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Give me to Juice: All About Partnerships

Hey! Do you want to start your own business? Maybe open up a juicer? Jump on the bandwagon of healthy eating in return for heaps of sweet profit—sweeter than any juice concoction you can come up with!

How do you decide what type of company to make? Will you be the sole owner? Do you want to be in a partnership? Deciding what type of business you'll run is important because the way you set up your juicery will determine your reporting requirements, how you profit from the business, the taxes that you have to pay, as well as your personal responsibilities and liabilities (1). If you don't feel like taking the plunge alone, and you know another juice fanatic who would be a terrific business partner, you can form a partnership. Finding the right person is vital—ideally you want someone you genuinely like and trust, someone who shares your values, has complementary/different traits and skills, supports your growth, shares your vision, and seeks productive solutions in conflicts (2). That's a hefty list! But once you find that person (or persons), you can move on to the requirements of becoming a partnership.

The Uniform Partnership Act (UPA) has been the governing document of partnerships since 1914; it was revamped in 1997 to be more modern and less confusing and was last amended in 2013 (3). The UPA has 4 general requirements for a partnership: 1) it is a voluntary association of two or more persons ("persons" meaning "natural" persons—human beings—as well as "artificial" persons—partnerships and corporations) 2) carrying on a business 3) as co- owners (everyone must agree to participate) 4) for profit (4,5,6).

To operate legally, partnerships have to register at all sorts of places. They need to go to the Social Security System, Securities and Exchange Commission, Department of Trade and Industry, and City/Municipal Office for pretty pieces of papers that allow them to pay employees, be recognized as a legal business, have a business name, and have a license to operate (7). For administrative stuff like registration, a partnership is like a sole trader. But taxes are another story altogether. Instead of one person contributing money, labor, skill, and/or property (and reaping all the rewards), two or more persons in a partnership are expected to share the outcomes of the business.

People who created the UPA wavered between treating partnerships like corporations (which are legal entities on their own) or a group of individuals; they decided on the aggregate theory, that partnerships are made up of an association of individuals (8). As a result the partners are jointly and severally liable for the business (1). So choose your partner carefully, because if that other person takes off with the money you might be held responsible for all the juicery's debt! Your juicery, by itself, wouldn't be considered a legal entity in court, and although it would have to report its annual gains, losses, incomes, and deductions, it wouldn't pay income taxes (9). The juicery's tax returns would be filed showing distribution of profits/losses between partners; additionally you and your partner(s) in crime--hopefully not actual crime--would also file personal taxes that include your individual share of income (1, 9).

An important distinction to note is that the people within a partnership are not employees—in fact partners are not allowed to receive salaries as there isn't an employer-employee relationship, which is similar to a sole proprietorship (9). Thus the infamous W-2 form, a tax form for employers to report wages and salaries of their employees related to withholding taxes from employee paychecks, does not apply to partnerships (10). Instead, the juicery must hand out copies of Schedule K-1 (Form 1065) to its partners.

Form 1065 is a nifty little tax form that shows a partnership's profit or loss as well as each partner's contributions. As the IRS doesn't consider partnerships to be entities for tax purposes, the taxes are paid by individual partners on their income tax returns (11, 12). Each partner has to set aside an estimated amount of money, the amount to be owed for the year as tax, and pay the IRS by the quarter (11).

Form 1065 covers the basics such as revenues and expenses, and also gives context to the type of partnership it is--do you have any assets or partners overseas (11)? The form also includes Schedule K, which would list the juicery's income by different categories (business, income, interest income, etc.). This information is split into further distinction by Schedule K-1 for each individual partner, which shows his or her share of each of the sources of income listed on the Schedule K, and is important to remain in these categories because certain types of income are taxed differently from others (11).

In addition to Form 1065, each partner must also submit their 1040 income tax returns and Schedule SE (self-employment) taxes on all the partnership profits that are distributed to them (12). Self-employment taxes include Social Security and Medicare--unfortunately, as employers match dollar-to-dollar contributions in these systems based on how much their employees put in, partners do not have the same setup and must pay twice as much as a regular employee to completely cover the taxes (12).

Another thing that is interesting about partnerships is that partners will get taxed on their share of the profit even if they did not receive it (11). For example, let's say you finally opened up that juicery with your friend--you fought tooth and nail for an empty spot in hub and bustle of downtown. You raised enough money, you got all the proper permissions, and you bought everything you need. Your first year was a success, and you both make $100,000. But you two think the business can grow quickly and decide to expand to a bigger city with a bigger hipster and some other cities beyond that. You and your partner decide not to distribute the cash, but instead to use it as capital for further expansion to by some new juicing machines, open up new locations, etc. Even though neither of you get the cash payout, you will still be taxed a third of the income for the year. However, it's also good to remember that you can deduct legitimate business expenses from your income, for example traveling and advertising/operating expenses, and startup costs (12).

The amount of tax that you and your partner pays depends on the profits that are allocated to each of you, your distributive share. If you both came into the partnership 50-50, you would each earn and pay taxes for $50,000 of the profits in our example. Most state laws will distribute the profits/losses/taxes according to your percentage interest in the business, with the percentage interest based on the initial value of your contribution--however, if you want to split up profits and losses improportionally, you can request a "special allocation" in your written partnership agreement, which must follow a certain set of IRS rules (11,12).

So having read all of that, hopefully you've learned a little more about partnership reporting requirements and now have the knowledge to go forth and begin your partnership! May you make boatloads of money running your juicery and retire early so you can travel the world and do good things.

References

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