons. • Restrictions on partners based on entity type. • Requires a separate tax return. • Requires tracking of basis for partners, both inside and outside the partnership.
Good Fit	<ul style="list-style-type: none"> • Businesses with partners not actively involved in business. • Businesses with equity capital needs. • Businesses with exposure to liability.

C Corporation

Pros	<ul style="list-style-type: none"> • No liability for non-active stockholders. • No restrictions on ownership. • Ownership can be transferred through the sale of stock. • Separate entity from stockholders. • Fringe benefits for owner-officers. • Can have ownership interest in any other business entity. • Perpetual existence. • Raising capital can be achieved by issuing stock.
Cons	<ul style="list-style-type: none"> • Double taxation of profits. • Complex and expensive to create and maintain. • Requires regular board of directors' meetings and minutes. • Requires a separate tax return.
Good Fit	<ul style="list-style-type: none"> • Businesses with ownership in multiple other entities. • Businesses with significant exposure to liability. • Businesses intended to exist eternally.

S Corporation

Pros	<ul style="list-style-type: none"> • Liability protection similar to that of C corporations. • No double taxation of profits. • Ownership is easily transferred through the sale of stock. • Separate entity from stockholders. • Self-employment tax is not assessed on the entire net profit of the business. • Losses can offset shareholders' other taxable income.
Cons	<ul style="list-style-type: none"> • Complex and expensive to create and maintain. • Requires a separate tax return. • Requires regular board of directors' meetings and minutes. • Requires tracking of basis for stockholders. • Ownership is limited to specific types of entities. • Deductibility of fringe benefits for owner-employees is limited.
Good Fit	<ul style="list-style-type: none"> • Businesses with significant exposure to liability.

Business Formalities

A common issue with a closely-held business is failure to adhere to business formalities. Trouble can occur when business and personal funds are intermingled, the business is not adequately capitalized, or reasonable compensation for services is not paid.

For example, separation of funds can be a key in preserving the liability protection of the "corporate veil." Courts can pierce the corporate veil if they find the corporation is an "alter ego" of the shareholder, which is likely to occur if shareholders pay personal expenses from the corporation checkbook or vice versa.

Transactions such as capital contributions or loans between the business and the owners can also be recharacterized by the IRS, creating unexpected negative tax consequences.

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 73.
- 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.

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S Corporations



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What You Need to Know About S Corporations

S corporations are corporations that elect to pass income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income.

To qualify for S corporation status, the corporation must meet the following requirements.

- It must be a domestic corporation.
- It must have only allowable shareholders.
 - Allowable shareholders include individuals, certain trusts, and estates.
 - Unallowable shareholders include partnerships, other corporations, and nonresident aliens.
- It must have no more than 100 shareholders.
- It must have only one class of stock.
- It may not be an ineligible corporation, such as certain financial institutions, insurance companies, and domestic international sales corporations.

In order to become an S corporation, the corporation must submit Form 2553, *Election by a Small Business Corporation*, signed by all the shareholders.

Corporate Formalities

Some or all of the benefits of establishing a corporation are lost when corporate formalities are not strictly followed. When a corporation is formed, a separate entity is created, with legal rights and responsibilities that are distinct and separate from the shareholders.

Corporate Veil

Corporations are often formed for purposes of protecting shareholders from liability. However, if formalities are not followed, the corporation is not adequately capitalized, or personal and corporation funds are intermingled, the corporate veil can be easily “pierced” by a court, which results in personal liability for the shareholders.

Reasonable Wages

Since a corporation is a separate legal entity, shareholders performing services for the corporation are treated as employees and must be paid reasonable wages for the duties performed. Even with a single-shareholder corporation, federal and state payroll taxes must be withheld and a year-end W-2 must be submitted, just as with any other employee.

IRS Issues

If tax formalities are not followed, such as reasonable wages being paid to shareholders, the IRS can reclassify income and expenses, causing unwanted tax consequences.



S Corporations

S Corporation Forms

Annual Return of Income—Form 1120-S, U.S. Income Tax Return for an S Corporation

A corporation or other entity must file Form 1120-S if:

- It elected to be an S corporation by filing Form 2553,
- The IRS accepted the election, and
- The election remains in effect.

Estimated Taxes

An S corporation may need to make estimated tax payments if it expects to owe taxes on certain built-in gains or passive income. Corporations must use electronic funds transfers to make all federal tax deposits, including installment payments of estimated tax.

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 corporation should check with each state in which it conducts business or has employees to ensure the state requirements are met.

Individual Forms

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

Schedule E (Form 1040) is used by the shareholder to report income or loss from the S corporation as provided to the shareholder on Schedule K-1 (Form 1120-S). Losses from S

corporations are limited to the shareholder's basis. Other separately stated items from Schedule K-1 (Form 1120-S) are reported on various forms and schedules of the shareholder's Form 1040.

For tax years 2018 through 2025, unreimbursed business expenses paid by an S corporation shareholder are not deductible as employee business expenses.

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

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

S Corporation Advantages/Disadvantages

Advantages	Disadvantages
<ul style="list-style-type: none">• Liability protection. An S corporation offers the same liability protection as a regular C corporation.• Pass-through taxation. An S corporation does not pay tax at the entity level. Income, loss, and deductions pass through to the shareholder. The double taxation of a C corporation is eliminated.• Net operating losses (NOLs). S corporation NOLs pass through to be claimed on the shareholder's tax return.• No self-employment tax on S corporation income. Net income passing through from an S corporation is not subject to payroll or self-employment tax. A reasonable wage must be paid to employee-shareholders.	<ul style="list-style-type: none">• One-class-of-stock rule. An S corporation may have only one class of stock. All shareholders must have equal rights to distributions. Special allocations are not allowed. Some loans can violate the rule and cause termination of the S election.• Debt basis. A shareholder's basis for deducting losses will only be increased by a direct loan to the S corporation.• Carryovers. Items such as net operating losses from C corporations are not allowed to be used in an S corporation.• All income taxed. Income is passed through and taxed to the shareholder, whether or not it is distributed.• Fringe benefits. Greater than 2% S corporation shareholders are treated as partners for purposes of fringe benefits, and many fringe benefits are not available.

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 73.
- 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.

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Partnerships



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.

Information Returns, Forms 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 Information*, or Form 1099-NEC, *Nonemployee Compensation*, is used.

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Partnerships

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 (Form 1040) 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 calculating his or her net earnings from self-employment.

Estimated Tax—Form 1040-ES, *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.

Partnership Advantages/Disadvantages

Advantages	Disadvantages
<ul style="list-style-type: none">• 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.	<ul style="list-style-type: none">• 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 self-employment 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 self-employment tax on guaranteed payments but is not subject to self-employment 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 self-employment tax on guaranteed payments, but uncertainty exists as to whether and when LLC members are subject to self-employment tax on the distributive share of income. For more information, ask your tax preparer for the handout titled *Limited Liability Companies (LLCs)*.

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- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 73.
- 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.

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