

Taxation of Carried Interest And Other Tax Developments Affecting Private Funds

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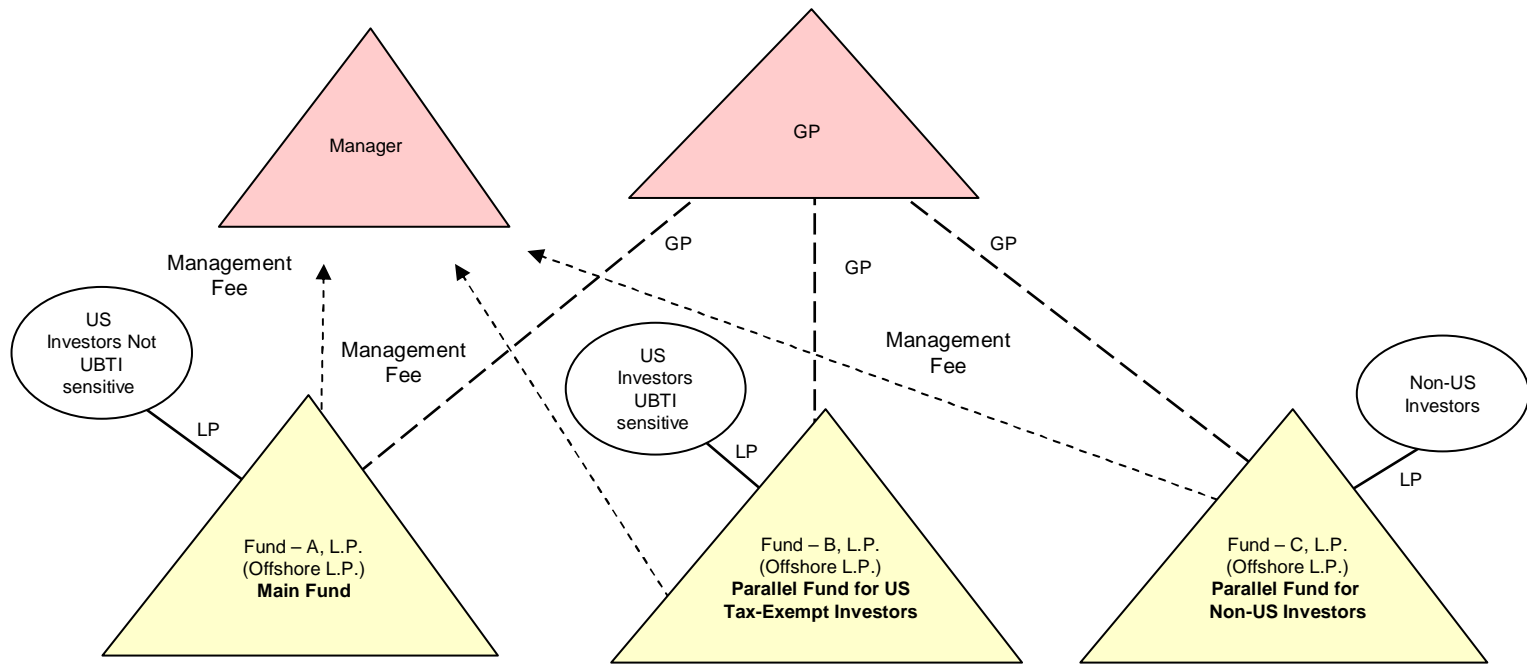
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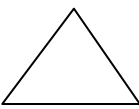
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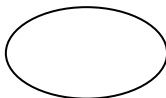
Typical Private Equity Fund Structure





