

## Kirkland Comments on IRS Management Fee Waiver Guidance

### PENpoints

*Proposed IRS regulations, if finalized in their current form, would treat fund management fee waivers more harshly than IRS officials had previously suggested.*

Kirkland & Ellis has submitted extensive comments (the “Comments”) on proposed IRS regulations issued in July 2015 addressing private equity (“PE”) fund management fee waivers.<sup>1</sup> The Comments can be accessed [here](#).

As noted in a prior *KirklandPEN*,<sup>2</sup> the proposed regulations and related guidance, if finalized in their current form, would be more harsh than IRS officials had suggested prior to their July 2015 issuance. The IRS guidance (i) would treat many traditionally structured PE fund management fee waiver arrangements as “disguised fees” subject to taxation at ordinary income rates (rather than as partnership profits interests taxable on a flow-through basis) and (ii) also suggests that a profits interest which does satisfy the requirements for flow-through treatment may immediately be taxed based on its value at the time of receipt.

Although the IRS guidance generally will apply only to arrangements entered into or modified after the regulations are issued in final form, the IRS asserts that the principles of the proposed regulations reflect “congressional intent” and current law,<sup>3</sup> suggesting that the IRS may seek on audit to apply similar arguments and theories even to management fees waived before the regulations are finalized.

The Comments explain the legal and factual support for the current law flow-through treatment of appropriately structured fee waiver arrangements, question the legal and factual basis for certain aspects of the proposed regulations, point out areas in which the proposed regulations are inconsistent with the applicable legislative history, and make 17 specific recommendations for changes to the proposed regulations.

As the regulatory comment period for the proposed regulations is now closed, the IRS will consider all comments provided by the public and proceed toward finalizing the regulations. The timing for issuance of final regulations is not known, but is likely to be some months in the future. We are hopeful that our Comments will challenge the IRS to consider guidance that fairly reflects more realistic assumptions about the private equity industry and which does not penalize PE fund sponsors for utilizing properly structured management fee waivers to achieve their business objectives in a tax-efficient manner.

### INSIDE KIRKLANDPEN

<i>PENbriefs</i> . . . . .	2
<i>Upcoming Events</i> . . . . .	3

- 1 The objective of the proposed regulations is to determine whether a profit allocation made as part of a fee waiver arrangement should be respected as a true allocation of partnership profits (which, for a PE fund, typically consists primarily of capital gains and qualified dividends) or whether the arrangement should be re-characterized as a disguised fee taxable to the private equity professionals as ordinary income.
- 2 For prior coverage of the proposed regulations and developments leading to their issuance, see [KirklandPEN](#) dated July 24, 2015, [KirklandPEN](#) dated June 9, 2014, and [KirklandPEN](#) dated May 29, 2013.
- 3 However, as noted in our prior coverage, many tax practitioners believe that the legislative history underlying the applicable tax statute is materially more taxpayer favorable than the principles set forth in the proposed regulations. See [KirklandPEN](#) dated July 24, 2015.

If you have any questions about the matters addressed in this *KirklandPEN*, please contact the following Kirkland authors or your regular Kirkland contact.

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## PENbriefs

## U.S. Treasury and Internal Revenue Service Issue New Anti-Inversion Guidance

In response to a wave of transactions in which a U.S. corporation is acquired by a smaller non-U.S. corporation, in part in order to achieve a more efficient tax profile for the U.S. corporation, the U.S. Treasury Department and the IRS have issued two notices intended to limit the ability of U.S. corporations to engage in and benefit from such so-called inversion transactions. The most recent of such notices not only expands upon and modifies guidance from the first notice, but also adds a few new surprising hurdles of its own. To learn more, see our recent [Alert](#).

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## New Guidelines for Protecting Secured Lenders' Share Foreclosure Rights in German Bankruptcies

A recent decision of the German Supreme Court represents its most authoritative pronouncement on a secured lender's right to foreclose on pledged shares of a German company. To learn more, see our recent [Alert](#).

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## AIM Update

Recently in our *KirklandAIM* newsletter, which is directed towards Chief Compliance Officers and other compliance professionals, we discussed a recent SEC publication discussing its concerns about SEC-registered investment advisers that outsource their Chief Compliance Officer function to unaffiliated third parties. Click [here](#) to access this edition of *KirklandAIM*.

## PENnotes

**2015 Registered Adviser Seminar & CCO Summit  
Los Angeles, California, December 2, 2015**

As the SEC continues its focus on private fund managers registered as investment advisers, firms must be familiar with the evolving regulatory environment. This seminar is designed specifically for private fund manager CCOs, general counsel and other senior executives. Click [here](#) for more information.

