

PwC alternatives

volume 3 no. 2

Insights for the private equity and hedge fund communities

In this issue:

Best practices for hedge fund managers and investors issued by President's Working Group on Financial Markets

The reports provide guidance for establishing best practices and support a principles-based approach to regulation for the financial services industry 1

The emerging market for carbon emissions rights

US industrial companies and investors are showing increasing interest in carbon trading 2

MiFID compliance: what's next?

MiFID is a new European Parliament Directive that brings a new set of operational challenges to many investment firms 4

The tax framework for US-managed hedge funds investing in Germany

Germany continues to be an attractive market for hedge fund investment 6

The administrator—integral player in the alternative investment industry

With fund administrators' newfound prominence comes significant challenges that test their ability to maintain the highest quality service 13

Real estate investment trusts: under the state looking glass

This article highlights various state statutes and state court cases addressing REITs and examines the impact of these developments on the use of REIT structures in the future 15

Real estate tax update

This article provides an update on REIT rules and taxation 19

Best practices for hedge fund managers and investors issued by President's Working Group on Financial Markets

On April 15, 2008, the Asset Managers' Committee and the Investors' Committee appointed by Treasury Secretary Henry Paulson, Chairman of the President's Working Group on Financial Markets, issued recommendations for best practices by hedge fund investors and managers.

The reports, developed by private sector committees composed of hedge fund managers and investors, provide guidance for establishing best practices and support a principles-based approach to regulation for the financial services industry.

The Asset Managers' Committee report calls on hedge fund managers to adopt comprehensive best practices in the management and administration of their funds, including disclosure, valuation of assets, risk management, business operations, compliance and conflicts of interest. The focus is on implementing innovative and far-reaching practices that exceed existing industry-wide standards and on increasing accountability for hedge fund managers.

The Investors' Committee report contains both a Fiduciary's Guide, which provides recommendations to individuals charged with evaluating the appropriateness of hedge funds as a component of an investment portfolio, and an Investor's Guide, which provides recommendations to those charged with executing and administering a hedge fund program once a fiduciary has decided to add hedge funds to the investment portfolio.

Industry participants are encouraged to review the reports, and can submit comments on them to the committees through their Web site at www.amaicmte.org. The deadline for submitting comments is June 13, 2008. The committees will review the comments and, as necessary, revise their recommendations on best practices and standards.

Partners from PricewaterhouseCoopers consulted with the Asset Managers' Committee, contributing to the development of the Recommendations on Valuation.

The Asset Managers' Committee report can be found here: http://www.amaicmte.org/Public/AMC_Report.pdf

The Investors' Committee report can be found here: http://www.amaicmte.org/Public/Investors_Committee_Report.pdf

The emerging market for carbon emissions rights

by Matthew Haskins

In 1997, the Kyoto Protocol to the United Nations Framework Convention on Climate Change established a framework for the adoption of market-based “cap-and-trade” systems to limit greenhouse gas emissions. Over the past several years, a market for carbon emissions rights, or “carbon credits,” has developed in Europe as an alternative to more conventional forms of regulation. Increasingly, US-based corporations and investment funds are trading in this market, but questions remain, particularly about the prospects for a US cap-and-trade system and the US tax treatment of carbon credits.

The European Union and United Nations systems

In 2005, the European Union (EU) established a cap-and-trade system governing greenhouse gas emissions in the EU. Greenhouse gas emitters were granted an initial allocation of specific rights to emit carbon dioxide in Europe (EU Allowances or EUAs) based on their prior levels of emissions and governmental pollution reduction goals. Under this system, an industrial company becomes either a potential buyer or a potential seller of emission credits, depending on the market price of carbon credits and the company’s costs for reducing its own carbon emissions. Companies that can economically reduce their emissions have an opportunity to sell their credits for profit. Companies that cannot reduce their emissions at a cost below that of the market price for emission credits are likely to become buyers of credits.

Developers of greenhouse gas reduction projects can seek certification for EUAs under the European Union or for Carbon Emissions Rights (CERs) under United Nations standards. These carbon credits may be used to meet up to 10 percent of an EU emitter’s need for carbon credits and also may be used in other non-EU jurisdictions.

Projects that are not certified by either the EU or the United Nations may meet the certification criteria set by certain nongovernmental organizations as Voluntary Emissions Reductions (VERs).

Many investment managers have begun trading in EUAs, and market research firm Point Carbon estimates that trading volume under the EU emissions trading scheme will reach US\$68 billion in 2008 and that the overall global carbon market will grow by 56 percent in 2008.¹

Potential in the US market

Many observers predict that the US will soon adopt a cap-and-trade system that will create a sizeable US-based market for carbon credits. A recent report by New Carbon Finance, a provider of carbon market analysis, predicts the “United States will be home to a US\$1 trillion carbon emission market by 2020,”² assuming lawmakers continue pursuing a comprehensive cap-and-trade program.

Several cap-and-trade bills are under consideration in the US, including the McCain-Lieberman Climate Stewardship Act, which would place mandatory caps on greenhouse emissions for power plants, industry and oil refineries. Altogether, there are currently 13 climate change bills under discussion by the US Congress. Most propose cap-and-trade systems similar to what already exists in the US for pollutants such as sulfur dioxide and nitrogen oxide.

Even in advance of federal action, several states have moved to implement either state-based or regional cap-and-trade systems to control and reduce various greenhouse gases. For example, the California Global Warming Solutions Act of 2006 sets a goal of a 25 percent reduction in the state’s greenhouse gas emissions levels by 2020. In addition, many US-based companies have started making voluntary emissions reductions or purchasing VERs to move toward “carbon neutrality” in their business operations.

1 “Market Making: Carbon Keeps Growing,” by Keith Johnson, Wall Street Journal Environment Writer, on the Wall Street Journal’s Environmental Capital blog, February 26, 2008: <http://blogs.wsj.com/environmentalcapital/2008/02/26/market-making-carbon-keeps-growing/trackback/>

2 “Economic Researchers Predict \$1 Trillion U.S. Carbon Trading Market by 2020,” press release from New Carbon Finance, February 14, 2008: <http://www.newcarbonfinance.com>

Current activity in US markets

Even without a US-based cap-and-trade system, carbon credits are actively traded on the Chicago Climate Exchange and the New York Mercantile Exchange and Evolution Markets-sponsored Green Exchange. Both have sought varying levels of Commodity Futures Trading Commission (CFTC) approval for their activities. In addition, there is a growing principal-to-principal market for transactions in EUAs, CERs, and even VERs, and increased interest in projects designed to reduce emissions and yield salable carbon credits. Such activity is expected to grow exponentially in the coming years.

Tax issues

With a headstart on implementation, some EU jurisdictions have clarified the tax treatment of carbon credits. For example, under UK guidance, trading in EUAs and CERs generally qualifies for the UK's investment manager exemption (IME) and, thus, does not give rise to a taxable presence in the UK. (VERs do not qualify for the UK IME and generally are traded via total return swaps.)

In contrast, neither law nor precedent provides much guidance on the appropriate US tax treatment of carbon credits. Without such guidance, potential investors in carbon emission rights have been left to form their own views on a variety of key issues, including whether carbon emission rights can be treated as "commodities," thus allowing favorable treatment for foreign investors under the US trading safe harbor. Among the issues to consider are (1) the strength of the analogy between carbon emission rights and traditional traded commodities, and (2) the differences among various types of carbon emission rights (EUAs, CERs and VERs).

Other US-based entities have had to consider whether trading in carbon credits by their affiliates creates Subpart F income. While there are supportable arguments for a Subpart F exception—because carbon emission rights are "commodities" or because they are operating intangibles—the technical support for either conclusion is unclear. The IRS has not issued guidance on this point, but some companies are considering requesting clarification.

Both industrial companies and investors in the US are showing increasing interest in carbon trading, and the IRS is expected to address the tax treatment of carbon emission rights as markets evolve in the US and the European Union.

by Aaron Caplan

The Markets in Financial Instruments Directive (MiFID) is a new European Parliament Directive that replaced the Investment Services Directive (ISD) on November 1, 2007. MiFID's principles-based approach provides a harmonized regulatory regime for investment services and activities across 30 European economies, bringing with it operational challenges for most investment firms, including US hedge fund managers with activities in Europe.

In order to prepare for MiFID, firms have been working to implement changes in their business. This has meant:

- Coming to grips with new rules and new terminology;
- Preparing client classification letters, order execution policies and conflict-of-interest maps;
- Training the business on changes; and
- Ensuring that systems, compliance manuals, policies and procedures are up to date.

The move from a rules-based regulatory regime to a more principles-based approach also increases the need for senior management to be aware of their firm's regulatory obligations and ensure the firm is fulfilling them. The question then remains: With all of the effort that has gone into being compliant with MiFID, how confident is senior management that the letter and the spirit of the updated rules have been implemented?

Many firms were comfortable with developing project plans, implementing changes and engaging the business to meet the November 1, 2007 deadline for compliance with MiFID. However, as firms focused on meeting the deadline, they may have overlooked such matters as the impact on the business control environment, including compliance monitoring and internal audit programs.

Management information

For a firm to be able to demonstrate that senior management is fulfilling its role in ensuring compliance with regulatory obligations, it should be able to point

to the management information that is used to fulfill obligations. This information needs to be both qualitative and quantitative.

Some firms may have been preoccupied with preparing for MiFID, and may not yet have considered how the information they receive needs to change. Information on compliance, and the links between the information received from compliance, internal audit and risk management, should now be reviewed to ensure that they are up to date and reflect the current regulatory environment in which the business operates.

A coordinated yet independent approach

The requirement to have independent compliance, risk and internal audit functions is not new in the United Kingdom. However, firms may want to reconsider how their different internal operating functions can act in an independent yet complementary fashion to ensure that the business is complying with regulatory requirements.

