

Tax Planning for Fund Managers:

Taxation of Carried Interests

Venture Capital Private Equity Group  
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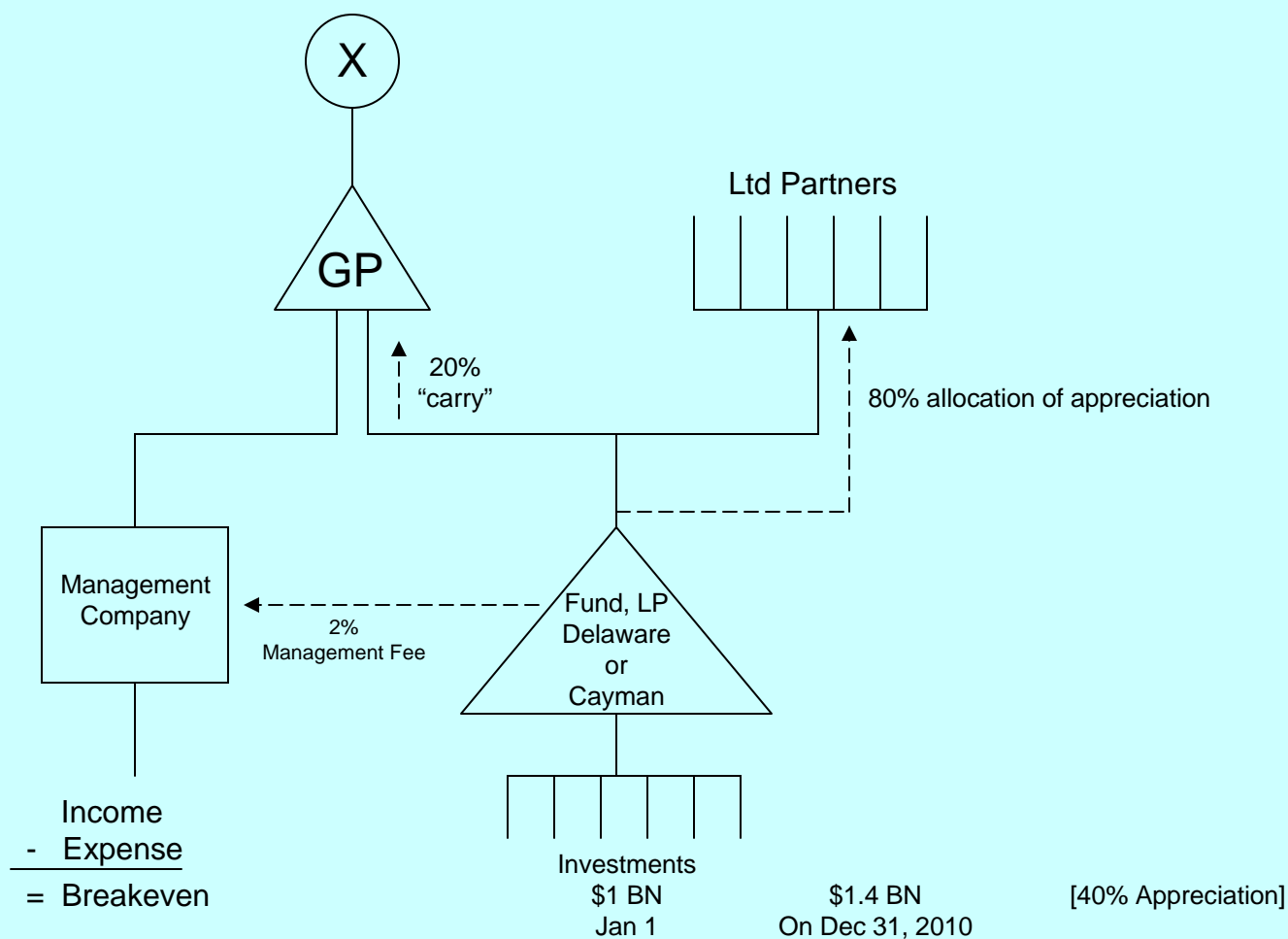
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# Tax Planning for Fund Managers

## Sole GP as Fund Manager



### GP (X)

	Tax Basis	Net Asset Value	Gains	Tax Rates	
				2010	2011 & Future
1. Investment in Fund					
- January 2010	10	25	15	15%	20%
- 40% Appreciation	<u>-0-</u>	<u>10</u>	<u>10</u>	15%	20%
- December 31, 2010	10	35	25		
2. Estimated Carried interest for 2011 20% x \$400 mm			80	15%	39.6% [transitions]

