

## 5th Circuit Gives Taxpayers *Sirius* Victory in Self-Employment Tax Case



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On Friday, January 16, 2026, the U.S. Court of Appeals for the Fifth Circuit ruled in a 2-1 decision in *Sirius Solutions, L.L.C. v. Commissioner* that state-law limited partners in a partnership may qualify for an exemption from federal self-employment taxes on their distributive share of partnership income, regardless of whether that partner is a passive investor in the partnership or not.<sup>[1]</sup> The taxpayer victory in this case will be a welcome development to investment fund managers, who often structure their fund management companies using limited partnerships.

The Internal Revenue Code (the Code) imposes self-employment tax on individuals' net earnings from self-employment, which, broadly defined, includes most income from the active conduct of a trade or business.<sup>[2]</sup> For this purpose, a partner's distributive share of partnership income is generally subject to self-employment tax, unless an exception applies.<sup>[3]</sup>

At issue in *Sirius Solutions* is an exception that excludes "the distributive share of any item of income or loss of a limited partner, as such," apart from guaranteed payments to the partner for services actually rendered by the partner to the partnership.<sup>[4]</sup> Notably, the Code does not define what constitutes a "limited partner, as such" for purposes of this exception.

Various courts have previously ruled on what a "limited partner, as such" means, including in *Soroban Capital Partners LP v. Commissioner*, where the U.S. Tax Court determined that only partners who are passive investors qualify for the exception.<sup>[5]</sup> Therefore, principals who managed investments, made key business decisions, and exercised control over hiring and firm operations could not qualify for the exception.<sup>[6]</sup>

However, the Fifth Circuit's opinion rejected that interpretation of "limited partner, as such" in *Sirius Solutions*, holding instead that a "limited partner" is a partner in a limited partnership that has limited liability,<sup>[7]</sup> based on the text of the Code and the Social Security Administration (SSA) and Internal Revenue Service's (IRS) historical interpretations of the term. Specifically, the Fifth Circuit pointed to dictionary definitions of "limited partner" at the time Section 1402(a)(13) of the Code was enacted, all of which pointed to how a "limited partner" is defined by such partner's limited liability, as well as how the SSA and IRS, in various guidance from the 1970's onward until 2022, lacked any requirement that a partner must be a passive investor in order to qualify for the limited partner exception, or that a partner's provision of services to the partnership disqualified it.<sup>[8]</sup>

The Fifth Circuit also explained the meaning of the phrase “as such,” interpreting it as addressing the situation where the same partner serves as both a general partner and a limited partner in the same partnership.<sup>[9]</sup> When such partner functions as a limited partner, the partner’s distributive share is excluded from self-employment tax, but when such partner functions as a general partner, such partner’s distributive share is subject to self-employment tax.<sup>[10]</sup> That is, the Fifth Circuit acknowledged that the same person can be both a general partner and a limited partner in a partnership and still be eligible for the self-employment tax exception for the limited partner interest.

The dissent wrote that the text and structure of Section 1402(a)(13) of the Code clearly stated that the tax exemption only applied to limited partners who functioned as passive investors and endorsed an analysis looking into the rights and responsibilities of the limited partners, echoing the Tax Court’s decision in *Soroban*.<sup>[11]</sup>

Investment management funds and their principals could see major tax benefits as a result of the Fifth Circuit’s ruling. Many fund management companies are structured in a manner that enables all or a majority of the ownership of the fund principals to be held by them as limited partners, notwithstanding the fact that they also own interests as general partners. Through such structures, they have claimed that the majority of income that the fund principals earn from the management company is not subject to self-employment tax.

The Fifth Circuit remanded *Sirius Solutions* to the Tax Court for further proceedings consistent with its ruling.

Other cases involving the self-employment tax have been appealed from the Tax Court to the First and Second Circuits,<sup>[12]</sup> including *Soroban*, and those circuits may or may not rule consistently with the Fifth Circuit. In addition, if there ultimately is a circuit split, the U.S. Supreme Court may weigh in on the issue. In the interim, partners who claim the limited partner exception but materially participate in the applicable trade or business can still expect IRS challenges.

Please contact one of the authors with any questions you may have regarding the impact of the Fifth Circuit’s ruling.

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[1] See *Sirius Solutions, L.L.L.P. v. Commissioner*, No. 24-60240 (5th Cir. Jan 16, 2026).

[2] Code Section 1401(a).

[3] Code Section 1402(a).

[4] See Code Section 1402(a)(13).

[5] See *Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (2023).

[6] See *Soroban Capital Partners LP v. Commissioner*, T.C. Memo. 2025-52 (May 28, 2025).

[7] See *Sirius Solutions* at 1.

[8] See *id.* at 7-8.

[9] See *id.* at 9.

[10] See *id.* at 14-16.

[11] See *id.* at 25 (Graves, Jr., J., dissenting).

[12] See *Denham Capital Management LP v. Commissioner*, T.C. Memo. 2024-114 (Dec. 23, 2024), appeal pending *Denham Capital Management LP v. Commissioner*, No. 25-1349 (1st Cir. 2025); See also *Soroban Capital Partners LP v. Commissioner*, T.C. Memo. 2025-52 (May 28, 2025), appeal pending *Soroban Capital Partners LP v. Commissioner*, No. 25-2079 (2nd Cir. 2025).

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