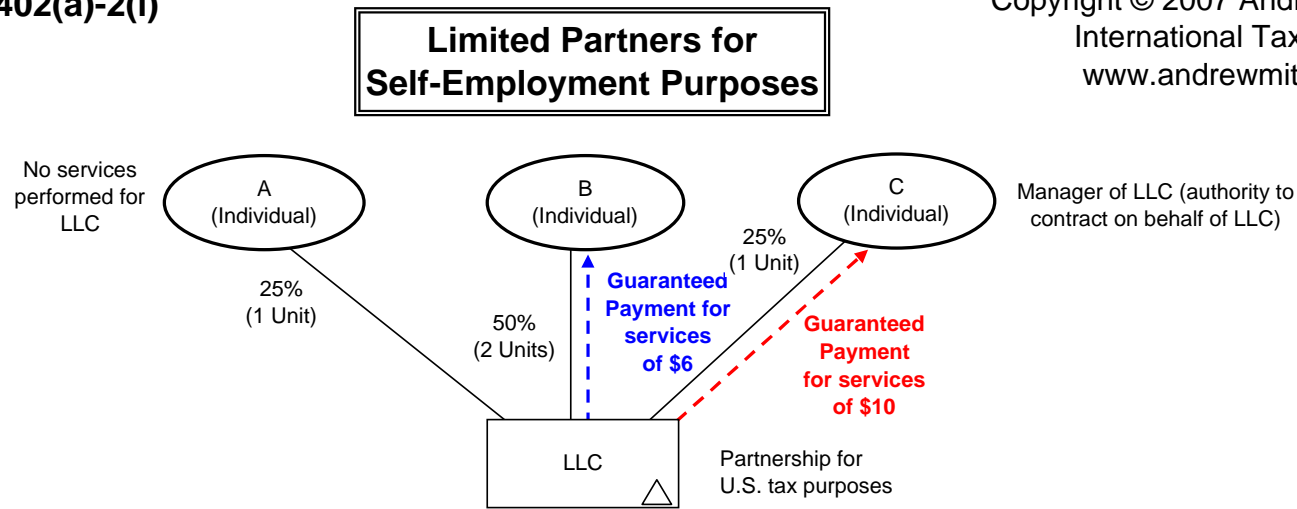


**Proposed Reg. 1.1402(a)-2(i)
Example**

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△ Flow-thru for U.S. tax purposes

A, B, and C form LLC, a limited liability company, to engage in a business that is not a service partnership. LLC, classified as a partnership for federal tax purposes, allocates all items of income, deduction, and credit of LLC to A, B, and C in proportion to their ownership of LLC. A and C each contribute \$1x for one LLC unit. B contributes \$2x for two LLC units. Each LLC unit entitles its holder to receive 25 percent of LLC's tax items, including profits. A does not perform services for LLC; however, each year B receives a guaranteed payment of \$6x for 600 hours of services rendered to LLC and C receives a guaranteed payment of \$10x for 1000 hours of services rendered to LLC. C also is elected LLC's manager. C has the authority to contract on behalf of LLC.

A is treated as a limited partner in LLC because A is not liable personally for debts of or claims against LLC, A does not have authority to contract for LLC under State's law, and A does not participate in LLC's trade or business for more than 500 hours during the taxable year. Therefore, A's distributive share attributable to A's LLC unit is excluded from A's net earnings from self-employment under section 1402(a)(13).

B's guaranteed payment of \$6x is included in B's net earnings from self-employment under section 1402(a)(13). B is not treated as a limited partner because, although B is not liable for debts of or claims against LLC and B does not have authority to contract for LLC, B does participate in LLC's trade or business for more than 500 hours during the taxable year. Further, B is not treated as a limited partner of this section because B does not hold more than one class of interest in LLC. However, B is treated as a limited partner because B is not treated as a limited partner solely because B participated in LLC's business for more than 500 hours and because A is a limited partner who owns a substantial interest with rights and obligations that are identical to B's rights and obligations. In this example, B's distributive share is deemed to be a return on B's investment in LLC and not remuneration for B's service to LLC. Thus, B's distributive share attributable to B's two LLC units is not net earnings from self-employment under section 1402(a)(13).

C's guaranteed payment of \$10x is included in C's net earnings from self-employment under section 1402(a). In addition, C's distributive share attributable to C's LLC unit also is net earnings from self-employment under section 1402(a) because C is not a limited partner. C is not treated as a limited partner because C has the authority to enter into a binding contract on behalf of LLC and because C participates in LLC's trade or business for more than 500 hours during the taxable year. Further, C is not treated as a limited partner because C does not hold more than one class of interest in LLC. Finally, C is not treated as a limited partner of this section because C has the power to bind LLC. Thus, C's guaranteed payment and distributive share both are included in C's net earnings from self-employment under section 1402(a).

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