

Client Alert

TREASURY DEPARTMENT ISSUES PROPOSED REGULATIONS ON MANAGEMENT FEE WAIVER ARRANGEMENTS

July 23, 2015 - The Treasury Department issued proposed regulations on July 22 that will directly affect management fee waivers currently employed by many investment funds. In a typical fee waiver, a manager or general partner waives its right to a fixed fee for management services in exchange for an enhanced share of future profits. Management fee waivers have been criticized recently by Treasury and IRS officials as an improper conversion of ordinary income into capital gains.

There are three principal “takeaways” from the proposed regulations:

- The new rules will not be retroactive – they will only apply to fee arrangements entered into, or fees waived after, the final regulations are published.
- The proposed regulations do not prohibit fee waiver arrangements. Several examples from the proposal describe valid arrangements. However, the examples are quite conservative and do not cover most of the fee waivers that investment funds currently have in place.
- The Treasury Department has made it clear that they do not believe a typical fee waiver arrangement is covered by the “profits interest” safe harbor described in Revenue Procedure 93-27. Treasury has indicated that it is going to issue new guidance to make it clear that a profits interest issued to a manager who waives a “substantially fixed fee for services” is outside the safe harbor.

The proposed regulations are complex and remain subject to modification by the Treasury Department, following public comment. However, they do provide a new insight into the Treasury Department's view of management fee waivers, in particular, and profits interests, in general.

Please feel free to call MoCo with any questions you may have regarding this development. In particular, Isaac Grossman (Tax), and Brian Snarr and Alan Levine (Benefits) are carefully monitoring these changes. We look forward to hearing from you.

Isaac P. Grossman
(212)735-8735
igrossman@morrisoncohen.com

Brian B. Snarr
(212) 735-8831
bsnarr@morrisoncohen.com

Alan M. Levine
(212) 735-8694
alevine@morrisoncohen.com