



# TaxNewsFlash

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## U.S. Tax Court: Active partners' income subject to self-employment tax

The U.S. Tax Court today held that partners were not limited partners for tax purposes due to their active involvement in the partnership's management, making their distributive shares subject to self-employment tax.

The case is: *Denham Capital Management LP v. Commissioner*, T.C. Memo. 2024-114 (December 23, 2024). Read the Tax Court's [opinion](#)

### Summary

The IRS issued Notices of Final Partnership Administrative Adjustment (FPAA) for the tax years 2016 and 2017, increasing the taxpayer's net earnings from self-employment (NESE) by over \$27.4 million and \$22.9 million, respectively. The main issues were whether the adjustments to NESE were subject to determination at the partnership level and whether the income attributable to certain partners was excludable under the limited partner exception.

The taxpayer, a limited partnership providing investment advisory services, argued that its partners should be classified as limited partners, thus excluding their distributive shares from NESE under section 1402(a)(13). The Tax Court, applying a functional analysis test, determined that the partners were not limited partners for tax purposes because they were actively involved in the management and operation of the partnership, similar to employees rather than passive investors. The court concluded that the partners' roles and responsibilities were integral to the taxpayer's business operations, and their income was derived from services provided rather than passive investment.

The court upheld the IRS's adjustments, holding that the partners' distributive shares were subject to self-employment tax, as they did not qualify for the limited partner exception.

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