

ALERTS

Recent Tax Court Opinion May Alter Limited Partners' Self-Employment Tax Liability

November 30, 2023

On Nov. 28, 2023, the United States Tax Court issued an opinion with respect to competing motions for summary judgment in the case of *Soroban Capital Partners LP v. Commissioner* [1], addressing the US federal self-employment tax liability of limited partners in a state law limited partnership. The Tax Court denied Soroban's motion for summary judgment, holding that a functional analysis test, similar to the test outlined in *Renkemeyer* [2] and subsequent cases, should be applied when determining whether the limited partner exception under section 1402(a)(13) [3] applies to limited partners in state law limited partnerships. The Tax Court opined that "the limited partner exception does not apply to a partner who is limited in name only" and that Congress "intended for the phrase 'limited partners, as such' used in section 1402(a)(13) to refer to passive investors." Factual determinations regarding the limited partners' roles and activities will be made in further proceedings.

In general, section 1401 imposes a tax on an individual's self-employment income. However, section 1402(a)(13) excludes from income subject to self-employment tax "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." Historically, many investment managers have formed management entities as limited partnerships and their limited partners have taken the position that their distributive shares of income from those limited

partnerships are not subject to the 3.8 percent Medicare portion of self-employment tax in accordance with section 1402(a)(13), even if such limited partners actively participate in the activities of the investment manager.

If sustained, the Tax Court opinion establishes as a matter of law that a limited partner that actively participates in the activities of a state law limited partnership is not eligible for the exclusion under section 1402(a)(13) solely by virtue of being a limited partner. We will continue to monitor developments in this and similar cases (including a final court decision in this case and any potential appeal) and industry practice. Based on these developments, investment managers that are formed as limited partnerships and their partners are encouraged to review with us whether their limited partners may take the position that their distributive share of income is not subject to the 3.8 percent Medicare portion of self-employment tax.

Please contact your Schulte Roth & Zabel LLP tax attorney for any questions about the potential consequences of the Tax Court opinion.

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[1] Soroban Capital Partners LP v. Commissioner, 161 T.C. No. 12 (2023).

[2] Renkemeyer, Campbell & Weaver, LLP v. Commissioner, 136 T.C. No. 7 (2011), a case that involved a partnership that did not have limited partners under the applicable state law.

[3] All section references are to the US Internal Revenue Code of 1986, as amended.

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