Key


Taxed as partnership
for US purposes

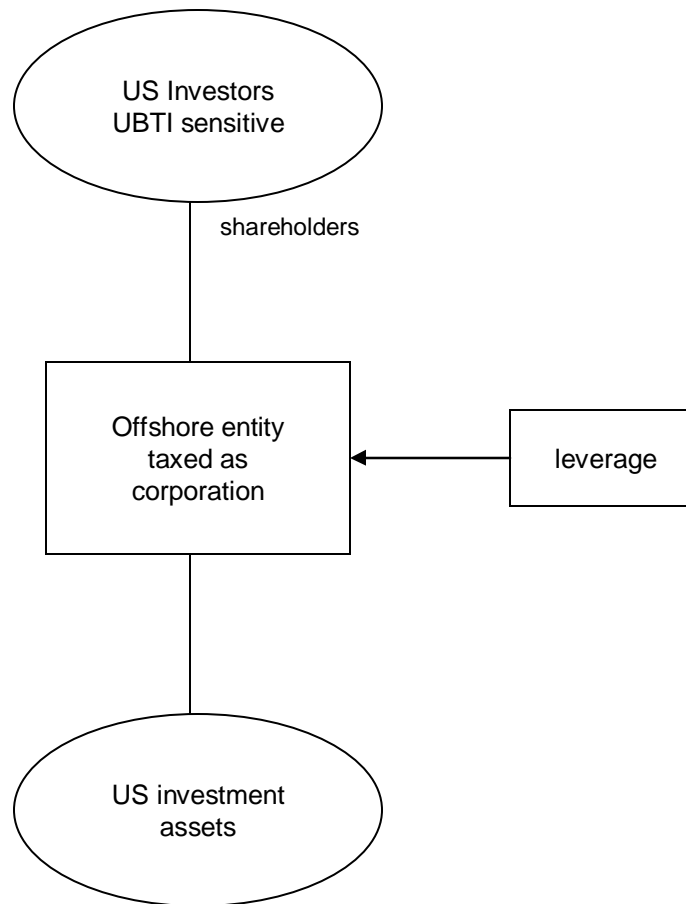

Taxed as corporation
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Not