Soroban: Second Circuit Curtails LP Exception for Self-Employment Tax

September 22, 2026

The United States Court of Appeals for the Second Circuit (the "Second Circuit") has issued an opinion in *Soroban Capital Partners LP v. Commissioner*,[1] holding that a limited partner, for purposes of the exclusion from federal self-employment taxes, means a partner who has limited liability **and who does not run, manage or otherwise control the partnership's business**.

The Second Circuit unanimously affirmed the 2025 United States Tax Court (the "Tax Court") decision and held that the three principals of Soroban Capital Partners LP ("Soroban"), who were limited partners of Soroban, were not "limited partners, as such" within the meaning of Section 1402(a)(13) of the Internal Revenue Code.[2] Section 1402(a)(13) (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. As a result, the Soroban principals' distributive share of partnership income was subject to self-employment tax.

The Second Circuit's holding generally aligns with the recent decision of the United States Court of Appeals for the Fifth Circuit (the "Fifth Circuit") in *K Alain L.L.L.P. v. Commissioner* (commonly known as the *Sirius* decision).[3] The Second Circuit expressly recognizes that a limited partner may participate in non-managerial aspects of a business, while rejecting the view that limited liability alone is sufficient to establish "limited partner" status for purposes of the LP Exception.

[1] Docket No. 25-2250 (2d Cir. Sept. 17, 2026).

[2] All subsequent Section references herein are to the Internal Revenue Code.

[3] 184 F.4th 766 (5th Cir. 2026). The taxpayer, formerly known as Sirius Solutions, L.L.L.P., changed its name to K Alain, L.L.L.P. in early 2026. The Fifth Circuit had originally sided with the taxpayer in defining "limited partner" broadly to require only limited liability but reversed its position on a request for a rehearing. We further analyzed the *K Alain* decision in a prior Debevoise Update.

BACKGROUND

- Section 1401 imposes a tax on an individual's "self-employment income." Section 1402 defines self-employment income to include an individual's share of income "from any trade or business carried on by a partnership of which he is a member." Under the LP Exception, however, self-employment income does not include the distributive share of income of a "limited partner, as such," which is not defined in the statute.

- In its 2023 decision in *Soroban*,[4] the Tax Court held that the LP Exception does not apply to a partner "who is limited in name only" and adopted a functional analysis from prior cases, requiring an analysis of the roles and activities of the partner to determine limited partner status.[5] In its subsequent 2025 decision applying the test to the facts, the Tax Court concluded that the Soroban principals, who essentially managed and ran the Soroban partnership, did not qualify for the LP Exception.[6]

THE *SOROBAN* HOLDING

- Consistent with the opinion of the Fifth Circuit in *K Alain*, the Second Circuit reviewed definitions of "limited partner" in dictionaries, treatises and partnership statutes from the time Congress enacted the LP Exception. The Second Circuit concluded that a lack of management authority was a "hallmark" of limited partners at the relevant time. It rejected Soroban's argument that, because some states permitted limited partners to participate in the control of a partnership's business and maintain limited liability, Congress could not have intended managerial authority to be relevant to limited partner status.

- The Second Circuit also found support for its holding in the phrase "limited partner, as such," concluding that the LP Exception applies only to income earned in a partner's capacity as a limited partner, rather than from managing the business.

- The court looked to the treatment of guaranteed payments to limited partners for services rendered, which do not benefit from the LP Exception and are subject to self-employment tax, as support for the holding. The court said that the carveout

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4 *Soroban Cap. Partners LP v. Commissioner*, 161 T.C. 310 (2023).

5 The functional inquiry test was developed by the Tax Court in cases addressing other types of pass-through entities. *See Renkemeyer, Campbell & Weaver, LLP v. Commissioner*, 136 T.C. 137 (2011) and *Hardy v. Commissioner*, T.C. Memo. 2017-16.

6 *Soroban Cap. Partners LP v. Commissioner*, T.C. Memo. 2025-52.

aligns with the paradigm that working (as opposed to investing) is subject to self-employment tax.

Comment: The court's view that the guaranteed payment carveout "fortifies" its interpretation may be somewhat overstated. The guaranteed payment carve-out suggests that limited partners may provide some services but doesn't provide guidance on what the boundaries are.

- On the facts of the case, the court held that Soroban's principals exercised control and managerial authority over Soroban and were not "limited partners" who could benefit from the LP Exception.

Comment: While the Fifth Circuit's standard differs from the Second Circuit's in looking to whether a limited partner has a "significant role" in running a partnership's business, in practical terms the opinions appear closely aligned. Neither opinion provides meaningful guidance on the circumstances when participating in business decisions crosses into impermissible management or control or running the business.

Comment: The facts in *Soroban* presented a clear application of the Second Circuit's standard. The Soroban partners were the three principals of the business, worked full time for the partnership, managed its underlying investments, served on governing committees and were involved in personnel decisions. For partners whose activities fall short of clearly running or managing the business, the difference between the Second Circuit's "control" standard and the Fifth Circuit's "significant role" formulation may matter at the margins.

Comment: Neither the Second Circuit's nor Fifth Circuit's formulation displaces the separate exclusion from self-employment tax for payments to a retired partner, which requires (among other requirements) that a retired partner provide no services during the relevant period.

WHAT'S NEXT

- The taxpayers in *Soroban* may still seek panel or *en banc* rehearing in the Second Circuit. The taxpayers in *Soroban* or *K Alain* may also petition the Supreme Court for review. In addition, the United States Court of Appeals for the First Circuit has yet to issue its opinion on the scope of the LP Exception in *Denham Capital Management LP v. Commissioner,* which may further clarify the extent of any differences among the circuits in their interpretation of the LP Exception. It is also possible that taxpayers in other federal circuits may test the waters in their jurisdictions.

- While the jury is still out on the final verdict on the LP Exception, the prospects for taxpayers in a managerial role using this exception do not look favorable. Partnerships that have historically taken the position that limited partners that manage the business qualify for the LP Exception should discuss with their advisors how to treat the distributive share of partnership income on their tax returns and consider outreach to impacted partners.

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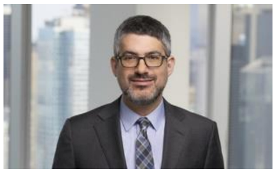
Please do not hesitate to contact us with any questions.



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