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SOPHISTICATED BOUTIQUE TAX ADVISORY

CLIENT ALERT | INVESTMENT MANAGERS | AUGUST 2026

The Fifth Circuit Rewrites Sirius

A win on remand, a loss of certainty for limited partners and self-employment tax

SELF-EMPLOYMENT TAX · §1402(a)(13) · K ALAIN v. COMMISSIONER

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WHY YOU SHOULD READ THIS

On August 12, 2026, a divided Fifth Circuit panel withdrew its January 16 opinion in *Sirius Solutions* and issued a materially different substitute, now captioned *K Alain, L.L.L.P. v. Commissioner*. The procedural result is unchanged: the Tax Court's judgment is vacated and the case returns on remand. The rule governing that remand, however, is entirely different. January's test asked whether the partner held limited liability in a state-law limited partnership. The substituted opinion instead defines a limited partner as one who "plays no significant role in managing or running a business."

For investment managers, the planning environment got worse, not better. Founders, investment professionals, and senior executives should no longer assume that limited-partnership form resolves the SECA question. This alert explains what changed, what the exclusion is worth in dollars, and the five things sponsors should do now.

Our take, up front: the rewrite is a net negative for taxpayers as a class, despite K Alain's favorable procedural result. The Fifth Circuit still rejects *Soroban*'s passive-investor rule and expressly recognizes that some participation is permissible. But the January opinion's administrable state-law test is gone. In its place is a federal functional standard the court does not define: no specified quantum of permissible participation, no catalogue of managerial functions, and no clear relationship among the opinion's "significant role," "managerial/non-managerial," and "control" formulations. K Alain preserved vacatur and remand; taxpayers lost the bright-line rule.[1]

Sponsors should inventory actual governance and management authority partner by partner, revisit positions that relied materially on the withdrawn January opinion, and build contemporaneous documentation showing who actually manages the enterprise (and who does not).

EXECUTIVE SUMMARY

- **The January rule is gone.** State-law limited liability no longer settles §1402(a)(13) in the Fifth Circuit. The court now asks whether the partner plays a "significant role in managing or running" the business.
- **Some participation is fine; nobody knows how much.** The guaranteed-payment carveout proves that services and limited-partner status can coexist. The opinion offers no hours threshold, no list of managerial functions, and no safe harbor.

[1] References in this alert to "§" and to the "Code" are to the Internal Revenue Code of 1986, as amended, and references to "Treas. Reg." are to the Treasury regulations issued under the Code, each as in effect on the date of this alert. "SECA" refers to the Self-Employment Contributions Act tax imposed under §1401.

- **The Fifth Circuit and the Tax Court now ask different questions.** *K Alain* asks about management; *Soroban* asks whether the partner is a passive investor. The First and Second Circuit appeals in *Denham* and *Soroban* are still pending.
- **The dollars are real.** On a $5 million distributive share, losing the exclusion costs roughly $150,000 a year after the income-tax offset, before interest and penalties. Keeping it can also keep the share outside the 3.8 percent net investment income tax.
- **Titles are not tax conclusions.** The analysis is now role by role: who can bind the entity, approve budgets, hire and fire, set compensation, and make investment decisions.
- **Build the file now.** Operating agreements, delegations of authority, committee charters, minutes, and signature matrices should tell one consistent story before the exam team asks for it.

01 BACKGROUND

Section 1402(a)(13), enacted in 1977, excludes from net earnings from self-employment the distributive share of a "limited partner, as such," other than guaranteed payments for services. Congress never defined the term, and the statute has carried nearly five decades of argument on its back. In *Soroban* (2023), the Tax Court held the exclusion was meant for passive investors and adopted a functional analysis; three appeals followed, in the First, Second, and Fifth Circuits.

Sirius Solutions, a Houston consulting firm organized as a Delaware limited liability limited partnership and later renamed K Alain, allocated its ordinary business income to its limited partners for 2014 through 2016 and reported zero net self-employment earnings. The IRS recharacterized those shares as SECA income; the Tax Court agreed under *Soroban*. On January 16, 2026, the Fifth Circuit vacated and remanded under a state-law limited-liability test. The government sought rehearing en banc in April. On August 12, the full court denied en banc review but, treating the government's petition as one for panel rehearing, the panel granted rehearing, withdrew the January opinion, and substituted a new management-based standard. The case remains on remand; the Fifth Circuit did not hold that K Alain's partners ultimately qualify for the exclusion.

