

PRIVATE EQUITY FUND DEEMED TRADE OR BUSINESS

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October 31, 2013

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In my previous post on this blog, I discussed the possibility of a Canadian company being called upon to pay for an affiliated U.S. company's pension liabilities. As discussed therein, this possibility potentially exists because the Employee Retirement Income Security Act of 1974 (ERISA) generally defines "employer" to mean all trades or businesses that are under common control, and it is the "employer" who is liable for any pension liabilities. Private equity funds have taken the position that they do not constitute trades or businesses, but are merely passive investors in their portfolio companies. As a corollary to this, private equity funds maintain that they may not be held liable for pension liabilities associated with one of their portfolio companies. A federal appellate court recently rejected this position, holding that a private equity fund constituted a trade or business.

The implications of the court's holding could be far reaching. Many potential consequences could follow if the definition of "trade or business" applied by the court were also applicable to provisions under the Internal Revenue Code using that term. Were the Internal Revenue Service to adopt the court's holding, the tax-exempt status of many qualified retirement plans could potentially be jeopardized because the manner in which discrimination testing is performed would change dramatically. Further, outside the employee benefits realm, viewing private equity funds as a trade or business could result in unrelated business taxable income for tax-exempt investors and, of particular interest to Canadian persons, effectively connected income for foreign investors.

To date, the Internal Revenue Service has remained largely muted regarding the decision. Officials have stated they are aware of the issue and that the government is moving "cautiously" on the tax implications that follow from the decision. So stay tuned.

For a more in-depth discussion of the decision, please see the Employee Benefits Practice Group's [August 2013 Employee Benefits Developments](#).