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HOLTZ RUBENSTEIN REMINICK

About This Series…

A periodic update of current finance-related issues covering audit and accounting, tax, and regulatory matters affecting organizations that operate within the financial services sector.

FINANCE ALERT

Carried Interest

Proposed Increase in Tax Rate

In April, Michigan congressman Sander M. Levin proposed a bill that would amend the treatment of partnership interests held by partners providing services.

Of particular interest within this bill (H.R. 1935) is the addition of Sec. 710, "Special Rules for Partners Providing Investment Management Services to Partnerships." This section is significant since according to the bill:

(A) any net income with respect to such interest for any partnership taxable year shall be treated as ordinary income, and

(B) any net loss with respect to such interest for such year, to the extent not disallowed under paragraph two (2) for such year, shall be treated as an ordinary loss.

All items of income, gain, deduction, and loss that are taken into account in computing net income or net loss shall be treated as ordinary income or ordinary loss (as the case may be).

This proposed bill is of considerable importance; at the heart of the matter is the approximate 20% increase in the effective federal tax rate when one takes into account ordinary income vs. capital gains.

As federal and local jurisdictions actively look for additional revenue channels, this need has reached the highest levels of the federal government. In fact, in President Barack Obama's February 26 budget, there is a line item on the taxation of carried interest as ordinary income, under "other revenue changes and loophole closers."

It is the White House's contention that the taxation of carried interest alone will bring into the U.S. Treasury an added $2.7 billion in additional revenue in 2011. Although past attempts to change the tax treatment on carried interest have failed, the current economic climate makes the possibility much more real that this change will take effect.

Should this change take effect, managers at funds must begin to examine their current operating agreements. More likely than not, there will be a need to restructure these agreements to mitigate the adverse impact of such new taxes on net income, returns and incentives.

The Financial Services Group at Holtz Rubenstein Reminick ("HRR") is actively assisting their clients, working in conjunction with management's counsel, to provide tax planning strategies including estate tax planning and succession planning. Our partners have extensive experience within the alternative investment industry. We also understand the importance of partner involvement, and, as such, we ensure that our partners manage all aspects of client engagements. Our clients know that we are always available and knowledgeable about their business. Since a high degree of partner involvement allows for increased efficiencies, we are able to remove unnecessary bureaucracy. Our clients speak directly with the decision-maker to work through the issues.

For more information, contact one of the following Financial Services Partners: John Basile, (212) 697-6900, JBasile@hrrllp.com, or Paul Finegan, (212) 697-6900, PFinegan@hrrllp.com.

HOLTZ RUBENSTEIN REMINICK
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Holtz Rubenstein Reminick LLP • www.hrrllp.com

125 Baylis Road
Melville, NY 11747
(631) 752-7400

1430 Broadway
New York, NY 10018
(212) 697-6900

To change contact information, or opt out at any time, contact info@hrrllp.com