

Investment Management and Hedge Funds: What's Happening Now

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Agenda

- ▶ How might funds be impacted by proposed legislation?
- ▶ Recent Developments

Tax Reform Possibilities

- ▶ A Better Way: Our Vision for a Confident America – Tax
 - Released 6/24/16 by Speaker Ryan
 - The “Blueprint”
- ▶ Trump proposals
 - Policies on campaign website
 - Speeches
 - Tweets
- ▶ Comprehensive Tax Reform for 2015 and Beyond –
 - Senator Hatch corporate integration “discussion draft”
- ▶ Camp bill
 - Not really being considered

How Can It Happen?

- ▶ Republicans have 52 seats in Senate and only a simple majority is required for passage, but can the bill get to a vote?
- ▶ Republicans do not have 60 seats in Senate
 - Democrats could filibuster, effectively blocking legislation from getting to the vote
- ▶ Use of budget reconciliation
 - Procedural process that precludes the ability to filibuster, thereby allowing the legislation to get to Senate floor, where there are the necessary 51 votes
 - Eliminates needs to negotiate with Senate Democrats

Budget Reconciliation

- ▶ House and Senate Republicans would first have to agree on an overall budget resolution
- ▶ Unique procedural limitations
 - All provisions must have a budgetary impact
 - All provisions cannot increase the deficit outside the 10-year budget window
 - As a result “revenue losing” provisions would “sunset” after 10 years (similar to the 2001 Bush tax cuts); creates new “extenders”
 - Might only be a temporary problem given if that Republicans hold 60 seats in the Senate in 2018
 - Generally used more for specific items like rates; not wholesale tax reform
- ▶ Given that there is only one annual budget reconciliation measure, comprehensive tax reform could be paired with ACA repeal/revision legislation, but not all of ACA meets the requirements for being included in the budget resolution

Overall State of Play

▶ Trump

- 15% business income rate, 15% pass-through rate
- Repatriation of accumulated e&p taxed at 10%
- Elective expensing for manufacturers with loss of interest expense deduction
- Most business provisions eliminated, except for R&D credit
- Individual: 12%, 25%, and 33% rates; deductions capped at \$100,000/\$200,000
- Tariffs on imported goods

Overall State of Play

▶ **Blueprint**

- 20% corporation tax rate
- 25% business income tax for pass-through entities
- Deduction eliminated for net business interest expense
- Territorial system for treating future foreign earnings
- Mandatory tax on accumulated foreign earnings
- Destination-basis tax system exempts income from exports while denying deductions for imports

▶ **Senate Finance Committee Chairman Hatch** – readying corporate integration proposal to eliminate the double taxation of corporate income

▶ **Senate Majority Leader McConnell** – insists that any tax reform be comprehensive

▶ **Incoming Senate Democratic Leader Schumer** – supports international tax reform to fund infrastructure spending

Basic Business Provisions of Blueprint

- ▶ 20% corporate income tax rate
- ▶ 50% deduction for capital gains and dividends
 - to moderate impact of double taxation
- ▶ 25% on pass through income/reasonable compensation deduction
- ▶ Reflects a cash flow approach and move toward a consumption tax
 - 100% expensing of all capital expenditure (other than land)
 - No deduction for net interest costs (rules for banks to be developed)
- ▶ R&D credit and LIFO accounting are maintained, but all other “benefits” eliminated
- ▶ Repeal §199 and AMT
- ▶ NOLs never expire; can only reduce taxable income up to 90%

Basic Business Provisions – President Trump

- ▶ 15% corporate income tax rate
- ▶ 15% top pass-through rate
- ▶ Repeal carried interest
- ▶ Repeal AMT
- ▶ Election – full expensing and no interest deduction
- ▶ Light on international, other than 10% tax on repatriation of accumulated earnings. Seems to leave current world wide system in place

