

Update: Fifth Circuit Changes Course and Redefines “Limited Partner” for Purposes of the 1402(a)(13) Exception to Self-Employment Tax

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On August 12, 2026, the United States Court of Appeals for the Fifth Circuit withdrew its prior opinion^[1] and substituted a new opinion^[2] in *Sirius Solutions, L.L.P. v. Commissioner* (now *K Alain L.L.P. v. Commissioner*) concluding that the term “limited partner” under Internal Revenue Code (“IRC” or “Code”) § 1402(a)(13) means a partner who plays “no significant role in managing or running a business.”



As the Kean Miller Tax Team wrote in January 2026,^[3] the Fifth Circuit’s previous opinion had held that a limited partner is a partner in a limited partnership that has limited liability, i.e., a limited partner under state law. In its January opinion, the Fifth Circuit vacated the Tax Court’s holding and rejected the Tax Court’s “passive investor” standard and the application of a “functional analysis test.” The functional analysis test examines the partner’s role in the partnership to determine whether the partner qualifies as a “limited partner.” In applying this test, the court evaluates several factors, including the extent of the partner’s involvement in generating the partnership’s income, the amount of time the partner devotes to partnership activities, and the amount of capital the partner has contributed to the partnership in relation to the income earned from the partnership.

The Fifth Circuit changed course in response to the Commissioner’s petition for rehearing en banc. While the Fifth Circuit denied the Commissioner’s petition for rehearing en banc, the same three judge panel granted a panel rehearing, which led the court to withdraw its prior opinion and substituted a new opinion. The ultimate ruling, viz., that the Tax Court’s decision is to be vacated and the case remanded to the Tax Court remains the same, however, the Fifth Circuit substantially changed its opinion with respect to the standard to be applied and its reasoning therefor.

Background

The Code imposes a tax on “self-employment income,” which is defined as “the net earnings from self-employment.”^[4] The tax is imposed on self-employed individuals, including individuals that are partners in a partnership. However, IRC Section 1402(a)(13) excludes the distributive share of income of a “limited partner, as such,” from the net earnings from self-employment (the “1402(a)(13) exception”). The term “limited partner” is not defined in the statute.

Based on the 1402(a)(13) exception, Sirius Solutions L.L.P., a Delaware limited liability limited partnership, excluded its limited partners’ distributive share of partnership income from its calculation of net earnings from self-employment for the 2014 through 2016 tax years. On audit, the Internal Revenue Service (“IRS”) determined that Sirius Solutions’ state law limited partners did not qualify as limited partners for purposes of the 1402(a)(13) exception because the exception only applies to passive investors under the “functional analysis test.”

Sirius Solutions contested the IRS’s determination and asserted that the meaning of the term “limited partner, as such” meant a limited partner under state law with limited liability. Relying on its decision in *Soroban Capital Partners, LP v. Commissioner*,^[5] the United States Tax Court held that “limited partner, as such,” for purposes of the 1402(a)(13) exception, only refers to passive investors. Sirius Solutions appealed.

Original Opinion

The Fifth Circuit’s original opinion, covered in detail in Kean Miller’s previous blog post, held that a limited partner under IRC § 1402(a)(13) is a partner in a limited partnership that has limited liability, i.e., a limited partner under state law. The Fifth Circuit’s holding in the original opinion relied largely on a textual analysis of the statute, agency interpretations, and of the role of state law in federal tax interpretation of the term “limited partner.”^[6] The Fifth Circuit reasoned that the “touchstone” for the term “limited partner” was limited liability, and the degree to which a partner participated in the business did not change such an analysis.^[7] The Fifth Circuit’s original opinion therefore rejected the “functional analysis test” used by the Tax Court.

Substituted Opinion

The Fifth Circuit’s substituted opinion substantially changes both its ruling and the reasoning supporting it. The same three-judge panel—with the same majority and dissent—now hold that the original meaning of “limited partner” is a partner who “plays no significant role in managing or running a business.”^[8]

The majority makes little mention of state law and again determines that the term “limited partner” is not defined and thus the court needs to determine its ordinary meaning at the time Congress enacted the statute. The majority reaches its conclusion by using a series of definitions, this time from dictionaries, the 1916 Uniform Limited Partnership Act, the 1976 Revised Uniform Limited Partnership Act, contemporaneous partnership treatises, and *Plasteel Products Corp. v. Helman*.^[9] The majority finds that, together, this series of sources define a limited partner as a partner who plays no significant role in managing or running the business.