02 WHAT THE REVISED OPINION ACTUALLY HOLDS

Three points anchor the new majority opinion. First, the panel again rejects *Soroban*'s passive-investor construction: if any service activity disqualified a partner, the statute's guaranteed-payment carveout, which taxes limited partners' service compensation, would have nothing to do. Second, the panel abandons its own limited-liability rule; the meaning of "limited partner" is a question of federal law informed by the term's ordinary meaning in 1977, when limited partners generally forfeited their liability shield by taking part in control of the business. Third, the resulting definition is functional: a partner "who plays no significant role in managing or running a business." Participation short of that is tolerated; control is disqualifying.

What the opinion omits matters as much as what it holds. Its stated holding asks whether a partner plays a "significant role" in managing or running the business, while the discussion elsewhere distinguishes managerial from non-managerial activity and draws on 1977-era law in which participation in control could jeopardize limited-partner status. The court does not explain whether these formulations describe the same line. That ambiguity may matter enormously for senior professionals who are operationally important but lack enterprise-level management authority. A favorable vacatur for K Alain; a fact-intensive framework that gives the government substantial room on remand. In tax-law terms, the taxpayer won the inning and lost the strike zone.

03 KEY OBSERVATIONS

State-law status is no longer dispositive in the Fifth Circuit. The Fifth Circuit now joins the Tax Court in requiring an inquiry beyond the state-law label, although the two courts articulate materially different tests: *K Alain* focuses on significant management or running of the business; *Soroban* asks whether the partner is functioning as a passive investor.

"Some participation" is expressly permissible, but unquantified. The guaranteed-payment carveout confirms that rendering services does not automatically destroy limited-partner status. The open question is when activity becomes a significant role in managing or running the business. Hours, titles, committee roles, authority to bind, hiring and firing power, budget authority, and investment or strategic decision rights are likely to matter, but the opinion supplies no weighting and no safe harbor.

The 1997 proposed regulations may get a second look. REG-209824-96 used a functional architecture involving personal liability, authority to contract, and a 500-hour participation threshold, while imposing a separate rule for specified service partnerships and permitting limited bifurcation of separate classes of interests. Congress temporarily barred finalization before July 1, 1998, and the proposal was never finalized. The Fifth Circuit's new emphasis on management and participation makes the proposal newly relevant, but it is not governing law.

LLCs remain unresolved. The opinion addresses a state-law limited partnership and does not decide whether an LLC member can be a "limited partner" under §1402(a)(13). Advisers should resist treating *K Alain* as resolving that question in either direction.

Dual-capacity and separate-interest structures remain unresolved. The substituted opinion does not explain how separately held GP, management-company, limited-partner, or investment interests should be analyzed. Commercially real separation of governance, service compensation, and passive capital may remain relevant, but formal separation cannot substitute for what the partner actually does.

04 APPLICATION TO INVESTMENT MANAGERS

Investment managers are particularly exposed because *Soroban* and *Denham* arise directly from that industry, although the §1402(a)(13) controversy extends to professional-service and other closely held partnerships. The revised opinion gives managers neither the comfort of the January rule nor the certainty of a defined standard. Individual outcomes will turn on facts the law does not yet grade.

Role-by-role analysis replaces entity-level answers. Founders, chief investment officers, and professionals with enterprise-level authority sit closer to the management end of the spectrum. Senior professionals with narrow functional mandates and no meaningful governance authority may present stronger facts. Titles alone should not control; "Managing Director" is not a tax conclusion, however much LinkedIn may suggest otherwise. Documentation should address what each partner actually can do, actually does, and is expressly prohibited from doing.

Bifurcation is the statute's own design, within limits. Guaranteed payments for services are SECA income, and the statutory carveout shows that some services can coexist with an excluded distributive share. But fair-value compensation is not a safe harbor: if a partner plays a sufficiently significant role in managing or running the business, reasonable guaranteed payments do not independently make the residual distributive share exempt. Compensation amount and functional status are distinct inquiries.

