

Nuts and Bolts of LLCs, LPs and Partnerships - Tax Aspects

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Please don't make me learn about tax

- Only the bare bones
- Only to help you understand what you are looking at when you read the partnership agreement
- Yes, all the tax stuff can go in an appendix or exhibit
- Even if you don't "own" the tax sections, at least read them.

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Why Is Partnership Taxation “Better”?

- Rate of tax on fully distributed income is lower than for corporation
- Partnership entity is not taxed (generally)
- Partners are taxed on their share of partnership taxable income
- In contrast, a corporation pays tax at corporate rate (currently, 21%) and then dividend distributions to shareholders are also taxed: “double taxation”
- Flexibility as to amount of taxable income allocated to a partner (“special allocations”)

Federal Tax Rate Comparison

Entity	Rate
C Corporation	21%
C Corporation, after shareholder pays tax on dividends (at 20% rate)	36.8%
Pass-through (highest individual marginal rate)	37%
Pass-through with §199A deduction of 20% of income	29.6%

*Ignores net investment income (NII) tax of 3.8%

Tax Rates After Tax Reform: Pass-Throughs

- Having lowered the rate on corporate income, Congress decided to offer a lower rate to certain businesses in pass-through form.
- For these purposes, Congress defined “pass-through” as including **partnerships, S corporations and sole proprietorships**.
- The new effective rate is implemented under new section 199A by allowing a **deduction of 20%** from income otherwise taxed at individual rates, thereby producing a blended or effective tax rate on such income that is lower than it otherwise would have been.

Section 199A Deduction

- Deduction for income from “**specified services**” is phased out above Threshold Amount and eliminated above Phaseout Amount:
 - Business involving the performance of services in the fields **health, law, accounting**, actuarial science, performing arts, consulting, athletics, financial services, brokerage services or any trade or business where the principal asset of such trade or business is the **reputation or skill** of one or more of its employees or owners; or
 - Investing and **investment management**, trading, or dealing in securities, partnership interests or commodities.
 - The fields of **architecture and engineering** were expressly removed from the list.

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