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U.S. Tax Court: Partners' active roles disqualify limited partner status for tax purposes

The U.S. Tax Court today issued a memorandum opinion that the taxpayer's partners that were designated as limited partners under state law were not able to exclude their allocable shares of the taxpayer's ordinary business income as limited partners for federal self-employment tax purposes under section 1402(a)(13).

The case is: *Soroban Capital Partners LP v. Commissioner*, T.C. Memo. 2025-52 (May 28, 2025). Read text of the Tax Court's [opinion](#)

Summary

For the 2016 and 2017 tax years, the taxpayer, a Delaware limited partnership subject to the TEFRA audit and litigation procedures, allocated its ordinary business income earned from managing investments to its general and limited partners as designated under state law. The taxpayer reported only the amounts allocated to its general partner and the guaranteed payments made to its limited partners as net earnings from self-employment. The taxpayer did not report the \ amounts of ordinary business income allocated to its limited partners as net earnings from self-employment for such tax years. The IRS challenged this exclusion, arguing that the partners were not limited partners in the context of federal tax law.

The court had previously held in cross motions for summary judgement that in determining the extent to which the limited partner exception to section 1402(a)(13) applies, a functional analysis is undertaken to determine the extent to which limited partners were acting as such. *See Soroban Capital Partners LP vs. Commissioner* (161 T.C. 310) (2023). In holding that a functional analysis is proper, the court had focused on specific language in the statute. In relevant part, section 1402(a)(13) excludes from net earnings from self-employment "the distributive share of any item of income or loss of a limited partner, as such." In focusing on this language, the court stated that "if Congress had intended that limited partners be automatically excluded, it could have simply said 'limited partner.' By adding 'as such,' Congress made clear that the limited partner exception applies only to a limited partner who is functioning as a limited partner."

While referencing its prior decision, the court did not specifically discuss its prior textual analysis. Rather, it moved directly to application of the functional analysis with respect to relevant facts and circumstances to determine the roles and responsibilities of the taxpayer's partners, referencing precedents set in similar cases. It found that the partners were actively involved in the management and operations of the taxpayer, contributing essential skills and all of their time and effort to the investment management business. The court

noted that in addition to working 2300 to 2500 hours each year in the taxpayer's investment management business, the partners also participated in management committees, and their expertise was marketed to clients as crucial to the firm's success. Additionally, the partners' capital contributions prior to 2016 were insignificant compared to their distributive shares, indicating that their earnings were not of an investment nature.

The court provided that the test of whether a partner functions as a general partner or a limited partner for federal tax purposes is not dictated by any set number of factors and that rather, it is a facts and circumstances test that takes into account all relevant facts and circumstances, stating further that state law labels are perhaps the least relevant because they may be inconsistent with the economic reality of a partner's relationship with the partnership.

Although the court also allowed the taxpayer to introduce additional evidence in the form of tax returns from 2010 to 2015 for sake of completeness, the court did not allow the taxpayer to introduce tax returns showing significant capital contributions made by the partners in 2019 through 2021. The court provided that those capital contributions did not shed light on the capital investments of partners during the years at issue in the case, and as such, would not have changed the outcome of the case.

The court concluded that the partners' earnings were not of an investment nature and thus the partners did not qualify as limited partners under section 1402(a)(13). Consequently, their allocable share of the taxpayer's ordinary business income was net earnings from self-employment, subject to self-employment tax for the years in issue.

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