What the exclusion is worth

Assume a management-company principal (married filing jointly) with a $500,000 guaranteed payment for services and a $5,000,000 distributive share for 2026. The guaranteed payment is SECA income under either test and absorbs the full $184,500 OASDI wage base. The fight is over the distributive share.

MARGINAL SECA EXPOSURE IF THE DISTRIBUTIVE SHARE LOSES THE EXCLUSION	2026
Net earnings from self-employment ($5,000,000 × 92.35%)	$4,617,500
OASDI at 12.4% (wage base already absorbed by guaranteed payment)	—
Medicare at 2.9%	$133,908
Additional Medicare Tax at 0.9% (§1401(b)(2) threshold exceeded)	$41,558
Annual exposure before income-tax offset	$175,466
Less: §164(f) deduction benefit (½ of the 2.9% portion at 37%)	($24,773)
Net annual cost of losing the exclusion	**≈ $150,700**
Three-year exposure, after assumed income-tax benefit, before interest and penalties	**≈ $452,000**

Exhibit 1. A $5 million distributive share, with and without the exclusion.

The mirror image can cut the other way. If the §1402(a)(13) exclusion applies and the partner materially participates in the relevant trade or business, the $5,000,000 distributive share may also fall outside the 3.8 percent net investment income tax. On these simplified facts, that represents as much as another $190,000 or so of annual federal tax differential. The NIIT computation does not use SECA's 92.35 percent multiplier.

Figures rounded and simplified; 2026 OASDI wage base of $184,500; §164(f) benefit assumed at a 37 percent marginal rate; NIIT comparison assumes the distributive share is otherwise outside §1411 by reason of material participation; state taxes, penalties, interest, and other limitations excluded.

Venue and posture matter. Fifth Circuit taxpayers now litigate under *K Alain*'s management-based standard; *Soroban* and *Denham* remain pending in the Second and First Circuits, respectively. *Denham* was argued in February 2026 and includes a threshold TEFRA jurisdictional issue. ASC 740 uncertain-tax-position analyses, refund-claim strategies, and amended-return positions should account for the divergence. Any position built materially on the withdrawn January opinion should be revisited.

05 FIVE ACTIONS FOR SPONSORS NOW

1. **Map actual authority, not titles.** Identify who can bind the entity, approve budgets, hire or fire senior personnel, set compensation, make investment or strategic decisions, or appoint committee members.
2. **Separate governance from execution where commercially real.** Determine whether professionals who perform important work actually possess enterprise-level management authority.
3. **Review dual-capacity structures.** Map GP, management-company, limited-partner, co-invest, and passive capital interests and test whether the documents match actual conduct.
4. **Revisit existing tax positions.** Review returns, refund claims, ASC 740 analyses, and audit files that relied materially on the withdrawn January opinion.
5. **Build contemporaneous evidence.** Operating agreements, committee charters, delegations of authority, job descriptions, minutes, signature matrices, and compensation documentation should tell the same factual story.

06 A BETTER LONG-TERM RULE?

The current dispute exposes an all-or-nothing cliff. A more coherent legislative approach would tax a market-based amount for the partner's own labor while excluding the residual return attributable to capital, enterprise value, and the work of others, broadly analogous to the reasonable-compensation concept used for S corporations. Section 707(c), the 1997 proposed regulations' bifurcation concept, and prior congressional proposals illustrate possible building blocks. This is a policy construct, not current law.

One partner, four regimes

Assume a 40-professional consulting partnership earning $8,000,000. Partner A holds a 25 percent limited partner interest (a $2,000,000 distributive share), works full time, and comparable managing directors earn $700,000. Her 2026 SECA bill on that share:

PARTNER A: SECA ON A $2,000,000 DISTRIBUTIVE SHARE	ANNUAL SECA
Soroban passive-investor test: full share included ($1,847,000 net earnings)	$90,814
January 2026 Fifth Circuit: state-law limited liability controls	$0
August 2026 Fifth Circuit: turns on “managing or running”; all or nothing	$0 or $90,814
Imputed-compensation approach: $700,000 deemed wage; residual exempt	$45,193
Reference: S corporation owner, $700,000 reasonable salary (FICA, both halves)	*$47,228*

Exhibit 2. The same partner under four regimes, one of them hypothetical.