a Fund entity

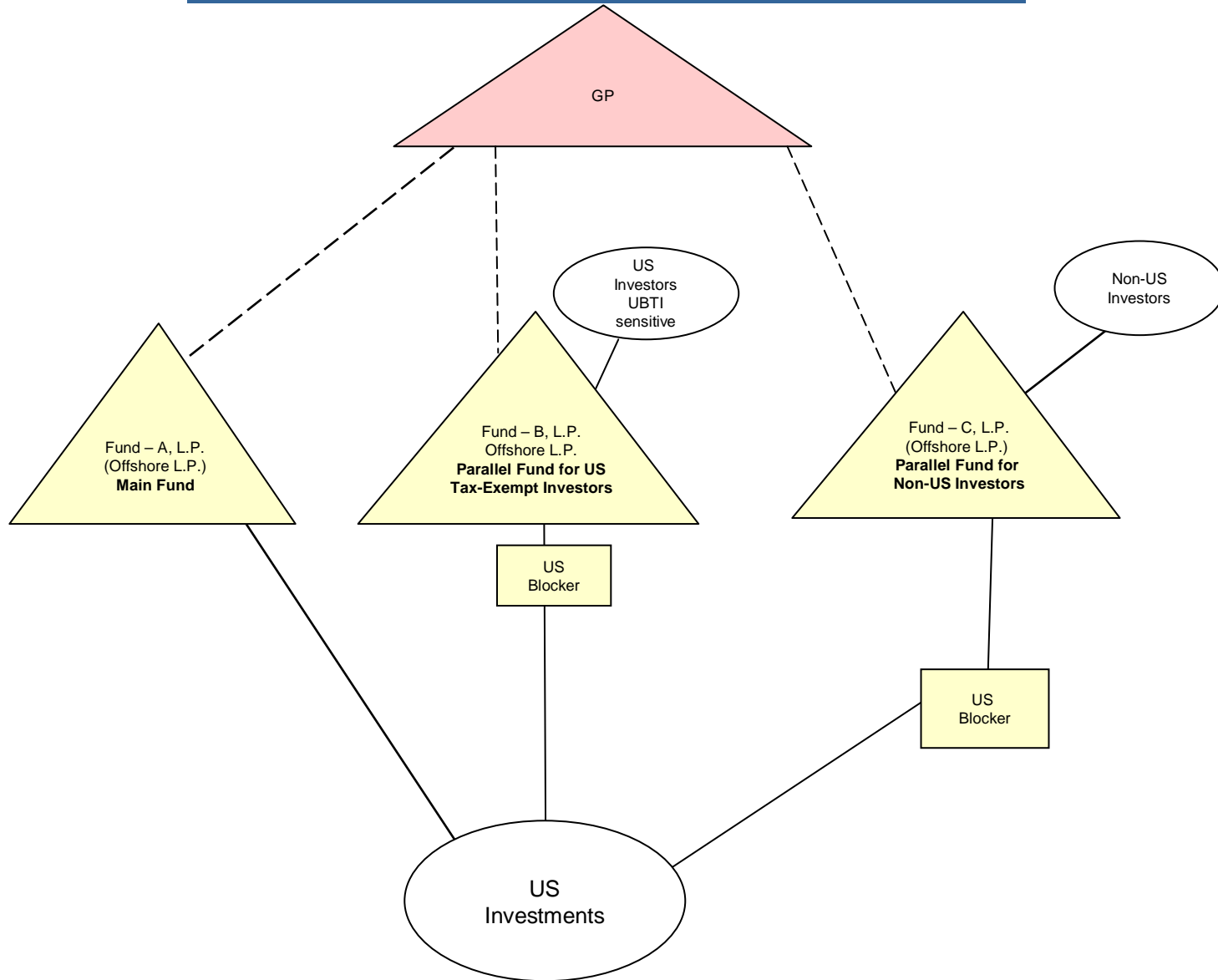
 Fund and parallel fund vehicles, AIVs, pooling vehicles, blockers and investments

