When Is a Limited Partner Really "Limited?" Soroban, K Alain, and the New § 1402(a)(13) Landscape

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For many partnerships, § 1402(a)(13) long appeared to offer a relatively straightforward rule: a limited partner's distributive share of partnership income generally is excluded from self-employment income, while guaranteed payments for services are not. The difficulty has always been that the Code does not define "limited partner," leaving open how much weight should be given to state-law status and, separately, to the partner's actual role in the business.

Section 1402(a)(13) excludes from net earnings from self-employment a limited partner's distributive share of partnership income, while generally leaving guaranteed payments for services subject to self-employment tax. The provision has been essentially unchanged since 1977. What Congress did not do was define "limited partner."

Almost fifty years later, that omission has produced an increasingly important line of cases involving law firms, investment managers, private-equity firms, consulting firms, and other closely held businesses.

Two appellate decisions in 2026 – *K Alain L.L.L.P. v. Commissioner,* 184 F.4th 766, in the Fifth Circuit and *Soroban Capital Partners LP v. Commissioner,* 2026 U.S. App. LEXIS 28448, in the Second Circuit – now address this issue. They also show that the disagreement among the courts is narrower and more nuanced than it appeared only a few months ago.

How We Got Here

The limited-partner exception was enacted in 1977, when the traditional limited partnership looked very different from many modern partnerships. A traditional general partner managed the business and bore unlimited liability. A limited partner contributed to the capital, enjoyed limited liability, and ordinarily stayed out of management.

The distinction worked reasonably well when legal form and economic function generally traveled together. However, after the limited-partner exception was enacted in 1977, some partners began to exploit a loophole by labeling themselves as limited partners while managing the partnership in exchange for large distributions. These large distributions would not be subject to self-employment tax because of the limited-partner exception.

Modern entity law complicated matters. Limited partnerships increasingly permit limited partners to participate in activities that once might have jeopardized their liability protection. LLCs and LLPs provide limited liability to owners who may simultaneously spend every working hour operating the business. Limited liability limited partnerships (LLLPs) add another variation: they preserve the limited-partnership form while extending limited liability to the general partner as well. *K Alain/Sirius* involved an LLLP, while *Soroban* involved a traditional Delaware limited partnership with a LLC, owned by Soroban's three limited partners, as its general partner.

The tax law never caught up. Treasury tried in 1997, proposing regulations that would have defined when an owner qualified as a limited partner for purposes of § 1402(a)(13). Congress temporarily prohibited Treasury from finalizing regulations addressing the issue, and the proposed regulations were never finalized. The statutory term remained undefined.

The courts eventually filled the vacuum.

In *Renkemeyer, Campbell & Weaver, LLP v. Commissioner*, 136 T.C. 137 (2011), the Tax Court considered lawyers practicing through a Kansas LLP. Virtually all of the firm's revenue came from legal services performed by the partners, and the partners contributed only nominal capital. The court concluded that the distributive shares were generated by the partners' services rather than investment and therefore were subject to self-employment tax.

Other cases followed, including *Castigliola v. Commissioner*, T.C. Memo. 2017-62. But those cases involved LLPs, LLCs, or similar entities. They left taxpayers with an argument: whatever *Renkemeyer* might mean for an LLC or LLP, surely an actual limited partner in an actual state-law limited partnership qualifies under a statute using the words "limited partner."

First out of the box was *Sirius Solutions, LLLP v Commissioner*, 165 F.4th 374 (5th Cir. 2026), which was vacated by *K. Alain*.[1] Then came *Soroban*. We will first discuss *Soroban*.

Soroban: Being Called a Limited Partner Is Not Enough

Soroban Capital Partners is a Delaware limited partnership that manages hedge funds. Its three founders were limited partners of Soroban and also members of its general partner. One "limited partner" was Managing Partner and Chief Investment Officer; the second wasCo-Managing Partner; the third was Head of Trading and Risk Management. Each worked approximately 2,300 to 2,500 hours per year, were members of the firm's governing

[1] *Sirius Solutions* and *K. Alain* are the same case; the company changed its name while the case was pending in the Fifth Circuit.

committees, exercised authority over personnel, and played central roles in the investment operation.

The economics attracted attention as well. The principals received approximately $2.5 million in guaranteed payments during 2016 and 2017, but approximately $141.5 million of distributive shares, more than 55 times their guaranteed payments. Two of the three had contributed no capital to Soroban, while the third had contributed approximately $4.3 million.

Soroban treated the guaranteed payments as self-employment income but excluded the $141.5 million of distributive shares under § 1402(a)(13). Because Soroban was a partnership, the IRS conducted a TEFRA partnership audit and determined that the distributive shares were subject to self-employment tax. Soroban petitioned the Tax Court.

In *Soroban I*, 161 T.C. 310 (2023), the Tax Court rejected the proposition that state-law status alone controlled. It held that § 1402(a)(13) requires a functional analysis: a person does not qualify merely because the partnership agreement places the words "limited partner" next to the person's name.

