



## Michael Spiro Testifies at IRS Hearing on Management Fee Conversions

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On February 26, 2016, Michael P. Spiro presented oral comments on behalf of the Connecticut Bar Association Tax Section at an Internal Revenue Service public hearing concerning proposed regulations aimed at curbing the utilization of “management fee conversions” by private equity fund managers (the “Proposed Regulations”). In his comments, Mr. Spiro encouraged the IRS to modify the Proposed Regulations so as to ensure that bona fide equity arrangements enjoying significant risk of loss or significant opportunity for gain are respected as such. In particular, he noted that it is often the case that fee waiver arrangements create true risk for fund managers whereby “foregoing of the management fee is specifically intended to convert compensation into at-risk equity.” In those cases, he argued, “to say that the choice [between a management fee and a profits interest] fixes the value of the equity is tantamount to saying that a \$1,000 bet on a roulette number fixes the value of that number, even though any probability analysis would probably fix the value of that event at a small fraction of that amount.”

Mr. Spiro’s comments elicited a number of questions from IRS officials Clifford Warren, Special Counsel, Office of the Associate Counsel, (Passthroughs & Special Industries), Glenn E. Dance, Special Counsel, Office of the Associate Chief Counsel, (Passthroughs & Special Industries), Faith P. Colson, Senior Counsel, Branch 1, Office of the Associate Chief Counsel, (Passthroughs & Special Industries), Wendy L. Kribell, Attorney, Branch 1, Office of the Associate Chief Counsel, (Passthroughs & Special Industries), and Ossie Borosh, Attorney-Adviser, Office of Tax Legislative Counsel, Department of the Treasury.

In one exchange, Mr. Warren asked whether limited partners are in fact indifferent to fee waivers as “in a lot of transactions we’ve seen they have to pay the same amount of cash out the door whether it’s denominated as a fee or as notional capital put up for the benefit of the general partner.” Mr. Spiro explained that “the payment of the general partner is contingent on there being sufficient profits to fill up that notional capital amount. So, if the money isn’t there, the LP would get its cash back. So, yes, if things go well, the LP is out the same amount of money, but if things go badly they’ll be entitled to return of capital, including the amount they put up on behalf of the GP because the GP’s right to receive that amount is subject to there being sufficient profit.”

Mr. Spiro's comments were quoted extensively in both the Bloomberg BNA Daily Tax Report (Laura Davison, "Some Fee Waivers a Gamble, Merit Safe Harbor, IRS Told" 39 DTR G-8) and Tax Notes Today (Amy Elliott, "Practitioners Urge Changes to Fee Waiver Regulations" Tax Notes Today, February 29, 2016).