

# Limited Partner Defined as One Who Does Not Run the Business

## Cross References

- *K Alain, LLLP*, 5th Circuit Court of Appeals, August 12, 2026

The Fifth Circuit Court of Appeals recently issued another ruling concerning the definition of a limited partner.

IRC section 1401(a) states that the self-employment income of every individual is subject to self-employment tax. Net earnings from self-employment includes an individual's distributive share of income from any trade or business carried on by a partnership. One exception to this rule applies in the case of a limited partner. IRC section 1402(a)(13) states:

"There shall be excluded the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments..."

There have been several court cases over the years defining the term "limited partner" for purposes of excluding a limited partner's distributive share of income from self-employment tax. In *Soroban Capital Partners LP*, 161 T.C. 310 (2023), the Tax Court held that for purposes of IRC section 1402(a)(13), the term "limited partners" only "refers to passive investors." Tax Court cases since that case have been based upon this definition of a limited partner. The taxpayer in this case appealed its Tax Court decision which was likewise based upon the *Soroban* decision.

The sole question before the appeals court is what "limited partner" means in IRC section 1402(a)(13). The appeals court ruled the ordinary public meaning of this phrase is a partner who plays no significant role in managing or running a business.

Two principles guide this opinion. First, tax law is federal law. Once it has been determined that state law creates sufficient interests in the taxpayer to satisfy the requirements of the statute, state law is inoperative.

Second, the phrase "limited partner" in the Internal Revenue Code is undefined. Thus, the job of the court is determining what, as a matter of federal law, the phrase "limited partner" means. To do so, the court interprets the words consistent with their ordinary meaning at the time Congress enacted the statute.

Contemporaneous legal dictionaries at the time the statute was enacted defined a "limited partnership" as a partnership with general partners who manage the business and limited partners who contribute capital and share in profits, but take no part in running the business.

These dictionaries are not outliers. For more than one hundred years, lexicographers have captured similar definitions of limited partnerships. One such definition from 1888 explains that a limited partnership features general partners by whom the business is

conducted, and one or more special partners, who contribute in cash a specific sum as capital, and who are not liable for the debts of the partnership. Similar legal descriptions reveal a common, mainstream definition of limited partner that turns on the role partners played in the enterprise.

In 1916, the National Conference of Commissioners on Uniform State Laws promulgated the Uniform Limited Partnership Act (ULPA), which was adopted in various forms by nearly all American States. The ULPA stated that a “limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.” In 1976, the revised version of that 1916 law carried over the same test. While States had not adopted the revised uniform law by the time Congress amended the relevant section of the Internal Revenue Code, the 1916 definition and the ratification of that definition in the 1976 changes provide key insight into the ordinary understanding of “limited partner.”

Contemporaneous treatises point towards the same result. One treatise from 1968 explains that limited partners “are members of statutory limited partnerships, typically sharing profits, immune from personal liability for firm debts, and not participating in management.” Another treatise from 1979 states “it has always been difficult to justify immunity from a debt that was incurred by one of the actual managers or directors of an enterprise, and thus the limited partners, in return for immunity, must refrain from any participation in the management or control of the business, to include control over any of the managing partners.”

And at least one circuit court from 1959 recognized that if a partner controlled partnership affairs, the partner was no longer functioning as a limited partner.

The court stated that all relevant sources suggest that when IRC section 1402(a)(13) was enacted, the ordinary public meaning of “limited partner” included a partner who did not play a significant role in managing or running the business.

In adopting this reading, the Circuit Court rejected the Tax Court’s *Soroban* decision, which held that the term “limited partner” could refer only to “passive investors.”