Moreover, based on these definitions, the majority continues to be unmoved by the Tax Court’s “functional analysis test” and again vacates the Tax Court’s ruling. The majority reasons that the Tax Court’s analysis is contrary to the statutory text and at odds with decades of IRS guidance.^[10] The Fifth Circuit also rejects the Tax Court’s *Soroban* decision, noting that it appeared to prohibit even the most minor involvement in corporate affairs.

The dissent would affirm the Tax Court’s decision, reasoning that the majority misconstrues cases which have limited application to the facts as controlling. Additionally, the dissent takes issue with the lack of textual support in the statute for the majority’s decision.

Implications

As in Kean Miller’s last blog post about this case, the implications of the Fifth’s Circuit’s revised decision are unclear, and the parties in *K Alain* (formerly *Sirius Solutions*) can still file a petition for a rehearing or a rehearing en banc, or the parties may appeal the decision. At present, two cases with the same issue, *Soroban Capital Partners LP v. Commissioner*^[11] (Second Circuit), and *Denham Capital Management LP v. Commissioner*^[12] (First Circuit), are still currently pending in other United States Circuit Courts of Appeals. In the event a circuit split occurs, a significant amount of uncertainty could arise absent action by Congress or a ruling by the United States Supreme Court.

Significantly, the revised Fifth Circuit decision shifts the analysis from state law limited liability status to a question of what role the partner has in the business, but the opinion does not define or determine the level of involvement in management or running the business that is permissible for a partner to have.

In light of the new Fifth Circuit opinion, and if the Fifth Circuit’s substituted opinion becomes final, taxpayers who are limited partners within the Fifth Circuit will need to analyze the level of their role in the management and running of the business to determine whether the partner falls into the 1402(a)(13) exception, and the partner’s

distributive shares of income are therefore excluded from the net earnings from self-employment, and thus from self-employment tax liability. The inquiry is no longer restricted to whether the partner simply has limited liability under state law.

It further remains possible that the Fifth's Circuit's revised decision could correspondingly result in a reduction in Social Security benefits of any person residing in the Fifth Circuit who paid self-employment tax on their self-employment income from a limited partnership as a result of the identical exception in 42 U.S.C. 411(a)(12), which would seemingly result in the removal of a limited partners' self-employment income from the benefits calculation. It is not clear if or when such a reduction would occur or how significant such a reduction would be given that, at present, the Fifth Circuit's revised decision is restricted to limited partners that "play no significant role in managing or running the business." Thus, any person residing in the Fifth Circuit that remitted self-employment tax on their distributive share from a limited partnership should still consider whether it is appropriate to file protective refund claims for all open tax years.

In addition, a resident taxpayer that is a limited partner, playing a non-significant role in managing or running the business, should consider their filing options going forward, e.g., whether to pay the self-employment tax and file a protective refund claim, thereby mitigating interest risk but losing the potential returns on the funds used to pay the tax for a period of time, or whether to not pay self-employment tax on their distributive share from a limited partnership and accept the risk of additional liability in the event Congress or the Supreme Court overturns *Sirius Solutions*.

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[1] *Sirius Solutions, L.L.L.P. v. Commissioner*, 165 F.4th 374 (5th Cir. 2026).

[2] *K Alain, L.L.L.P. v. Commissioner*, No. 24-60240 (5th Cir. Aug. 12, 2026).

[3] The Fifth Circuit Defines “Limited Partner” for Purposes of the 1402(a)(13) Exception to Self-Employment Tax – Kean Miller.

[4] IRC §§ 1401(a), 1402(b).

[5] *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023).

[6] See generally *Sirius Solutions*, 165 F.4th 374.

[7] *Sirius Solutions*, 165 F.4th at 397, 381.

[8] *K Alain, L.L.L.P. v. Commissioner*, No. 24–60240 (5th Cir. Aug. 12, 2026).

[9] *K Alain, L.L.L.P. v. Commissioner*, No. 24–60240 (5th Cir. Aug. 12, 2026) (citing *Plasteel Products Corp. v. Helman*, 271 F.2d 354, 356 (1st Cir. 1959)).

[10] *K Alain, L.L.L.P. v. Commissioner*, No. 24–60240 (5th Cir. Aug. 12, 2026).

[11] *Soroban Capital Partners LP v. Commissioner*; (T.C. Memo. 2025–52).

[12] *Denham Capital Management LP v. Commissioner* (T.C. Memo. 2024–114).