 GP and manager entities

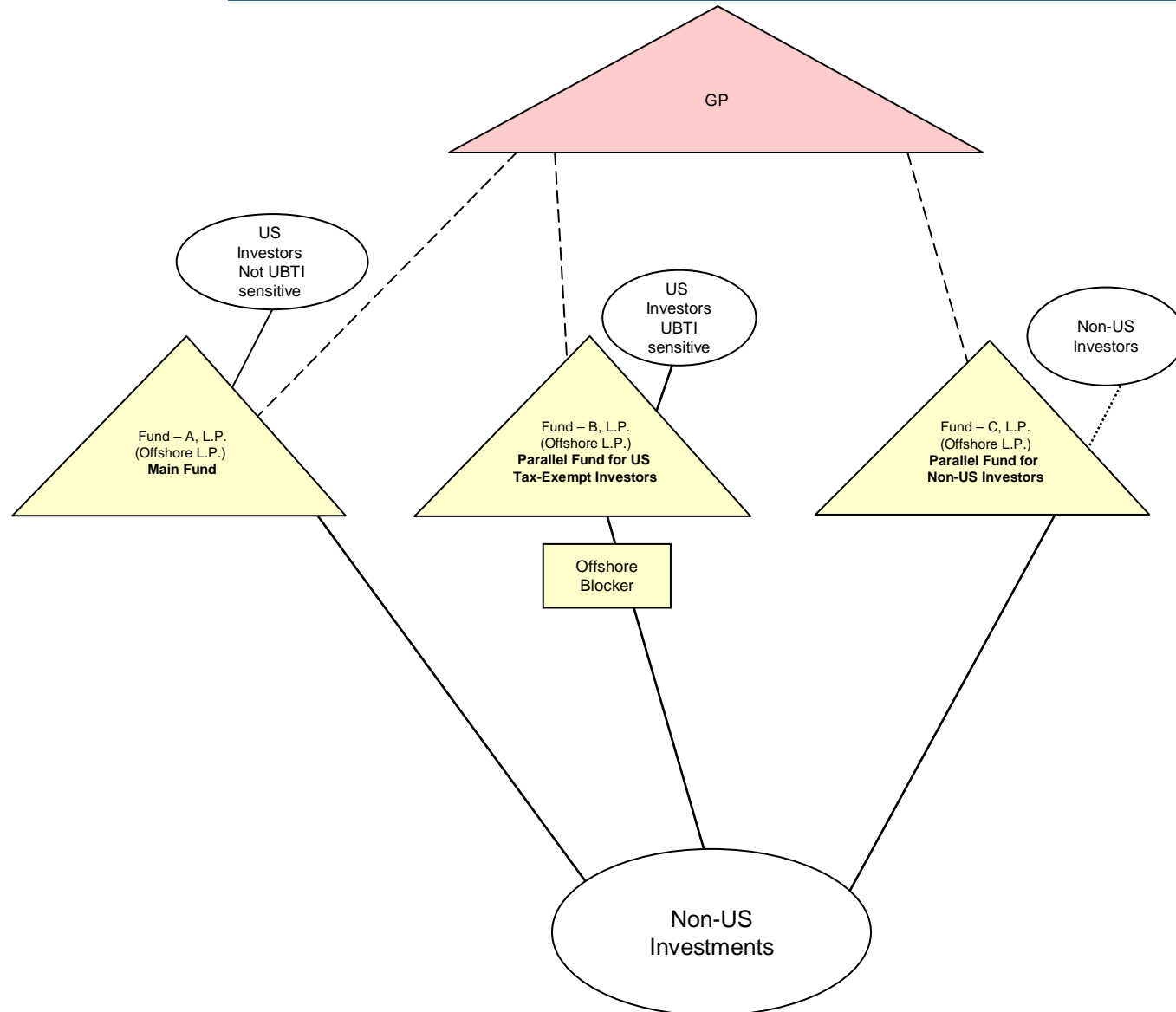
Typical Simplified Hedge Fund Structure



Use of Blocker to Block Bad US Income



Use of Blocker to Block Bad Non-US Income



Background to Put Issues in Context

I. '06 Election.

A. Six for '06.

1. Emphasis on middle income anxiety and income gap between rich and poor.
2. Tough budget discipline – pay go.

B. Democrats believe the election was about 6 for '06, not a referendum on Bush and the war.

II. Focus on '08 Election.

Election Effect on Tax Policy

- I. Tax Policy is a mix of personnel and policy.
 - A. New Democratic control of both Houses of Congress.
 - 1. Not so dramatic change in Senate where bipartisanship rules.
 - 2. Dramatic in House.
- II. The Congress and legislation is a reactive process.
 - A. Reaction to the list of billion dollar annual paydays in the hedge fund industry.
 - B. Reaction to perceived individual excesses highlighted in the media.

Election Effect on Tax Policy (continued)

- C. Legislation by Anecdote – Arguing both sides passive and active in the BX documents.
- III. Pay Go is by far the most dramatic change; completely changes the dynamic.
- A. Lots of pent up demand for tax benefits related to politically popular causes – renewable energy, education tax benefits, amt relief, etc.
 - B. Extremely limited supply of “tax loopholes/revenue raisers”, particularly “miracle cures”, large pools of revenue generation from politically unpopular sources.
 1. “Big Oil.”
 2. “Rich Folks.”

Tax Developments Affecting Hedge Funds and Private Equity Funds

- I. Not surprisingly, there is massive confusion in the political process about the subtle, but important, distinctions between the two.
- II. Therefore, the issues are “mucked” together.

The 5 Specific “Mucked” Together Issues Under Congressional Scrutiny

- I. Utilization of non-qualified deferred comp arrangements by off-shore hedge funds.
- II. Blockers.
 - A. BX style blockers.
 - B. Blockers by offshore entities to make sure tax-exempt investors do not pay UBIT.
- III. Strategies to convert the 2% management fee to l.t.c.g. “carry”.
- IV. PTP status for hedge funds and private equity firms.