International Issues - Blueprint

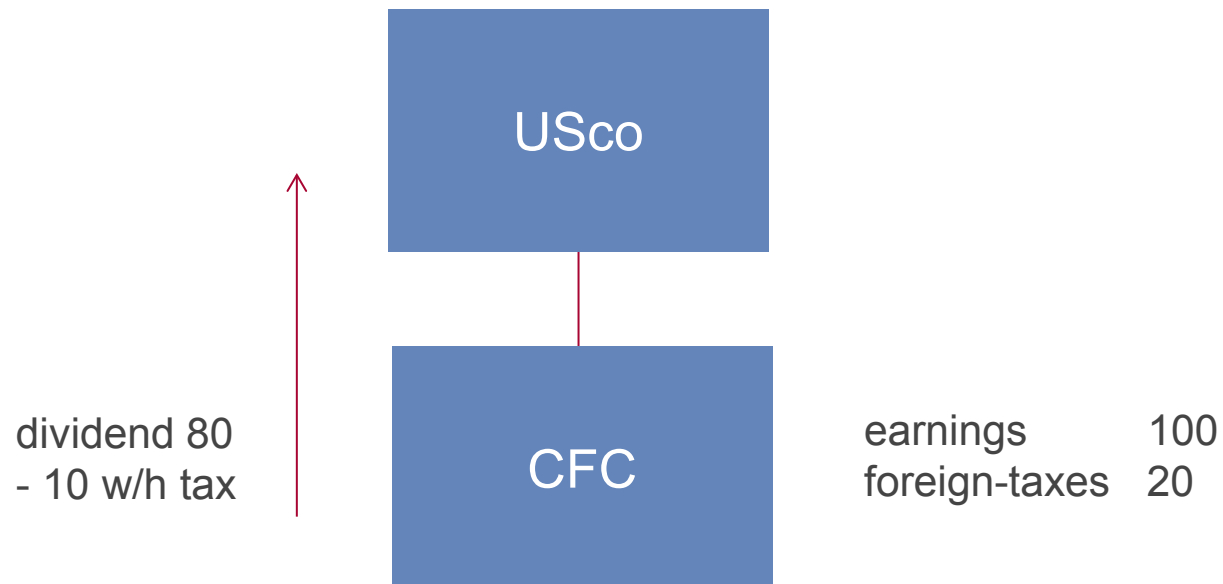
- ▶ Move to territorial system going forward
- ▶ Tax existing deferred earnings at 8.75% for cash/cash equivalents, 3.5% for earnings invested in other assets. Eight years to pay the taxes
- ▶ Border adjusted taxation
 - Exclude export sales from tax base
 - Tax imports
 - Consumption tax?
 - Income tax?

What Does this Mean – Maybe?

- ▶ Subpart F no longer needed?
 - Impact on structures created to avoid subpart F
 - Allows for credit facilities to be guaranteed because no §956 issues

What Does this Mean – Maybe?