In order for management to get the information it needs, firms should reevaluate the risks that the compliance and internal audit functions are responsible for and what is actually being monitored. For many, this will mean updating the relevant risk registers and feeding that through the monitoring programs of compliance and internal audit reviews.

For those not taking a risk-based approach to compliance monitoring, meeting the MiFID requirements should serve as a catalyst to reassess compliance risks, and then modify compliance monitoring programs to focus on the areas of greatest risk.

The role of compliance monitoring

Using a risk-based approach, compliance monitoring plans should be reviewed to ensure that MiFID-related regulatory changes have been incorporated. A good

starting point may be the areas the Financial Services Authority (FSA) has said will be its supervisory priorities arising from the November 2007 changes to its handbook. A summary of the main FSA supervisory priorities can be found in the diagram below.

FSA supervisory priorities



*Senior Management Arrangements, Systems and Controls section of the FSA handbook

Potential high risk areas

Some of the considerations for compliance may include:

Best execution

- How will the firm check that traders are following the order execution policy; and
- How will the firm check that the order execution policy is actually providing best execution?

Suitability and appropriateness

- What monitoring needs to be undertaken to ensure that the correct test(s) have been performed (if necessary), that the outcome of the test is recorded and that staff are following all relevant procedures?

Record-keeping

- How will the firm test the controls that are in place to make sure that all necessary data are stored for five years;
- Are the proper controls in place over that data; and
- Has the firm considered the link to the data protection principles, including that data must be accurate, up to date and not kept for longer than is necessary?

Conflicts of interest

- How has the firm's conflicts policy been implemented in the business; and
- How will the firm ensure that its conflicts register captures all of the real or potential conflicts, and is kept up to date?

Transaction reporting

- Are the firm's systems capturing all of the necessary information;
- Is the information correct; and
- Are transaction reports being sent to the appropriate regulator on a timely basis?

Now that most firms should have implemented MiFID, the question remains how to adapt management information and monitoring to reflect the regulatory changes.

Now is the time to review the role of compliance monitoring and internal audit, and to ensure that the areas being monitored and the information being produced are appropriate for senior management. Only then will investment firms be able to demonstrate their understanding and control of regulatory risk.

The tax framework for US-managed hedge funds investing in Germany

by Philip Fried, Hans-Ulrich Laueremann, Thomas Swoboda and Oscar Teunissen

Despite the credit and liquidity crises, hedge funds are attracting investment not only from traditional sources such as large asset managers, pension funds and wealthy families, but also from new players such as sovereign wealth funds¹ and the Asian central banks.²

Traditionally, the US has been the largest foreign investor in other countries as well as a leading target for hedge fund investors. While the US remains the world's largest and most liquid financial market, with US\$56.1 trillion in assets, nearly one-third of the global total, Europe's financial markets are collectively approaching the size of the US market with US\$53.2 trillion in assets (both 2006 figures).³

Within Europe, Germany continues to be an interesting market for hedge fund investments,⁴ with investment opportunities including a broad base of attractive mid-sized companies, a nonperforming loan market and attractive real estate prices.⁵

Hedge funds seeking to invest in Germany should understand the local tax framework and its implications, especially for the asset classes they most frequently invest in, including real estate, nonperforming loans, credit card and consumer debt, bonds, publicly traded shares, private equity and music rights, film rights and other intellectual property.

General considerations

Hedge funds usually organize parallel structures for onshore US investors and offshore investors. US taxable investors typically invest through vehicles that are transparent for US tax purposes. This allows investors to preserve the character of the underlying investment income earned by the funds with respect to capital gains and other preferential items. A transparent structure also generally permits the flow-through of foreign taxes as credits to US taxable investors.

Non-US investors, as well as US investors who are exempt from US taxes, usually invest through an offshore corporation. This serves to mitigate Unrelated Business Income Tax (UBTI) issues for US tax-exempt investors and tax reporting requirements for foreign investors.

Some funds employ master-feeder structures in which both the onshore fund and the offshore fund invest through a single offshore entity. If it is not actually a partnership, the offshore entity will usually be treated as one for US tax purposes. In either structure, funds frequently set up holding platforms in favorable treaty locations (e.g., Luxembourg, the Netherlands, Mauritius and Cyprus) which would hold a variety of investments in various target countries.

From the perspective of a management company, US hedge funds are usually managed out of the US with subadvisors providing assistance from financial centers such as London, Zurich, Singapore, Hong Kong and Tokyo. Offshore investors often rely on the US trading safe harbor⁶ to avoid a taxable presence in the US.

Management company issues

Among the few countries offering safe harbor rules similar to those of the US,⁷ allowing the mitigation of permanent

1 The Carlyle group has recently sold a minority stake to the Abu Dhabi government.

2 Blackstone sold a US\$3bn stake to the investment arm of the Chinese government before going public.

3 McKinsey Global Institute *Mapping Global Capital Markets—Fourth Annual Report*, January 2008, p. 11.

4 In 2006, Germany ranked among the Top 10 recipients of capital inflow for the reported asset classes that include foreign direct investment, equity securities, debt securities, and lending and deposits, McKinsey Global Institute *Mapping Global Capital Markets—Fourth Annual Report*, January 2008, p. 49.

5 The Urban Land Institute mentioned Munich and Hamburg among the Top Ten real estate markets for 2007, *Emerging Trends in Real Estate Europe 2007*, p. 30.

6 Sec. 864(b)(2) Internal Revenue Code (IRC).

7 Sec. 864(b) IRC.

establishment (PE) exposure, are the UK,⁸ Singapore and Hong Kong. However, most European countries, including Germany, do not offer such a trading safe harbor. If advisors or subadvisors in Germany negotiate contracts on the behalf of offshore (i.e., non-German) investment funds, there is a significant risk that the local management company's activities will create a PE for the funds. If a German fund manager has a subadvisor relationship with a US investment manager, its activities also could create a PE for the US investment manager.

In any event, the creation of a PE in Germany could have a significant tax impact. Profits allocated to the German PE may be subject to an effective German tax rate of as much as 47 percent. To mitigate such exposure, the scope of the activities of a German subadvisor typically would be well-defined in a subadvisory agreement, and the subadvisor's employee agreements would lay out clearly the scope of the permitted activities.

The risk of creating a PE is especially high for asset classes that require activities to be performed on the ground in Germany, such as real estate investments and workouts of nonperforming loans. In such cases, careful tax planning can mitigate the risk of an unwanted tax liability for the fund or the European platform holding the asset. Some activities may be outsourced, such as the daily management of German real estate investments. Other nontax issues may arise. For example, activities such as nonperforming loan workouts may be subject to regulatory oversight and require country or region-specific licenses before they can be performed.

Tax consequences of investments in Germany

Listed stock/private equity investments

Capital gains of offshore funds from the sale of shares in both listed and unlisted companies are subject to German corporate income tax if the investment exceeds one percent of the share capital (so-called material shareholding).⁹

Even though the effective tax rate may currently be as low as 1.3 percent of the capital gain, this risk should be considered when structuring investments into Germany through a European holding location. Otherwise, funds that employ transparent structures may end up filing tax returns for all of their investors. For example, if an offshore partnership fund sells a material German shareholding, all investors in the funds would be subject to German tax, resulting in a substantial compliance burden. German tax law generally does not allow funds to fulfill such obligations by making lump-sum payments

without revealing the identity of the investors in the transparent partnership.

At the target level, profits are currently subject to a 15 percent corporate income tax and a 5.5 percent solidarity surcharge that is levied on the corporate tax due. An additional trade tax levied by municipalities effectively runs to between 7 percent and 14 percent of the taxable income, leading to a current overall German income tax burden of approximately 23 percent to 31 percent. Before the Tax Reform Act 2008, the overall tax burden amounted to approximately 38 percent to 40 percent.¹⁰

The German trade tax allows only 75 percent of any interest paid on any form of debt to be deducted for trade-taxable income. Additionally, rental or leasing payments are partly treated as nondeductible for purposes of determining the trade tax.

The recently amended interest-capping rules have had an important impact on assessing the optimum amount of leverage for private equity deals.¹¹ Under the Tax Reform Act 2008, the German thin-cap and anti-debt pushdown rules were replaced by an earnings-stripping rule. According to the new rule, tax relief for interest expenses will be limited to 30 percent of the taxable income of the German target before (net) depreciation, interest expenses and taxes. The new rule captures interest on both bank loans and shareholder loans. Interest disallowed under the interest-capping rules can be carried forward indefinitely but increases the interest expenses in subsequent years.

The interest-capping rules will not apply unless net interest expenses (i.e., after deduction of any interest income) exceed EUR 1m (approx. US\$1.57m). Under an escape clause, the interest-capping rules are not applicable if the business' debt-to-equity ratio (under its IFRS stand-alone financial statements) does not exceed the debt-to-equity ratio in the highest-level consolidated audited accounts under IFRS. Under certain circumstances, German generally accepted accounting principles (GAAP) consolidated accounts or US GAAP consolidated accounts may be used.

When applying the escape clause, it is important to determine whether the leverage at the holding company level would be relevant for the leverage of the German target, or whether the debt-to-equity ratio at the level of the investment fund or even on the investor's level would be decisive.

Another exemption applies if the German special purpose vehicle (SPV) is not part of a group, i.e., if its interest is held by various investors and its accounts are not consolidated in either of the investor's accounts.

⁸ The UK Investment Management Exemption (IME) allows offshore funds to be managed in the UK with regard to certain asset classes if certain prerequisites are fulfilled.

⁹ Sec. 49 para 1 no. 2 lit. (f) German Income Tax Act.

¹⁰ The Annual Tax Bill 2008 was enacted December 29, 2007.

¹¹ Sec. 8a Corporate Income Tax Code.

A careful analysis of the facts and circumstances is highly recommended.

