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Fifth Circuit Withdraws Sirius Solutions Opinion and Adopts New "Significant Role" Standard for the Limited Partner Exception

Tax Talks on **August 24, 2026**

On August 12, 2026, in *K Alain, L.L.L.P. v. Commissioner*,[1] the U.S. Court of Appeals for the Fifth Circuit withdrew its taxpayer-friendly January 16, 2026 opinion in *Sirius Solutions, L.L.L.P. v. Commissioner*,[2] and replaced it with a decision that is ambiguous in its application but appears to favor the IRS.

Section 1402(a)(13)[3] excludes from excludes from self-employment net earnings "the distributive share…of a limited partner, as such, other than guaranteed payments…for services actually rendered". In the original *Sirius* case, the Fifth Circuit held that, for self-employment tax purposes, a "limited partner" means "a partner in a limited partnership that has limited liability." Accordingly, it rejected the Tax Court's "functional analysis" test announced in *Soroban* [4] and allowed the limited partners that have limited liability in a fund management firm (and who also worked for the firm) to avoid self-employment tax on the income allocated to them as limited partners, except with respect to guaranteed payments. The original *Sirius* case would allow most fund managers structured as limited partnerships to avoid self-employment tax for their limited partners' allocable share of profits.

In *K Alain*, the very same court held that a "limited partner" means a partner who "plays no significant role in managing or running a business." The *K Alain* test is different than the Tax Court's "functional analysis" test in *Soroban* which clearly would impose self-employment tax on the limited partners in the *K Alain* structure, but it is unclear if the two tests would result in different outcomes based on the same facts. The *Sirius* case was grounded in a partner's liability under state law. The *K* Alain case rejected a state law test and relied on the "original public meaning" of "limited partner" in 1977,[5] which it concluded permitted a partner to take part in "certain non-managerial aspects of the business" so long as the partner did not exercise "control" over it, but did not extend to a partner who plays "a significant role in managing or running the business." Thus, under the *K Alain* opinion, state-law status is no longer dispositive; the inquiry is now a fact-specific one focused on the partner's actual role in the enterprise.

The majority again rejected *Soroban*'s passive investor standard (which the Tax Court based its functional analysis test on) as "divorced from statutory text," but the opinion did not identify where "non-managerial" or "non-operational" participation ended and a "significant role" began, leaving that line-drawing to be resolved on remand.[6] Judge Graves dissented, as he did in January, arguing that the text and structure of Section 1402(a)(13) support only a passive-investor standard and that the majority's management-based test has no grounding in the statute, calling it an "indefensible, illogical, and illegal loophole." Judge Graves would have adopted the standard put forward by the Tax Court in *Soroban*, which mandates an analysis of the functions of the limited partners in the partnership.

Practical Implications and Outlook

The decision remains binding only in the Fifth Circuit (Texas, Louisiana, and Mississippi). The *K Alain* partnership will now face further factual determinations from the Tax Court on remand, and the outcome here may well be consistent with *Soroban*'s functional analysis in practice. The Tax Court in *Soroban* takes the position that its own passive-investor, functional-analysis approach continues to apply elsewhere, including in the pending *Soroban* appeal before the Second Circuit and the *Denham Capital* appeal before the First Circuit.[7]

The Government has already taken the position in *Soroban* and *Denham Capital* that the new Fifth Circuit opinion is consistent with the Tax Court's standard, urging the First and Second Circuits to reject the taxpayers' appeals in those cases.[8] On August 24, the taxpayer in *Soroban* filed a response, arguing that the Second Circuit lacks jurisdiction to consider the issue, that the Fifth Circuit's revised test is inconsistent with statutory language, and that, even if the Fifth Circuit's test applies, the taxpayer in *Soroban* meets the revised test because the partnership's documents prohibit its limited partners from managing or controlling the business.[9]

Fund managers, private equity and hedge fund principals, and other limited partners who had begun planning around January's limited liability-only test should revisit that analysis: limited liability alone may no longer be sufficient, though absolute passivity is also not required.