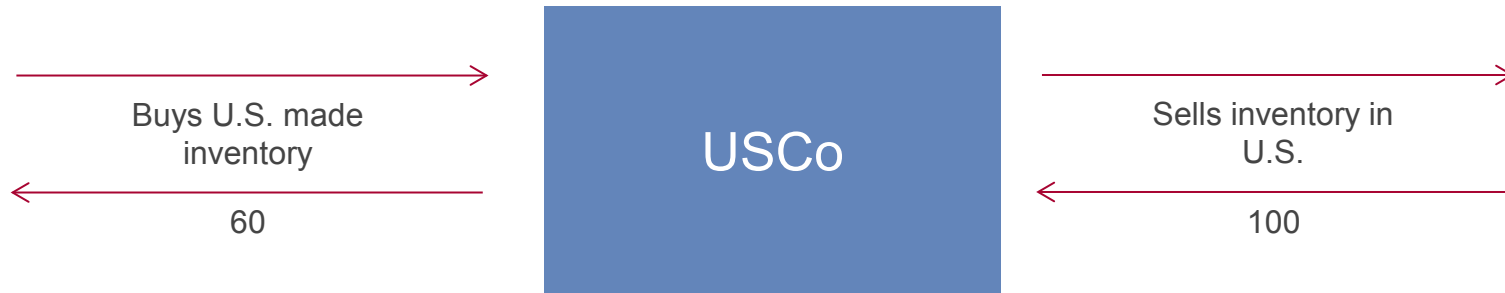
- ▶ Territoriality



- ▶ DRD 90; no U.S. tax
- ▶ No FTC for the 10 or the 20
- ▶ Could USCo have other FSTI against which to use the credit?

What Does this Mean – Maybe?

▶ All U.S./retailer



Under Today's System

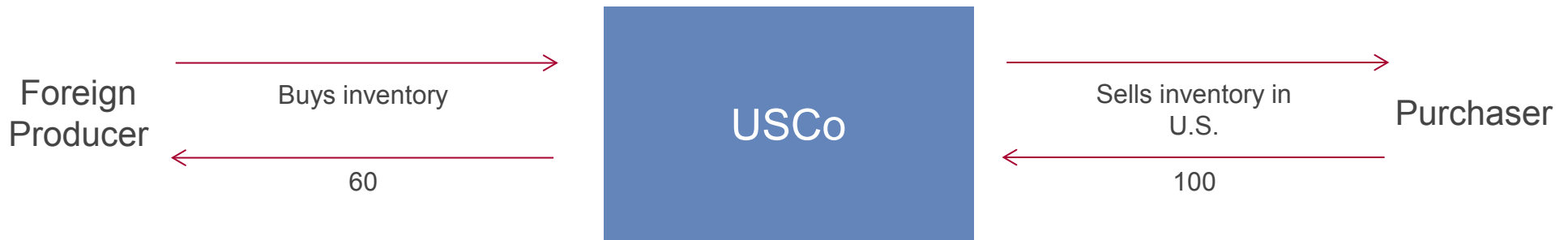
100	Income
60	COGS
40	Gross Profit
10	SG&A
30	Pre-tax
10.5	Tax @ 35%
19.5	Net income

Under Blueprint

100	Income
60	COGS
40	Gross Profit
10	SG&A
30	Pre-tax
6	Tax @ 20%
24	Net income

What Does this Mean – Maybe?

▶ Imports/retailer



Under Today's System

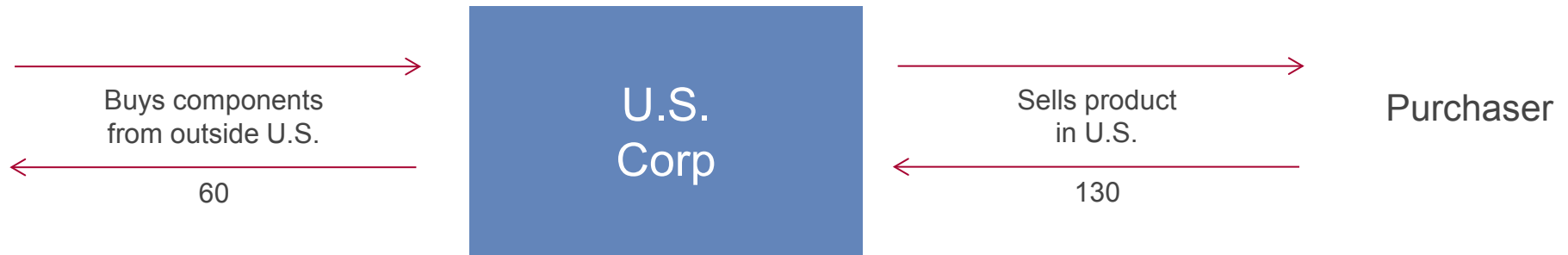
100	Income
60	COGS
<hr/>	
40	Gross Profit
<hr/>	
10	SG&A
30	Pre-tax
<hr/>	
10.5	Tax @ 35%
<hr/>	
19.5	Net income

Under Blueprint

100	Income
- 0 -	COGS
<hr/>	
100	Gross Profit for Taxes
<hr/>	
10	SG&A
90	Pre-tax for tax
<hr/>	
60	COGS for book
<hr/>	
30	Pre-tax book
<hr/>	
12	Net income

What Does this Mean – Maybe?