In addition, the German legislature amended the “change of control rule.”¹² The direct or indirect transfer between 25 percent and 50 percent of the shares or voting rights in a corporation to one acquirer or persons related to the acquirer within five years results in a pro rata forfeiture of any tax loss carryforwards. Should the transfer exceed 50 percent, all of the tax loss carryforwards are forfeited. This rule also applies to any interest carried forward.

The new rules will affect the economics of private equity transactions. In the past, buyers paid premiums for companies with net loss carryforwards.¹³ Under the new rules, loss carryforwards will be forfeited in many cases. Previously, private equity investors could reduce the effective tax rate of target companies by granting shareholder loans within the limits of the safe harbor rules. Now, introduction of leverage requires careful tax planning. The issue is exacerbated because the 30 percent limit relates not only to shareholder debt but also to bank debt. However, because treaty benefits for dividends payments may not be available due to the recently revised German anti-treaty shopping rules, debt funding may still be favorable in many cases.

In general, US individual investors can credit only foreign withholding taxes (e.g., German dividend withholding tax) against their personal tax liability. Taxes paid at the level of the German target generally are not available as a credit at the investor level. Accordingly, it may make sense to treat the German target as transparent from a US federal tax perspective. Under the check-the-box rules,¹⁴ the owners of a US or foreign entity can choose to treat the entity as a corporation or partnership¹⁵ for US tax purposes. As a result, the income of the German target company would be realized directly by US investors in a transparent fund and be taxable on a current basis.¹⁶ US investors also may claim a tax credit for taxes paid at the level of the German target, subject to various limitations. Filing a check-the-box election requires that the income or loss of the foreign entity be calculated under US tax principles.

According to the regulations, every non-US entity has a default status.¹⁷ In some cases, a different classification can be achieved by filing a timely election on Form 8832.

12 Sec. 8c Corporate Income Tax Code.

13 Under old law, Sec. 8 para. 4 Corporate Income Tax Act causes the forfeiture of net loss carryforwards only if more than 50 percent of the shares in a corporation are transferred and the fair market value of newly infused assets (cash, etc.) after the ownership transfer exceeds the fair market value of the assets (including self-generated goodwill) of the corporation before the ownership transfer (anti-stuffing test).

14 The US entity classification rules are contained in Treas. Regs. 301.7701-1 et. seq.

15 If an entity has only one shareholder, it would turn into a disregarded entity rather than a partnership for tax purposes.

16 Sec. 702(a) IRC.

17 Treas. Reg. 301.7702-3(b).

In Germany, the following types of entities are available for business ventures:

- *Offene Handelsgesellschaft* (general partnership)
- *Kommanditgesellschaft* (limited partnership, or KG)
- *Gesellschaft mit Beschränkter Haftung* (limited liability company, or GmbH)
- *Aktiengesellschaft* (corporation, or AG)

According to the regulations,¹⁸ an AG is considered a *per se* corporation. The filing of a check-the-box election is therefore not possible and an AG will always be treated as a corporate body for US tax purposes.

However, for a limited liability company, a timely check-the-box election may be filed to treat the company as a partnership. The compliance burden of reporting the foreign entity’s activities based on US tax principles may be justified by the potential benefit to US individual investors of claiming a credit for the taxes paid at the level of the foreign entity.¹⁹

In some instances, hedge funds acquiring minority shares may not be able to change the classification of an entity without the majority owner’s consent. That could mean that US taxable investors would not be able to credit any entity-level taxes against personal tax liability. However, in an exit scenario such as an Initial Public Offering (IPO), US investors might be able to claim long-term capital gain treatment from the sale of the stock in the foreign corporation, as long as the shares were held for at least 12 months before the sale.

US individual investors also may benefit from a 15 percent tax rate on dividend income if the dividend qualifies as Qualified Dividend Income (QDI).²⁰ Dividends may qualify for such treatment if they are received from a Qualified Foreign Corporation, which is any corporation eligible for benefits of a comprehensive income tax treaty with the US, including an exchange of information program.²¹ In order to be eligible for the benefits of a US income tax treaty, a Qualified Foreign Corporation must satisfy the relevant income tax treaty’s limitation of benefits provision.

If the foreign target is treated as a corporation, the US rules relating to Controlled Foreign Corporations (CFC) or Passive Foreign Investment Companies (PFIC) may apply. Since non-US source income in principle is taxed only upon remittance to the US, the US tax code includes provisions to prevent the deferral of US tax on certain

18 Treas. Reg. 301.7701-2(b)(8).

19 In practice, many funds do not pass foreign tax credits to investors due to the administrative burden of tracking tax credits available to a changing portfolio of investors.

20 Sec. 1(h)(11) IRC. Please note that the QDI rules are scheduled to sunset after December 31, 2009.

21 Sec. 1(h)(11)(C) IRC. For a list of qualifying treaties see Internal Revenue Bulletin 2006 47.

types of highly portable passive income (such as interest, dividends, certain capital gains, rents and royalties) where there is little business rationale for earning the income outside the US.

Controlled Foreign Corporations

A Controlled Foreign Corporation is one in which “US shareholders” own or are considered to own more than 50 percent of the total combined vote or value of the corporation’s stock on any day during the taxable year of the corporation.²² “US shareholders” are US citizens, resident individuals, domestic partnerships, domestic corporations, trusts or estates that directly or indirectly own 10 percent or more by vote of the foreign corporation.²³ For every year in which an entity qualifies as a CFC, US shareholders may be required to include their ratable share of Subpart F income in their taxable income.²⁴

Subpart F income includes several types of income. For hedge funds, the most important type may be foreign personal holding company income (FPHC),²⁵ which typically includes dividends, interest, royalties, rents and gains from sales or exchanges of property.

If a company qualifies as a CFC for US federal tax purposes, any gain from the sale of the shares in that company will not benefit from the 15 percent tax rate applicable to long-term capital gains but instead will be taxable at ordinary rates to the extent of certain earnings and profits of the CFC at the point in time when the shares are sold.²⁶ Dividends received from a CFC that are sourced out of FPHC income are also not eligible for treatment as Qualified Dividend Income.

Passive Foreign Investment Corporations

A Passive Foreign Investment Corporation (PFIC) is a foreign entity that holds assets of which more than 50 percent is held for the production of passive income or, alternatively, which receives gross income of which 75 percent or more is passive.²⁷

In general, US taxable shareholders of a PFIC should elect to treat the PFIC as a Qualifying Electing Fund (QEF) by attaching Form 8621 to their tax return.²⁸

If a QEF election is made, the current earnings of the PFIC are included in the taxable income of US shareholders on a current basis, and the income received by the PFIC retains its character.

If no QEF election is made, an excess distribution or gain from the sale of the PFIC stock is spread over the years in which the shareholder held the stock and any amounts allocated to years prior to the current taxable year are taxed at the highest ordinary income tax rates in effect in those prior years. In addition, the IRS charges interest as if these payments had actually been taxed in an earlier year.²⁹ Dividend payments received by a US individual taxpayer from a PFIC do not qualify for treatment as Qualified Dividend Income (see above).³⁰

The rules applying to PFICs complement those applying to CFCs. The PFIC rules apply without regard to the number of US shareholders in the foreign entity, if the foreign entity meets the definition of a PFIC. The CFC rules supersede the PFIC rules in many cases in which both apply.³¹

Anti-treaty shopping rules

Germany revised its anti-treaty shopping rules effective January 2007.³² The revised rule may lead to a definitive determination of German dividend and royalty withholding tax for non-US investors and any US investors who cannot rely on the benefits of a the US-German double-tax treaty because, for example, they did not provide a timely residence certificate to the funds or because the fund did not pass on tax credits to its US investors due to the administrative burden.

Full or partial treaty or European Union (EU) directive relief from German withholding taxes is available only to the extent that a foreign company has shareholders who would be entitled to the same relief if they received the income directly from the German company, or alternatively, if the foreign company passes all of the following tests:

1. There are economic or other important nontax objectives for the interposition of the foreign company. A recently issued circular³³ holds that objectives such as improved cost efficiency, coordination or internal organization will not qualify.
2. The foreign company derives more than 10 percent of its gross income from its own commercial activities, not including income from shareholdings or income from commercial activities outsourced to third parties.
However, the circular provides that a foreign company can meet this requirement *if* it is an active management holding company for at least two directly owned subsidiaries. Management activities entail situations in which policy decisions are made by the foreign parent company and oversight is

22 Sec. 957(a) IRC.

23 Sec. 951(b) IRC; Treas. Regs. 1.951-1(g); Sec. 7701(a)(30) IRC.

24 Sec. 951(a)(1)(A)(i) IRC.

25 Sec. 954(c) IRC.

26 Sec. 1248 IRC.

27 Sec. 1297(a) IRC.

28 Sec. 1295 IRC.

29 Sec. 1291(a) IRC.

30 Sec. 1(h)(11)(C)(iii) IRC.

31 Sec. 1297(e) IRC.

32 Sec. 50(d) para. 3 German Income Tax Act.

33 German Ministry of Finance, Circular IV B 1—S 2411/07/0002, dated April 3, 2007.

exercised on behalf of the subsidiaries. This means setting general group policies, as opposed to performing day-to-day management functions, but it must be carried out regularly.

The policies by a management holding company have to be documented in writing since verbal directives given to lower-tier subsidiaries are not accepted by the German tax authorities. Activities conducted in branches outside the foreign company's country of tax residence do not generate qualifying income under the income test.

In the case of a management holding company, qualifying income for purposes of the 10 percent test includes dividends, interest and royalty payments received from managed subsidiaries.

The circular further confirms that the anti-treaty/anti-directive shopping provision does not apply to capital gains realized by a foreign company on the sale of shares in a German subsidiary. With respect to such gains, the general anti-avoidance legislation continues to apply.³⁴

3. The foreign company maintains its own business premises and infrastructure sufficient for enabling it to participate in the business community. Typically, these situations are closely scrutinized by the German tax authorities, which may request copies of financial statements, rental agreements, employment contracts and telephone bills.

