

# Memorandum

## Fifth Circuit Rules That *Soroban* Was Incorrectly Decided and SECA Tax Exception Applies to Limited Partners With Limited Liability Regardless of Activities

January 20, 2026

On January 16, 2026, in *Sirius Solutions LLLP, v. Commissioner* (“*Sirius*”) the Fifth Circuit court of appeals ruled that for purposes of the self-employment tax exception that applies to a limited partner’s distributive share of partnership income, a “limited partner” is a “partner in a limited partnership that has limited liability,” without regard to the nature of the limited partner’s activities.<sup>1</sup> The decision in *Sirius* marks the first of three appellate court decisions that are expected to weigh in on the proper scope of the self-employment tax exception for limited partners.<sup>2</sup>

### Background

Section 1402(a)(13) of the Internal Revenue Code of 1986, as amended (the “Code”), excludes from earnings subject to U.S. federal self-employment tax (the “SECA tax exception”) “the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in Section 707(c) to that partner for services actually rendered to or on behalf of the partnership.” The Code does not define the phrase “limited partner, as such” for these purposes. Certain taxpayers have taken the position that an individual who renders services to or on behalf of a partnership is eligible for the SECA tax exception with respect to their distributive share of partnership income as long as they are a “limited partner” in a partnership with limited liability, as determined by reference to the rights that exist under applicable state law. The IRS, however, has taken the position that Congress intended for the SECA tax exception for limited partners to be read narrowly and to only apply to such individuals’ distributive share of partnership income to the extent they act as passive investors in a partnership, irrespective of whether they have limited liability for state law purposes.

Multiple taxpayers have petitioned the Tax Court to rule on the scope of the SECA tax exception in recent years. In *Soroban*,<sup>3</sup> the first major Tax Court case to consider this issue with respect to state law limited partnerships, the Tax Court ruled in the IRS’s favor and held that state law classifications are not controlling in the determination of whether a limited partner’s distributive share of income is excluded from self-employment tax. Instead, the Tax Court required the application of a “functional analysis” test, which involves a comprehensive facts and

<sup>1</sup> *Sirius Solutions LLLP v. Commissioner*, No. 24-60240 (5th Cir. 2026).

<sup>2</sup> Two other cases are pending in the First and Second Circuits.

<sup>3</sup> *Soroban Capital Partners LP et al. v. Commissioner*, 161 T.C. 310 (2023).

circumstances based inquiry into the substance of a limited partner's role in a partnership, and whether the limited partner is generally akin to that of a passive investor, to be eligible for the SECA tax exception.<sup>4</sup>

## Discussion

In the Fifth Circuit's decision that was released on Friday, the Court ruled 2-1 in Sirius's favor, holding that a limited partner "is a partner in a limited partnership that has limited liability." In reaching this opinion, the majority emphasized the plain meaning of the statute over other more restrictive textual interpretations that equated the term "limited partner" with "passive investor." This reading allows individuals who are partners in a state law partnership<sup>5</sup> with limited liability to exclude their distributive share of partnership income (other than guaranteed payments for services) from self-employment tax, even if they perform services for the partnership, without further inquiry.

Ultimately, whether a functional analysis test is required for purposes of determining the scope of the SECA tax exception is not settled. *Sirius* is not necessarily indicative of how the First and Second Circuits will decide this issue and this case is not binding precedent for the other Circuit Courts. If either the First or Second Circuit rule in the IRS's favor, there will be a circuit split, possibly causing this issue to end up before the Supreme Court. Alternatively, it is possible that either Congress will take legislative action or the IRS will issue regulatory guidance in an effort to clarify the current uncertainty regarding the scope of the SECA tax exception.

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<sup>4</sup> In December 2023 following the Tax Court's decision in *Soroban*, Sirius agreed that the *Soroban* decision was precedential and further conceded that if the functional analysis test described in *Soroban* were required, Sirius's partners would not qualify as "limited partners, as such," for purposes of Section 1402(a)(13) of the Code. Sirius settled with the IRS in early 2024, enabling the case to be immediately appealed to the Fifth Circuit. For a discussion of *Soroban* and the functional analysis test, see our prior alert [here](#).

<sup>5</sup> This decision is limited to entities formed as limited partnerships under state law and does not change any prior guidance or court decisions with respect to limited liability partnerships or limited liability companies.