▶ Manufacturer



Manufactures at cost of 30, total COGS 90

Under Today's System

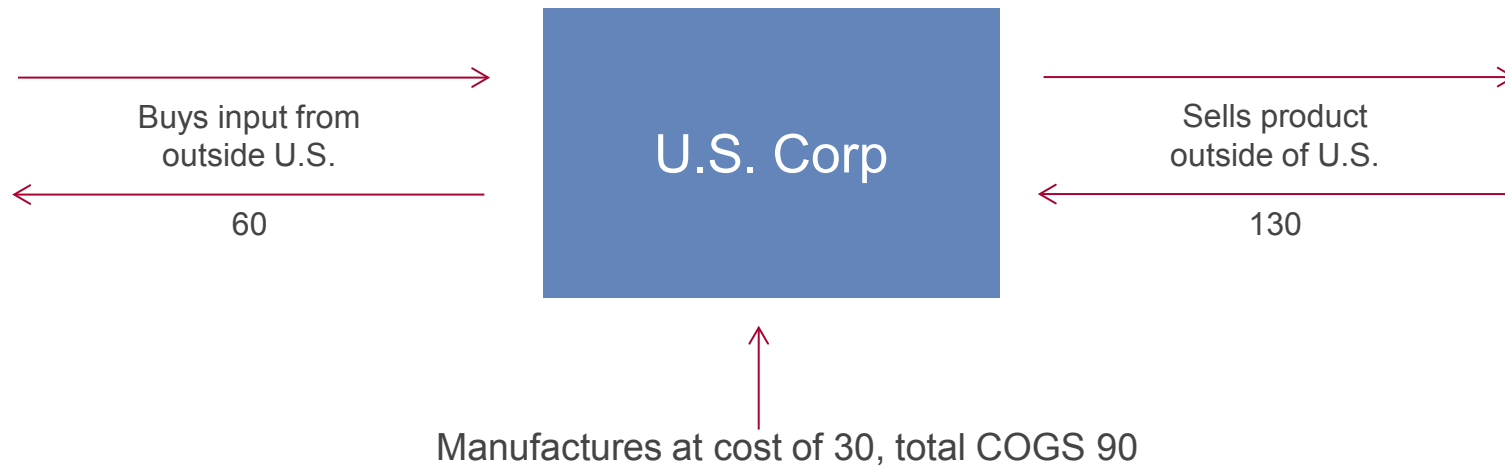
Income	130
COGS	90
SG&A	10
Taxable inc.	30
Tax @ 35%	10.5
Net income	19.5

Under Blueprint

Income	130
COGS	30 (60 is excluded)
SG&A	10
Taxable inc.	90
Tax @ 20%	18
Net income (book)	12

What Does this Mean – Maybe?