Listed foreign companies do not fall within the scope of the anti-shopping rules, provided that a significant number of shares are regularly traded on a recognized stock exchange. The same principle applies to certain foreign investment funds structured as corporations.

The new anti-treaty/anti-directive shopping rule may trigger a withholding tax exposure whenever a German dividend or royalty is paid to a foreign company that neither satisfies the aforementioned requirements nor is a qualifying shareholder (i.e., one that would also be eligible for the claimed relief if he owned the German paying entity directly). In practice, many hedge funds and private equity funds may find it difficult to comply with the new rules and claim treaty benefits with regard to dividends paid by German entities to Luxembourg and Dutch holding platforms.

There is debate over whether the extended scope of the new German anti-shopping provision might potentially violate EU law since it could be viewed as going beyond what is covered by the anti-avoidance clause of the EU's parent subsidiary directive. However, these issues have yet to be resolved.

Taxpayers should consider creating a limited partnership above the German structure. Distributions made by a

³⁴ Sec. 42 German General Fiscal Code. See below for the recent amendment of this rule.

German partnership to its foreign interest holder should not be subject to any withholding taxes in the absence of a branch profits tax in its home jurisdiction. Careful planning is required, and professional advice should be sought, since this strategy may not be appropriate for all investors.

Under current law, the withholding tax on dividends and royalties effectively amounts to 21.1 percent before any reduction by tax treaty or EU Directive. In the case of platform structures of hedge funds and private equity funds, this withholding tax may arise whenever the strict requirements of the anti-treaty shopping rules cannot be satisfied. Since capital gains taxes are not covered by the new rule, investments that are undertaken in view of a subsequent trade sale or IPO should not be affected by the tax law change.³⁵

Investments in German real estate

Investments in the attractive German real estate market require especially careful tax planning. Germany imposes income tax on rental income as well as on capital gains derived from real estate located within its boundaries,³⁶ and also typically reserves the right in treaties to levy taxes on rental income and capital gains from the sale of German real estate.

However, few treaties allow Germany to impose a tax on the sale of German companies which have substantial real estate holdings. Accordingly, the interposition of a treaty blocker may result in significant tax savings.

Under current law, nonresident companies, such as offshore funds structured as corporate entities, are taxed at a rate of about 16 percent. If shares of a treaty blocker holding the real estate are sold and properly structured, the effective tax rate from the sale may be reduced to less than one percent.

Individuals holding German real estate through a transparent structure (e.g., a US partnership) are subject to German tax on their share of the rental income or capital gain at tax rates as high as 47 percent. Consequently, every direct or indirect investor in real estate could have to file a German tax return.

A direct investment may lead to prohibitive compliance costs in real estate investments, because profits are generated at the exit phase and taxable current returns are modest due to depreciation and third-party financing. If a blocker is used, only the blocker entity would have to file a local German tax return. For US CFC investors, US PFIC rules and the consequences of filing a check-the-box election for US federal tax purposes must be considered.

From a US perspective, investments in foreign real estate generally do not lead to US Effectively Connected Income

³⁵ Sec. 43(a) para. 1 Income Tax Code. As from January 1, 2009 the dividend withholding tax will increase to 26.375 percent.

³⁶ Sec. 49 para 1 no. 2 lit. f (capital gains), and no. 6 (rental income).

(ECI) for offshore investors.³⁷ Therefore, investments in foreign real estate might well be managed from the US.

Moreover, real estate management activities conducted in Germany must be limited in order to prevent the creation of a German PE. If a PE is created in Germany, income from real estate may be subject not only to income tax but also to trade tax.

Additionally, Germany generally levies a 3.5 percent real estate transfer tax on the direct or indirect transfers of real estate or real estate holding companies. However, careful planning may mitigate this tax.

German real estate investment trusts

Effective January 1, 2007, Germany introduced real estate investment trusts (G-REITs), which must take the form of a listed corporation and can hold German and foreign real estate—including foreign real estate companies if certain requirements are met—with an exception for German residential real estate.³⁸

In order to avoid taxation at the level of both the G-REIT and the investor, the G-REIT itself is exempt from taxation.³⁹

Withholding tax will be levied on distributions to nonresidents. Distributions will be treated as if they were dividend payments. As a result, distributions to nonresident investors will be subject to withholding at a rate of 26.375 percent. Distributions to nonresident investors in treaty countries may enjoy the treaty benefits applicable to dividend payments.

Since investors will not be able to hold 10 percent or more of the interest in a G-REIT, the withholding tax rate applicable to nonresident minority shareholders is relevant.⁴⁰ Therefore, US investors will be subject to a 15 percent withholding tax, and the lower 5 percent treaty rate will not be available.⁴¹

Investors in nontreaty countries, such as offshore funds in corporate form, will face a 26.375 percent withholding tax rate.

In order to prevent the accumulation of tax-free reserves, 90 percent of the G-REIT's book profits must be distributed each year.⁴²

Depending on their foreign tax credit position, the unavailability of lower withholding tax rates might put foreign investors at a disadvantage when investing in a G-REIT.

37 Sec. 864(c)(4)(A) IRC.

38 Sec. 1 REIT Act.

39 Sec. 16 REIT Act.

40 Sec. 11 para. 4 REIT Act.

41 Art. 10 DTA.

42 Sec. 13 REIT Act.

As G-REITs must be established as listed corporations, a check-the-box election is not available for US investors.⁴³ It will not be tax-efficient for US investors if the G-REIT holds non-German real estate investments and is taxed on profits derived from or in connection with the real property in the country in which the property is located. Noncorporate US investors will not be able to claim a credit for tax paid in the target country.

It also may be attractive for US funds to buy units in local German investment trusts (*Sondervermögen*). These trusts generally are exempt from both CIT and trade tax. However, they are subject to regulatory restrictions which limit excessive leverage, and also include other rules on eligible assets and regulatory reporting requirements.

Investments in nonperforming loans

Investments in loans generally should result in a German tax liability only if they are secured by German real estate or ships registered in Germany.⁴⁴ In such cases, a German tax return would have to be filed.⁴⁵ If such secured loans are held through transparent vehicles (e.g., partnerships), the investors in those vehicles would be required to file tax returns.⁴⁶

Without taking into account any other available treaty benefits, the compliance costs alone should justify holding loans through a holding platform. From a compliance perspective, only the holding companies would have to file a tax return in Germany. The investors' names would not have to be disclosed.

Another benefit of setting up a holding company in a country which has a tax treaty with Germany would be that most such treaties do not allow Germany to levy a tax on interest payments, even if the underlying loan is secured by German real estate or German-registered ships.

In the US, it is not always clear whether the safe harbor rules of Sec. 864(b) of the Internal Revenue Code (IRC) cover the acquisition and a potential subsequent work-out of the acquired loans.

Outside the US, many countries anticipate greater regulatory supervision of loan origination activities. For example, Germany requires issuers of loans to hold a valid banking license or a license issued by another EU country (a so-called EU pass).

In addition, some debtor residence countries may require the issuer to possess a valid banking license (e.g., Italy).

43 Treas. Regs. 301.7701-2(b)(8).

44 Sec. 49 para 1 no. 5 lit. c German Income Tax Act.

45 Sec. 43 following German Income Tax Act do not provide for a withholding tax on interest paid on shareholder loans.

46 There is no filing requirement if the loans are not secured by German real estate or ships registered in Germany.

Therefore, consideration should be given to where a loan origination platform is set up and also whether the regulatory framework of the debtor's resident country requires another special purpose vehicle.

Germany's new general anti-abuse rule

In the Annual Tax Bill 2008, Germany revised the general anti-abuse rule.⁴⁷ The goal of the revision was to make the rule more precise and effective by defining the term "abuse of law."⁴⁸ Effective January 1, 2008, the new anti-abuse rule applies when a taxpayer or a third party realizes a tax benefit from an "inappropriate" specific structure which was not intended by law. If the taxpayer can demonstrate sufficient business reasons to justify the specific structure chosen, the general anti-abuse rule would not apply. The tax authorities bear the burden of proof as to whether or not a structure is inappropriate.

Transfer pricing

Transfer pricing rules also were amended by the Tax Reform Act 2008.⁴⁹ In principle, transfer prices will be determined using the comparable uncontrolled price method.

When a comparable uncontrolled price cannot be determined, other pricing methods with limited comparability, appropriately adjusted, should be used. If there is a bandwidth of prices with limited comparability, the median within the confined bandwidth should be used as the transfer price. Where prices with limited comparability are not available, a hypothetical arm's-length comparison needs to be performed. The mean of the range of prices thereby determined should be used as the transfer price unless the taxpayer can prove that another price within the bandwidth of the hypothetical comparison has a higher likelihood of being regarded as arm's-length in nature.

47 The Annual Tax Bill 2008 was enacted December 29, 2007.

48 In the US, Congress may also codify the economic substance doctrine this year despite the administration's continued opposition as part of the "Farm, Nutrition and Bioenergy Act of 2007."

49 Sec. 1 para. 3, Law to Prevent Tax Evasion.

Repercussions of having German investors investing in offshore funds

German investors are keen to invest in offshore hedge funds and increase their exposure to alternative asset classes. In order to avoid lump-sum taxation on income derived from offshore funds, German investors typically will urge fund managers to comply with certain year-end and daily reporting requirements.

Depending on the structure of the fund, certain tax data may have to be submitted to the local German tax authorities or may even have to be published in the German Electronic Federal Gazette (*elektronischer Bundesanzeiger*). Some fund managers fear that fulfilling these reporting requirements could expose them to scrutiny by the German tax authorities or even allow competitors to reverse-engineer tax figures, thereby revealing the fund's investment strategy. These fears are largely unfounded. An obligation to comply with German tax reporting should not normally hinder a fund from accepting German-sourced funding, even if the fund also has exposure to German assets.

