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Top Federal Tax Cases To Watch In 2026

By **Kat Lucero**

Law360 (January 2, 2026, 12:03 PM EST) -- The application of self-employment taxes to limited partners, the economic substance doctrine's threshold and whether Internal Revenue Service penalties need a jury's deliberation are topics federal courts likely will examine in coming decisions.

Here, Law360 reviews the top federal tax cases to watch in the coming year.

Partners' Self-Employment Tax

Three appellate courts are in the midst of deciding whether to affirm the U.S. Tax Court's unanimous position that said investors classified as limited partners under state law — but actively participating in the partnership's business — are still liable for self-employment tax.

At issue is a limited partner exclusion from the Self-Employment Contributions Act, or SECA, tax on their distributive share of partnership income under Internal Revenue Code Section 1402. Congress created the exclusion in 1977 to prevent passive investors from participating in the Social Security program without being in the workforce. But as partnership structures evolved over the years, the IRS said businesses have found ways to circumvent this exclusion and reduce taxable income, including an investor registering as a "limited partner" under state law, but nevertheless is an active officer or employee.

Cases before three appellate courts test the U.S. Tax Court's unanimous position that investors classified as limited partners under state law, but actively participating in the partnership's business, are still liable for self-employment tax.

The agency launched a compliance campaign in 2018 to curb the practice — which triggered the continuing controversy surrounding the meaning of limited partners, according to Erin Hines of Akerman LLP.

"Now, the issue is about what the term 'limited partner' actually means under the statute, including what that term meant when the statute was enacted in 1977," Hines said.

In the past few years, the Tax Court has sided with the IRS in four opinions in cases all lodged by investment and financial companies structured as partnerships. Those companies are appealing those decisions in three circuits.

Soroban Capital Partners LP has a highly influential case pending in the Second Circuit after it lost twice in the Tax Court, according to practitioners.

In the first opinion in November 2023, the Tax Court established a "functional analysis" for examining whether a partner is eligible for the limited partner exception. It did not apply the analysis to Soroban's status until its second opinion in May, which maintained the IRS' $142 million increase to its taxable net earnings due to three limited partners who were key to generating the business's income during the 2016 and 2017 years.

The "new, extra-statutory analysis" could prove to be a compliance burden for taxpayers, who would no longer be able to rely on state law classifications for federal self-employment tax purposes, said Laura Gavioli of Proskauer Rose LLP.

Sirius Solutions LLLP, a management consulting firm, brought a closely watched case in the Fifth Circuit, challenging the Tax Court's 2024 decision that used the functional analysis to subject the income of limited partners to the SECA tax.

Nearly a year after a panel heard oral arguments in February, the Fifth Circuit has yet to issue an opinion — a delay that may signal the case's importance, according to Naveid P. Jahansouz of Meadows Collier Reed Cousins Crouch & Ungerman LLP.

The decision is "profoundly important" because it would be the first appellate test of the Tax Court's functional analysis, he said, adding it will affect countless similar businesses, particularly in the financial services and real estate sectors.

Meanwhile, the First Circuit is mulling Denham Capital's appeal of another Tax Court decision from December 2024, which ruled that five partners tried to exclude more than $50 million in partnership income from the self-employment tax. The opinion held that partners relied on Delaware law to label themselves as limited partners, yet had near total control over the company's investment advisory services.

A solution is critical because the impact will go beyond tax to "how partnerships form themselves and how they identify the roles of their partners," Hines said.

The cases are Soroban Capital Partners LP v. Commissioner, case number 25-2079, in the U.S. Court of Appeals for the Second Circuit, Sirius Solutions v. Commissioner, case number 24-60240, in the U.S. Court of Appeals for the Fifth Circuit, and Denham Capital Management v. Commissioner, case number 25-1349, in the U.S. Court of Appeals for the First Circuit.

Economic Substance Doctrine

The Tenth Circuit's upcoming decision on the economic substance doctrine authority under IRC Section 7701(o) in the Liberty Global v. U.S. case is important for its potential influence on the IRS' wielding of a powerful tool to curb abusive tax avoidance arrangements.

