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Second Circuit: Limited partners subject to self-employment tax because they exerted managerial control over partnership

The U.S. Court of Appeals for the Second Circuit has affirmed the decision of the Tax Court and held 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) because such partners exerted managerial control over the partnership.

The case is: *Soroban Capital Partners LP v. Commissioner*, Nos. 25-2079 (L) and 25-2250 (CON) (2nd Cir. September 17, 2026). Read the Second Circuit'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" for purposes of section 1402(a)(13).

The Tax Court first 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. 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." *See Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023).

In its subsequent decision applying that functional analysis, the Tax Court found that the partners did not qualify as "limited partners" under section 1402(a)(13) because they 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. *See Soroban Capital Partners LP v. Commissioner*, T.C. Memo. 2025-52 (2025).

On appeal, the Second Circuit affirmed the Tax Court, holding that because the limited partners exerted managerial control over the taxpayer, they did not qualify as limited partners under section 1402(a)(13). The court specifically held that “limited partner” for purposes of section 1402(a)(13) “means a partner who, in addition to having limited liability, does not run, manage, or control the partnership's business.” In arriving at its conclusion, the court relied on the text of the statute and the ordinary meaning of limited partner in 1977 when section 1402(a)(13) was enacted, which it found to be “a partner who had limited liability for partnership debts and who did not partake in running the business.” The Second Circuit also affirmed the Tax Court’s prior decision that it had jurisdiction over the proceedings.

The Second Circuit noted that the Fifth Circuit also recently addressed the meaning of "limited partner" for purposes of section 1402(a)(13) in *K Alain L.L.L.P. v. Commissioner*, 184 F.4th 766 (5th Cir. 2026). There, the Fifth Circuit held that a limited partner is "a partner who plays no significant role in managing or running a business." The Second Circuit stated that “[t]he Fifth Circuit did not expound on what it considers to be a non-significant role, but to the extent [it] holds that a limited partner may provide *some* services to the partnership, we do not disagree. Nor does the Commissioner. [citation omitted] 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 [section] 1402(a)(13).”

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