



DID YOU KNOW?

Did you know you can use ‘tracking interests’ to create different profit and loss sharing ratios in different lines of a company’s businesses?

Sometimes it is desirable to provide an owner or employee with an interest in less than all lines of business conducted by a company. For instance, if a company manufactures both boats and ATVs, it may be desirable to grant a profits interest in just the boat business to an executive who works only in that line of business. Similarly, for a partner whose ATV business is acquired all or in part for equity of the company, it may not be desirable to share the profits of the boat business.

In the example above, the company could create two classes of interest (e.g., Class A and Class B). One class of interest would be entitled to share only in the profits and losses arising from the boat business while the other class of interest would be entitled to share only in the profits and losses of the ATV business. Then the appropriate class of interest is issued to the desired partner or employee. This can also be effective for having partners or employees share in both business lines but in different proportions.

The distribution and allocation provisions in a partnership or LLC agreement require careful drafting to ensure the desired result is accomplished. It is also important to remember that each class of interest must have at least two owners. If there is a single owner of a class of interest, the IRS will likely treat the assets underlying that interest as being constructively distributed to that partner. This obviously can have unintended tax consequences.

Bottom Line: The use of tracking interests can permit businesses to tailor income and profit sharing in a company to the interests of and contributions made by particular individuals.

“If you don’t know where you are going, you might wind up someplace else.” –Yogi Berra



[James E. Duffy](#) / (612) 977-8626 / JDuffy@Taftlaw.com