



DID YOU KNOW?

Did you know that you can make up for profits interest that you intended (but forgot) to issue in a prior year?

We frequently deal with companies that would like to issue profits interest retroactively. The typical scenario is that the company intended to or agreed to issue profits interests to a service provider and for one reason or another the paperwork was never done and the profits interest was never issued. As a result, the service provider misses out on the appreciation in the value of the company that occurred during the intervening two or three (or however many) years.

While it is not possible to go back in time to grant that interest, a grant of a “catch-up profits interest” is the next best thing. A catch-up profits interest provides for a priority distribution of profits to the service provider to catch them up for the missed appreciation.

For example, assume a service provider was supposed to receive a 1% profits interest three years ago and that if it had been issued at that time, the profits interest would be worth \$300,000 currently. A catch-up profits interest could be issued which would provide that the first \$300,000 of partnership profits (on a sale for example) would be distributed to the service provider and the remainder of the profits would be divided up in accordance with the partners’ percentage interests. (Technically, to receive a full 1% interest, the catch-up distribution would have to be \$303,030 rather than \$300,000.)

Assuming there is \$300,000 of profit at the time of sale, the service provider is put in as good a position as he or she would have been if the profits interest had been issued timely.

Bottom Line: While not perfect, a catch-up profits interest can be an effective way to deal with common scenario of the failure to issue an agreed-upon profits interest in a prior year.

If you have any questions, please contact the author or one of Taft’s Tax attorneys.



[Jim Duffy](#) / (612) 977-8626 / jduffy@taftlaw.com

If at first you don't succeed, remove all evidence you ever tried. - David Brent