

IRS Issues Proposed Regulations Targeting Management Fee Waivers by Private Equity Funds

July 28, 2015

The Internal Revenue Service (the “IRS”) recently released proposed regulations providing that certain arrangements in which a service provider receives allocations of a partnership’s underlying income may be treated as compensatory payments for services under the Internal Revenue Code (the “Code”). In releasing such regulations, the IRS is attempting to crack down on certain “management fee waiver” practices by private equity firms which try to convert management fees into profits interests in order to get capital gains treatment on such income as opposed to ordinary income treatment. The proposed regulations provide a facts and circumstances test and factors to evaluate whether an arrangement should be treated as a disguised payment for services. An arrangement that is recharacterized as a disguised payment for services under the proposed regulations will be treated as such for all purposes of the Code. Such payment will be subject to tax at ordinary income tax rates, and if such payments are not structured properly, may be subject to additional taxes under Sections 409A and 457A of the Code. As these are issued as a clarification of existing regulations, the IRS may be able to pursue taxpayers currently if they have any of these problematic fee waivers. A copy of the proposed regulations can be found [here](#).