

IRS Proposes Carried Interest Regulations

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Last Friday, the IRS and Treasury proposed regulations (the “Carried Interest Regulations”) on the taxation of carried interest under Section 1061 of the tax code. Section 1061 was added to the tax code as part of the 2017 tax reform legislation and generally provides that capital gain allocated under certain carried interest arrangements is eligible for the favorable 20% U.S. federal income tax rate only if the underlying asset was held for more than three years at the time of sale.

The Carried Interest Regulations are, on the whole, consistent in most respects with the manner in which most taxpayers have been applying Section 1061 since its enactment. However, while Section 1061 includes a statutory exception for capital gain attributable to a sponsor’s own capital interest, the Carried Interest Regulations take a surprisingly narrow view on when this exception is available. Further, the Carried Interest Regulations include a variety of rules designed to prevent taxpayers from avoiding the application of Section 1061, including rules relating to distributions of property that has a holding period of three years or less and rules relating to the sale (directly or indirectly) of a partnership interest that is subject to Section 1061.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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