

Year-End US Tax Considerations

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Alon Sherer,
Tax Department



- The purpose of this document is to highlight certain year-end U.S. Federal¹ tax consideration issues.
- The information contained in this presentation is for general guidance on matters of interest only. As such, it should not be used as a substitute for consultation with professional tax advisers.
- This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding any federal, state or local tax penalties.

¹ The scope of this document does not intended to cover any U.S. state or local tax aspects nor does it intend to cover any non-U.S. tax aspects.

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Part I: Current & Possible Future Tax Changes



Possible Future Tax changes

President elect Barack Obama's historic victory as the first African-American President of the United States also marks a milestone in the history of the Democratic party, as for the first time since 1992, Democrats will control the White House and both houses of Congress. As such, it is expected that legislation (e.g., Tax legislation) will be easier to pass.

The likelihood of such a morbid fiscal reality can only increase, especially in view of Obama's expected health care, energy and environmental policies.

Possible Future Tax changes – (cont.)

The following are some of Mr. Barack Obama's proposals for tax changes:

▪ **Alternative investment funds**

Tax carried interest of alternative investment funds as ordinary income

▪ **Corporation provisions**

- Lower corporate tax rates for companies "that expand or start operations in the United States"
- Create refundable American Jobs Tax Credit of \$3,000 for each additional full-time employee hired by an existing business in 2009 and 2010.

▪ **Individuals Positions**

- Top individual rate 39.6% up from 35%
- Dividends and capital gains - Increase rates to 20% for income over \$250,000 (\$200,000 for separate returns).
- Eliminate capital gains taxation of start-up businesses.

What's New for 2009 - Partnership Tax Returns

- Form 1065 can only be extended 5 months (to September 15) starting 1/1/09

- Expanded Schedule B Questions
 - Additional information on who owns the partnership (50% or more owners)
 - Additional information as to what the partnership owns (i.e., investments) both directly and indirectly (20% or more of any entity)
 - The IRS now wants ownership based on voting rights, excluding stock option dilution
 - Funds may want to review these new requirements and include the additional data requests as part of their year-end reporting packages from portfolio companies

What's New for 2009 - Partnership Tax Returns

- K-1 Ownership Interest Disclosure
 - “Various” no longer allowed
 - Partner Ownership: use greater of capital, loss or profits interest

- Form 5471: IRS has automated “late filing” penalty notices for form 5471s filed after the applicable due date .

Foreign Bank Account Report" (FBAR)

- The IRS has published a new version of Form TD F 90-22.1, "Foreign Bank Account Report" (FBAR) (rev. Oct. 2008). This is the most significant revision of this form since its introduction following the enactment of the Bank Secrecy Act in 1970
- What is an FBAR?
FBAR is a Report of Foreign Bank and Financial Account.
- Who must file an FBAR?
Any United States person who has a financial interest in, or a signature authority, or other authority over any financial account in a foreign country, if the aggregate value of these accounts exceeds \$10,000 at any time during the calendar year

Foreign Bank Account Report" (FBAR)

- Major changes and highlights:
 - The term “United States person” has been extended to include a citizen or resident of the United States, or a person in and doing business in the United States.
 - The term “Financial Account” has been clarified to include mutual funds as well as a debit card and prepaid credit card accounts in the other account category.
 - The instructions greatly expand the discussion of what is a “financial interest”
 - Exact “maximum value” must now be reported instead of a range
 - A delinquent FBAR must attached a statement to explain the late filing

Foreign Bank Account Report" (FBAR)

- It should be recalled that the civil and criminal penalties for failure to file or for filing a false or fraudulent form might be severe, including in some circumstances a fine of up to \$500,000 and imprisonment of up to five years.
- In addition, unlike tax return information, this Form can be shared with other agencies of the U.S. government.