**Building the Case for Private Equity Emerging Markets:  
A Conversation with HBS Professor Josh Lerner  
Chicago, Illinois, December 8, 2015**

Kirkland & Ellis and The Abraaj Group present this leadership summit for private equity investors focused on growth markets in Latin America, Eastern Europe, the Middle East and beyond. The event will engage industry thought leaders in discussions about the latest developments in the asset class and emerging economies and offer practical insight into capital investment in today's strategic growth markets. Click [here](#) for more information.

**Drafting and Negotiating Corporate Agreements  
2016  
New York, New York, January 8, 2016  
Chicago, Illinois, February 4, 2016**

This PLI seminar will teach the basics of drafting and negotiating corporate agreements — from how the provisions of an agreement fit together, to the fundamental drafting and negotiating principles common to all corporate agreements. Kirkland partner Kevin Morris is co-chair of the Chicago event and partner Sarkis Jebejian will be a panelist at the New York event. Click [here](#) for more information.

**43rd Annual Securities Regulation Institute  
Coronado, California, January 25-27, 2016**

Hosted by Northwestern Law, the 43rd Annual Securities Regulation Institute will take place in Coronado, California. One of the most visible and highly regarded securities and corporate law conferences in the country, the Securities Regulation Institute reaches prominent attorneys from both firm and in-house practices. Kirkland partner Robert Khuzami will be a panel member for the Enforcement and Government Investigations session. Click [here](#) for more information.

**15th Annual Beekun Petty O'Keefe & Company  
Private Equity Conference  
Chicago, Illinois, February 19, 2016**

Kirkland is a sponsor of the Chicago Booth Private Equity Conference (PEC), an annual event that brings together financiers, students and entrepreneurs to network and share insights into the dynamics of investing in a constantly changing economy. This year's conference is themed "Navigating Industry Cycles: Investing in an Evolving Market." Click [here](#) for more information.

**Columbia Business School's 22nd Annual Private  
Equity & Venture Capital Conference  
New York, New York, February 19, 2016**

Kirkland will sponsor Columbia Business School's 22nd Annual Private Equity & Venture Capital Conference, which will focus on the emerging challenges and opportunities facing the private equity and venture capital industries in the coming year. The event will bring together industry professionals, students, alumni and faculty to share their knowledge and experiences.

**11th Annual Stern Private Equity Conference  
New York, New York, March 4, 2016**

Kirkland will sponsor New York University's Stern School of Business' 11th Annual Stern Private Equity Conference. The conference will provide a forum for industry leaders to discuss the opportunities and risks of today's private equity and venture capital environment, including how tepid global growth, regulatory dynamics, political pressure and financial market conditions are posing challenges to fundraising, deal financing and operations.

**22nd Annual Harvard Business School Venture  
Capital and Private Equity Conference  
Boston, Massachusetts, March 5, 2016**

Kirkland will sponsor Harvard Business School's 22nd Annual Venture Capital and Private Equity Conference, held on the Harvard campus. The panels will address a range of today's most relevant topics, from growth equity investing and fundraising to geography-specific investment opportunities.

# Private Equity Practice at Kirkland & Ellis

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Kirkland & Ellis' nearly 400 private equity attorneys have handled leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 400 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Private Equity Group of the Year" in 2012, 2013 and 2014 by *Law360* and was commended as being the most active private equity law firm of the last decade in *The PitchBook Decade Report*. Kirkland was named "Law Firm of the Year in Mergers and Acquisitions Law" by U.S. News Media Group and Best Lawyers in its 2014 "Best Law Firms" rankings. The Firm was named "Best M&A Firm" at *World Finance's* 2014 Legal Awards, "North American Law Firm of the Year: Fund Formation" and "North American Law Firm of the Year: Transactions" at *Private Equity International's* 2014 Private Equity International Awards and "Private Equity Deal of the Year" at the 2014 IFLR Americas Awards.

In 2012, 2013 and 2014, Chambers and Partners ranked Kirkland as a Tier 1 law firm for Investment Funds in the United States, United Kingdom, Asia-Pacific and globally. The Firm was ranked as the #1 law firm for both Global and U.S. Buyouts by deal volume in Mergermarket's *League Tables of Legal Advisors to Global M&A for Full Year 2011, 2012, 2013 and 2014*, and has consistently received top rankings among law firms in Private Equity by The Legal 500 and IFLR, among others.

*The Lawyer* has recognized Kirkland as one of its "Transatlantic Elite" every year since 2008, having noted that the Firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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