

US Tax Court Can Determine Whether Limited Partner Exception Applies to Partnership Distributions of Self-Employment Income

4 December 2023

Report from our correspondent Stephen Basiaga, J.D., LL.M.

The US Tax Court has held ([Soroban Capital Partners LP v. Commissioner](#) , 161 T.C. No. 12) that it had jurisdiction over partnership-level proceedings to determine whether a partnership's ordinary business income allocated to its state law limited partners is excepted from net earnings subject to self-employment tax under IRC [section 1402\(a\)\(13\)](#) (see Notes 1 and 2).

The principal question for the Tax Court was whether Soroban's net earnings from self-employment should include the limited partners' distributive shares of ordinary business income. There were also two preliminary issues to additionally address:

- (1) whether the limited partner exception in section 1402(a)(13), stating that though federal law fails to define the term, the legislative history and case law interpreting the phrase "limited partner, as such" in the statute resulted in rejecting the taxpayer's claim that as state law-defined limited partners the exception automatically applied.

The Tax Court, instead, determined that a functional inquiry should be made to determine whether the exception applied, stating that "the limited partner exception does not apply to a partner who is limited in name only" and that the Court must examine the functions and roles of the limited partners in the partnership to determine whether their shares of earnings qualify for exclusion; and

- (2) whether the Tax Court had the requisite jurisdiction to make a functional inquiry in the partnership-level proceedings or whether it must wait until partner-level proceedings instead.

The Tax Court found that the functional inquiry into the roles and activities of Soroban's individual partners required by section 1402(a)(13) involves factual determinations that are necessary to determine Soroban's aggregate amount of net earnings from self-employment which are appropriately determined by the Court at the partnership level.

The Tax Court ultimately denied Soroban's motion for summary judgment and granted the IRS's motion for partial summary judgment, ruling that (i) the Court must apply a functional analysis test for determining whether a partner in a state law limited partnership is a "limited partner, as such" under IRC section 1402(a)(13); and (ii) that for those partnerships subject to TEFRA the application of the functional analysis test is a "partnership item" that the Tax Court does have jurisdiction to determine in a TEFRA proceeding.

Note 1: IRC §1402(a)(13) provides for a "limited partner exception" that excludes from net earnings from self-employment "the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in [section 707\(c\)](#) to that partner for services actually rendered to or

on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services."

Note 2: The [Tax Equity and Fiscal Responsibility Act of 1982](#) (TEFRA) unified audit and litigation procedures were enacted to provide a method for making adjustments at the partnership level. IRC [section 6221](#) provides that "the tax treatment of any partnership item...shall be determined at the partnership level." Generally, the IRS is precluded from assessing liabilities attributable to partnership items until after a partnership-level proceeding. IRC section 6225(a); see also *Grigoraci v. Commissioner*, T.C. Memo. 2002-202.

United States - US Tax Court Can Determine Whether Limited Partner Exception Applies to Partnership Distributions of Self-Employment Income (04 Dec. 2023), News IBFD.

Exported / Printed on 9 Mar. 2024 by hkermadi@deloitte.lu.