Filing Requirements for Partnerships and LLCs that the Are Taxed as that Partnerships

Abstract:
This material discusses the filing requirement for partnerships and LLCs that are taxed as partnerships. It defines those entities that are excluded from the partnership rules and discusses how and when to make the election

ISSUE 3: FILING REQUIREMENTS FOR PARTNERSHIPS AND LLCS THAT ARE TAXED AS PARTNERSHIPS

Taxpayers in general (and agricultural producers specifically) frequently agree to pool efforts and resources to engage in different types of economic activities. These agreements should be formal written documents that specify details of formation, operation, and potential dissolution of the activity.
Unfortunately, many such activities are started, operated, and terminated based on a verbal understanding, a handshake, and possibly a lawsuit.

Definition: The Internal Revenue Code defines "partnership" in two separate sections: §761(a) and §7701(a)(2). Both define "partnership" in a negative way, i.e., what it is not. A partnership is not a corporation, trust, estate, or sole proprietorship. The IRS defines a partnership as the relationship between two or more persons who join to carry on a trade or business, with each person contributing money, property, labor, or skill and each expecting to share in the profits and losses of the business, whether or not a formal partnership agreement is made. The term "partnership" includes a limited partnership, syndicate, group, pool, joint venture, or other nonincorporated organization, through or by which any business, financial operation, or venture is carried on.

A joint undertaking merely to share expenses is **not** a partnership. Mere co-ownership of property that is maintained and leased or rented is **not** a partnership. However, if the co-owners provide services to the tenants, a partnership exists. It is not always easy to determine whether an arrangement is a profit-sharing agreement with employees or a valid partnership. If an individual proprietor takes in an outsider or an employee, who is to share in profits and losses and contributes cash or other property to the business to be used for its requirements, there is usually a partnership, regardless of whether a formal partnership agreement has been made. A commingling of funds or assets of two or more persons for a common business purpose, from which the earnings are shared, usually denotes a partnership, unless it is clear that only a loan was intended. However, a joint undertaking merely to share expenses is not a partnership. It is possible that an arrangement can make two persons partners in an enterprise even though the word "partnership" is not mentioned, if the arrangement has the effect of a partnership or joint venture. If there is a partnership, the members who participate in the venture are partners.

EXCLUSION FROM PARTNERSHIP RULES

A qualifying syndicate, pool, joint venture, or similar organization may elect under Treas. Reg. §1.761-2 not to be treated as a partnership for federal income tax purposes and will not be required to file Form 1065 except for the year of election.

Reasons for Making the Election Not to Be Treated as a Partnership

- • It allows partners to make separate tax elections which, under I.R.C. §703(b), are otherwise required to be made by the partnership. For example, by electing out of the partnership provisions, partners can avoid the need to use the same accounting method as the partnership and can elect individually whether to use the installment method or not; whether to expense an asset under I.R.C. §179; whether to use accelerated or straight-line methods of depreciation; elect to expense or to capitalize intangible drilling costs, and so forth.

- • It avoids the added burden of maintaining partnership records and preparing partnership tax returns

- • It provides assurance of proper tax treatment when it is uncertain whether the arrangement is a partnership or a co-ownership arrangement.

Qualifying Entities. The types of entities that may make the election out of partnership treatment are unincorporated organizations that are formed according to one of the following:

- • For investment purposes only and not for the active conduct of a business (investing partnerships), or

- • For the joint production, extraction, or use of property, but not for selling services or property produced or extracted (operating agreement groups), or

- • By a syndication of dealers in securities, for a short period, for underwriting, selling, or distributing a particular issue of securities (securities syndicates).

Practitioner Note. Partnerships that sell goods or services in the name of the partnership do not qualify for the election.

How to Make the Election. The election not to be taxed as a partnership is made in a statement attached to, or incorporated in, a partnership tax return, Form 1065. The return does not have to set forth the information requested on Form 1065 or in its instructions relating to the partnership's income, expenses,

balance sheet, and so on. It must, however, show the name and address of the organization, and it, or an attached statement, must also

- • State that the organization qualifies for the election as an investing partnership, operating agreement group, or securities syndicate.
- • State that all members of the organization elect that it be excluded from all partnership provisions.
- • State where a copy of the agreement under which the organization operates is available. If the agreement is oral, state from whom the provisions of the agreement may be obtained.
- • List the names, addresses, and identification numbers of all the members of the organization.

Sample Election 3.1. Election Pursuant to Code §761:

To Be Wholly Excluded from Partnership Rules (Subchapter K)

The name of our organization is Bosworth Enterprises, the address of which is 1234 Anyplace Rd, Anywhere, US, where a copy of the agreement under which the organization operates is available.

Pursuant to Code §761, full exclusion is hereby elected in behalf of Bosworth Enterprises from the application of all the provisions of Subchapter K beginning with the tax year ending Dec. 31, 20XX, to the return for which year this statement is attached.