## Alternative 1: Distribute Cash Out in 2010

Distribute cash in 2010 that represents

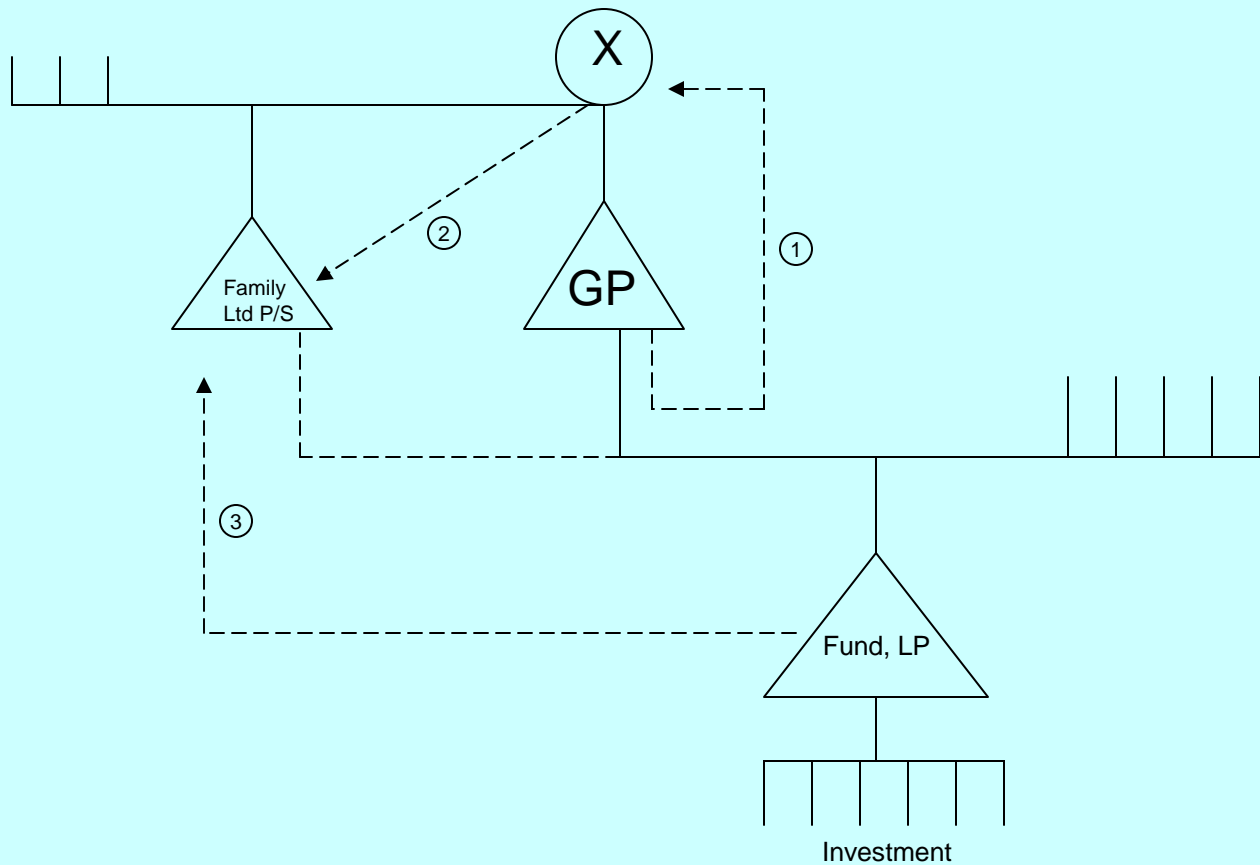
- (1) Recovery of basis – first 10 is tax free return of capital
- (2) Distribute additional cash out of 25 - Cash > basis = long-term gain \*
- (3) Distribute even more cash out as long-term gain \*

\* A Section 754 election needs to be made at Fund level to step up basis of GP's interest, otherwise gain will be taxed a second time.

### Questions

1. Is there cash available in Fund to distribute to GP?
2. Distribution accelerates gain into 2010, but rates may not go up in 2011 or 2012. Is risk worth it?

## Alternative 2: Installment Sale of Capital Account



### Steps

- (1) GP distributes full NAV capital account to X tax-free
- (2) GP sells interest in Fund [NAV] on installment basis to Family Limited Partnership. FLP becomes a limited partner in Fund.
- (3) As Fund sells investments over time, cash distributions to FLP will not be taxed on appreciation up to year of sale (2010). Only subsequent gain will be taxed.
- (4) X is taxed on installment gain when the note is repaid.
  - Carried interest not taxed at ordinary tax rates.

### Questions

- (1) Effective date of proposals: Jan 1, 2011
  - Installment sales not permitted under new law.
  - Will final law be retroactive?