▶ Manufacturer/export



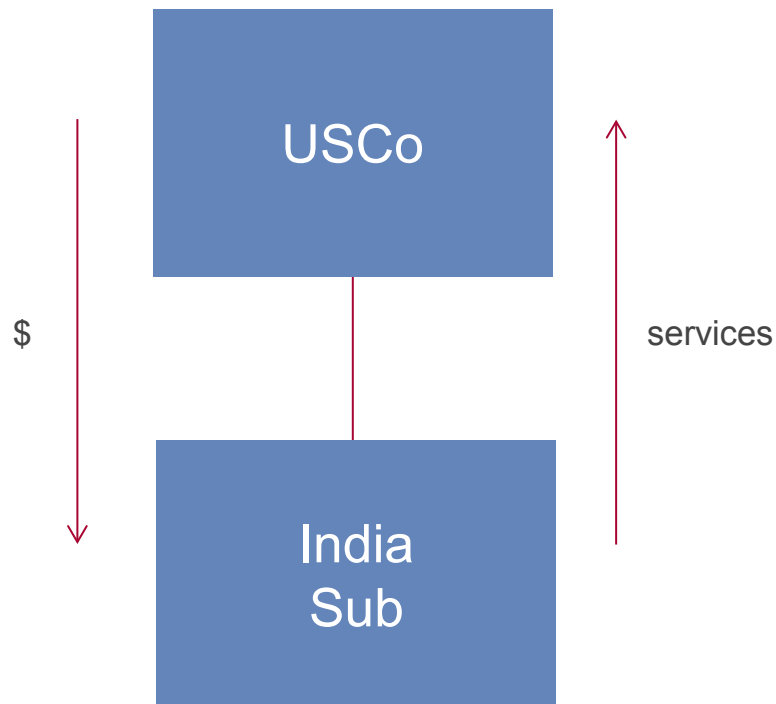
Under Blueprint

Income	0
COGS	<30>
SG&A	<10>
	<hr/>
	<40>

- ▶ Presumably the <40> can offset the gain on sale within U.S. but the 60 is lost forever?

What Can We Expect – Maybe?

▶ Services



- ▶ India sub performs R&D functions for USCo
- ▶ USCo pays arms length service fee – cost + 15%
- ▶ Border adjusted – is service fee is not deductible?
- ▶ Does 15% lower tax rate offset?
- ▶ Consider ETR of USCo under current system

Border Adjusted Taxation - Trump

- ▶ Advocate of a tariff on imported goods
 - Unclear if it is only on imports of U.S. companies that shifted jobs outside the U.S.
 - Unclear if it is in addition to border adjusted taxation
- ▶ Vacillates on usefulness of border adjusted taxation
 - Doesn't like complexity

What Can Funds Expect-Maybe?

- ▶ Effects of expected stronger dollar?
- ▶ Effects on management services?
 - Would services provided to Cayman fund be an export?

Recent Developments

Revised Form W-8BEN-E

- ▶ Form W-8BEN-E was revised in April 2016 to require a foreign entity claiming treaty benefits to identify which LOB provision it satisfies
 - Form 1042-S was also updated to add an LOB reporting code
- ▶ In October 2016, the IRS stated that withholding agents may accept the prior (February 2014) revision of Form W-8BEN-E until January 1, 2017

Part III Claim of Tax Treaty Benefits (if applicable). (For chapter 3 purposes only).

14 I certify that (check all that apply):

- a The beneficial owner is a resident of _____ within the meaning of the income tax treaty between the United States and that country.
- b The beneficial owner derives the item (or items) of income for which the treaty benefits are claimed, and, if applicable, meets the requirements of the treaty provision dealing with limitation on benefits. The following are types of limitation on benefits provisions that may be included in an applicable tax treaty (check only one; see instructions):
- | | |
|--|---|
| <input type="checkbox"/> Government | <input type="checkbox"/> Company that meets the ownership and base erosion test |
| <input type="checkbox"/> Tax exempt pension trust or pension fund | <input type="checkbox"/> Company that meets the derivative benefits test |
| <input type="checkbox"/> Other tax exempt organization | <input type="checkbox"/> Company with an item of income that meets active trade or business test |
| <input type="checkbox"/> Publicly traded corporation | <input type="checkbox"/> Favorable discretionary determination by the U.S. competent authority received |
| <input type="checkbox"/> Subsidiary of a publicly traded corporation | <input type="checkbox"/> Other (specify Article and paragraph): _____ |
- c The beneficial owner is claiming treaty benefits for U.S. source dividends received from a foreign corporation or interest from a U.S. trade or business of a foreign corporation and meets qualified resident status (see instructions).

