The Bankler Report

June 25, 2014

INTRODUCTION

Federal Court confirms that owners of an LLC cannot be both employees (W-2) and "partners" of an LLC. They must pay self-employment taxes on partnership profits.

Background.

Dr. and Mrs. Robert Riether jointly owned New Mexico Medical Diagnostic Imaging, LLC (an entity taxed as a partnership). Basically, these taxpayers received $51,000 in "wages" and $76,986 in "profits distributions" from their LLC. They treated the profits distributions as passive income, not subject to self-employment taxes.

Federal Court Decision.

In its opinion, the Court stated: "In fact, Plaintiffs should have treated *all* the **LLC's income as self-employment income, rather than characterizing some of it as wages.** Revenue Ruling 69-184 says members of a partnership are not employees of the partnership for purposes of self-employment taxes. Rev. Rul. 69-184, 1969-1 C.B. 256. Instead, a partner who participates in the partnership business is 'a self-employed individual.' ... But the LLC's improper treatment of the 'wage' income further undermines Plaintiffs' simplistic argument that they owed no self-employment taxes simply because they received W-2s." (**Emphasis Added**)

IRS position.

Tax Notes reported that Mr. Clifford Warren (special counsel to the IRS associate chief counsel [passthroughs and special industries], on May 20 at the Practising Law Institute seminar in New York "Tax Planning for Domestic and Foreign Partnerships, LLCs, Joint Ventures, and Other Strategic Alliances") said: "I would expect guidance on this issue. There is a lot at stake; it's a very tough issue."

Conclusion.

We have always assumed that Rev. Rul. 69-184 was a correct interpretation of the law and our planning has taken this into account.

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