The 5 Specific “Mucked” Together Issues Under Congressional Scrutiny (continued)

- A. S.1624 Baucus Grassley.
 - 1. Eliminates the §7704(c) exception for [hedge funds and private equity funds].
 - 2. Effective Date of June 14, 2007.
 - a) 5 year grandfather for currently trading entities [so called FIG provision].
 - b) 5 year grandfather for filed entities [so called BX provision].
- B. HR 2785 Cong. Welch Legislation.
 - 1. Also eliminates 7704 exception.

The 5 Specific “Mucked” Together Issues Under Congressional Scrutiny (continued)

2. Effective June 20, 2007 for everybody whether trading or filed.

C. Congressional Activity.

1. Strongly supported in the Finance Committee despite rather recent strenuous lobby activity against the legislation.
2. Lots of “lobbying” re effective date.
 - a) unfairness of 5 year rule in light of 10 year transition in 1987 legislation.
 - b) newly filed registrations by Och Ziff and KKR after June 14.
 - c) rumored in process filings by other entities.

The 5 Specific “Mucked” Together Issues Under Congressional Scrutiny (continued)

- V. Initiatives to treat “carry” as ordinary income for performance of services.
 - A. Again, a reaction by Congress.
 - B. HR 2834 - Levin/Rangel.
 - 1. While very broadly drafted, intention is to tax traditional “carry” as wages for income tax and social security purposes.
 - 2. Is intended to disallow ptp status because income earned is wages.
 - 3. No effective date which raises numerous possibilities.
 - a) grandfather entities or “carries” in existence on date of enactment.

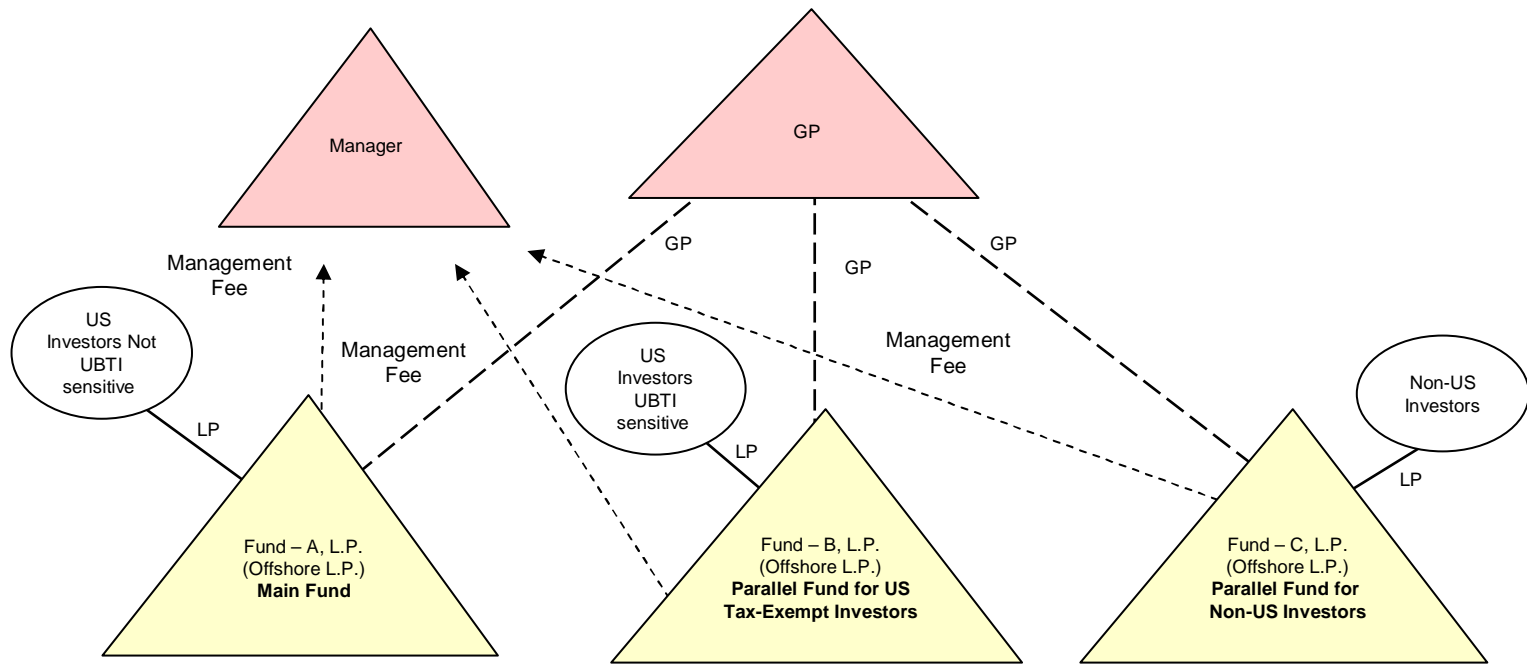
The 5 Specific “Mucked” Together Issues Under Congressional Scrutiny (continued)

