

Financial, Legal & Tax Advisory

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IRS Penalties – a fact of life – or are they?

Do you have a “Partnership”? Are you filing a Partnership Tax Return, otherwise known as a 1065? Or do you file your part of the Partnership on your personal tax return, your 1040? Are you eligible for a Small Partnership exemption? Do you have to file IRS form 1065? The answers to these questions might be Yes, No, and Maybe. The breakdown follows the simple understanding that the IRS wants a report in some form or another. You must file taxes every year as a partnership or as an individual; you can apply for an extension if you can't file or if you are not prepared to pay taxes immediately, but every year it is the same routine. As a partnership it is your size (amount of partners) which determines whether you are subject to a penalty if you do not file the correct type of tax return; be it in the form of personal income (schedule C) or 1065. Some individuals in partnerships actually file their income and loss on a Schedule C. This is where the problem comes in, as the IRS cannot always match up who the partners are, and thus cannot tell if the Partnership should have filed a separate tax return.

The ramifications to not filing a partnership tax return correctly is that there are mandatory penalties associated when a partnership fails in a requirement that the IRS has imposed. For example, if a partnership is required to file a tax return and fails to file on time including extensions, they are liable for penalties and interest unless the failure is due to reasonable cause. But there is always an exception to every rule! One of the exceptions is the size of the partnership. If the partnership has 10 or fewer partners, it may be exempt from the failure to file a Partnership tax return penalty and thus the partners may end up filing their part of the partnership on their personal tax returns. It is rare to have a large 11+ person partnership, and for the few that are, they are typically already filing a separate tax return and thus not concerned with the possible penalty.

Be aware – there is no automatic exemption of the penalty, but what is clear is that partnership can avoid the penalty for failure to file when there is ‘reasonable cause’ attributable to the failure. The relief available when you satisfy the ‘reasonable cause’ standard is that the IRS may set aside any penalties and/or interest imposed. Whenever we are dealing with a tax owed situation, we always request abatement of penalties and interest. In fact, the IRS has a separate form to request this on ALL tax matters whenever a taxpayer faces a tax owed plus penalties and interest.

So there you have it, the Internal Revenue Code does exempt some small partnerships from the failure to file penalty. Thus if you have a partnership with 10 or fewer partners, and you have not been filing a 1065 tax return, you may qualify for the relief. With that relief, you may then be able to file your taxes on your personal tax return which would typically show up on Schedule C of your 1065. Now, keep in mind, this is not the recommended course of action if you do indeed have a Partnership, we would prefer that you file a 1065 or that you incorporate your business and file a Corporate tax return, but each situation is different and requires its own proper analysis. One of the services we offer is a free tax analysis of your situation. We typically will request 3 years of past tax returns for you personally and your business. We then review those at no charge, and then have a phone consultation with you at no charge, and then follow that up with recommendations and the associated cost to implement those.

The Center routinely advises on these matters, as well as business succession, business valuations, tax planning and estate planning. If you have questions, please call us at 618-997-3436 or visit us at www.taxplanning.com.

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