EVERSHEDS SUTHERLAND

Limited Partner Exception to SECA Taxes: Decades of Battles, Recent Taxpayer Losses, and Open Questions



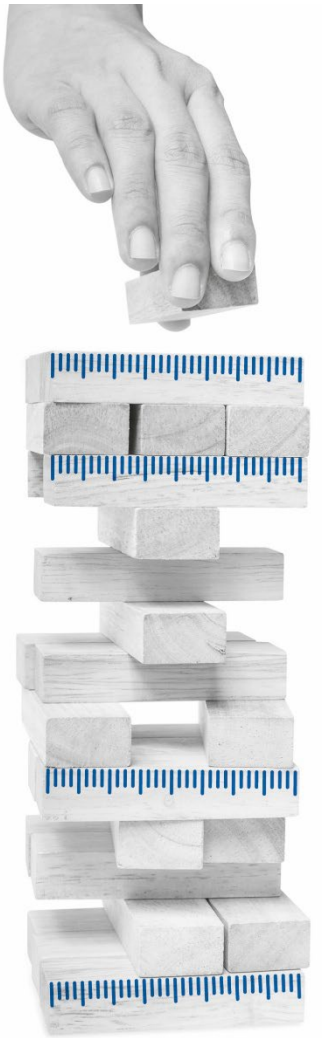
EVERSHEDS SUTHERLAND



Hale E. Sheppard
Partner

T: +1 404 853 8360
halesheppard@eversheds-sutherland.com

Introduction



Introduction

- What have partnerships done wrong?
- IRS says not limited partners
- Taxpayer positions based on 1977 law
- Government inaction for five decades = chaos

Overview of SECA Taxes



Overview of SECA Taxes

- Earnings subject to employment taxes
- FICA taxes versus SECA taxes
- 15.3% of “net earnings from self-employment”
- General rule – include distributive share
- Exception - Section 1402(a)(13) excludes distributive share

Long Road to Uncertainty



Long Road to Uncertainty

- SECA taxes start in 1950
- Limited partner exception in 1977
  - Text
  - Legislative rationale
  - Broad solution

Long Road to Uncertainty

- First proposed regulations in 1994
  - Rules for partnerships and LLCs
  - Definition of limited partner
  - IRS goals

Long Road to Uncertainty

- Second proposed regulations in 1997
  - Rules for all entities
  - New definition of limited partner
  - Service partners
  - Example
  - IRS goals - “functional test”

Long Road to Uncertainty

- Congressional moratorium in 1997
- “Sense of the Senate”
- Legislative versus Executive Branch
- Ended July 1, 1998

Long Road to Uncertainty

- Three proposals 1998 to 2005
  - Material participation standard
  - Reasonable compensation standard
  - Safe harbor formula

Long Road to Uncertainty

- IRS gives taxpayers hope in 2003
  - Respect for second proposed regulations

Long Road to Uncertainty

- IRS rulings and court cases
- Not precedential

Long Road to Uncertainty

- Most famous case – *Renkemeyer*
  - Key facts
  - Taxpayer position
  - IRS position
  - Tax Court rulings

Long Road to Uncertainty

- IRS gives taxpayer more hope in 2011
  - Respect for second proposed regulations
  - This, despite *Renkemeyer*

Long Road to Uncertainty

- IRS compliance campaign in 2018
  - LPs, LLPs, LLCs and more
  - Focus on service partners

Long Road to Uncertainty

- IRS Concept Unit in 2019
  - No limited partner definition exists
  - Unit applies to all types of entities
  - Material participation rules irrelevant
  - Respect for second proposed regulations

Long Road to Uncertainty

- IRS removes from priority list in 2019
  - Finalizing regulations not a focus

Long Road to Uncertainty

- Green Book – presidential proposals in 2021
  - Need to “rationalize” conflicting rules
  - Proposes material participation standard

Long Road to Uncertainty

- IRS threatens more litigation in 2021
  - More audits and trials

Key Rulings and Cases



Key Rulings and Cases

- Two cases about working interests
  - Johnson v. Commissioner – working interest
  - Perry v. Commissioner – working interest
- Three PLRs about entity conversions

Key Rulings and Cases

- Norwood v. Commissioner
- Renkemeyer et al v. Commissioner
- Riether v. United States
- Howell v. Commissioner
- CCA 201436409

Key Rulings and Cases

- CCA 201640014
- Hardy v. Commissioner
- Castigliola v. Commissioner
- Joseph v. Commissioner

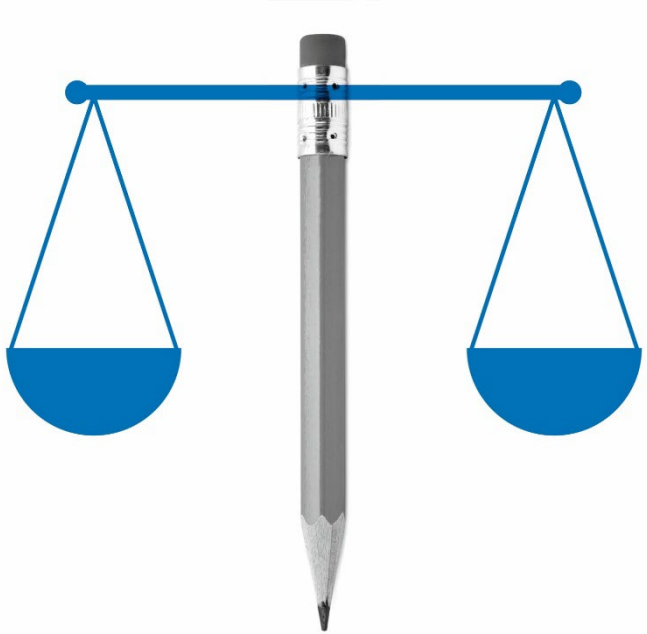
Heads the IRS Wins, Tails the Taxpayer Loses



