Tax Insights
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Acquisitions

Fifth Circuit creates new definition of “limited partner” for self-employment tax purposes

August 14, 2026

In brief

What happened?

The US Court of Appeals for the Fifth Circuit issued a new opinion in *Sirius Solutions, L.L.L.P. v. Commissioner of Internal Revenue*, No. 24-60240, holding that the meaning of “limited partner” in Section 1402(a)(13) is “a partner who plays no significant role in managing or running a business,” thus establishing a new test that requires a factual examination into a limited partner’s role in the partnership. The Fifth Circuit withdrew its prior opinion (165 F.4th 374 (5th Cir. 2026)), which had established a bright-line rule that partners in state law limited partnerships who have limited liability are entitled to apply the limited partner exception in Section 1402(a)(13) (the “SECA limited partner exception”) to exclude their distributive shares of partnership earnings from net earnings from self-employment, and issued a new opinion. The new opinion does not provide a standard for determining significance, instead remanding the case to the Tax Court to interpret and apply the new test.

Why is it relevant?

The new opinion injects additional uncertainty into the long-standing debate regarding the application of the SECA limited partner exception. While the Fifth Circuit continues to reject the functional analysis test established by the Tax Court in *Soroban v. Commissioner*, 161 T.C. 310 (2023), the “no significant role” standard created in the new opinion appears to be closer to the *Soroban* line of inquiry than the original Fifth Circuit opinion, which limited the examination solely to whether a limited partner had limited liability.

Under the new opinion, the SECA limited partner exception can apply to limited partners beyond those who are purely passive investors, but only after an inquiry into the limited partner's management or operational activities with respect to the partnership and a determination that those activities are not significant.

Actions to consider

Limited partners in a state law limited partnership who participate in the managing or running of the business of the partnership should continue to monitor developments in this area and discuss tax reporting, including potential disclosure, with their advisors.

In detail

Sirius Solutions, L.L.L.P. (Sirius) is a business-consulting firm organized as a Delaware limited liability limited partnership and treated as a partnership for US federal tax purposes. Sirius's limited partners received allocations of Sirius's ordinary business income or loss. Sirius excluded its limited partners' shares of ordinary business income or loss from its computation of the partners' net earnings from self-employment.

After the IRS challenged the position on audit, Sirius's general partner (GP) petitioned the Tax Court for review. In a motion for summary judgment, Sirius's GP argued that ordinary business income allocated to Sirius's limited partners should be excluded from the partners' net earnings from self-employment because the partners are limited partners under state law. On August 8, 2022, the court denied this motion because there were still genuine disputes of material fact as to Sirius's operations and the question of law on the meaning of "limited partner."

On November 28, 2023, the Tax Court noted in *Soroban* that "Congress intended section 1402(a)(13) to apply to partners that are passive investors," and held that determining whether a limited partner in a state law limited partnership is a limited partner for purposes of the SECA limited partner exception requires an inquiry into the function and roles of the limited partner. Under the decision, a limited partner who actively participates in the business of the partnership may not be able to exclude his distributive share of income or loss from net earnings from self-employment.

Following the *Soroban* decision in late 2023, Sirius concluded that *Soroban* was controlling with respect to its facts and asked the Tax Court to issue an order allowing it to appeal to the Fifth Circuit. In response, the Tax Court issued a stipulated decision in favor of the IRS on February 20, 2024. In January 2026, the Fifth Circuit issued an opinion rejecting *Soroban's* functional analysis test and holding that a limited partner's eligibility for the SECA limited partner exception depends solely on whether the partner has limited liability. On August 12, 2026, the Fifth Circuit responded to a government petition for a rehearing by withdrawing the January 2026 opinion and issuing the new opinion.

While the Tax Court in *Soroban* and the Fifth Circuit in the withdrawn opinion focused on the term "limited partner, as such," the Fifth Circuit in the new opinion examined the meaning of "limited partner." After noting that the statute and legislative history do not define "limited partner," the Fifth Circuit 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."

Importantly, under the Fifth Circuit's test, a limited partner is not entirely excluded from participating in the partnership's business (i.e., a limited partner may be more than a passive investor in a partnership), but a partner that controls the business cannot be a limited partner for purposes of the SECA limited partner exception. Thus, while the Fifth Circuit's new limited partner standard appears to be more permissive than Soroban's passive investor test (itself an interpretation of the Tax Court's functional analysis test, announced in *Renkemeyer v. Commissioner*, 136 T.C. 137 (2011)), the court did not retain a bright-line rule under which limited partners could apply the SECA limited partner exception.

Observation: In light of the Fifth Circuit's new opinion, limited partners will need to consider the facts and circumstances surrounding their participation in the management or running of a partnership in determining whether to apply the SECA limited partner exception. Notably, the new Sirius opinion does not provide guidance on how to apply the "no significant role" standard. The Fifth Circuit remanded Sirius to the Tax Court to apply and interpret the new standard.

Observation: Since 2018, the IRS has maintained a compliance campaign focused on the application of self-employment tax to partner income. This opinion bolsters the IRS's approach and IRS activity could continue with ongoing facts and circumstances determinations regarding the status of limited partners for self-employment tax purposes in all jurisdictions.

Observation: *Soroban* is currently on appeal to the Second Circuit, which held oral arguments on June 25, 2026. The Tax Court also applied the functional analysis test in *Denham Capital Management v. Commissioner*, T.C. Memo. 2024-14, currently on appeal to the First Circuit. The First Circuit held oral arguments on February 5, 2026, and requested supplemental briefing on TEFRA procedural issues. Neither the First nor the Second Circuit has ruled as of the date of this Insight. The possibility of a circuit split remains should either the First or the Second Circuit interpret limited partner in a different manner than the Fifth Circuit.

See also

- Fifth Circuit rejects narrow interpretation of "limited partner" for self-employment tax purposes (Jan. 22, 2026)
- Tax Court limits meaning of "limited partner" for self-employment tax purposes (Dec. 4, 2023)

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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