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Squire Patton Boggs: IRS Releases Latest Management Contract Private Letter Ruling

On February 7, 2025, the IRS released [Private Letter Ruling No. 202506001](#) in which it concluded that a management contract providing an incentive fee equal to a percentage of gross revenues of a managed hotel and contingent on two metrics, one of which is a variant of net profits, did not constitute the sharing of net profits and so did not result in private business use.

Under the terms of the management contract at issue, the service provider receives a “base fee” and an “incentive fee” each equal to a percentage of gross revenues of the managed facility. This arrangement is not particularly notable. What is notable is that the incentive fee is triggered only if two conditions are met: (1) if revenue per room exceeds an industry average, and more interestingly, (2) if the annual excess of gross receipts over operating expenses of the hotel meets a specified percentage. In concluding that the incentive fee does not constitute sharing of net profits under the facts and circumstances, the IRS reasoned that any increases or decreases in net profits do not result in proportional increases or decreases in the incentive fee. The incentive fee (if there is one) is fixed and predetermined. The IRS also noted that the timing of the payment of the incentive fee does not take into account net profits in that it is paid annually from a regularly funded operating account. Finally, the IRS noted that the incentive fee is “further distanced from net profits” due to the existence of the second metric which is not based on net profits.

Private Letter Ruling 202506001 is reminiscent of [Private Letter Ruling 201145005](#) which also considered a management contract with an incentive fee contingent on a variant of net profits. The IRS determined there that that management contract was outside the safe harbor of Revenue Procedure 1997-13 but that its incentive fee did not represent a sharing of net profits.

By Robert Radigan on February 18, 2025

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