- b) grandfather all gains on “carriers” as of the effective date/valuation date concept.
 - c) all “carriers” realized after date of enactment are wages.
 - 4. Obviously, the effective date is critical.
- C. No formal legislation on Senate Side yet.
 - 1. Two hearings held thus far.
 - 2. Enormous interest in a huge “pay for” in the pay go environment.

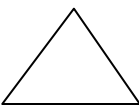
The 5 Specific “Mucked” Together Issues Under Congressional Scrutiny (continued)


- D. Intensive “lobbying” by several affected industries – hedge funds, private equity, real estate, venture capital, oil and gas, etc.
- E. Congressional analysis less fully developed (particularly on Senate side) on “carry” issue as opposed to ptp issue.
- F. Congressional timetable dictates both issues will probably be subject of specific action in the fall (mid September – mid November) with result unclear at this time.

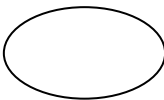
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



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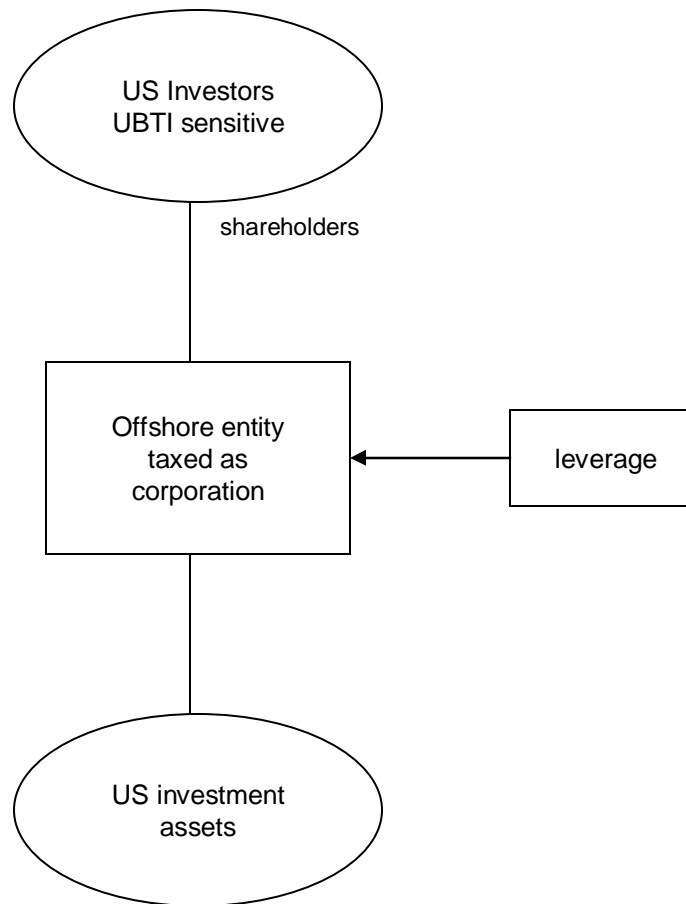

