Fifth Circuit Revises *Sirius*: Management Test Replaces Limited-Liability Rule

August 19, 2026

The United States Court of Appeals for the Fifth Circuit has withdrawn and substituted its January 16, 2026, opinion in *Sirius Solutions, L.L.L.P. v. Commissioner,*[1] with a new opinion.[2] This surprising development came after the three-judge panel that issued the original opinion granted panel rehearing in response to the Department of Justice's petition for rehearing *en banc*.[3]

Section 1402(a)(13) of the Internal Revenue Code (the "LP Exception") generally excludes the "distributive share of any item of income or loss of a **limited partner, as such**" from earnings subject to U.S. federal self-employment tax. The new opinion holds that, for purposes of the LP Exception, a "limited partner" is a partner who "plays no significant role in managing or running a business." The Fifth Circuit does not define "significant" and gives no real guidance on when participation in strategy, committees, financial or personnel matters, client or investor relationships or other business activity rises to an impermissible level of involvement in managing or running the business.

The new opinion represents a mixed bag for taxpayers that rely on the LP Exception. On the one hand, it preserves a taxpayer-favorable feature of the original *Sirius* decision by rejecting the Tax Court's view in *Soroban Capital Partners LP v. Commissioner*[4] that only "passive investors" qualify as limited partners, expressly recognizing that a limited partner may participate in non-managerial aspects of a business. On the other hand, the new opinion abandons the original opinion's ruling that a limited partner is "a partner in a state-law limited partnership that is afforded limited liability."

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1 165 F.4th 374 (5th Cir. 2026).

2 K Alain, L.L.L.P. v. Commissioner, No. 24-60240 (5th Cir. Aug. 12, 2026). The taxpayer, formerly known as Sirius Solutions, L.L.L.P., changed its name to K Alain, L.L.L.P. as of April 2026. The prior name is reflected in the substitute opinion and throughout this discussion.

3 Although the government's April 1 petition for rehearing *en banc* was denied by the Fifth Circuit, the three-judge panel that issued the original opinion viewed the petition as a request for a panel rehearing, which was granted.

4 161 T.C. 310 (2023).

BACKGROUND: LEGACY IRS VIEW AND PRE-*SOROBAN* CASES

- Congress did not define "limited partner, as such" in the statute, and the Internal Revenue Service's partnership return instructions historically described a limited partner principally only by reference to limited liability.

- In cases addressing other types of pass-through entities, the Tax Court developed a functional inquiry into the LP Exception. In *Renkemeyer, Campbell & Weaver, LLP v. Commissioner*,[5] the Tax Court held that limited liability limited partners of a law firm did not qualify for the LP Exception because their distributive shares arose from legal services rather than a return on invested capital, and they participated in management. In *Hardy v. Commissioner*,[6] the Tax Court reached the opposite conclusion for a surgeon's minority limited partnership interest, where he had no day-to-day management responsibilities, was paid separately for surgeries and received distributions that did not depend on how many procedures he performed.

Comment: These cases emphasized the taxpayers' actual activities and the economic source of their income but did not directly address whether an individual who is, in form, a limited partner in a state-law limited partnership automatically qualifies for the LP Exception.

SOROBAN EXTENDED THE FUNCTIONAL TEST TO STATE-LAW LIMITED PARTNERS

- In *Soroban*, the Tax Court rejected the taxpayer's argument that status as a state-law limited partner was, alone, sufficient to satisfy the LP Exception. In doing so, the court interpreted "as such" in section 1402(a)(13) to require that a limited partner also function as a passive investor, adopting the functional test from prior cases.

- In applying this standard in a later opinion, the Tax Court held the principals in *Soroban* did not qualify for the LP Exception, given that their roles were not passive in nature, and their partnership earnings were not meaningfully tied to their capital.[7]

Comment: *Soroban*'s passive-investor formulation created significant uncertainty for taxpayers. Many limited partners exercise governance rights, serve on committees, maintain client or investor relationships or perform services for a partnership, while the general partner formally retains management authority.

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5 136 T.C. 137 (2011).

6 T.C. Memo. 2017-16.

7 *See Soroban Capital Partners LP v. Commissioner*, T.C. Memo. 2025-52.

SIRIUS'S ORIGINAL RULING

- In the original *Sirius* opinion, a divided panel rejected *Soroban* and its functional test and held that a limited partner for purposes of the LP Exception was a partner in a state-law limited partnership who had limited liability. The majority relied on dictionaries contemporaneous with the LP Exception's enactment and legacy IRS and Social Security Administration materials.

Comment: The original opinion provided an easily administered rule for taxpayers, although the court's decision did not address how its analysis would apply to other, non-partnership legal entity forms.

NEW FACTS & CIRCUMSTANCES TEST

- The new *Sirius* opinion purports to reject *Soroban*'s passive-investor standard as too restrictive, arguing that the Tax Court did not ground this standard in the original public meaning of "limited partner" from the time of the statute's enactment.

- The new standard, whether the limited partner plays a "significant role in managing or running the business," clarifies that while partners may participate in certain "non-managerial aspects of a business," they cannot play a significant role in managing or running the business. In its majority decision, the Fifth Circuit does not acknowledge the prior *Sirius* opinion or explain its substantial divergence in analysis and holding.

Comment: The new opinion does not offer much guidance in applying the "significant role" standard, including the weight given to a partner's formal authority versus actual conduct, the type of governance rights that amount to "managing" or how revenue-generating professional or investment-related work translates to "running" the business.

Comment: Though there are significant open questions as to its application, the "managing or running the business" standard may be a lot closer to *Soroban*'s "functional analysis" standard than the explicit repudiation of *Soroban* in the new opinion would suggest. Under *Sirius* and *Soroban*, satisfying the LP Exception becomes more difficult where a limited partner has operational authority, manages personnel, has authority to legally bind the entity, controls core investment or service decisions or is held out internally or externally as responsible for operating the business.

WHAT'S NEXT

- In issuing its new opinion, the Fifth Circuit again vacated the Tax Court's 2024 holding that a "limited partner" must be a "passive investor" and remanded for application of the new "managing or running the business" standard. The taxpayer has 45 days to file its own petition for a panel rehearing, a rehearing *en banc* or both.

- Meanwhile, the question of what "limited partner" means in section 1402(a)(13) is set to be answered by two more Circuits, as *Soroban* is pending appeal in the Second Circuit and a separate case[8] is being appealed by taxpayers to the First Circuit following an unfavorable Tax Court ruling.

Comment: In addition to determining if their activities constitute "managing or running the business," audited limited partners may soon have to also navigate a circuit split.

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[8] *Denham Cap. Mgmt. LP v. Commissioner*, T.C. Memo. 2024-114, 2024 WL 5200039 (2024).

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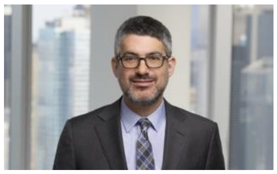

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