



BUYNAK LAW FIRM

## **Avoiding Self-Employment Taxes for Partners in Partnerships (General & Limited) and Limited Liability Companies**

Self-employment taxes are substantial – 15.3% of an individual's wages. Here are the general rules governing partnership (general and limited) and limited liability companies:

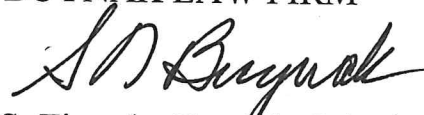
1. If you are a **general partner in a general partnership** or other entity taxed as a general partnership, you must pay self-employment tax on your entire distributive share of the ordinary income earned from the partnership's business.
2. **Limited partners** don't pay self-employment tax on their distributive share of the partnership's profits.
3. Both general and limited partners pay self-employment taxes on any guaranteed payments for services performed for the partnership.
4. **LLC members** classified as general partners pay self-employment taxes on their distributive shares but avoid such tax if classified as limited partners, i.e., separate your participation.
5. IRS proposed regulations provide that LLC members are classified as limited partners only if they lack authority to enter into contracts for the LLC or work less than 500 hours per year in the LLC business.
6. IRS proposed regulations always classify members of service LLCs as general partners.
7. The Tax Court has held that **LLC members** can be classified as limited partners for self-employment tax purposes only if they are passive investors who do not actively participate in the LLC's business.

Be sure that your partnership and limited liability company's Operating Agreements properly restrict your activities, duties and responsibilities they should be consistent with these Rules. The IRS has proposed regulations, but Congress has not approved them. The Tax Court is developing its own criteria for inclusions/exclusions of self-employment tax liability with partnerships and LLCs. Cease being a partner and legally avoid self-employment taxes if you are **not** actually a partner in the business with decision making entitlements. Under number 5. It is possible for participants to be general and limited partners in these entities and thereby avoid being classified as "employees".

Be Careful; Don't be overzealous; Don't have your documentation undermining your position when you are audited by the IRS

Helping clients thrive!

BUYNAK LAW FIRM

A handwritten signature in black ink, appearing to read "S. Timothy Buynak". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

S. Timothy Buynak, Principal