Conclusions

The investment climate in Germany is becoming more favorable. With a strong economy and many opportunities, Germany should be an appealing venue for hedge funds investors.

However, periodic tax law changes require investors to monitor developments and, if necessary, adjust their investment structures to address challenges posed by new or amended laws.

In particular, the recently revised anti-treaty shopping/anti-directive shopping rules require careful planning in order to mitigate tax risks.

In addition, the new interest-capping rule and the new change-of-control rule necessitate proactive tax planning. It remains to be seen whether peer pressure from the UK and France, which have recently introduced REITs, will force Germany to revise the current G-REIT Act to make these vehicles more attractive to investors.

The administrator—integral player in the alternative investment industry

by Ian Drachman and James G. Raney, Jr.

With more than 10,000 hedge funds, and nearly \$2 trillion in assets¹ under management and institutional money continuing to flow in, the alternative investment industry is growing at a rapid clip. Established managers are growing existing funds and traders are leaving Wall Street firms to launch start-up funds at unprecedented rates.

Many new funds, in particular, are started by star traders who know little and care less about back-office functions such as securities valuation, custody and recordkeeping. However, they *do* care about the fund's net asset value (NAV),² which determines their asset management and performance fees. As a result, industry leaders are paying greater attention to the operational side of the house.

Some fund managers continue to perform all of their operations in-house. However, many are choosing to focus on their core competencies of asset-gathering, fund management and trading. These funds outsource some or all back-office and even middle-office (posttrade, presettlement) functions.

This is where third-party fund administrators come in, providing some of the most important of these functions on a cost-effective, outsourced basis. As a result, the fund administrator has become an integral player in the alternative investment industry.

With fund administrators' newfound prominence comes significant challenges that test their ability to maintain the highest quality service. These challenges include:

- The need to provide real-time pricing of new exotic instruments and daily profit and loss calculations;
- Increased competition from custodian banks, prime brokers and the funds themselves;

- Requirement for a scalable technology platform; and
- Increased demand for transparency and qualified staff.

Real-time pricing and increased competition

The alternative investments industry is not only continuing to increase assets under management, but also developing new trading strategies and complex new instruments designed to increase returns or mitigate risk. The fund administrator's ability to price derivatives, less-liquid instruments and private investments is critical, not only to the fund manager but also to investors who are scrutinizing NAVs to ensure that NAV-based fees are calculated accurately. Whereas monthly NAVs once were the norm, today daily profit and loss data and daily "lite" NAV are the least that is expected. This has put pressure on the administrators to keep upgrading their technology and also has resulted in the continued use of spreadsheet-based workarounds.

Many administrators are expanding their service offerings to provide middle-office and, in some cases, front-office services, such as P&L, risk reporting and more prime broker reporting. The provision of these services is changing the ballgame and attracting new entrants. For example, some hedge funds are entering the administration business as the biggest fund managers grow into full-service financial services firms. Major custodian banks have also become some of the largest administrators, and many custodians and/or prime brokers are expanding into administration via acquisitions.

Scalable technology platform

The technology used by administrators varies depending on the firm's size. Many use commercially available software packages, while many of the newer administrators have built their own. In almost all cases,

¹ Chicago-based Hedge Fund Research, Inc.

² Net asset value (NAV) is the excess of the fair value of securities owned, cash, receivables and other assets over the liabilities of the company. The valuation of the underlying investments within a fund may be determined by the fund administrator, who would use various sources to value as accurately as possible the investments in the portfolio, such as equities, debt or other securities and transaction types. One of the key issues is valuing illiquid investments, such as many private equity fund holdings.

spreadsheet-based manual processes are common in order for administrators to manage data and create statements. This is especially true when there are side-pocket deals³ and breakpoint schedules that cannot be managed within a conventional portfolio accounting system. Allocation models must be developed as end-user computing systems (frequently using spreadsheets) to perform the accounting and ensure the manager receives accurate information.

Some administrators have begun using third-party providers for fund performance reporting to investors. Information appearing on these reports is generated by the fund administrator, usually through spreadsheet-based manual workarounds. Customization and handholding is an integral component of the administrator's customer service model.

Technology platforms continue to be upgraded and/or replaced to increase scalability, provide tighter operational controls and improve capabilities to manage and track new products, such as credit derivatives. However, the need to be creative and flexible when servicing fund managers with increasing trade volumes will mean client services processes will continue to include user-based workarounds (with the use of spreadsheets) and data manipulation outside of core processing systems.

It is estimated that over 40% of financial data are currently transported, aggregated or presented via spreadsheets. Given their centrality in operations processing, spreadsheets are here to stay and administrators must put in place controls to ensure efficiency and quality.

Transparency and staffing

The influx of institutional and pension fund money into hedge funds is resulting in more regulation, increased demands for transparency and the need for faster and more frequent valuation of NAVs. Fund administrators and other independent third parties, such as valuation services, are being pressed to deliver greater transparency, more frequent valuations and increased reporting even as they face decreasing margins and staffing issues.

³ Some hedge funds have investment strategies that allow the fund to invest in illiquid securities, yet investors are still allowed periodic redemption. In such cases, a common mechanism used is a "side pocket," whereby, at the time an investment is made in such an illiquid security, a proportionate share of a limited partner's capital account, relative to the entire capital balance of the fund, is assigned a separate memorandum capital account or "side pocket account." These are often referred to as "designated or special investment accounts."

The third-party administrator service model is based primarily on the work of two professionals: The fund accountant and the investor relationship manager. The most skilled of these professionals are always in demand and often in short supply. As a result, lengthy work cycles often require staff to work extensive overtime, resulting in high turnover and a negative impact on service.

Manual processes with spreadsheets will continue to be needed in order to meet the demand for customization. However, their use must be controlled and ultimately improved to automate and streamline processing of data and minimize the staff time focused on mechanics rather than on data.

In order to maintain high margins, many administrators already have established headquarters or operations in other venues where funds are domiciled, such as Ireland (particularly Dublin), Bermuda and the Cayman Islands. In addition, some administrators are moving processing work to lower-cost locations such as India, which may place further cost pressures on their competitors.

As the industry continues to grow, fund administrators will need to increase technology spending to remain competitive. They must build technology platforms that are scalable and integrate that service across the entire lifecycle of a trade, including capture, bookkeeping, reconciliation and reporting. This technology will not solve all problems for administrators, since many functions cannot be automated. Although standardization of data and information are needed, customization of services will continue. Thus, administrators must continue to improve manual processes, such as spreadsheets, to remain competitive in an industry under pressure to provide not only fast but also accurate service in basic tasks such as NAV calculation.

As alternative investment funds grow in importance, fund administrators will need to continue to strengthen their operations, product set and global footprint. They must strive to retain experienced staff and recruit new professionals, continue to develop advanced technology, provide robust processes and perform with a boutique mindset while supporting even the biggest of clients.

Real estate investment trusts: under the state looking glass

by Carolyn Puzella and Jane Steinmetz

For a number of years, real estate investment trusts (REITs) have been popular investment vehicles specializing in the passive investment of real estate. However, a point of controversy between state taxpayers and state tax administrators has recently developed regarding state conformity, or lack thereof, with the federal tax treatment of REITs. The discrepancies between federal law and state law have resulted in situations where income generated by a REIT and received by its shareholders has not been subject to state taxation. In the past few years, state legislatures have responded with an unprecedented number of legislative proposals aimed at regaining the tax revenues lost due to these differences. Many of those proposals are arguably overreaching and erode the originally intended purpose to provide tax-favored status for these legitimate investment vehicles. This article highlights various state statutes and state court cases addressing REITs and examines the impact of these developments on the use of REIT structures going forward.

Background

REITs were established by the Real Estate Investment Trust Act of 1960 with the intention of creating passive investment vehicles, similar to mutual funds, through which the average individual investor could participate in a pool of investments in real estate and enjoy the benefits of portfolio diversification, knowledgeable and professional management, regular and significant returns on investments, wider access to capital, and direct ownership of real estate, which had been previously enjoyed only by wealthier investors with larger resources. Most REITs are organized as corporations to own interests in and derive revenue from real property such as office buildings or mortgages and many are widely held by individual shareholders. In most states, if a REIT qualifies as such for federal purposes, a REIT will automatically qualify as such for state purposes.

To foster returns on investments, the Internal Revenue Code (IRC) provides REITs with favorable tax treatment. To qualify as a REIT and the consequent tax treatment, an entity must elect to be treated as a REIT and must meet certain requirements as to its organization, ownership, asset diversification, income characterization and income distributions. Most notably, the REIT must distribute at least 90 percent of its income as dividends.

With a few exceptions (e.g., built-in gains), a REIT is generally subject to federal corporate income tax on its “real estate investment trust taxable income” (REIT taxable income). In arriving at REIT taxable income, a REIT is allowed a deduction for dividends paid (DPD) to its shareholders. Because REITs generally pay dividends that equal or exceed their income, the DPD usually eliminates REIT taxable income, resulting in a single layer of tax at the REIT shareholder level; thus, REITs are viewed as conduit vehicles. Individual shareholders must include REIT distributions in their federal taxable income. Similarly, corporate shareholders of a REIT must include dividends distributed from a REIT in their taxable income, since the general deduction for dividends received (DRD) does not apply to REIT dividends.

State concerns

The majority of states that impose a corporate income tax currently conform to the federal income tax treatment of REITs and, therefore, allow REITs to claim a DPD. However, unlike the federal tax regime, state tax structures may not ensure that a state receives its share of tax at the shareholder level.

With respect to corporate shareholders, some corporations have organized nearly wholly owned REITs to which they transfer income-producing assets, (e.g., mortgages or rental real estate). At the REIT level, the income from such assets is not taxed at the state level

as a result of the DPD enjoyed by REITs. The income also may not be taxed at the corporate shareholder level if the corporation is located in a state that does not impose tax or a state that allows a deduction for dividends received from a REIT. Further, even if the REIT shareholders are subject to tax in some states, a state may assert that it is not getting its share of tax revenue from the REIT's property located in that state if the state affords a DPD to the REIT and the shareholders are not subject to tax in that particular state.