The standard in *K Alain* seems to favor the IRS, but, in most fund management companies, the principals hold majority limited partnership interests alongside the active general partner of the management company. It is this general partner that manages or runs the business. The Fifth Circuit opinion does not directly analyze this specific structure.However, in a 2025 opinion in the *Soroban* case,the Tax Court addressed the argument that the services provided by the principals in managing the funds were provided in their capacity as members of the general partner of the management company and not as its limited parters ("bifurcation").[10] The Tax Court did not find this bifurcation argument factually persuasive, finding that the distributive share of the management company's income allocated to the limited partners was disproportionally high as a return on their investment, which points to that return being allocable to their services. The Tax Court in *K Alain* may well take that same analytical approach to the bifurcation argument on remand from the Fifth Circuit. Because the Fifth Circuit did not decide whether *K Alain*'s own partners satisfy the new standard, further guidance on the boundary between permissible participation and a "significant role" may emerge as the case proceeds on remand.

We are continuing to monitor this and other developments affecting the self-employment tax treatment of limited partners, including the pending appeals noted above. If you have questions about how this decision may affect your fund, partnership, or portfolio company structures, please reach out to a member of Proskauer's Tax or Private Funds Group, or your regular Proskauer contact.

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[1] *K Alain, L.L.L.P. v. Commissioner*, No. 24-60240 (5th Cir. Aug. 12, 2026) (per curiam), withdrawing and substituting *Sirius Solutions, L.L.L.P. v. Commissioner*, 165 F.4th 374 (5th Cir. 2026). As the opinion explains, K Alain is the current name of the Sirius partnership at issue. Proskauer updated our clients on the *Sirius* opinion here, and we have previously written about case law developments on this subject here, here and here.

[2] *Sirius Solutions, L.L.L.P. v. Commissioner*, 165 F.4th 374 (5th Cir. 2026).

[3] References to "section" are to the Internal Revenue Code.

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

[5] *See Plasteel Products Corp. v. Helman*, 271 F.2d 354, 356 (1st Cir. 1959).

[6] *K Alain*, *supra* note 1, at 9–11.

[7] *Soroban Capital Partners LP v. Commissioner*, Nos. 25-2079, 25-2250 (2d Cir. filed Aug. 25, 2025); *Denham Capital Management LP v. Commissioner*, No. 25-1349 (1st Cir. filed Apr. 11, 2025). The Tax Court's position is based upon the *Golsen* rule, which provides that the Tax Court will, in a given case, follow the binding precedent of the federal appellate court that would hear an appeal of a Tax Court decision; otherwise, the Tax Court generally will follow its own authority, if on point. *Golsen v. Commissioner*, 54 T.C. 742 (1970).

[8] *Denham Capital Management LP v. Commissioner*, No. 25-1349 (1st Cir.) (Rule 28j Letter dated Aug. 14, 2026, notifying the court of subsequent authority); *Soroban Capital Partners LP v. Commissioner*, Nos. 25-2079, 25-2250 (2d Cir.) (Rule 28j Letter dated Aug. 18, 2026, further stating that remand is unnecessary).

[9] *Soroban Capital Partners LP v. Commissioner*, Nos. 25-2079, 25-2250 (2d Cir.) (Rule 28j Letter dated Aug. 24, 2026).

[10] *Soroban Capital Partners LP v. Commissioner*, T.C. Memo. 2025-52 ("Petitioner relies on the fiction that the Principals did not serve Soroban in their individual capacities as limited partners. Instead, petitioner argues, they acted with authority delegated to them by the general partner, which they in turn had the authority to manage. This type of legal fiction is precisely why application of federal tax law to the economic arrangement of the parties controls, and not mere state law classifications").

Related Professionals

- **Richard M. Corn**
  Partner
- **Laura Gavioli**
  Partner
- **Abraham Gutwein**
  Senior Counsel
- **Martin T. Hamilton**
  Partner
- **Christine Harlow**
  Partner
- **Arnold P. May**
  Partner
- **David S. Miller**
  Partner
- **Jeremy Naylor**
  Partner
- **Amanda H. Nussbaum**
  Partner
- **Stephen Severo**
  Partner
- **Jacqueline Watson**
  Associate