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**The proposed tax regulations could deeply impact the practices of sponsors in the private equity, real estate and family office sectors.**

The Internal Revenue Service (IRS) and the Department of the Treasury recently released proposed regulations implementing the provisions of Section 1061.

Arising out of the 2017 Tax Cuts and Jobs Act, Section 1061 increases the holding period necessary to benefit from long-term capital gain treatment from **one year to three years**. If this three-year holding period is not met, then the gains are treated as short-term capital gains and taxed accordingly. Generally, the three-year holding period applies to the gain distributed to taxpayers from applicable partnership interests (an API). An API is an interest in a partnership which arises out of a taxpayer's work in an applicable trade or business (ATB). ATBs include 1) raising or returning capital, and 2) investing or developing "specified assets" including debt instruments and real estate held for rental or investment. Such conduct is closely connected with the everyday activities of private equity funds, real estate developers and family offices.

Some of the most significant highlights of the proposed regulations include:

- A warning about carried interest waivers. Such waivers have been used in fund agreements to give partners the ability to delay carried interest allocations as a work-around to the new Section 1061 holding period. However, the proposed regulations fire a shot across the bow, warning that the waivers may be challenged by the IRS as attempting to circumvent the regulations.
- For a taxpayer to transfer API directly or indirectly to certain members of their family or to a related person, the taxpayer must include as short-term

capital gain the excess deemed net long-term capital gain with respect to their API under Section 1061(d) attributable to the sale or exchange of any asset held for not more than three years over.

- A narrow interpretation of the capital interest exception which makes it possible that gain arising out of such investments will require a three-year holding period. For instance, the proposed regulations exclude from the exception monies borrowed from or guaranteed by a management company, partners, or a general partner.
- The amount treated as short-term capital gain should fall under the general Section 1061(a) rules.
- An exclusion of Section 1231 gain.

If you have any questions about the proposal and what it could mean for those in the real estate and family office sectors, contact our office [here](#) for more information.

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