



# Partnership General Tax Information

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**Course #3181D**

**Taxes**

**2 Credit Hours**

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# PARTNERSHIP GENERAL TAX INFORMATION

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This course is designed to give a general overview of the taxation of partnerships. It explains how income tax laws apply to partnerships and partners.

## LEARNING ASSIGNMENTS AND OBJECTIVES

*As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.*

### SUBJECTS

#### Partnership General Tax Information

Study the course materials from pages 1 to 48

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

#### Objectives:

- Recognize how the income tax law applies to partnerships, as well as partners.
- Identify which partnership items partners must include on their partnership return.

## **NOTICE**

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## EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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# PARTNERSHIP GENERAL TAX INFORMATION

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## Course Objectives

### After completing this course, you should be able to:

- Recognize how the income tax law applies to partnerships, as well as partners.
- Identify which partnership items partners must include on their partnership return.

## I. WHAT'S NEW/REMINDERS

**Section 1061 reporting.** Section 1061 recharacterizes certain long-term capital gains of a partner that holds one or more applicable partnership interests as short-term capital gains. An applicable partnership interest is an interest in a partnership that is transferred to or held by a taxpayer, directly or indirectly, in connection with the performance of substantial services by the taxpayer or any other related person, in an applicable trade or business. See *Section 1061 Reporting Instructions* for more information.

**Schedules K-2 and K-3 (Form 1065).** Schedules K-2 and K-3 replace the reporting of certain international transactions on Schedules K and K-1. The schedules are designed to provide greater clarity for partners on how to compute their U.S. income tax liability with respect to items of international tax relevance, including claiming deductions and credits. See the Instructions for Schedules K-2 and K-3 for more information.

## II. INTRODUCTION

This course explains how the income tax law applies to partnerships and to partners. Generally, a partnership does not pay tax on its income but “passes through” any profits or losses to its partners. Partners must include partnership items on their tax returns.

## III. IMPORTANT ISSUES

**Withholding on foreign partner or firm.** A partnership that has foreign partners or engages in certain transactions with foreign persons may have one (or more) of the following obligations.

***Fixed or determinable annual or periodical (FDAP) income.*** A partnership may have to withhold tax on distributions to a foreign partner or a foreign partner's distributive share when it earns income not effectively connected with a U.S. trade or business. A partnership may also have to withhold on payments to a foreign person of FDAP income not effectively connected with a U.S. trade or business.

***Withholding under the Foreign Investment in Real Property Tax Act (FIRPTA).*** If a partnership acquires a U.S. real property interest from a foreign person or firm, the partnership may have to withhold

tax on the amount it pays for the property (including cash, the fair market value of other property, and any assumed liability).

***Withholding on foreign partner's effectively connected taxable income (ECTI).*** If a partnership has income effectively connected with a trade or business in the United States (including gain on the disposition of a U.S. real property interest), it must withhold on the ECTI allocable to its foreign partners.

***Withholding on foreign partner's sale of a partnership interest.*** A purchaser of a partnership interest, which may include the partnership itself, may have to withhold tax on the amount realized by a foreign partner on the sale for that partnership interest if the partnership is engaged in a trade or business in the United States.

***Withholding under the Foreign Account Tax Compliance Act (FATCA).*** A partnership may have to withhold tax on distributions to a foreign partner of a foreign partner's distributive share when it earns withholdable payments. A partnership may also have to withhold on withholdable payments that it makes to a foreign entity. A partnership that has a duty to withhold but fails to withhold may be held liable for the tax, applicable penalties, and interest.

## IV. FORMING A PARTNERSHIP

The following sections contain general information about partnerships.

### ORGANIZATIONS CLASSIFIED AS PARTNERSHIPS

An unincorporated organization with two or more members is generally classified as a partnership for federal tax purposes if its members carry on a trade, business, financial operation, or venture and divide its profits. However, a joint undertaking merely to share expenses is not a partnership. For example, co-ownership of property maintained and rented or leased is not a partnership unless the co-owners provide services to the tenants.

The rules you must use to determine whether an organization is classified as a partnership changed for organizations formed after 1996.

**Organizations formed after 1996.** An organization formed after 1996 is classified as a partnership for federal tax purposes if it has two or more members and it is none of the following.

- An organization formed under a federal or state law that refers to it as incorporated or as a corporation, body corporate, or body politic.
- An organization formed under a state law that refers to it as a joint-stock company or joint-stock association.
- An insurance company.
- Certain banks.
- An organization wholly owned by a state, local, or foreign government.



- An organization specifically required to be taxed as a corporation by the Internal Revenue Code (for example, certain publicly traded partnerships).
- Certain foreign organizations identified in section 301.7701-2(b)(8) of the regulations.
- A tax-exempt organization.
- A real estate investment trust.
- An organization classified as a trust under section 301.7701-4 of the regulations or otherwise subject to special treatment under the Internal Revenue Code.
- Any other organization that elects to be classified as a corporation by filing Form 8832.

**Limited liability company.** A limited liability company (LLC) is an entity formed under state law by filing articles of organization as an LLC. Unlike a partnership, none of the members of an LLC are personally liable for its debts. An LLC may be classified for federal income tax purposes as either a partnership, a corporation, or an entity disregarded as an entity separate from its owner by applying the rules in regulations section 301.7701-3.

### Tip



A domestic LLC with at least two members that does not file Form 8832 is classified as a partnership for federal income tax purposes.

**Organizations formed before 1997.** An organization formed before 1997 and classified as a partnership under the old rules will generally continue to be classified as a partnership as long as the organization has at least two members and does not elect to be classified as a corporation by filing Form 8832.

**Community property.** Spouses who own a qualified entity (defined later) can choose to classify the entity as a partnership for federal tax purposes by filing the appropriate partnership tax returns. They can choose to classify the entity as a sole proprietorship by filing a Schedule C (Form 1040) listing one spouse as the sole proprietor. A change in reporting position will be treated for federal tax purposes as a conversion of the entity.

A **qualified entity** is a business entity that meets all the following requirements.

- The business entity is wholly owned by spouses as community property under the laws of a state, a foreign country, or a possession of the United States.
- No person other than one or both spouses would be considered an owner for federal tax purposes.
- The business entity is not treated as a corporation.