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Fifth Circuit: “Limited partner” for purposes of exception to self-employment income means a partner who plays no significant role in managing or running business

The U.S. Court of Appeals for the Fifth Circuit on August 12, 2026, withdrew its prior opinion in *Sirius Solutions v. Commissioner*, 165 F.4th 374 (5th Cir. January 16, 2026) holding that a “limited partner” for purposes of the exception to self-employment income under section 1402(a)(13) means a limited partner in a state-law limited partnership that has limited liability, and substituted a new opinion holding that a “limited partner” under section 1402(a)(13) means “a partner who plays no significant role in managing or running a business,” and not simply a “passive investor” as the Tax Court had held.

The case is: *K Alain v. Commissioner*, No. 24-60240 (5th Cir. August 12, 2026). Read the Fifth Circuit’s **decision**

The decision by the three-judge panel was again not unanimous, and the same judge again wrote a lengthy dissenting opinion.

Summary

Under section 1402(a)(13), a limited partner’s pass-through share of partnership income (or loss) (excluding certain guaranteed payments described in section 707(c)) is exempt from the Social Security and Medicare tax imposed in section 1401. The IRS determined that the exception under section 1402(a)(13) did not apply to the taxpayer’s limited partners because they were not “limited partners” for purposes of section 1402(a)(13) and thus adjusted the taxpayer’s net earnings from self-employment to include its limited partners’ distributive shares of partnership income (or loss). The taxpayer contested the IRS’ adjustments before the Tax Court, and on February 20, 2024, the Tax Court rejected the taxpayer’s challenge and upheld the adjustments. It reasoned that it was bound by a recent Tax Court decision, *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023), in which it held that for purposes of the section 1402(a)(13) exception, the term “limited partners” only “refer[s] to passive investors.”

The taxpayer appealed the Tax Court’s decision to the Fifth Circuit, which overturned the Tax Court’s decision in *Sirius Solutions v. Commissioner*, 165 F.4th 374 (5th Cir. January 16, 2026) and held that a “limited partner” for purposes of section 1402(a)(13) is a limited partner in a state-law limited partnership that has limited liability. The court concluded that the “passive investor” rule championed by the IRS was not only inconsistent with the statutory text but would also introduce uncertainty and complexity and “a great deal of litigation.”

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The government petitioned the Fifth Circuit for a rehearing en banc, which the court denied. However, the court treated the petition as a petition for rehearing, which the court granted. The court withdrew its prior opinion in *Sirius Solutions* and issued a new substitute opinion, in which it held that—based on "the original public meaning of the text enacted by Congress in 1977"—the term "limited partner" under section 1402(a)(13) means "a partner who plays no significant role in managing or running a business." The court then remanded to the Tax Court for further proceedings consistent with the new opinion.

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