Then, in *Soroban II*, T.C. Memo. 2025-52, the Tax Court applied that test to the stipulated facts and held that the principals were limited partners "in name only." Their operational and managerial involvement was simply too substantial.

The Second Circuit affirmed on September 17, 2026. The rationale for its decision and its formulation of the test deserves careful attention.

The Second Circuit held that a limited partner under § 1402(a)(13) is a partner who has limited liability and "does not run, manage, or control the partnership's business." Because Soroban's principals plainly managed and controlled the enterprise, they failed that test.

In reaching its decision the Second Circuit looked at three sources for guidance: (1) the text of the statute and its ordinary meaning at the time of enactment in 1977; (2) the statute's surrounding text and structure; and (3) the statute's legislative history and historical context.

The statute uses the phrase "limited partner, as such" not "limited partner." The ordinary meaning in 1977 of limited partner was a partner who contributed capital to the partnership, shares in the profits, is not personally liable for partnership debts, and takes no part in running the business. "As such" modifies "limited partner" to one who acts in that capacity, i.e., by not managing the partnership. Additionally, the Uniform Limited Partnership Act, as in effect in most states in 1997, limited the liability of a limited partner only if he takes no part in control of the business.

Second, the surrounding text makes clear that the other exceptions to self-employment tax were for income from a passive investment. The meaning of "limited partner" was to be interpreted in accordance with the general statutory scheme.

Third, the historical context of the Social Security Act was to provide retirement benefits for workers. Prior to the enactment of § 1402(a)(13), people would obtain social security benefits by investing a small amount as a limited partner and receive small distributions that would make them eligible for Social Security benefits. Legislative history showed that Congress meant to deny benefits based on being a passive investor in a limited partnership. This further reinforced the Second Circuit's determination that "limited partner" refers to a person who had limited liability and did not manage the partnership.

But, the Second Circuit did not say that performing any services destroys limited-partner status. A limited partner may participate in the business and provide services. The dividing line is management and control: activities that amount to controlling, managing, or running the business are the problem. That clarification may matter in future cases.

***K Alain* – former *Sirius Solutions*: The Fifth Circuit Changes Course**

The Fifth Circuit's path was less direct.

K Alain involved Sirius Solutions, a Delaware limited liability limited partnership engaged in business consulting. During the relevant years, Sirius had between five and nine individual limited partners and a separate general partner holding less than 1% of the partnership. Sirius allocated all of its ordinary business income essentially to the limited partners and reported no net earnings from self-employment attributable to those distributive shares.

The IRS disagreed. The Tax Court did not reach the issue after a trial on the partners' activities. After *Soroban*, the parties stipulated that the partners would not qualify under the Tax Court's functional test, and Sirius requested entry of decisions under Tax Court Rule 251 in favor of the Commissioner so it could preserve and appeal its legal challenge to *Soroban*.

In January 2026, the Fifth Circuit issued *Sirius Solutions, L.L.L.P. v. Commissioner*, 165 F.4th 374, holding that limited liability in a state-law limited partnership was effectively sufficient. We addressed this decision in our prior blog.

It didn't take long for the Fifth Circuit to change its opinion. It granted the government's petition for rehearing and, on rehearing, withdrew *Sirius* and substituted *K Alain L.L.L.P. v. Commissioner*, 184 F.4th 766 (5th Cir. 2026). The new opinion holds that the original public meaning of "limited partner" is "a partner who plays no significant role in managing or running a business." The Fifth Circuit vacated the Tax Court's judgment and remanded for application of that standard.

Thus, the taxpayer retained a victory, but a much narrower one.

The Fifth Circuit rejected the Tax Court's characterization of the exception as limited to purely "passive investors." Historical partnership law, it reasoned, permitted at least some involvement without turning a limited partner into a manager.

But *K Alain* rejects the argument that a state-law designation ends the inquiry. What the partner actually does matters.

Is There Really a Circuit Split?

Yes, but it is considerably smaller than the split created by the now-withdrawn *Sirius* opinion.

The Second Circuit asks whether the partner has limited liability and refrains from running, managing, or exercising managerial control over the partnership. The Fifth Circuit asks whether the partner plays a significant role in managing or running the business. Those formulations are not identical. "No significant role" arguably permits some managerial participation that might create a harder question under the Second Circuit's formulation.