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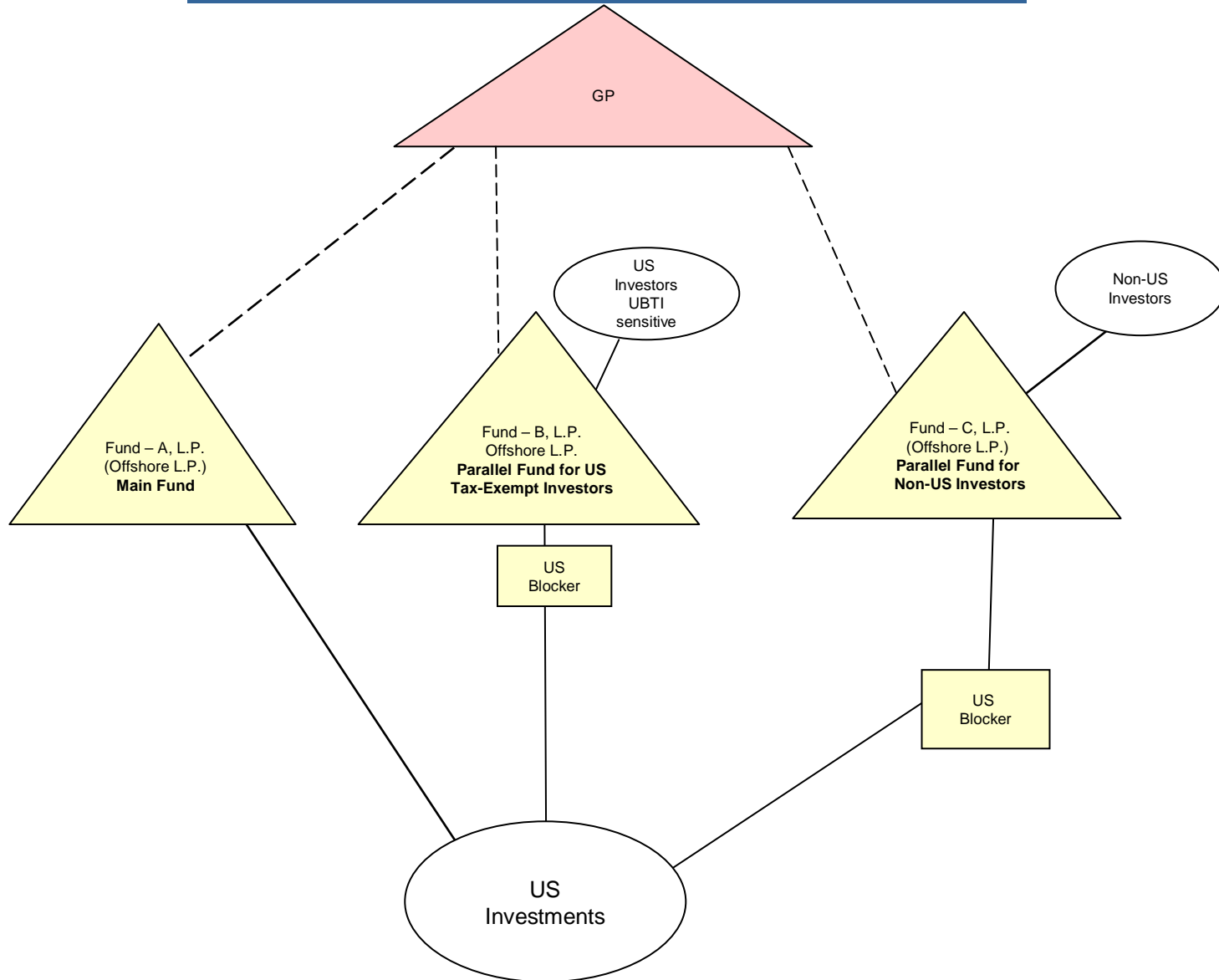
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