At issue is Section 7701(o)'s so-called relevancy requirement, which Liberty Global Inc. attorneys insist requires the IRS to first assess whether an economic substance review is even relevant to the audited transaction. The initial review is important, they argued, because the IRS will slap strict liability penalties under IRC Sections 6662 and 6662A on a tax break arrangement found without economic substance.

The Tenth Circuit has been mulling a decision on this topic for over a year since the panel heard oral arguments from Liberty Global. But practitioners said there is now more anticipation for one following the U.S. Tax Court's November release of its own opinion on the matter in a microcaptive case known as Patel v. Commissioner, according to practitioners.

In a Nov. 12 opinion, the Tax Court unanimously concluded the IRS has to first assess the relevancy of an economic substance review in a transaction before proceeding to a formal review under Section 7701(o), which could further expose the taxpayer to the stiff penalties.

The IRS could appeal the decision in the Patel case, but that move could also hinge on what the Tenth Circuit decides in the Liberty Global dispute, according to S. Starling Marshall of Crowell & Moring LLP.

Meanwhile, questions remain from the Patel case on how the threshold will be applied in practice, according to practitioners.

"I think everyone is curious to see whether the Tenth Circuit will expand on how that relevancy determination should and is going to be made in the future," said Stephen Josey of Vinson & Elkins LLP.

If the Tenth Circuit agrees with the Tax Court's analysis in Patel, "it would set the IRS back in asserting the economic substance doctrine as a challenge to taxpayers' positions," said Mario Verdolini of Davis Polk & Wardwell LLP.

That could result in "more freedom in tax planning, relatively speaking," Verdolini said.

The case is Liberty Global Inc. v. U.S., case number 23-1410, in the U.S. Court of Appeals for the Tenth Circuit.

Penalties After Jarkesy

The U.S. government recently asked the Fifth Circuit to overturn a Texas federal court decision that ruled its $1 million penalties against Sharnjeet Sagoo for not reporting her foreign bank and financial accounts was unconstitutional because the fines were assessed without a jury.

Sagoo's winning argument was based on the U.S. Supreme Court's June 2024 decision in SEC v. Jarkesy, which found that a jury must first review a federal agency's penalties before they are assessed against an individual, business or organization under the Seventh Amendment.

Since the Jarkesy opinion came out, taxpayers have used this precedent to challenge different penalties in the Tax Court and federal district courts with mixed results. Two district courts, which includes the one that decided Sagoo's case, are split on the relevance of the Jarkesy precedent in tax penalty cases.

In a Pennsylvania federal court, the government won in September a case lodged by HDH Group Inc., which sued the IRS over $6.6 million in civil fraud penalties using the Jarkesy argument. The court ruled that the penalties were constitutional even without a jury first assessing them.

Meanwhile, the Tax Court took a rare unified stance in August to say it can adjudicate penalties under the Seventh Amendment even though the court does not offer a jury trial in a case brought by Silver Moss Properties. In that opinion, the judges said the IRS civil tax fraud penalty against Silver Moss falls

under the "public rights" exception to the Seventh Amendment right to a jury trial, which is different from the Supreme Court's holding in Jarkesy.

Sagoo's appeal will be of interest, according to Josey, because the Fifth Circuit in 2025 sided with wireless giant AT&T in an appeal raising the Jarkesy precedent against the Federal Communications Commission's $57 million privacy fine.

The Fifth Circuit decision then created a circuit split over the need for jury trials when the agency seeks certain penalties — which AT&T and others recently asked the U.S. Supreme Court to review.

Nevertheless, the Fifth Circuit analysis of the Jarkesy opinion in Sagoo's appeal will be noteworthy in determining whether the appellate court will adopt a similar or different view of the justices' 2024 opinion as applied to penalties from other federal agencies, according to Josey.

In the AT&T decision, the Fifth Circuit took a narrow view of the public rights exception, which is what the Tax Court relied on in the Silver Moss dispute, according to Josey.

"We'll see where that goes," he said, adding that there certainly could be a split among the courts as to when and how the Seventh Amendment applies to tax and tax-adjacent penalties.

The case is U.S. v. Sagoo, case number 25-11271, in the U.S. Court of Appeals for the Fifth Circuit.

--Editing by Tim Ruel and Neil Cohen.
