

Memorandum

Tax Court Finds Management Company Limited Partners Do Not Qualify for the Self-Employment Tax Exception

May 30, 2025

Background

Section 1402(a)(13) of the Internal Revenue Code of 1986, as amended (the “Code”), excludes “the distributive share of any item of income or loss of a limited partner, as such” from earnings subject to U.S. federal self-employment tax (“SECA”). The Code does not define the phrase “limited partner, as such” for these purposes and certain taxpayers have taken the position that an individual is eligible for such SECA exception so long as it is a “limited partner” in a partnership under applicable state law. One such taxpayer, Soroban Capital Partners LP (“Soroban”), a New York-based hedge fund manager organized as a state law limited partnership, claimed such exception with respect to its limited partners’ distributive shares of partnership management fee income. The Internal Revenue Service (“IRS”) disagreed and adjusted the reported net earnings from self-employment to include each limited partner’s distributive share of income for the years at issue. Soroban initially responded by requesting the Tax Court issue a summary judgment that a limited partner’s distributive share of partnership income in a state law limited partnership is excluded from net earnings subject to SECA as a matter of law.

In November 2023, the Tax Court issued an opinion rejecting Soroban’s motion for summary judgment. In its opinion, the Tax Court agreed with the IRS’s position that state law classifications are not controlling in the determination of whether a limited partner’s distributive share of income is excluded from SECA and held that a “functional analysis test” must be applied.¹

Discussion

On May 28, 2025, the Tax Court released its memorandum opinion applying the “functional analysis test” to the facts in *Soroban*, holding that Soroban’s limited partners were limited partners in name only.²

In *Soroban*, the Tax Court noted that the test is designed to be a comprehensive inquiry into whether the limited partners were generally akin to passive investors and emphasized the need for a facts and circumstances inquiry rather than an analysis focused on a specific list of factors. In applying the functional analysis test, the Tax Court considered the limited partners’ role in generating Soroban’s income, their role in the management of Soroban,

¹ *Soroban Capital Partners LP et al. v. Commissioner*; No. 16217-22; No. 16218-22; 161 T.C. No. 12; 161 T.C. 310.

² *Soroban Capital Partners LP et al. v. Commissioner*; No. 16217-22; No. 16218-22; T.C. Memo. 2025-52.

the time they devoted to the business, how Soroban marketed the limited partners, and the significance of the limited partners' capital contributions to Soroban relative to the fees Soroban charged for its services. The Tax Court found that the limited partners were essential to generating the business's income, oversaw day-to-day management, worked for the business full time, were held out to the public as essential to the business, and that their relatively insignificant capital contributions that bore no relationship to their distributive shares showed that their distributive shares of Soroban's income were not a return on a capital investment. Accordingly, the Tax Court found that the Soroban limited partners were not "limited partners, as such" for purposes of Code Section 1402(a)(13) and their distributive shares of income from Soroban were subject to SECA.

Whether a functional analysis test is required or permissible and if so, what form it will take in the determination of whether a person is a "limited partner, as such" for purposes of the self-employment exception is not settled. Two other pending appeals filed with the First and Fifth Circuits seek appellate review of the Tax Court's decision regarding the application of Section 1402(a)(13) to state law limited partners. The decision in *Soroban* itself may be appealed to the Second Circuit.

While there is more to come on this issue, investment partnerships currently relying on the limited partner exception are encouraged to evaluate their facts and circumstances in light of *Soroban* and similar cases.

For further information regarding this memorandum, please reach out to your regular contact in the [Simpson Thacher Tax Department](#).

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