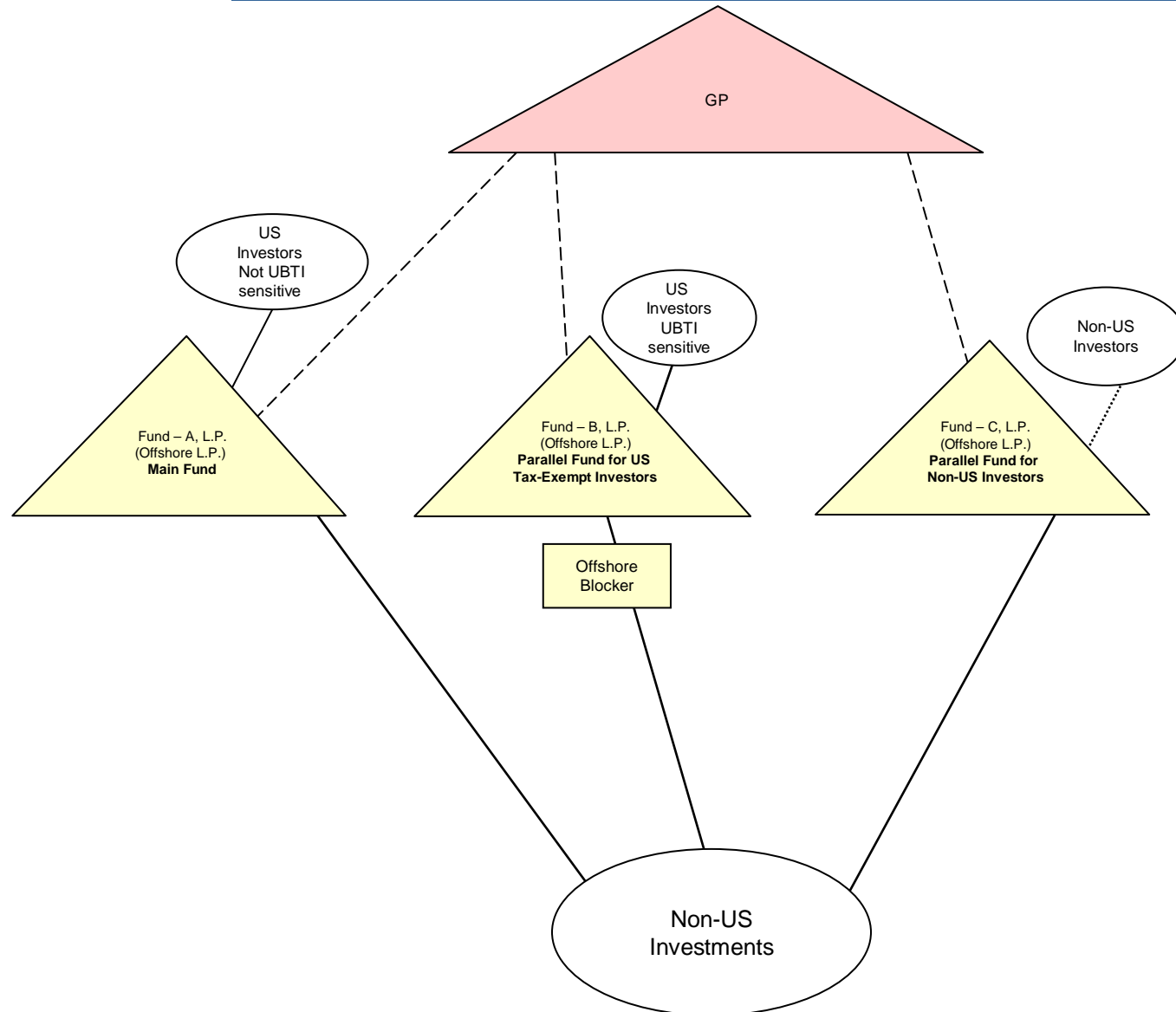
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Question & Answer Period