

Internal Revenue Service acquiesces in taxpayer lawsuit claimant refund for self-employment taxes imposed on a limited partner

In a recently published Tax Court answer filed in response to taxpayer's petition in *Sands v. Comm'r*¹, the Internal Revenue Service (IRS) admitted that it had erred in its determination of employment tax on the taxpayer, but surprisingly did not agree that it had assessed the self-employment tax.

Background

The taxpayer was an individual named Frank Sands. He was the CEO and CIO for an investment management firm based in Virginia. The lowest tier entity, Sands Capital Management LLC (SCM LLC) was the operating business. This entity paid Mr. Sands approximately \$6.5 million in wages in the year in question. SCM LLC was owned 99.32 percent by Sands Capital Management LP (SCM LP) and 0.68 percent by the Sands Family Trust LLC (Trust). Trust served as the general partner of SCM LP. The rest of SCM LP was owned by 29 individuals directly and Mr. Sands through his wholly owned entity, F-J Sands Family I LLC. F-J Sands Family I LLC had previously been a regarded entity but was a disregarded entity for the year in question. (Please refer to organization structure below as described in the petition).

For the year in question, in addition to having paid payroll taxes on the \$6.5 million salary, Mr. Sands reported as net earnings from self-employment (NESE) the \$25,000 he earned through the trust, which ultimately came from the operations of SCM LLC. None of the distributive share he earned through SCM LP, approximately \$18 million, was reported as NESE.

According to the petition, filed on March 2, 2015, in its notice of deficiency, the IRS asserted self-employment taxes on the income Mr. Sands earned through SCM LP. In the petition, the taxpayer sought relief from the Tax Court because he believed the income he earned through SCM LP, due to the statutory exclusion provided in IRC section 1402(a)(13) for the distributive share of a limited partner, was not NESE.

In its answer dated May 8, 2015, the IRS admits that it erred in its "determination except denies that (the IRS) assessed self-employment tax." Further the IRS asks that its "determination, as set forth in the notice of deficiency, be in all respects denied."

One can speculate that for now the IRS may only be interested in pursuing employment taxes where the individual partner is not a state law limited partner. The fact that the limited partner interest was owned through a disregarded LLC did not seem to matter.

¹ *Sands v. Comm'r*, Docket 5650-15, May 8, 2015

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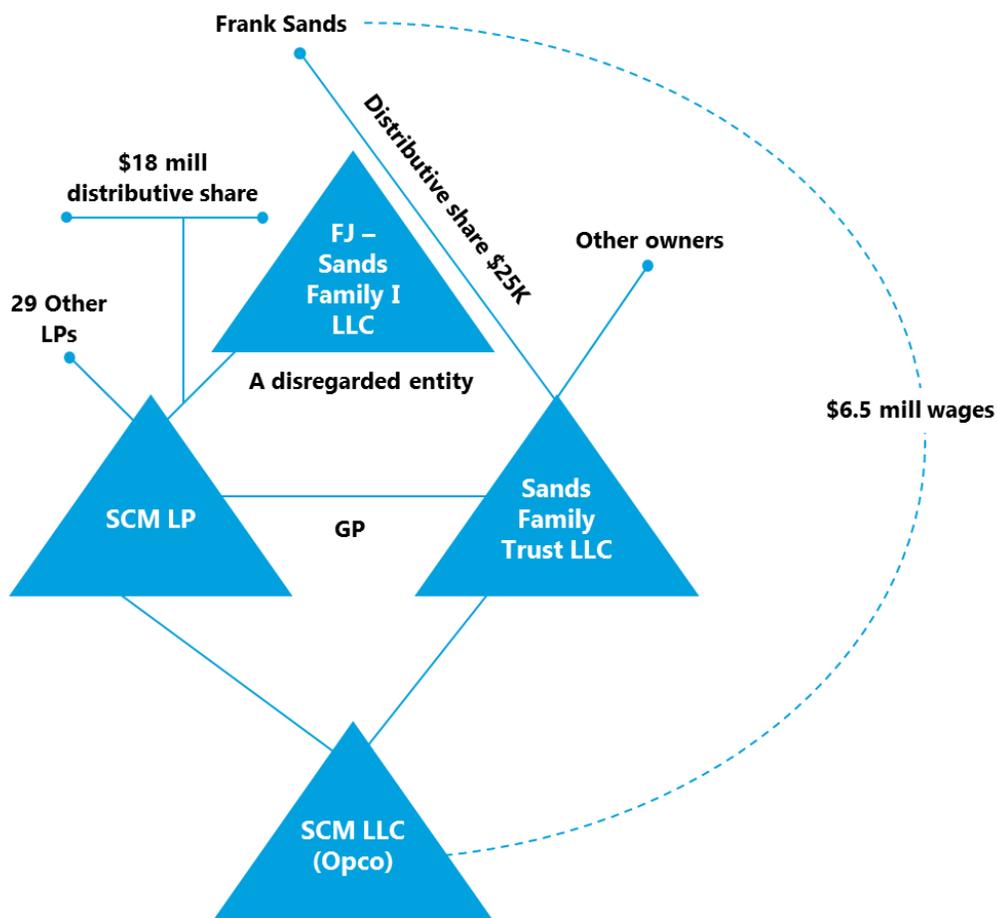
We will continue to monitor these developments and keep you apprised as appropriate.

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