Bosworth qualifies for this election as an investing partnership that satisfies the requirements of Treas. Reg. §§1.761-2(a)(1) and (2). All the members of the organization elect that Bosworth Enterprises be excluded from all the provisions of Subchapter K. The names, addresses and Social Security numbers of the members are:

Rufus P. Bosworth 1234 Anyplace Anywhere, US 111-11-1111	James Jones 12345 Jones Rd. Austin, TX 222-22-2222
John Jones 9 Rob Roy Austin, TX 333-33-3333	Rufetta Bosworth 1234 Anyplace Rd. Anywhere, US 444-44-4444

When to Make the Election. Form 1065, with the required statements attached, must be timely filed (including extensions) for the first taxable year for which the

election is to be effective. There is an automatic six-month extension for making the election even if there is no extension for filing the return [Treas. Reg. §301.9100-2(b)].

Deemed Election. When an organization has not filed the forms and statements that are required to make the election not to be taxed as a partnership, it will nevertheless be **deemed** to have made a proper election if it can be shown from all the surrounding facts and circumstances that, at the time of its formation, the organization's members **intended** to secure exclusion from all of the partnership tax rules beginning with the first taxable year of the organization. Either of the following facts may indicate that the required intent was present:

- • At the time of formation of the organization, there was an agreement among the members that the organization be excluded from the partnership tax rules beginning with the first taxable year of the organization [Treas. Reg. §1.761-2(b)(2)(ii)(a)].

- • The members of the organization owning substantially all of the capital interests **report** their respective shares of the items of income, deductions, and credits of the organization on their respective returns (making such elections as to individual items as may be appropriate) in a manner consistent with the exclusion of the organization from the partnership tax rules beginning with the first taxable year of the organization [Treas. Reg. §1.761-2(b)(2)(ii)(b)].

Required to File. Except as provided below, every domestic partnership must file Form 1065, unless it neither receives income nor incurs any expenditures treated as deductions or credits for federal income tax purposes.

A foreign partnership that engages in a trade or business within the United States or has gross income derived from sources in the United States must file Form 1065, even if its principal place of business is outside the United States or all its members are nonresident aliens. Entities formed as LLCs and treated as partnerships for federal income tax purposes must file Form 1065.

Each partner includes his or her share of partnership income and deductions on his or her income tax return for his or her taxable year in which the partnership year ends. It does not matter when the partnership income is distributed or distributable to the partner.

When Form 1065 is required, some partnerships can skip page 4 (Schedule L, Balance Sheet per Books, Schedule M-1 and Schedule M-2) by answering yes to all three parts of question 5 below:

Question 5: Does This Partnership Meet ALL THREE of the Following Requirements?

a. Total receipts are less than $250,000.

b. Total assets are less than $600,000.

c. Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return.

When to File. Generally, a domestic partnership must file Form 1065 by the 15th day of the 4th month following the date its tax year ended as shown at the top of Form 1065. A partnership whose partners are all nonresident aliens must file its return by the 15th day of the 6th month following the date its tax year ended. If the due date falls on a Saturday, Sunday, or a legal holiday, the tax return is due on the next business day. If more time to file is needed, **Form 8736,** Application for Automatic Extension of Time to File U.S. Return for a Partnership, REMIC, or for Certain Trusts, should be filed for an automatic 3-month extension. Form 8736 must be filed by the regular due date of the partnership return. If additional time is needed, **Form 8800,** Application for Additional Extension of Time to File U.S. Return for a Partnership, REMIC, or for Certain Trusts, should be filed for an additional extension of up to 3 months. The partnership must show reasonable cause to get this additional extension. Form 8800 must be filed by the extended due date of the partnership return.

Late Filing Penalty. A penalty is assessed against any partnership that must file a partnership return and fails to file on time, including extensions, or fails to file a return with all the information required. The penalty is $50 times the total number of partners in the partnership during any part of the tax year for each month (or part of a month) the return is late or incomplete, up to 5 months.

Relief for Late Filing. The penalty will not be imposed if the partnership can show reasonable cause for its failure to file a complete or timely return. Certain small partnerships (with 10 or fewer partners) meet this reasonable cause test if

- • All partners are individuals (other than nonresident aliens), estates, or C corporations.

- • All partners have timely filed income tax returns fully reporting their shares of the partnership's income, deductions, and credits.

- • The partnership has not elected to be subject to the rules for consolidated audit proceedings.

(Rev. Proc. 81-11, 1981-1 C.B. 651; Rev. Proc. 84-35, 1984-1 C.B. 509)

If a penalty is assessed, a request for relief under Rev. Proc. 84-35 should be sent in writing to the service center where the return is filed. All partners' names and tax identification numbers should be included.