For individuals, dividend income is generally only subject to tax in the state in which an individual resides. Thus, unlike the federal tax regime, income generated by a REIT from property located in a particular state will only be subject to tax in that state to the extent it is distributed as dividends to resident shareholders. States argue, therefore, that distributions to individuals who do not reside in a state in which the REIT owns property will not be subject to taxation by that state.

States, however, may not be losing as much revenue as they fear from REITs and, in fact, may be receiving a windfall from publicly traded and widely held REITs. Admittedly, there may be instances where a state, looking at one particular REIT structure in isolation, may not derive its fair share of tax associated with income generated by the REIT's real estate located within that state. However, that same state is likely collecting tax revenues from residents who are individual shareholders in numerous widely held REITs, whether or not those public REITs own property located in that state. Thus, the perceived loss in tax revenues may not exist if the state analyzed the situation on a macro basis.

Given the perceived loss of state tax revenues, there has been a sweeping trend among the states to propose legislation that curtails the tax-favored status of REITs. While it is appropriate for states to shut down structures formed exclusively to avoid state taxation, many legislative proposals and recently enacted tax provisions cast their net very widely. These proposals risk disturbing the tax-favored status of REITs organized for legitimate investment purposes, but which are directly held by a few entities, such as partnerships (which in turn are widely held), listed Australian property trusts (LAPTs), or tax-exempt entities attempting to tax nonresident shareholders of a REIT. Each approach is described below.

One state response: elimination of DPDs and DRDs

As one course of action, states have sought to eliminate the federally provided DPD to REITs in calculating their

state taxable income. The effect of this restriction is the imposition of state income tax on income earned by the REIT in the states in which the REIT property is located.

Statutory amendments passed in 2007 in Maryland and Indiana are examples of such state action.¹ In targeting captive REITs, Maryland enacted a provision that eliminates the DPD of a REIT that is more than 50 percent held by a taxable C corporation that is not itself a REIT or a LAPT. Of note, the originally proposed Maryland statute would have eliminated the DPD of a REIT if it was more than 50 percent owned by one "person," other than a REIT or qualified REIT subsidiary (QRS). The original language was changed so as not to affect those REITs formed for legitimate investment purposes, such as REITs owned by LAPTs, which are basically the Australian equivalent of REITs. The statutory amendment enacted by Indiana is similar to Maryland's in that it eliminates the DPD for captive REITs that are not majority owned by another REIT or an exempt organization. However, unlike the Maryland statute, the Indiana statute does not specify an exception for REITs owned more than 50 percent by LAPTs. The absence of this language is a concern for LAPTs that invest in domestic REITs for legitimate investment reasons.

While some states, like Maryland and Indiana, have sought to eliminate the DPD only within the context of captive REITs, other states have proposed legislation that broadly seeks to eliminate the DPD for all REITs as a result of their concern with the continued growth of REIT structures in general and the real or perceived loss of state revenue. A statutory amendment proposed in Montana is an example of this line of thinking.

As states are amending their individual REIT statutes, the Multistate Tax Commission (MTC) is concurrently in the process of drafting a model statute for use by states seeking to target captive REITs. While the MTC is targeting captive REITs organized to avoid state tax, it is not finalized and there are concerns it may capture REITs organized for legitimate investment purposes.

Indeed, an unintended consequence of eliminating the federally afforded DPD for state purposes is to eliminate the REIT conduit treatment at the state level, which results in double taxation with respect to individual shareholders who remain taxable in their state of residence on dividends distributed from the REIT. This is in stark contrast to the original intent of the federal taxing scheme.

Finally, rather than eliminating the DPD, some states have sought to eliminate the DRD available at the corporate REIT shareholder level. Massachusetts, for example, amended its DRD provision to clarify that dividends received by a corporate shareholder directly or indirectly

¹ Maryland H.B. 1257 and S. 945; Indiana S. 500.

from a REIT are not eligible for the DRD. This approach is preferable. Targeting the DRD is more closely aligned with the federal conduit treatment of REITs in which tax is only imposed at the shareholder level, rather than the REIT itself, and prevents instances in which REITs organized for legitimate investment purposes are subject to tax as a result of state attempts to curtail the use of captive REIT planning.

A second state approach: State income taxation of nonresident REIT shareholders

While constitutionally suspect, there are instances in which a state will seek to impose income tax on nonresident shareholders of a REIT operating in that state. States generally do not have constitutional nexus over nonresident shareholders with no connection to a state other than as shareholders in a corporation which is located there. However, some states are taking the position that nonresident REIT shareholders have taxable nexus with the states in which the REIT property is located, by virtue of the “benefits and protections” that the state affords them. As support, these states look to the US Supreme Court’s holdings in *Wisconsin v. J.C. Penney Co.* and *International Harvester Co. v. Wisconsin Department of Taxation*, in which the Supreme Court sustained the state’s ability to impose income tax on a corporation for the “privilege of declaring and receiving dividends” from income earned from property located within the state.

In *Bridges v. Autozone Properties, Inc.*, No. 2004-C-814 (La. Sup. Ct., Mar. 24, 2005), the Louisiana Supreme Court determined that, under the Due Process Clause of the Fourteenth Amendment, Louisiana had direct taxing jurisdiction over a nonresident corporate shareholder of a REIT because Louisiana provided many benefits, opportunities and protections that helped generate the income. The Louisiana court, in part, relied heavily on *International Harvester Co.*, which held that a state “may impose the burden of the tax either upon the corporation or upon the shareholders who derive the ultimate benefit from the corporation’s ...activities” within the state. The Louisiana court was apparently swayed by the state’s argument that the REIT structure at issue was an abusive tax shelter designed to deprive Louisiana of income tax.

The court, however, did not address Louisiana’s taxing jurisdiction under the “substantial nexus” standard of the Commerce Clause, since the Commerce Clause argument was neither raised nor considered on appeal. Arguably, had the court addressed Louisiana’s taxing jurisdiction under the higher level of review required under the Commerce Clause, it likely would have held differently.

Furthermore, it is questionable whether the assertion of state tax jurisdiction over nonresident corporate REIT shareholders is broad enough to reasonably extend to nonresident individuals and corporate shareholders of REITs that operate for legitimate investment purposes.

Interestingly, a concurring opinion to the denial of Autozone’s application for rehearing (based on lack of timely filing) suggested that the Louisiana Supreme Court confused personal jurisdiction with taxing jurisdiction and that the case might have been decided incorrectly. The concurring opinion analyzed the flaws in the Louisiana Supreme Court’s reliance on *International Harvester* and suggested that it did not adequately address the holding in other US Supreme Court decisions regarding the minimum contacts standard for personal jurisdiction under the Due Process Clause. Although the concurring opinion is not legal precedence, it highlights the flaws in the Louisiana Supreme Court’s original opinion the next time similar taxing jurisdiction issues arise.

Along with taxation of nonresident individual REIT shareholders, states are also attempting to require REITs to withhold income tax on the dividends distributed to its shareholders. Maryland, for example, proposed legislation that would have required such withholding and New Jersey taxing officials have mentioned that they are considering such a regime. Although withholding is an effective method for a state to ensure that it receives tax from flow-through entities, an administrative withholding mechanism at the REIT level would be extremely burdensome from the REIT’s perspective. In many cases, the sheer number of nonresident individual REIT shareholders would preclude the REIT from the efficient and accurate calculation and reporting of withholding. Additionally, an effective and manageable credit mechanism for individual income taxes withheld and paid with respect to REIT dividend income would also be required. Therefore, this overall view of state taxation of nonresident REIT shareholders is not without considerable administrative hurdles.

Looking forward

In the coming months and years, it is expected that the trend toward shutting down the use of captive REITs and ongoing attempts to capture state income tax will continue, as more states focus on these issues. Some state legislatures ended their most recent sessions without reviewing proposed captive REIT legislation, so it is likely some will continue to consider those proposals. It is also likely that more states will continue down the path of eliminating the federally afforded DPD or DRD to ensure the appropriate taxation of REIT dividends.

Further, the MTC is expected in the near term to publish its suggested model captive legislation, which will be available for adoption by those states that have not already amended their REIT laws.

From a taxpayer's perspective, it is hoped that states will carefully draft these proposals so as not to disturb the conduit nature of various legitimate REIT structures, such as REITs owned by tax-exempt entities, LAPTs, or widely held partnerships. Similar to the federal regime, it would be wise for states to target taxing REIT dividends, rather than risk taxing legitimate REITs themselves at the entity level. The policy considerations in affording REITs federal and state tax favorable status appear relatively clear from federal legislative history and arguably outweigh the need for additional state restrictions that could erode the REIT industry's place in the investment market. As mentioned, with the exception of abusive captive REITs, the income of REITs is generally subject to state income tax somewhere (the domicile of their shareholders). Thus, REITs with genuine investment intent should be afforded their tax-favored status at both the federal and state levels, as originally intended by Congress, in order to allow REIT shareholders to receive greater returns on their investments and, therefore, encourage considerably broader investment from the public.

From a tax administrator's perspective, it is hoped that newly passed legislation will eliminate the state tax benefit garnered by captive REITs organized exclusively for state tax reasons. The challenge for the states is to narrowly draft the legislation so it does not disturb the broader REIT population that was organized exclusively for investment reasons.