15 **Special rates and conditions** (if applicable—see instructions):

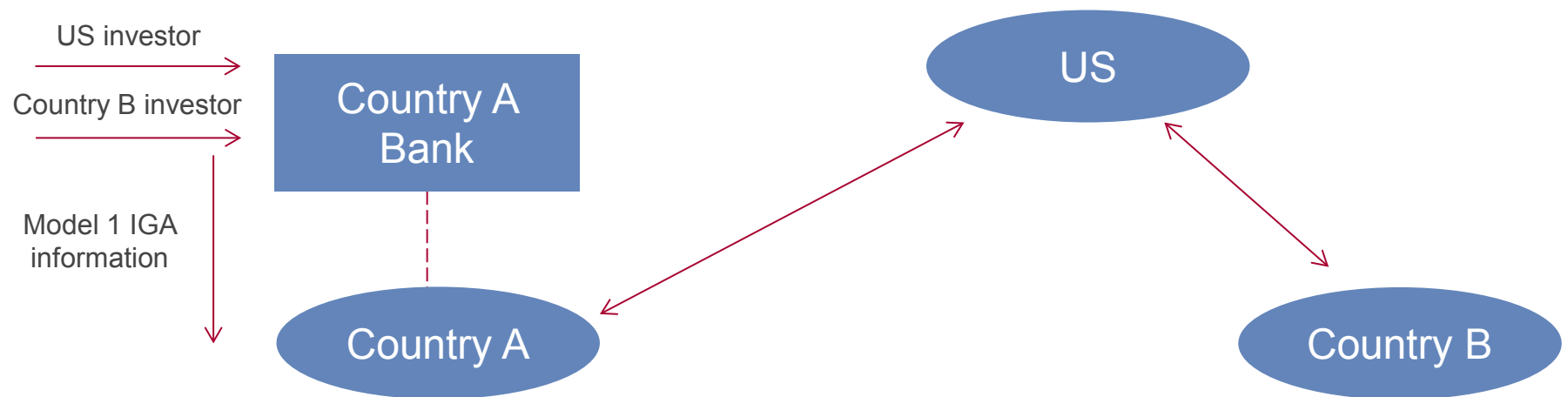
The beneficial owner is claiming the provisions of Article and paragraph _____ of the treaty identified on line 14a above to claim a _____ % rate of withholding on (specify type of income): _____
Explain the additional conditions in the Article the beneficial owner meets to be eligible for the rate of withholding: _____

Enhanced QI LOB Procedures

- ▶ Notice 2016-42 contains a proposed new QI Agreement that, among other provisions, would require the collection of new LOB information for entity account holders claiming treaty rates of withholding
 - Generally required for accounts opened or documented on or after January 1, 2017
 - For pre-existing accounts (subject to change in circumstances):
 - Forms W-8 may be relied upon until normal expiration period
 - Where account was documented with documentary evidence, there is a two-year transition period for collection of information
- ▶ New LOB information may be Form W-8 or treaty statement containing LOB certification
- ▶ QI cannot rely on LOB claim if it has actual knowledge or reason to know claim is incorrect
 - Reason to know=treaty under which benefits are claimed does not exist or is not in force

FATCA

- ▶ Temp Regs sunset in 2017
 - What's to happen?
- ▶ Common reporting standards – why?



- ▶ Under model 1 IGA, Country A collects information to identify taxpayers, passes it onto the US, US passes it onto Country B pursuant to US-B tax treaty
- ▶ Goal is to leverage the IGAs to make information exchange automatic

FATCA and CRS

- ▶ FATCA is a US only initiative
- ▶ CRS is an initiative of participating jurisdictions, overseen by G20, OECD and Global Forum
- ▶ FATCA documentation
 - W-8; W-9
 - self certifications under IGAs if desired
- ▶ CRS
 - W-8, W-9 would not capture all of the information, self certification required

FATCA and CRS

- ▶ The US has not implemented CRS. Most of Europe has.
- ▶ Still impacts US persons with overseas accounts
 - Documentation rules vary
 - FATCA reports payments to FIs
 - CRS makes them non reportable
 - Presumption rules of FATCA aren't found in CRS
- ▶ How will governments use the information?
 - Privacy/Cybersecurity concerns
- ▶ How will enforcement work?
 - IRS monitoring?
 - Global Forum monitoring?

