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Fifth Circuit Revises Standard for "Limited Partner" Status Under Self-Employment Tax Rules

The US Court of Appeals for the Fifth Circuit has issued a revised opinion in *Sirius Solutions, L.L.L.P. v. Commissioner of Internal Revenue* (No. 24-60240), holding that a "limited partner" for purposes of Section 1402(a)(13) of the tax code is a partner who does not assume a significant role in managing or operating a business. This establishes a fact-intensive test requiring examination of a limited partner's actual involvement in the partnership.

In reaching this conclusion, the court withdrew its own prior opinion in the same case, which had established a bright-line rule: under that earlier approach, any partner in a state-law limited partnership who possessed limited liability was automatically entitled to the exclusion for self-employment tax purposes (commonly referred to as the "SECA limited partner exception"). The new opinion does not specify how courts should assess whether a partner's role rises to the level of "significant," and the Fifth Circuit has remanded the case to the Tax Court to interpret and apply the newly articulated standard.

Why This Matters

The revised opinion adds further uncertainty to the ongoing debate over how the SECA limited partner exception should be applied. Although the Fifth Circuit continues to reject the functional-analysis approach the Tax Court adopted in *Soroban v. Commissioner*, 161 T.C. 310 (2023), the court's new "no significant role" standard is arguably closer to the Soroban line of reasoning than the Fifth Circuit's own withdrawn opinion, which had looked exclusively at whether a partner carried limited liability under state law.

Under the revised standard, the exclusion is not limited to partners who are purely passive investors; it may extend to limited partners with some degree of involvement in the business, provided that, upon examination of their management and operational activities, that involvement is found not to be significant.

Actions to Consider

Limited partners in a state-law limited partnership who participate in managing or running the partnership's business should continue to monitor developments in this area and consult their advisors regarding tax reporting, including any potential disclosure obligations.

Background

Sirius Solutions, L.L.L.P. (Sirius), a business consulting firm organized as a Delaware limited liability limited partnership and treated as a partnership for U.S. federal tax purposes, allocated ordinary business income or loss to its limited partners. Sirius excluded those limited partners' distributive shares from the computation of net earnings from self-employment.

After the IRS challenged Sirius's position on audit, its general partner petitioned the Tax Court for review. In a motion for summary judgment, the general partner argued that ordinary business income allocated to the limited partners should be excluded from net earnings from self-employment solely because those partners were limited partners under state law. On August 8, 2022, the Tax Court denied the motion, citing genuine disputes of material fact regarding Sirius's operations and an unresolved legal question concerning the meaning of "limited partner."

On November 28, 2023, in *Soroban Capital Partners LP v. Commissioner*, the Tax Court observed that "Congress intended section 1402(a)(13) to apply to partners that are passive investors" and held that determining whether a state-law limited partner qualifies for the SECA limited partner exception requires an inquiry into the partner's functions and roles. Under that decision, a limited partner who actively participates in the partnership's business may be unable to exclude his or her distributive share of income or loss from net earnings from self-employment.

Following the Soroban decision in late 2023, Sirius Solutions, L.L.L.P. concluded that the decision was controlling based on the facts at issue and requested that the Tax Court issue an order permitting an appeal to the U.S. Court of Appeals for the Fifth Circuit. The Tax Court subsequently entered a stipulated decision in favor of the IRS on February 20, 2024.

In January 2026, the Fifth Circuit issued an opinion rejecting the functional analysis test established in *Soroban* and holding that eligibility for the SECA limited partner exception depended solely on whether the partner had limited liability. Following a petition for rehearing filed by the government, the Fifth Circuit withdrew its January 2026 opinion on August 12, 2026, and issued a revised opinion addressing the treatment of limited partners for purposes of the SECA exception.

The Fifth Circuit's Revised Interpretation

Whereas the Tax Court in *Soroban* and the Fifth Circuit in its withdrawn opinion had each focused on the statutory phrase "limited partner, as such," the Fifth Circuit's new opinion instead examines the underlying meaning of "limited partner" itself. Observing that neither the statute nor its legislative history defines the term, the court determined that the ordinary public meaning of "limited partner" as of 1977 — when the SECA limited partner exception was enacted — was a partner who plays no significant role in managing or running a business.

Under this standard, a limited partner is not necessarily confined to a purely passive role; some degree of participation in the partnership's business is permissible. However, a partner who exercises control over the business cannot qualify as a limited partner for purposes of the exception. As a result, while the Fifth Circuit's new standard is somewhat more permissive than the passive-investor test applied in *Soroban* — itself derived from the functional-analysis approach the Tax Court first articulated in *Renkemeyer v. Commissioner*, 136 T.C. 137 (2011) — the court declined to preserve a bright-line rule under which limited partner status alone would guarantee application of the exception.

Observations

Fact-specific analysis required. In light of this opinion, limited partners will need to evaluate the specific facts and circumstances of their involvement in managing or operating a partnership to determine whether the SECA limited partner exception applies. The opinion does not provide guidance on how the "no significant role" standard should be applied in practice; that task has been left to the Tax Court on remand.

Continued IRS scrutiny likely. The IRS has maintained a compliance initiative targeting the application of self-employment tax to partnership income since 2018. This opinion reinforces the IRS's position and may support continued examination of limited partners' status on a facts-and-circumstances basis across jurisdictions.

Potential for a circuit split. The *Soroban* case remains on appeal before the Second Circuit, which heard oral argument on June 25, 2026. Separately, the Tax Court applied the functional-analysis test in *Denham Capital Management LP v. Commissioner*, T.C. Memo. 2024-114, which is currently on appeal before the First Circuit. The First Circuit heard oral argument on February 5, 2026, and has requested supplemental briefing on procedural issues arising under TEFRA. As of this writing, neither the First nor the Second Circuit has issued a ruling. Should either court adopt an interpretation of "limited partner" that differs from the Fifth Circuit's, a split among the circuits could result.