State legislatures and state courts should be mindful of the original intention of the REIT Act of 1960 and take special care not to overextend their state taxing power on account of a real or perceived loss of state revenue. Such state overreaching could result in a partial erosion of the specific tax and financial benefits REITs afford to their investors. The collective goal in the coming year will be to monitor state attempts to target abusive captive REIT structures so they do not inadvertently affect REITs organized and operated for legitimate investment purposes. Taxpayers considering or already using REIT structures should be aware of the vast number of states that have proposed or enacted REIT legislation targeting its tax-favored status as well as those that will propose such legislation in the coming year.

by Philip C. Sutton, Yen Ta and Dawn M. Timan

REIT rules—temporary investments

In private letter ruling (PLR) 200740004, the IRS addressed the issue of whether temporary investments held indirectly by a real estate investment trust (REIT), through its ownership interest in a limited partnership, generate qualifying income for purposes of the REIT income tests under Internal Revenue Code (IRC) Section 856(c).

In the PLR, REIT is the managing general partner of a limited partnership. The limited partnership owns and operates real property throughout the United States through business entities classified as partnerships or disregarded entities for federal income tax purposes.

During the year, REIT raised capital through a public offering of senior convertible debt. The net proceeds from the debt offering were loaned to the limited partnership, with the REIT receiving convertible debt from the limited partnership that mirrored the terms of the REIT's convertible debt. The limited partnership used the proceeds to purchase real estate assets and fund working capital. However, in the interim, the limited partnership made temporary investments in money market funds.

IRC Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, rents from real property, interest and dividends. IRC Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, rents from real property and qualified temporary investment income.

IRC Section 856(c)(5)(D)(i) defines qualified temporary investment income as any income which (I) is attributable to issuance of stock or certain debt instruments; (II) is attributable to the temporary investment of new capital; and (III) is received or accrued during the one year period beginning on the date on which the REIT receives the capital.

Treasury Regulation Section 1.856-3(g) provides that a REIT is considered to own its proportionate share of each of the assets of the partnership and to be entitled to income from the partnership attributable to that share.

For REIT qualification purposes, REIT will be treated as owing its proportional share of the limited partnership's assets and deriving its proportional share of the limited partnership's income. Therefore, the character and attributes of the income and assets from the limited partnership pass through to the REIT and are treated the same at the REIT level. This means that the partnership income must satisfy the definition of qualified temporary investment income to be treated as such by REIT. In the PLR, the IRS concluded that any property attributable to the temporary investments of new capital, whether held directly by REIT or through its interest in the limited partnership, should be treated as a real estate asset for the one year period beginning on the date(s) on which REIT receives the proceeds from the debt. Therefore, the limited partnership's investments in money market shares should generate qualified temporary investment income for purposes of IRC Section 856(c).

Foreign currency gains and losses

Rev. Rul. 2007-33, IRB 2007-21, allows for a REIT that recognized income from rents denominated in euros and interest income on euro denominated mortgage loans to treat the IRC Section 988 foreign currency gain with respect to such income as REIT qualifying income under IRC Sections 856(c)(2) and (3).

The REIT collected both rents and interest income from notes secured by real property. The rents were payable in euros. In some cases, rent was accrued and included in income prior to the actual receipt of cash. Because of the fluctuations in the value of the euro, REIT generated foreign currency gains or losses on the payment of the rent. REIT had a similar issue in relation to interest accrued on mortgages denominated in euros.

IRC Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, rents from real property, interest and dividends. IRC Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, rents from real property and qualified temporary investment income.

Rev. Rul. 74-191, 1974-1 CB 170, holds that otherwise qualifying assets do not fail to satisfy the REIT asset tests merely because the assets are foreign. The ruling however does not address the treatment of foreign currency gains that may result from investing in real property or other assets that produce income denominated in a currency other than the taxpayer's functional currency. Although IRC Section 856(c) describes the source of REIT qualifying income, neither the statute nor regulations described what is meant by the income "derived from" those sources. However, Rev. Rul. 2007-33 made it clear that if there is a close nexus between the IRC Section 988 gain on payments received by a REIT and the qualifying income from which that payment is derived, the IRC Section 988 gain should qualify under the 75 percent gross income test and the 95 percent gross income test to the extent that the underlying income does.

The foreign currency gains arise only as a result of the fluctuation in the US dollar relative to the foreign currency from the time the REIT accrues the income to the time the cash payment is actually received. Because the rent and interest are qualifying REIT income, and the foreign currency gains are derived from those sources as a result of cash payments, the foreign currency gains should be treated as qualifying REIT income.

IRS announcement—proposed Form 8926, Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information

Announcement 2007-114 released on November 28, 2007 revealed the new proposed Form 8926, Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information. The proposed form is posted on the IRS Web site under Draft Tax Forms and is applicable for the 2008 tax year and beyond (once finalized). Corporate taxpayers who either paid or accrued disqualified interest for the taxable year or carried forward disallowed disqualified interest from prior taxable years under IRC Section 163(j) are required to include information regarding the application of IRC Section 163(j) limitations and the related computations.

IRC Section 163(j) imposes a limitation on the deduction for interest paid or accrued by corporations to related persons where the interest is exempt or partially exempt from tax. The limitation is generally imposed when the

paying corporation is "thinly capitalized" (i.e., has a debt-to-equity ratio greater than 1.5:1). If the corporation is thinly capitalized, then the amount of the interest expense the corporation can deduct is generally limited to 50 percent of the corporation's adjusted taxable income. The excess interest expense is then carried forward indefinitely.

The rules of IRC Section 163(j) apply to (i) any interest paid or accrued to a related person if no tax is imposed with respect to such interest; (ii) any interest paid or accrued to an unrelated party if (a) the interest is not subject to a gross basis tax¹ and (b) the guarantor is a related person who is either a foreign person or a tax-exempt organization; and (iii) any interest paid or accrued by a taxable REIT subsidiary of a REIT.

The new form is in response to an IRS study conducted by the Treasury Department on earnings stripping. The study advised that the tax forms should include more information about earnings stripping. Form 8926 was created to capture that information. Specifically, the proposed form requests the following information:

- Calculation of the taxpayer's debt-to-equity ratio;
- Net interest expense;
- Adjusted taxable income;
- Excess interest expense;
- Total disqualified interest for the tax year;
- Amount of interest deduction disallowed under IRC Section 163(j); and
- Information regarding the related persons receiving the disqualified interest.

IRC Section 470—loss disallowance rule

Generally, IRC Section 470 disallows a current deduction attributable to tax-exempt use property. Unfortunately, because the way IRC Section 470 is drafted, many real estate partnerships get caught in the IRC Section 470 loss limitation rule because their allocations are not "qualified" or "straight up" allocations.

Relief from Section 470 had previously been granted by the IRS via Notice 2005-29, Notice 2006-2 and Notice 2007-4. The relief only applied to disallowed losses associated with property that was treated as tax-exempt use property solely as a result of the application of IRC Section 168(h)(6) (because the partnership has both tax-exempt and taxable partners and allocations are not "qualified" allocations).

¹ Gross basis tax is defined as any tax imposed which is determined by reference to the gross amount of any item of income without any reduction for any deduction allowed by the IRC.

In November 2007, the House Ways & Means and Senate Finance Committees released H.R. 4195/S. 2374, the Tax Technical Corrections Act of 2007 (the Act). The Act would solve the issues raised by IRC Section 470 when a real estate partnership (and perhaps a REIT) has a tax-exempt partner/investor and the partnership/REIT uses an allocation method other than “straight up” allocations. The tax technical corrections have been added to HR 3997, The Heroes Earnings Assistance and Relief Act of 2007.

The Act would amend IRC Section 470 by excluding from its application any property which would be tax-exempt use property solely by reason of IRC Section 168(h) (6), which is how the application of IRC Section 470 applies to many of the real estate partnerships. Further, the Act would apply the rules of IRC Section 470 only to partnerships that are considered lease arrangements under IRC Section 7701(e). Some factors the IRS will consider in determining whether a partnership will be considered a leasing arrangement are whether:

- The partnership is the entity providing the services related to the property;
- The partnership has no or minimal risk of ownership over the property;
- The service recipient still has physical possession of the property;
- The service recipient controls the property; and
- There is insignificant equity investment by the partners.

In addition, the Joint Committee Report added other factors such as whether the transfer of the property would result in a change in use and that such property is necessary for the provision of governmental services. Based on these factors, it is hopeful that many real estate partnerships will not be considered leasing arrangements under IRC Section 7701(e).

Disallowance of passive activity losses

In *Carolyn D. Fenderson v. Commissioner*,² the Tax Court determined that an individual taxpayer cannot deduct a loss from her real estate activities based on the facts presented in the case.

Carolyn Fenderson (the Taxpayer) worked for Symantec Corporation as an account manager. In her role as account manager, the Taxpayer was primarily responsible for servicing eight existing customers. Her compensation from Symantec included a base salary, stock options and sales commissions. While her salary for 2002 was

\$186,487, Taxpayer tracked the amount of time she spent working at Symantec as only 15 hours a week; these records were kept contemporaneously with when the work was performed.

The Taxpayer also owned a number of residential rental units that she held for rent during that year. She performed personal services for the rental units. During 2002, Taxpayer generated losses from her real estate activity of \$57,506. She claimed to have spent 1,062 hours during 2002 in the rental real estate business. No contemporaneous records were prepared and the records used to support the real estate activities appear to have been recreated after the end of 2002.

The Taxpayer reported the rental income and expenses of the rental units on her Schedule E, Supplemental Income and Loss. The aggregate rental loss was deducted from the other income on the Taxpayer’s return. The Taxpayer later sent a second return for the same taxable year meant to be an amended return to the IRS. The IRS did not process the second return. This second return showed on Schedule C, Profit or Loss From Business, the income and expenses originally reported on Schedule E.

The issue before the Tax Court was whether the Taxpayer spent more than one-half of her time performing personal services during such taxable year in real property trades or businesses in which she materially participated. If she spent more than one-half of her time in the real estate trade or business, then she could take a current deduction for the losses generated from that trade or business. Otherwise, she would be subject to the general material participation rule that would treat the amounts as passive activity losses. A taxpayer can establish personal services performed in an activity by any reasonable means, which may include identification of services performed over a period of time, based on appointment books, calendars or narrative summaries.