State Tax – Updates to Reporting Requirements

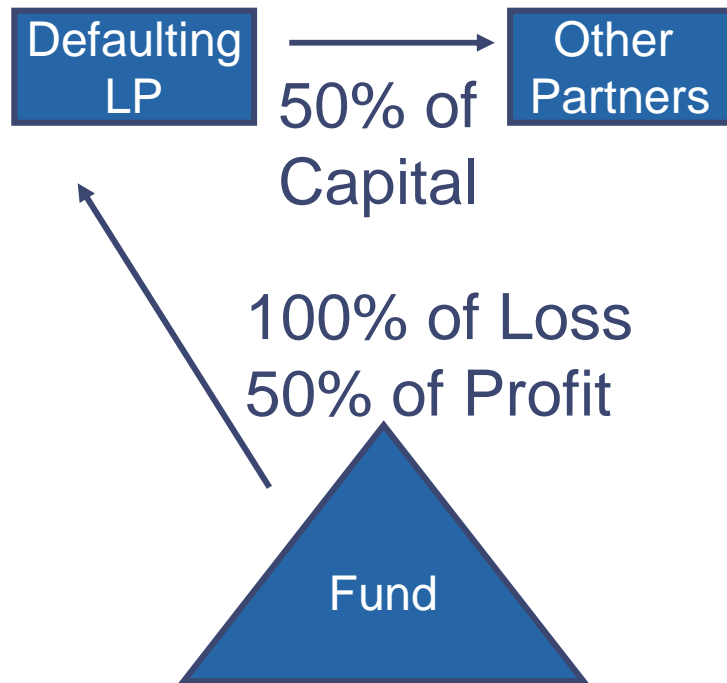
The following states generally require the filing of a state tax return if certain partners are residents in such state, regardless of the amount of its income and its source:

- Delaware
- Florida
- Georgia
- Hawaii
- Maine
- Missouri
- Nebraska
- New Jersey
- New York
- Oregon
- Pennsylvania
- West Virginia
- Wisconsin

Part II: Year-End Issues to Consider

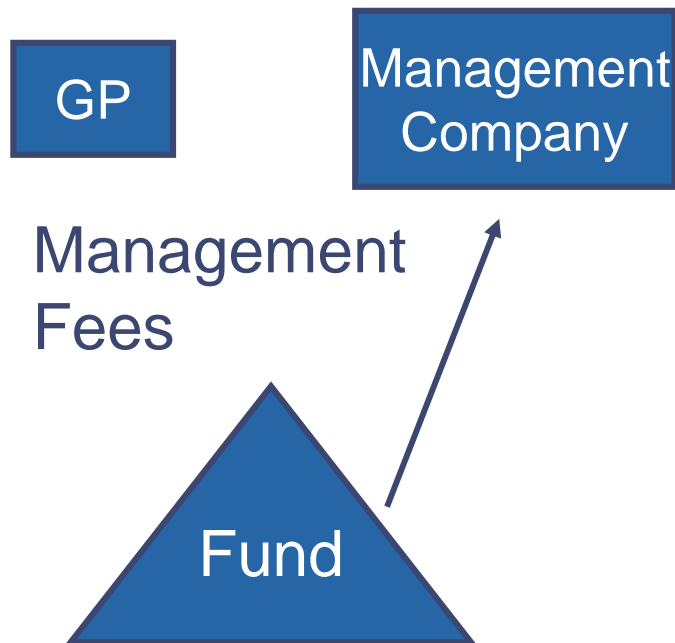


LP Defaults - Tax Issues



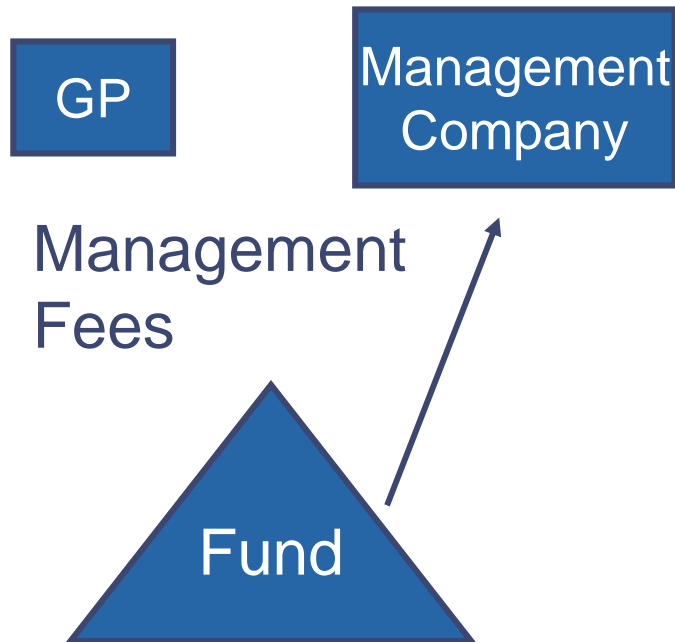
- The economic downturn might result in some partners defaulting. Funds should review the LPA to determine how default impacts capital, profits and losses. A typical default provision reduces the LP's capital and share of gross profits by 50%.
- LP Defaults might cause some tax concerns:
 - continuing partners may be allocated with gain as a result of the reallocation of capital.
 - Allocation of Income: Distortive allocations may be required to adjust defaulting LP's capital account.

