

Fifth Circuit Narrows, but Preserves, Taxpayer-Favorable Ruling on Limited Partner Exception to Self-Employment Tax on Rehearing

WRITTEN BY

Saba Ashraf | Thomas Gray

KEY POINTS

- The Fifth Circuit's August 2026 opinion in *K Alain, L.L.L.P. v. Commissioner* (No. 24-60240) replaces its prior *Sirius Solutions* ruling and holds that a "limited partner" under 26 U.S.C. § 1402(a)(13) is a partner who plays no significant role in managing or running a business.
- The new opinion rejects both the Tax Court's "passive investor" standard from *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023), and the prior *Sirius* rule that state-law limited-partner status alone controls the federal tax analysis.
- The Fifth Circuit grounded its holding in the original public meaning of "limited partner" as understood in 1977, drawing on *Black's Law Dictionary* (4th and 5th editions) and the Uniform Limited Partnership Act (1916) and its 1976 revision.
- The case was remanded to the Tax Court for the Commissioner to determine in the first instance whether the specific partners at issue satisfy the Fifth Circuit's articulated standard.
- Taxpayers outside the Fifth Circuit remain subject to the Tax Court's *Soroban* "passive investor" standard absent a contrary appellate ruling in their jurisdiction.

On August 12, 2026, the U.S. Court of Appeals for the Fifth Circuit issued its opinion on rehearing in *K Alain, L.L.L.P. v. Commissioner of Internal Revenue*, No. 24-60240, withdrawing its prior opinion in *Sirius Solutions, L.L.L.P. v. Commissioner of Internal Revenue*, 165 F.4th 374 (5th Cir. 2026), and substituting a new per curiam opinion. This opinion was issued in response to the government's petition for rehearing en banc, in which the Justice Department asserted that the prior opinion improperly allowed state-law limited-partner status and limited liability alone to control the federal tax analysis. The court vacated the Tax Court's decision and remanded the case, maintaining its taxpayer-favorable holding that the term "limited partner" in 26 U.S.C. § 1402(a)(13) means "a partner who plays no significant role in managing or running a business." As we discussed in our [January 23, 2026, article](#), this case has significant implications for fund managers, professional services partnerships, and other pass-through entities whose partners seek to rely on the limited partner exception to self-employment tax.

The underlying dispute involves Sirius Solutions, L.L.L.P. (now called K Alain, L.L.L.P.), a limited liability limited partnership formed under Delaware law that operates a business consulting firm based in Houston, TX, with offices in Dallas and London. For tax years 2014 through 2016, Sirius allocated all ordinary business income to its limited partners and excluded those amounts from net earnings from self-employment under § 1402(a)(13). The IRS challenged this treatment, asserting that the limited partners did not qualify for the statutory exception and adjusting net earnings from self-employment upward by approximately \$5.9 million (2014), \$7.4 million (2015), and

downward by a loss of approximately \$490,000 (2016). The Tax Court upheld the IRS adjustments, reasoning that it was bound by its own decision in *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023), which had adopted a “passive investor” standard for determining limited partner status.

On rehearing, the Fifth Circuit refined its textual analysis but maintained its rejection of the Tax Court’s approach. The panel looked to the original public meaning of “limited partner” at the time Congress enacted § 1402(a)(13) as part of the Social Security Amendments of 1977. Drawing on contemporaneous sources — including *Black’s Law Dictionary* (4th and 5th editions) and the Uniform Limited Partnership Act (1916) and its 1976 revision — the court concluded that a “limited partner” was understood to be a partner who does not take part in managing or controlling the partnership business. The court emphasized that this standard permits some participation short of exercising control, distinguishing it from the Tax Court’s more restrictive “passive investor” test.

The Fifth Circuit specifically rejected the *Soroban* framework, finding that the Tax Court’s “passive investor” standard was “divorced from statutory text” and made no attempt to ground its rule in the original public meaning of the statutory language. The court also noted that from 1978 onward, IRS instructions defined “limited partner” based on limited liability alone, not on the degree of control exercised by the partner. While declining to adopt the IRS’s historical administrative position as its own, the court observed that the commissioner’s own longstanding interpretation was inconsistent with the restrictive position now being advanced. The court further declined to engage with policy-based arguments, stating that its role is to apply the plain text of the statute as enacted.

In sum, while the prior Fifth Circuit opinion in *Sirius* defined “limited partner” by looking at whether a person was a limited partner under state law, holding that the level of activity was irrelevant, the new opinion replaces that approach and instead holds that a “limited partner” is a partner who plays no significant role in managing or running a business. Both the prior and the new Fifth Circuit opinions reject the Tax Court’s “passive investor” standard. However, the new opinion introduces an activity- or role-based inquiry.

The case was remanded to the Tax Court for the Commissioner to consider in the first instance whether the partners at issue fall within the Fifth Circuit’s articulated meaning of “limited partner.” Judge Graves dissented, arguing that the majority’s interpretation creates “an indefensible, illogical, and illegal loophole” and that the court should have affirmed the Tax Court’s decision. The petition for rehearing en banc was denied, indicating that the full court declined to disturb the panel’s analysis.

This decision is significant for several reasons. First, it establishes a circuit-level precedent that rejects *Soroban*’s “passive investor” test on more thoroughly reasoned grounds than the prior, now-withdrawn opinion — grounding its holding in a rigorous textual analysis of the original public meaning of “limited partner” as understood in 1977, drawing on contemporaneous legal dictionaries, the Uniform Limited Partnership Act, and legal treatises to conclude that the statutory exception applies to a partner who plays no “significant role in managing or running” the business. Second, the decision may encourage other circuits to adopt a similar textual approach if the issue arises in their jurisdictions. Third, for partnerships operating in the Fifth Circuit, the decision provides greater clarity and a more workable framework for evaluating whether partners may rely on the § 1402(a)(13) exception. We also recently discussed the implications of this case and structuring considerations in our [“Carried Away” podcast series](#).

Practitioners and fund sponsors should take note of this development and evaluate their partnership structures in

light of the Fifth Circuit's standard. While the case has been remanded and its ultimate outcome on the facts remains to be seen, the legal framework is now more clearly defined within the Fifth Circuit. Taxpayers outside the Fifth Circuit should be aware that the Tax Court's *Soroban* standard remains the governing precedent in that forum absent a contrary appellate ruling. We will continue to monitor developments in this area and provide updates as the remand proceedings and any further appellate activity unfold.

For more information about how this decision may affect your partnership's self-employment tax positions, please contact [Saba Ashraf](#) or [Thomas Gray](#), or visit Troutman Pepper Locke's [Tax Practice Group](#).

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