

**AUGUST 1, 2022**

For more information,
contact:

John K. Sweet
+1 212 827 4382
jsweet@kslaw.com

Jonathan Talansky
+1 212 790 5321
italansky@kslaw.com

Abraham N.M. Shashy, Jr.
+1 202 626 5614
hshashy@kslaw.com

L. Wayne Pressgrove, Jr.
+1 404 572 2722
wpressgrove@kslaw.com

Suyoung Moon
+1 202 626 5453
smoon@kslaw.com

King & Spalding

Atlanta
1180 Peachtree Street, NE
Suite 1600
Atlanta, Georgia 30309
Tel: +1 404 572 4600

New York
1185 Avenue of the Americas
New York, New York 10036-4003
Tel: +1 212 556 2100

Washington, D.C.
1700 Pennsylvania Avenue, NW
Suite 900
Washington, D.C. 20006
Tel: +1 202 737 0500

Changes to Taxation of Carried Interest in the Inflation Reduction Act of 2022

The recently proposed “Inflation Reduction Act of 2022” includes a proposal (the “carried interest proposal”) to amend the rules under section 1061 of the Internal Revenue Code of 1986, as amended (the “Code”)¹ relating to the taxation of the “carried interest” or “promote” earned by investment managers. Section 1061 was itself enacted in 2017 to address the taxation of these interests, however the current proposal would go further in limiting the favorable treatment of carried interest. The carried interest proposals were previously set forth in the Build Back Better Act (H.R. 5376, 117th Congress).

Under current law, a taxpayer whose carried interest is subject to section 1061 may still recognize long-term capital gain with respect to assets that have been held for at least 3 years. The carried interest proposal would, among other things, now require a 5-year holding period in order to obtain favorable long-term capital gains treatment with respect to carried interests. However, a 3-year holding period requirement would apply with respect to any individual holder of a carried interest that has adjusted gross income of less than \$400,000. Of particular note to sponsors of real estate private equity funds, the shorter, 3-year requirement would also apply to income allocations attributable to a real property trade or business, which is defined under a different Code provision as “any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.” If the applicable (3- or 5-year) holding period requirement is not met, the holder’s “net applicable partnership gain” with respect to its carried interest would be treated as short-term capital gain (taxable at ordinary income rates).

“Net applicable partnership gain” generally is defined to include net long-term capital gain and other amounts includible in the holder’s gross income with respect to carried interests, to the extent such other amounts are treated as long-term capital gain or would otherwise be subject to tax at long-term capital gain rates. Among other things, this definition would



pick up section 1231 gains (generally, gains from depreciable property and real property used in a trade or business and held for more than one year, other than inventory or property held for sale) and qualified dividend income, both of which categories are not currently subject to section 1061.

Under the carried interest proposal, a taxpayer’s holding period for a carried interest would begin on the later of (i) the date on which the taxpayer acquired substantially all of its carried interest with respect to which gain is realized and (ii) the date on which the partnership in which the carried interest is held acquired substantially all of the assets held by such partnership. The proposal does not define “substantially all” for purposes of applying the above tests. It appears that under this “tolling” rule, the applicable holding period for long-term capital gains will be more than 5 years in many situations. For example, in a typical multi-asset fund, where assets are acquired over an “investment period,” the 5-year holding period may not begin until the end of the investment period.

Under the carried interest proposal, a taxpayer would recognize gain on any transfer of a carried interest, notwithstanding any other provision of federal income tax law.

Importantly, under the carried interest proposal, these modified rules will be applied “without regard to Code section 83 and any election in effect under section 83(b).” This means that a holder of a promote that is subject to vesting may need to wait until the interest vests before the 5-year holding period begins, even if a section 83(b) election was otherwise made to start the holding period under general tax principles. The carried interest proposal also includes an amendment that would make section 1061 specifically applicable to carried interests held by S corporations.

The proposed amendments to section 1061 would be effective for taxable years beginning after December 31, 2022.

ABOUT KING & SPALDING

Celebrating more than 130 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 1,200 lawyers in 23 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality, and dedication to understanding the business and culture of its clients.

This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice. In some jurisdictions, this may be considered “Attorney Advertising.” View our [Privacy Notice](#).

ABU DHABI	CHARLOTTE	FRANKFURT	LOS ANGELES	PARIS	SINGAPORE
ATLANTA	CHICAGO	GENEVA	MIAMI	RIYADH	TOKYO
AUSTIN	DENVER	HOUSTON	NEW YORK	SAN FRANCISCO	WASHINGTON, D.C.
BRUSSELS	DUBAI	LONDON	NORTHERN VIRGINIA	SILICON VALLEY	



¹ References to “section” herein are to sections of the Code.