

PwC's Law Firm Services News Alert

Proposed Regulations May Affect the U.S. Tax Treatment of Certain Guaranteed Payments Made to Law Firm Partners



July 28, 2015

On July 22, 2015, the Treasury Department ("Treasury") and the IRS issued proposed regulations (REG-115452-14) under Section 707(a)(2)(A) addressing when an arrangement with a service provider structured as an allocation (typically of net capital gain or qualified dividend income) and a distribution may be recharacterized as a disguised payment for services (treated as compensation income). The proposed regulations were anticipated for several months and were expected to target management fee waiver arrangements. However, the guidance is broader than anticipated and its applicability appears to extend beyond management fee waiver arrangements.

The background section explains Congress' intention to focus upon entrepreneurial risk as indicia of a partnership participation. As such, the Notice warns that regulations which are currently applicable will be updated to reflect this increased scrutiny. Of particular importance to law firms is Example 2 in Treas. Reg. Section 1.707-1(c), which currently addresses two scenarios: (1) where a partner is entitled to receive a certain percentage of the partnership's income or a minimum guaranteed amount, and the income paid to the partner exceeds the minimum guaranteed amount, the total income paid to the partner is treated as distributive share under Section 704(b); and (2) where the partner's income allocation is less than the minimum guaranteed amount, the partner will have a distributive share to the extent of the income allocation, and a guaranteed payment to the extent the minimum guaranteed payment exceeds the minimum income allocation. The IRS explains in the Notice that this regulation will be modified so that the entire minimum amount paid to the partner will be treated as a guaranteed payment. As such, the Treasury and IRS intend to obsolete Rev. Rul. 66-95, 1966-1 CB 169, and Rev. Rul. 69-180, 1969-1 CB 183, once the regulations are finalized.

The proposed regulations are not effective until finalized. However, the regulations also state that the current position of Treasury and the IRS is that the proposed regulations generally reflect current law under the legislative history of Section 707(a)(2)(A).

[Read more](#)

Contact PwC's Law Firm Services for further details

PwC can assist your firm in evaluating the potential impact of these changes on your partners that receive guaranteed payments. Please give us a call to start the conversation.

Gary M. Pogharian at +1 (646) 471-7202 or gary.m.pogharian@us.pwc.com

Gregg Sincoff at +1 (646) 471-1335 or gregg.sincoff@us.pwc.com

Nancy Regan at +1 (973) 236-5771 or nancy.regan@us.pwc.com

or any member of your PwC Law Firm Services team