

May 2009

Obama's Revenue Proposals Impact Private Investment Funds

On May 11, 2009, the U.S. Treasury released its *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals* (the "Revenue Proposals"). The Revenue Proposals include several provisions affecting private investment funds, such as private equity funds, hedge funds and venture capital funds, and their managers.

"Carried Interest" to be Taxed at Increased Ordinary Income Tax Rates

Currently, the character of income received from a partnership is determined at the partnership level, so that partners report ordinary income, capital gain and/or qualified dividend income depending on the treatment to the partnership. Thus, if the partnership recognizes long-term capital gains and qualified dividends, the individual partners would be subject to tax on that income at capital gains rates. The Revenue Proposals would tax income and gain from a partnership interest received in exchange for services ("carried interest") as ordinary income regardless of the character at the partnership level, unless the income or gain was attributable to the partner's "invested capital." The income from a carried interest would also be subject to self-employment taxes. Invested capital is money or other property contributed to the partnership, but does not include contributions attributable to the proceeds of any loan or other advance made or guaranteed by any partner or the partnership. In addition to partnership interests, ordinary income treatment would also apply to persons providing services to an entity if that person holds convertible or contingent debt of the entity or an option or any derivative instrument with respect to the entity (excluding a partnership interest or stock in certain taxable corporations). The carried interest proposal would apply

to all partnerships. This is broader than the bill proposed by Senator Levin in April, which would have required ordinary income treatment for "investment services" partnership interests. This proposal would be effective for taxable years beginning after December 31, 2010.

In addition, the Revenue Proposals would eliminate the current 33% and 35% tax brackets and would add tax rate brackets of 36% and 39.6% for individuals with income over \$250,000 (or \$200,000 for single taxpayers). The Revenue Proposals would increase the tax rate on capital gains and dividends to 20% for individuals with income over \$250,000 (or \$200,000 for single taxpayers), effective for taxable years beginning after December 31, 2010.

New Withholding Rules

Under current regulations, an offshore fund may be able to reduce or eliminate the amount of withholding tax remitted to the IRS on behalf of the fund's investors simply by providing appropriate documentation to a withholding agent. The Revenue Proposals would require certain offshore funds to register with the IRS as qualified intermediaries. Absent such registration, the fund, and therefore its investors, will be subjected to withholding tax at the maximum rate even if the investors are entitled to reductions under applicable tax treaties. Investors entitled to such reductions will have to file a U.S. tax return in order to claim a refund. [View a more detailed report on withholding rules.](#)

Enhanced FBAR Reporting Requirements

Under current law, U.S. persons must disclose whether, at any time during the preceding year, they had an interest

in, or signatory authority over, financial accounts in a foreign country if the aggregate value of these accounts exceeds \$10,000. The disclosures are made on the Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1 ("FBAR"). The Revenue Proposals would significantly increase reporting requirements for foreign financial accounts as well as provide the IRS with certain tools to combat noncompliance with these rules. [View a more detailed report on FBAR reporting requirements.](#)

New Rules for Equity Swaps and Forward Sales

The Revenue Proposals would treat income earned by foreign persons with respect to equity swaps referencing U.S. equities as U.S. source income to the extent that the income is attributable to (or calculated by reference to) dividends paid by a U.S. domestic corporation. The Revenue Proposals would also require a corporation that enters into a forward contract to sell its stock to treat currently a portion of the payment on the forward sale as a payment of interest. [View a more detailed report on equity swaps and forward sales.](#)

Additional Information

The Hunton & Williams Private Investment Fund Group regularly represents funds, sponsors and a variety of investors in all types of private investment fund matters, including tax, structuring, formation, offerings and compliance. We are able to help you determine the impact of the Revenue Proposals on your business. We will continue to monitor the Revenue Proposals as well as other relevant trends in private investment fund regulation.

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