The only evidence the Taxpayer had to support her time allocation was her calendar. Upon examination, the Tax Court found that there were many inconsistencies between her tax return, her calendar and other exhibits created during the course of the IRS audit. The calendar did not reflect total actual hours spent because the calendar did not have a concise record of actual time or events relating to the rental units. The review of the calendar led the Tax Court to determine that less than half of her hours were spent performing personal services for her real estate trade or business as compared with the hours spent performing personal services as an employee of Symantec. Therefore, IRC Section 467(c)(7) did not apply and the Taxpayer was forced to treat all of her rental activities as passive activities without regard to whether she materially participated or not. The deduction for her rental losses was disallowed as a passive activity loss.

2 T.C. Summary Opinion 2007-191 (November 13, 2007).

PricewaterhouseCoopers Alternative Investment Funds Group

United States

Boston, MA

Greg Collins	617 530 7012	greg.collins@us.pwc.com
Dave Foss	617 530 7878	david.foss@us.pwc.com
Kristin Francisco	617 530 7507	kristin.francisco@us.pwc.com
Timothy Grady	617 530 7162	timothy.grady@us.pwc.com
Patricia Jabar	617 530 7387	patricia.jabar@us.pwc.com
Mark Rosenblatt	617 530 7240	mark.rosenblatt@us.pwc.com
Paula Smith	617 530 7906	paula.e.smith@us.pwc.com

Chicago, IL

Chris Cornwall	312 298 4816	chris.cornwall@us.pwc.com
James Lelko	312 298 5768	james.s.lelko@us.pwc.com

Dallas, TX

Mike Bohling	214 756 1734	mike.bohling@us.pwc.com
Robert Collins	713 356 6851	robert.c.collins@us.pwc.com

Denver, CO

Hugh Armstrong	720 931 7207	hugh.armstrong@us.pwc.com
----------------	--------------	---------------------------

Houston, TX

Robert Collins	713 356 6851	robert.c.collins@us.pwc.com
Hadassah Wagner	713 356 4124	hadassah.wagner@us.pwc.com

Los Angeles, CA

David Chrencik	213 356 6130	david.g.chrencik@us.pwc.com
Alison Monahan	213 217 3374	alison.monahan@us.pwc.com
Andy Nolan	213 217 3830	andrew.nolan@us.pwc.com

Minneapolis, MN

Jennifer Ward	612 596 6382	jennifer.l.ward@us.pwc.com
---------------	--------------	----------------------------

New York, NY

Murray Alter	646 471 0556	murray.alter@us.pwc.com
Tony Artabane	646 471 7830	anthony.artabane@us.pwc.com
Virginia Benson	646 471 7940	virginia.benson@us.pwc.com
Gina Biondo	646 471 2770	gina.biondo@us.pwc.com
Barrett Brown	646 471 3024	barrett.c.brown@us.pwc.com
Frank Calabro	646 471 7842	frank.m.calabro@us.pwc.com
Mark Casella	646 471 2500	mark.j.casella@us.pwc.com
Gregory Cullo	646 471 7504	gregory.cullo@us.pwc.com
Judith Daly	646 471 5292	judith.daly@us.pwc.com
Lyn Desantis	646 471 2084	lyn.desantis@us.pwc.com
Cindy Price Gavin	646 471 2148	cindy.gavin@us.pwc.com
Bruce Graber	646 471 1447	bruce.graber@us.pwc.com
Mike Greenstein	646 471 3070	michael.s.greenstein@us.pwc.com
Michael Guarnuccio	646 471 2949	michael.guarnuccio@us.pwc.com
Michael Hayes	646 471 4429	michael.f.hayes@us.pwc.com
Robert Kelley	646 471 2066	robert.c.kelley@us.pwc.com
Barry Knee	646 471 5898	barry.m.knee@us.pwc.com
Marvin Nagler	646 471 8429	marvin.nagler@us.pwc.com
Gerard O'Callaghan	646 471 8833	gerard.m.ocallaghan@us.pwc.com
Michael O'Neill	646 471 5556	michael.j.oneill@us.pwc.com
Maureen Renick	646 471 3049	maureen.renick@us.pwc.com
John Reville	646 471 7845	john.reville@us.pwc.com
Thomas Romeo	646 471 8048	thomas.romeo@us.pwc.com
Michael Ruggeri	646 471 7588	michael.ruggeri@us.pwc.com
Michael Spiryda	646 471 7597	michael.spiryda@us.pwc.com
David Steiner	646 471 3836	david.a.steiner@us.pwc.com
Scott Sulzberger	646 471 7410	scott.r.sulzberger@us.pwc.com
William Taggart	646 471 2780	william.taggart@us.pwc.com
Oscar Teunissen	646 471 3223	oscar.teunissen@us.pwc.com
Belanne Ungarelli	646 471 5431	belanne.marie.ungarelli@us.pwc.com
Joe Wiggins	646 471 7378	joe.wiggins@us.pwc.com

Philadelphia, PA

Chris May	267 330 1398	christopher.r.may@us.pwc.com
Bill McGinley	267 330 3140	william.c.mcginley@us.pwc.com

United States (continued)

San Francisco, CA

Richard Carson	415 498 7359	richard.g.carson@us.pwc.com
Greg Eckert	415 498 7443	gregory.eckert@us.pwc.com
Laura Martinez	415 498 7656	laura.e.martinez@us.pwc.com
Cindy Powers	415 498 6210	lucinda.powers@us.pwc.com
Ted Wilm	415 498 8005	ted.wilm@us.pwc.com

Seattle, WA

Michele Godvin	206 398 3801	michele.l.godvin@us.pwc.com
Chris Hugo	206 398 3070	christopher.j.hugo@us.pwc.com

Asia

Hong Kong

Robert Grome	852 2289 1133	robert.grome@hk.pwc.com
--------------	---------------	-------------------------

Shanghai

Shirley Xie	86 21 6123 2855	shirley.xie@cn.pwc.com
-------------	-----------------	------------------------

Singapore

Justin Ong	65 6236 3708	justin.ong@sg.pwc.com
------------	--------------	-----------------------

Tokyo, Japan

Raymond Kahn	81 3 5251 2909	raymond.a.kahn@jp.pwc.com
--------------	----------------	---------------------------

Canada

Toronto

Chris Pitts	416 947 8964	chris.pitts@ca.pwc.com
-------------	--------------	------------------------

Europe

Channel Islands

Brendan McMahon	44 1534 838234	brendan.mcmahon@je.pwc.com
-----------------	----------------	----------------------------

Dublin, Ireland

Damian Neylin	353 1 792 6551	damian.neylin@ie.pwc.com
---------------	----------------	--------------------------

Frankfurt, Germany

Robert Welzel	49 0 69 9585 6758	robert.welzel@de.pwc.com
---------------	-------------------	--------------------------

Geneva, Switzerland

Thomas Huber	41 0 58792 2436	thomas.huber@ch.pwc.com
--------------	-----------------	-------------------------

London, England

Pars Purewal	44 20 721 24738	pars.s.purewal@uk.pwc.com
--------------	-----------------	---------------------------

Luxembourg

Kees Hage	352 49 4848 2059	kees.hage@lu.pwc.com
-----------	------------------	----------------------

The Netherlands

Frank van Groenestein	31 10 4076 444	frank.van.groenestein@nl.pwc.com
-----------------------	----------------	----------------------------------

Paris, France

Jean-Pierre Bouchart	33 15 657 1702	jean-pierre.bouchart@fr.pwc.com
----------------------	----------------	---------------------------------

Offshore

Bahamas

Clifford Johnson	242 302 5307	clifford.a.johnson@bs.pwc.com
------------------	--------------	-------------------------------

Bermuda

Andrew Brook	441 299 7126	andrew.brook@bm.pwc.com
--------------	--------------	-------------------------

Cayman Islands

Noel Reilly	345 914 8600	noel.t.reilly@ky.pwc.com
-------------	--------------	--------------------------

Curaçao

Cees Rokx	599 9 430 0105	cees.f.rokx@an.pwc.com
-----------	----------------	------------------------

This document is provided by PricewaterhouseCoopers LLP for general guidance only, and does not constitute the provision of legal advice, accounting services, investment advice, written tax advice under Circular 230 or professional advice of any kind. The information provided herein should not be used as a substitute for consultation with professional tax, accounting, legal, or other competent advisers. Before making any decision or taking any action, you should consult with a professional adviser who has been provided with all pertinent facts relevant to your particular situation. The information is provided 'as is' with no assurance or guarantee of completeness, accuracy, or timeliness of the information, and without warranty of any kind, express or implied, including but not limited to warranties or performance, merchantability, and fitness for a particular purpose.

The information contained in this document is for general guidance on matters of interest only. The application and impact of laws can vary widely based on the specific facts involved. Given the changing nature of laws, rules and regulations, there may be omissions or inaccuracies in information contained in this document. This document is provided with the understanding that PricewaterhouseCoopers is not herein engaged in rendering legal, accounting, tax, or other professional advice and services. It should not be used as a substitute for consultation with professional accounting, tax, legal or other competent advisers who have been provided with all pertinent facts relevant to your particular situation. Before making any decision or taking any action, you should consult a competent professional adviser.

Although we believe that the information contained in this document has been obtained from reliable sources, PricewaterhouseCoopers is not responsible for any errors or omissions contained herein or for the results obtained from the use of this information. All information in this document is provided "as is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied, including, but not limited to warranties of performance, merchantability and fitness for a particular purpose. In no event will PricewaterhouseCoopers, its related partnerships or corporations, or the partners, principals, agents or employees thereof be liable to you or anyone else for any decision made or action taken in reliance on the information in this document or for any consequential, special or similar damages, even if advised of the possibility of such damages.