

THE JOURNEY TO CHAOS:
SECA TAXES, LIMITED PARTNER EXCEPTION,
EVOLUTION, AND CURRENT DISPUTES



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INTRODUCTION

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

OVERVIEW OF SECA TAXES

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- Components and magnitude
- FICA / SECA
- 15.3% of “net earnings from self-employment”
- Section 1403(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 (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

- 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 (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

- Various groups offer proposals
 - Material participation standard
 - Reasonable compensation standard
 - Safe harbor formula

LONG ROAD TO UNCERTAINTY (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

- IRS rulings
 - Taxpayers in informal partnerships
 - LPs issuing bifurcated amounts
 - LLCs instead of LPs
- CCAs are not precedential

LONG ROAD TO UNCERTAINTY (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

- 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 (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

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

LONG ROAD TO UNCERTAINTY (cont.)

- Summary from 1977 to present

KEY RULINGS AND CASES

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

KEY RULINGS AND CASES (cont.)

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

KEY RULINGS AND CASES (cont.)

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

HEADS THE IRS WINS,
TAILS THE TAXPAYER LOSES

HEADS OR TAILS

- Setting the scene
- Conflicting positions by IRS
- Broad LP meaning – Section 469
- Narrow LP meaning – Section 1402
- Compare and contrast

HEADS OR TAILS (cont.)

- IRS position in Section 469 cases
- Seven tests for material participation
- Special rules for limited partners
- Legislative history – targeting LPs

HEADS OR TAILS (cont.)

- Recurrent IRS loses in Section 469 cases
 - Gregg v. United States
 - Garnett v. Commissioner
 - Thompson v. United States
 - Hegarty v. Commissioner
 - Newell v. Commissioner

HEADS OR TAILS (cont.)

- IRS changes tune after five losses
- Proposed regulations in 2011
- Limited liability not determinative

MOST RECENT TAX COURT CASES

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- Sirius Solutions, LLLP v. Commissioner
 - Review of key facts
 - Summary Judgment Motion
 - Main positions by taxpayer
 - Main positions by IRS
 - Holding by Tax Court

MOST RECENT TAX COURT CASES

- Soroban Capital Partners, LP v. Commissioner
 - Review of key facts
 - Questioning IRS motivations
 - Four observations about bifurcation
 - Not a service partnership
 - Likely IRS position

Thank You

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