New Partnership Examination Regime

- ▶ The new partnership examination regime for tax years after beginning after 2017
 - Eliminates current TEFRA and Electing Large Partnership (ELP) in favor of a “streamlined procedure” for partnership audits.
- ▶ Exceptions:
 - Partnerships issuing 100 or fewer form K-1 statements are not covered by the new examination regime.
 - Only partnerships that have partners that are individuals, C-corporations or S-corporations and estates of deceased partners are currently allowed to opt out. Thus, tiered partnerships are currently excluded from the opt-out rule

New Partnership Examination Regime

- ▶ New Default rule is to make partnerships, rather than partners, subject to federal income tax on audit
- ▶ Still awaiting more detailed rules regarding implementation the new regime
- ▶ In order to pass the tax liability through to its partners, the partnership will have to make a special election.
- ▶ Although the tax assessed to the partnership will generally be computed at the highest rate applicable to individuals, partnerships can demonstrate that a lower rate should apply

New Partnership Examination Regime

- ▶ New regime provides for a Partnership Representative, rather than a tax matters partner, and provides fewer rights by statute to the partners
- ▶ All partners are bound by a final resolution in the partnership audit and penalties are determined at the partnership level; no partner defenses to penalties exist
- ▶ Just as TEFRA presented many difficulties in auditing partnerships, so does the new law. However, the new law imposes those difficulties on the partnerships rather than the IRS

New Disguised Sale Regulations

- ▶ Proposed Regulations issued January 30, 2014
- ▶ Final and temporary regulations issued on October 5, 2016
- ▶ New regulations create a new type of qualified liability: “A liability that was not incurred in anticipation of the transfer of the property to the partnership, but that was incurred in connection with a trade or business in which property transferred to the partnership was used or held but only if all the assets related to that trade or business are transferred other than assets that are not material to a continuation of the trade or business”
 - Reg. § 1.707-505(a)(6)(i)(E)

New Disguised Sale Regulations

- ▶ Pursuant to the Temporary regulations, a partner's share of liabilities is determined for disguised sales purposes based on the partner's share of excess nonrecourse liabilities
 - Partner cannot be allocated more than its profits interest share of partnership liabilities, as determined under general rule of Reg. § 1.752-3
 - Even if Partner guarantees a portion of the debt
 - No guidance re what profits interest share of partnership liabilities means when have complex waterfall

New 752 Regulations: Liability Allocation

- ▶ Pursuant to the Temporary regulations, a partner's share of liabilities is determined for disguised sales purposes based on the partner's share of excess nonrecourse liabilities
 - Partner cannot be allocated more than its profits interest share of partnership liabilities, as determined under general rule of Reg. § 1.752-3
 - Even if Partner guarantees a portion of the debt
 - No guidance re what profits interest share of partnership liabilities means when have complex waterfall

New 752 Regulations: Temporary Regulations

- ▶ Bottom-dollar payment obligations are generally ignored
 - “Bottom-dollar payment obligations” include tiered partnerships, intermediaries, senior and subordinate liabilities and other obligations involving multiple liabilities if the liabilities were incurred as part of a common plan to avoid having at least one of the liabilities be treated as a bottom-dollar payment obligation
 - Reasoning: IRS generally views such arrangements as lacking significant non-tax commercial business purpose
- ▶ Exceptions
 - “Vertical slice” of partnership liability
 - Certain arrangements where the obligor retains 90% or more of the economic risk of loss for the liability
- ▶ Disclosure required of all bottom-dollar payment obligations that are incurred or modified
- ▶ Effective: immediately (although exception for obligations undertaken or imposed pursuant to a written binding contract and 7 year transition relief available in certain instances)