In Soroban, the Second Circuit discussed the K. Alain decision:

> We note that a panel of the Fifth Circuit also recently addressed the meaning of "limited partner" for purposes of § 1402(a)(13) in *K Alain, L.L.L.P. v. Comm'r of Internal Revenue*, 184 F.4th 766 (5th Cir. 2026). There, the court held that a limited partner is "a partner who plays no significant role in managing or running a business." *Id.* at 767.15
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> The Fifth Circuit did not expound on what it considers to be a nonsignificant role, but to the extent *K Alain* holds that a limited partner may provide *some* services to the partnership, we do not disagree. Nor does the Commissioner. *See* Appellee's Br. at 62 ("It is not the Commissioner's position -- and the Tax Court's interpretation of § 1402(a)(13) does not mean -- that providing *any* services to . . . or having *any* participation in . . . a partnership renders the individual not a limited partner."). So long as the activities in question do not constitute controlling, managing, or running the business, a partner may play a role in the partnership and still qualify as "limited" under § 1402(a)(13)

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For taxpayers, therefore, the important question is no longer simply whether a person is a limited partner under state law. It is also to what extent the person is involved in controlling, managing or running the partnership. This moves the factual inquiry toward such matters as authority to make business decisions; committee participation and voting rights; hiring and firing; supervision of senior personnel; authority over budgets or investments; authority to bind the partnership; responsibility for day-to-day operations; and whether anyone reports to the partner.

Hours worked and the types of services performed matter as evidence, but neither appellate court appears to treat services alone as dispositive.

TEFRA Versus BBA: A Procedural Difference That Should Not Be Overlooked

There is another important feature of *Soroban* that may receive less attention than the substantive holding: the case involved TEFRA.

Both *Soroban* and *K Alain* concern pre-2018 partnership years governed by the TEFRA partnership-audit regime.

Soroban argued that net earnings from self-employment and the partners' functional status were not “partnership items” that could be determined in a TEFRA partnership-level proceeding. The Second Circuit rejected that argument. It held that Net Earnings from Self-Employment (NESE) was sufficiently tied to partnership income, distributive shares, guaranteed payments, and partnership-level factual determinations to constitute a partnership item. The Tax Court, therefore, had jurisdiction to decide the issue in the FPAA proceeding.

That part of *Soroban* should not automatically be carried forward to current BBA audits.

The BBA centralized partnership audit regime generally applies to partnership years beginning after 2017 and replaced TEFRA. Congress expressly provided that the BBA regime does not apply to taxes imposed under Chapter 2, which includes self-employment tax. See I.R.C. § 6241(9); Treas. Reg. § 301.6241-6.

That may create a significant procedural distinction.

A BBA examination can determine partnership-related items for Chapter 1 purposes, for example, the amount and character of partnership income or a partner's distributive share. Those determinations may then have consequences in computing Chapter 2 self-employment tax. But the self-employment tax itself is not assessed through the BBA imputed-underpayment mechanism merely because the partnership is subject to BBA.

The IRS's own BBA guidance recognizes this distinction: Chapter 2 taxes are outside the BBA procedures, even though partnership-level income determinations may affect a partner's subsequent self-employment-tax liability. See Internal Revenue Bulletin 2017-28.

So, for current audits, advisers should resist the temptation to treat *Soroban*'s TEFRA jurisdiction holding as resolving the BBA procedural question. The substantive definition of "limited partner" carries forward; the procedural route for asserting and assessing the resulting self-employment tax may not.

That distinction can matter for statutes of limitation, notices, partnership-representative authority, partner-level examinations, litigation strategy, and ultimately who must receive what procedural protection.

What Should Partnerships Do Now?

The easiest cases are becoming clearer.

A founder who works full time as CEO, controls the governing body, hires and fires employees, supervises senior management, and makes the firm's major business decisions will have a difficult time characterizing a substantial distributive share as exempt under § 1402(a)(13)—regardless of what the partnership agreement calls that person.

At the other end of the spectrum, neither *Soroban* nor *K Alain* says that a limited partner must sit silently at home and collect a check. A partner may perform services and retain some involvement without necessarily losing the exception.

The difficult cases are now in the middle.

For those cases, CPAs and counsel should document not merely what services the partner performs, but what management authority the partner possesses and actually exercises. Partnership agreements matter, but so do committee minutes, job descriptions, organizational charts, signature authority, compensation arrangements, capital contributions, personnel decisions, and the way the business actually operates.

And taxpayers should remember the statutory starting point: guaranteed payments for services remain subject to self-employment tax even when the recipient otherwise qualifies as a limited partner. The fight is over the treatment of the distributive share.

The Next Case to Watch

The story is not finished. *Denham Capital Management LP v. Commissioner*, No. 25-1349, involving another investment-management partnership, is pending in the First Circuit after argument in 2026. The Second Circuit specifically identified *Denham* as presenting both the jurisdictional and substantive questions addressed in *Soroban*.

Further appellate review of *Soroban* or *K Alain* also remains possible.

For now, however, one proposition is true: the words "limited partner" on a Schedule K-1 or partnership agreement are not a tax conclusion.

After *Soroban* and *K Alain*, the real question is what the partner does – particularly whether the partner actually manages, controls, or runs the business. And for post-2017 years, practitioners should ask a second question immediately afterward: under which procedural regime can the IRS properly make and assess that determination?

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