Heads the IRS Wins, Tails the Taxpayer Loses

- Conflicting positions by IRS
- Broad LP meaning – Section 469
  - Seven material participations test
- Narrow LP meaning – Section 1402
- Conclusion

Most Recent Tax Court Cases



Most Recent Tax Court Cases

- Sirius Solutions, LLLP v. Commissioner
  - Overview of facts
  - Summary Judgment Motion
  - Main positions by taxpayer
  - Main positions by IRS
  - Tax Court Decision
  - Notice of Appeal – Fifth Circuit

Most Recent Tax Court Cases

- Soroban Capital Partners, LP v. Commissioner
  - Overview of facts
  - First Tax Court Decision
  - Second Tax Court Decision
  - Notice of Appeal – Second Circuit

Most Recent Tax Court Cases

- Denham Capital Management, LP v. Commissioner
  - Overview of facts
  - Tax Court Decision
  - Notice of Appeal – First Circuit

Recent Court of Appeals Decisions



Recent Court of Appeals Decisions

- Recent Court of Appeals Decision – Sirius Solutions
  - Victory for partnership, finally
  - Reasons for the win
  - Reasons for rejecting IRS, Tax Court, and dissent
  - Ultimate ruling
  - Replacement Opinion Issued by Fifth Circuit

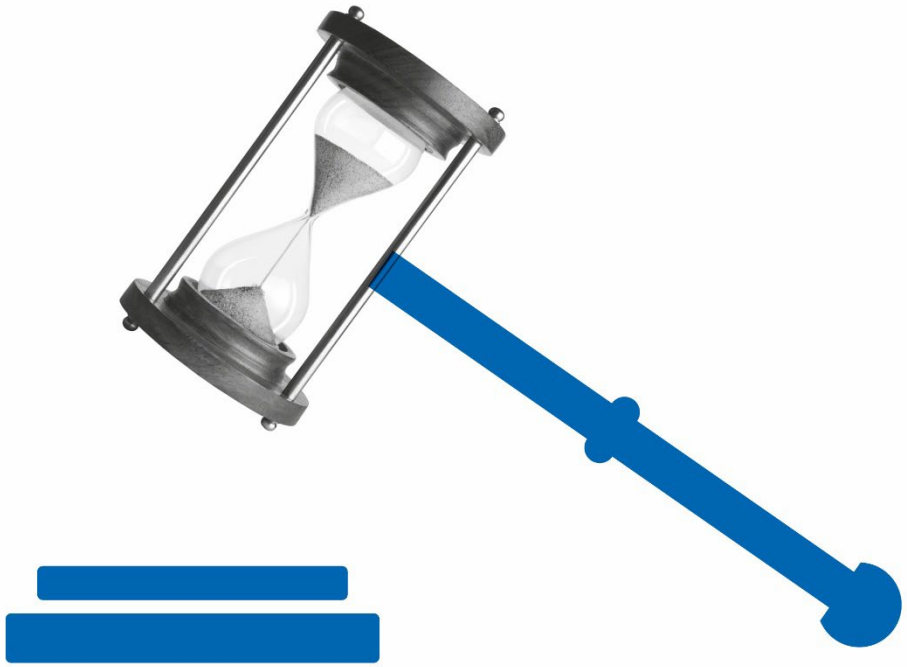
Recent Court of Appeals Decisions

- Recent Court of Appeals Decision – Sirius Solutions – Part II
  - Court issued a "substituted" decision in August 2026
  - New standard for limited partner status
  - "Plays no significant role in managing or running a business"
  - "Can participate in non-managerial aspects."
  - Remanded to Tax Court to apply new standard

Recent Court of Appeals Decisions

- Recent Court of Appeals Decision – Soroban
  - Court issued decision in September 2026
  - New standard for limited partner status
  - Has limited liability + does not “run, manage, or control” the business
  - A partner without “management authority”
  - Can provide “some services” to the partnership
  - Can play a “non-significant” role

Pending Cases



Pending Cases

- Cases Pending in Tax Court
  - Riverstone Equity Partners, LP v. Commissioner
  - MKP Capital Management, LP v. Commissioner
  - Moon Capital Management, LP v. Commissioner
  - Atalaya Capital Management, LP v. Commissioner
  - Stelliam Investment Management, LP v. Commissioner
  - Valinor Management, LP v. Commissioner
  - Summit Rock Advisors, LP v. Commissioner
  - MDRA GP LP v. Commissioner

Pending Cases

- Cases Pending in Courts of Appeal
  - Denham Capital Management, LP – First Circuit

Conclusion



Conclusion

- Many open issues
  - What will the First Circuit do?
  - Will the Supreme Court get involved?
  - What will the Tax Court do in the meantime?
  - Does the IRS have capacity to effectively audit?
  - Will the IRS start a settlement initiative?
  - Will the IRS issue new proposed regulations?
  - Will Congress enact a statutory definition?
  - Will partnerships continue the pattern thankful for new standards?

Questions?

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Hale E. Sheppard
Partner

T: +1 404 853 8360
halesheppard@eversheds-sutherland.com

eversheds-sutherland.com

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