New 752 Regulations: Proposed Regulations

Proposed regulations regarding payment obligations under Reg. § 1.752-2

- ▶ Proposed regulations differ from 2014 proposed regulations
 - Abandon the “all-or-nothing” approach, net-value requirement, and “arm’s length consideration” requirement
 - **Create a non-exclusive list of 10 factors in a new anti-abuse rule indicating plan or intention to avoid payment obligation, including:**
 - Lack of commercially reasonable restrictions to protect likelihood of payment
 - Unilateral right to terminate payment obligation (unless objective factors)
 - Obligor holds excess assets
 - Inability of creditor to pursue remedies
 - Credit support did not modify borrowing terms
 - Beneficiary of credit support did not receive relevant documents within reasonable time
 - Would eliminate Reg. § 1.752-2(k) (the disregarded entity rule)
- ▶ Effective: when published in final form

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- ▶ Concentrates his practice in securities law, particularly in representing investment management companies and other clients on matters arising under the Investment Company Act of 1940 and the related Investment Advisers Act of 1940, and broker dealers and commodity futures traders and pool operators.
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- ▶ Also represents broker-dealers and CTAs and CPOs with respect to matters under the Securities Exchange Act of 1934 and the Commodity Exchange Act.
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- ▶ President of the American College of Tax Counsel, vice chair of the Tax Section of the American Bar Association, vice president and a member of the executive committee of the U.S. Branch of the International Fiscal Association, and on the executive committee of the George Washington/IRS Annual International Tax Institute.



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- ▶ Focuses his practice on domestic and international tax and private equity matters.
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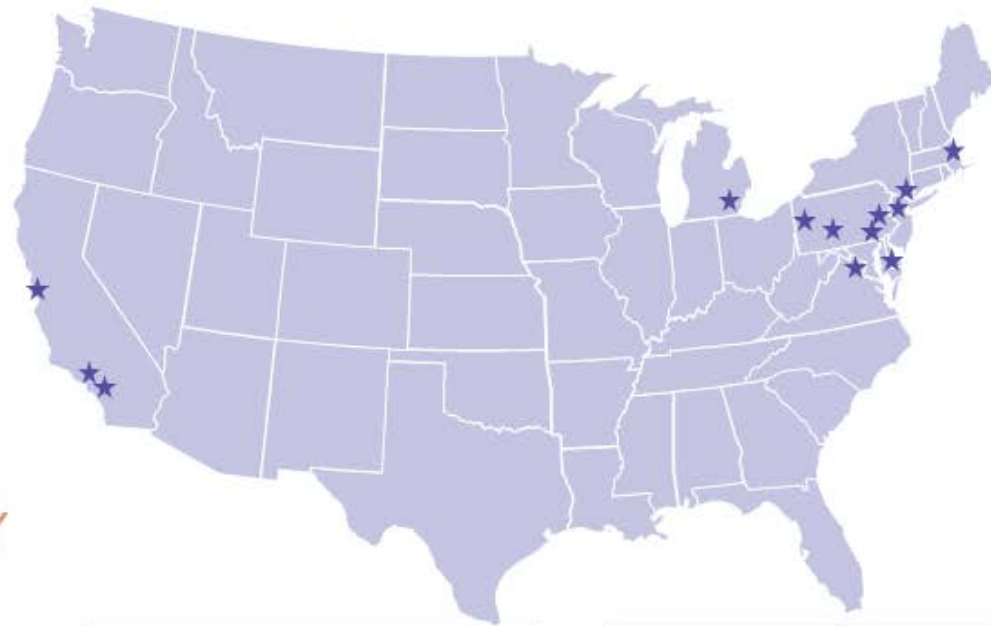
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