Management Fees - Deferral and Conversion



- Delayed exits and increased financing needs push GPs to consider management fee deferral.
- Deferral of management fees does NOT defer tax for accrual method manager. However, if fees are subject to a significant precondition (measured under the “all events test”), income can be deferred.

Management Fees - Deferral and Conversion



- If deferred fees are payable only out of future gains, conversion of fees to priority gains is feasible.
- Fewer GPs are waiving management fees for cashless contribution or fee conversion out of fear that future legislation will impose higher tax on priority gains.

Additional year-end considerations

- The following areas should be given additional consideration as funds are preparing for the year-end:
 - Worthless securities
 - Form 1042 & 1042-S -Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
 - Convertible / bridge loans
 - Passive foreign investment company (PFIC)
 - Form 5471- Information Return of U.S. Persons With Respect to Certain Foreign Corporations

Worthless securities

- Revisit portfolio investment for possible write-offs.
- The following are the guidelines in determining if a security is worthless for US tax purposes:
 - That it has no liquidating value (i.e., balance sheet insolvency), and
 - That there is no reasonable hope and expectation that a continuation of the business will result in any profits to its stockholders. In other words, it must have NO present or foreseeable value.

Worthless securities

- Although one event rarely suffices, case law has shown that some events are more significant than others. The following events are often cited in the attempt to assert or deny the identifiable event for a deduction under §165(g):
 - A cessation of the business;
 - Sale of substantially all of the assets;
 - Surrender or revocation of corporate charter;
 - Adoption and commencement of a plan of liquidation, sale of assets, and distribution in liquidation to creditors;
 - Bankruptcy and receivership

Form 1042-Annual Withholding Tax Return for U.S. Source Income of Foreign Persons

- U.S. source income, including dividends and certain type of interest paid by a U.S. resident and earned by non-US partners, might be subject to withholding and reporting requirements.
- Capital gain from stock sales is generally not subject to withholding.
- IRS has increased focus on adherence to withholding rules.

Form 1042-Annual Withholding Tax Return for U.S. Source Income of Foreign Persons – (cont.)

- US Partnerships - Form 1042 & 1042-S are the primary reporting forms. Note that the form is required regardless if there were any withholdings or distributions made.
- Foreign Partnerships – As a general rule do not need to file Form 1042. Make sure, if required, to provide the withholding agent with W-8IMY and W-8BEN to prevent unnecessary withholdings. It is difficult, time consuming and sometimes costly to try to recover those withholdings. Foreign partnership may still have filing requirements. Each foreign partnership should be examined on a case by case basis.

Convertible / bridge loans, PFIC & CFC

- **Convertible / bridge loans**

Review all loans for doubtful collectability exceptions

- **Passive foreign investment company (PFIC)**

Timely review the foreign portfolio companies status as a PFIC and the need to make a a timely Qualified Electing Fund (QEF) election to avoid adverse US tax consequences on exit.

- **Form 5471- Information Return of U.S. Persons With Respect to Certain Foreign Corporations**

The IRS now imposes an automatic penalty notice for failing to file or for a late filing of information return (Form 5471).
Penalty can be up to \$10,000 per form per year.

Alon Sherer
Tax Department
PwC Israel
Tel: 03-7954520
alon.sherer@il.pwc.com