Same 2026 parameters as Exhibit 1; no separate guaranteed payment assumed, so the OASDI wage base applies within each computation. The August 2026 row illustrates the all-or-nothing cliff under current law. The S corporation row is only a policy reference: it shows a broadly similar gross employment-tax burden at the same assumed compensation level, not complete economic or income-tax equivalence. The roughly $2,000 difference principally reflects SECA's 92.35 percent multiplier, which FICA lacks.

Current law does not authorize a court simply to impute a deemed guaranteed payment and exempt the residual. Any such regime would raise difficult compensation-benchmarking and administrability questions and would likely require legislation. The immediate task for taxpayers is therefore not to engineer an imputed-compensation result, but to analyze and document status under the governing law in the relevant venue.

07 WHAT THE FUTURE MAY BRING

Prediction in this area has aged badly (the January opinion survived only seven months), so what follows is scenario-mapping rather than forecast. The First and Second Circuits could adopt the Fifth Circuit's formulation, affirm *Soroban*, or develop different standards. A genuine circuit split on the meaning of “limited partner, as such” would materially increase the prospect of Supreme Court review. By contrast, if both courts substantially align with *K Alain*, certiorari becomes less likely, not more: uniform appellate authority would eliminate the strongest traditional reason for Supreme Court intervention, and the Court generally does not sit to referee fact-intensive application of an agreed legal standard. The issue would remain nationally important, but importance alone is usually a weaker certiorari vehicle than a clean circuit conflict.

The certiorari calculus also depends on who loses and when. *K Alain* itself is on remand, so the merits may return to the Fifth Circuit only after further proceedings (and either party may yet seek en banc review of the substituted opinion, or certiorari); the First and Second Circuit cases could therefore become cleaner vehicles sooner.

If either court endorses *Soroban*'s passive-investor formulation while the Fifth Circuit retains *K Alain*'s “no significant role” test, the resulting conflict would be unusually cert-worthy: the question is recurring, nationally significant, outcome-determinative for a large class of partnerships, and turns on the meaning of a federal tax statute. If all three circuits converge, however, the more likely near-term path is the least tidy one: more exams, more fact-intensive skirmishes over hours and committee seats, and settlement patterns built around an undefined standard.

OUR TAKE

Investment managers should plan for a multi-year period in which SECA positions are graded on facts, files, and venue. The January opinion offered a rule you could plan around; the August opinion offers a standard you can only document toward. That is not a reason to abandon limited-partner positions. It is a reason to know, partner by partner, what each person can do, does do, and is barred from doing, and to have the paper that proves it. Build the file now, preferably before the exam team asks for it.

SELECTED RESEARCH AND PRIMARY AUTHORITIES

K Alain, L.L.L.P. v. Commissioner, No. 24-60240 (5th Cir. Aug. 12, 2026) (substituted opinion on panel rehearing), withdrawing *Sirius Solutions, L.L.L.P. v. Commissioner*, 165 F.4th 374 (5th Cir. Jan. 16, 2026).

Soroban Capital Partners LP v. Commissioner, 161 T.C. 310 (2023), appeal pending (2d Cir.).

Denham Capital Management LP v. Commissioner, T.C. Memo. 2024-114, appeal pending, No. 25-1349 (1st Cir.).

Renkemeyer, Campbell & Weaver, LLP v. Commissioner, 136 T.C. 137 (2011).

REG-209824-96, 62 Fed. Reg. 1702 (Jan. 13, 1997).

Loper Bright Enterprises v. Raimondo, 603 U.S. 369 (2024).

IMPORTANT NOTES

This alert addresses U.S. federal self-employment and net investment income tax. State taxes, penalties, interest, and other limitations are excluded from the illustrations, which are hypothetical and simplified. This alert reflects authorities and publicly available developments as of August 17, 2026, including the Fifth Circuit's substituted opinion issued August 12, 2026; the law and the pending appellate proceedings may change, potentially with retroactive effect. La Presa Partners LLC undertakes no obligation to update this alert.

This alert is not a formal tax opinion and is not written advice directed to any taxpayer's penalty-protection analysis. Any tax position should be evaluated independently under the applicable substantive and professional standards, including §6662 and Circular 230. Summaries of judicial opinions and government filings are necessarily incomplete; consult the primary sources.

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