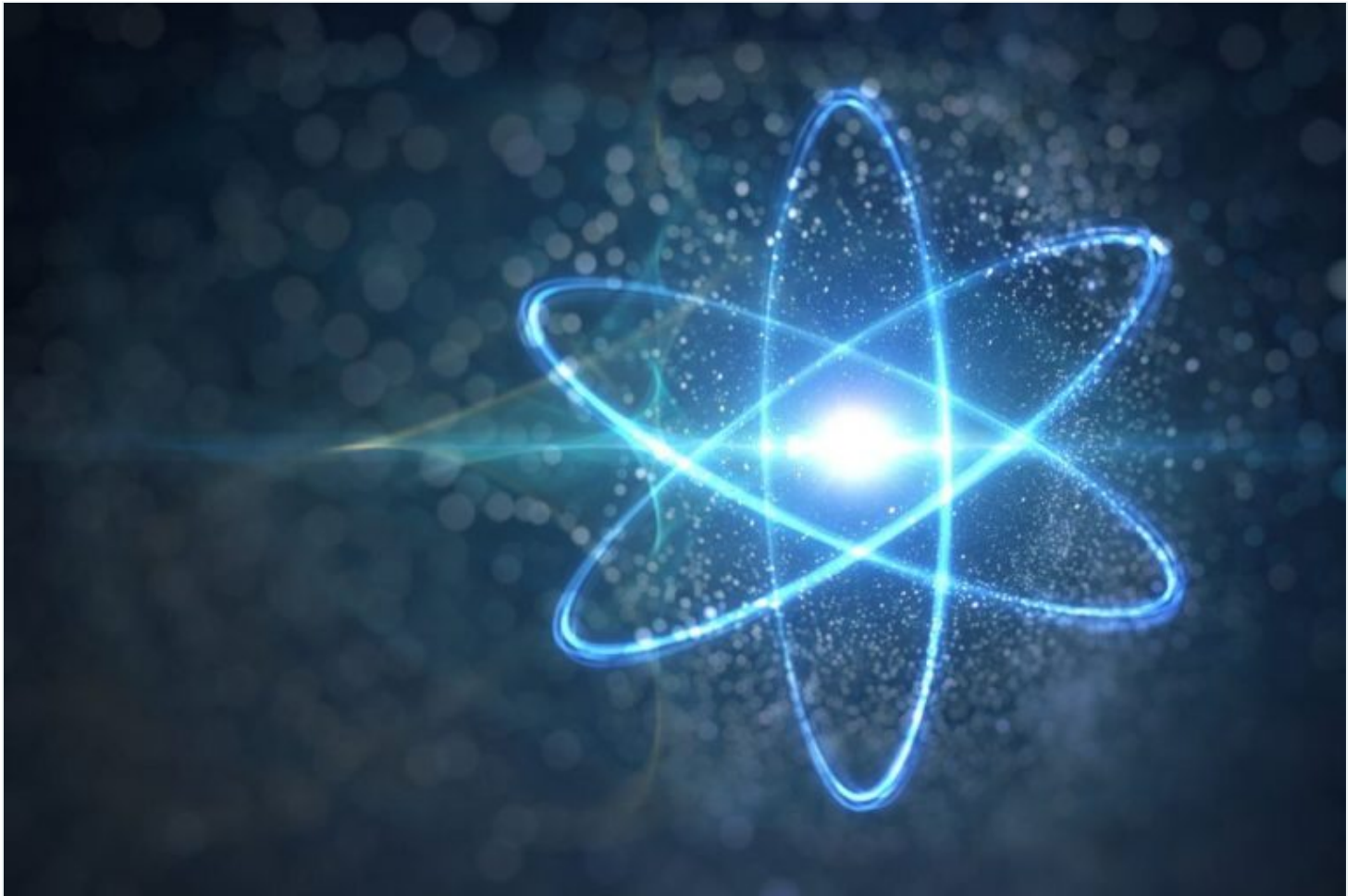


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the intuitive to the concrete.

Jan. 30, 2023



By Jim Hamill, Albuquerque Journal, NM (TNS)

Albert Einstein was, as we all know, a brilliant theoretical physicist. His fame likely comes from the ability to look at problems in ways that others simply could not.

Richard Feynmann won the 1965 Nobel Prize for Physics for his work on electrodynamics. His introduction to the field occurred while a doctoral student at Princeton in the early 1940s.

Feynmann's first lecture at Princeton was in 1940, when he was 22 years old. In the

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Tax pros are not likely to be confused with Einstein. Yet there are areas of tax practice that are moving from the intuitive to the concrete.

If you are self-employed (SE), you pay a 12.4% tax on the first \$160,200 of your 2023 SE income. You pay an additional 2.9% on all of your SE income.

If you make enough to pay the Medicare surtax, you may pay another .9%. All of this is before your income tax liability.

You have reasons to try to avoid this tax. Partners are generally considered to be in the business of their partnership. So this SE tax can apply to your share of partnership income.

If you are a limited partner, the law generally exempts you from SE tax for your share of partnership income. This much seems clear.

What is not clear is the result if you are a member of a limited liability company (LLC). LLC members can participate in management and can bind the entity. Limited partners cannot.

But both limited partners and LLC members have limited liability. LLC members have characteristics of both limited and general partners.

The tax issue, then, is do LLC members get the SE tax benefit of limited partner treatment? No one really knows. So, tax pros have had to adopt intuitive, Einstein-like, solutions.

In 2011 the IRS won a Tax Court case involving a Kansas law firm. The firm was organized as a limited liability partnership (LLP) in Kansas.

A Kansas LLP is effectively a general partnership that files a separate form with the

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A Mr. Sands was paid \$6.5 million by the LLC on a W-2. He also reported SE income for the small income coming from the trust, but no SE income for the larger share coming from the limited partnership.

Mr. Sands was held not subject to SE tax on his limited partner income. This decision suggested a way to avoid SE tax for much of the LLC income (\$18 million in this case).

There is a new case docketed with the Tax Court that may move tax pros further from the old intuitive way of dealing with SE tax.

The new case involves a pure limited partnership (LP). The general partner (GP) manages the entity. The three limited partners are paid by the GP for management work.

The partners have reported no SE income for the large share of income coming through the LP. They have paid SE tax on the payment received from the GP for services performed.

This new case is being watched because it is more “pure” than the LLC structures. This entity is an LP. It may then present less confusion about how to apply the SE tax.

The case name is Soroban. It may move us from the intuitive Einstein approach to the concrete Feynmann approach. Moving can be stressful.

ABOUT THE AUTHOR

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