Seward & Kissel LLP

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Memorandum To Our Investment Management Clients

TAX PROPOSALS TARGET INVESTORS, HEDGE FUNDS AND MANAGERS

Several federal, New York State and New York City tax proposals would, if adopted, substantially change the tax landscape facing investors, hedge funds and their investment managers. The following is a brief summary of some of the more significant proposals that we are monitoring.

- On March 2, 2009, Senator Carl Levin (D-Mich.), along with Senators Whitehouse, McCaskill and Bill Nelson, re-introduced the "Stop Tax Haven Abuse Act" (S. 506) as an "improved version" (in Senator Levin's words) of 2007 legislation co-sponsored by then-Senator Barack Obama. A companion bill (HR 1265) was introduced by Representative Lloyd Doggett (D-Tex) in the House. The new bill includes provisions which, if enacted, would:

    - Tax offshore corporations, including offshore hedge funds, as though they were U.S. corporations if: (i) they have aggregate gross assets of $50 million or more at any time during the taxable year or any preceding taxable year or are regularly traded on an established securities market; and (ii) the "management and control" of the corporation occurs, directly or indirectly, primarily within the U.S. In the case of a corporation that primarily holds assets being managed on behalf of investors, "management and control" of the corporation is treated as occurring primarily within the U.S. if decisions about how to invest the corporation's assets are made in the U.S. This proposal, which was not contained in the 2007 legislation, would have an effective date for taxable years beginning on or after two years from the date of enactment. If enacted, this proposal would significantly impact the ability of fund managers to utilize current offshore corporate structures.

    - Close the "offshore dividend tax loophole" by subjecting dividend equivalent payments in respect of stock of U.S. corporations that are made pursuant to notional principal contracts (e.g., total return swaps), securities lending transactions, and "repo" transactions to the same 30% U.S. withholding tax that is imposed on dividends paid by U.S. corporations. This proposal would apply to payments made on or after 90 days after enactment. If enacted, this proposal would significantly limit the ability of offshore investors to avoid U.S. withholding taxes on dividends through the use of swaps and other derivatives.

    - Impose broader reporting requirements for "each [U.S.] person who is a shareholder of, or who directly or indirectly forms, transfers assets to, is a beneficiary of, has a beneficial interest in, or receives money or property or

the use thereof from, a passive foreign investment company [such as an offshore investment fund].”

- On March 6, 2009, a top aide to Senate Finance Committee Chairman Max Baucus (D-Mont.) told a tax conference that Senator Baucus is writing his own legislation to address offshore tax noncompliance.

- President Obama’s fiscal year 2010 Budget includes revenue raising proposals that target investment managers and “upper-income” taxpayers (taxpayers earning over $200,000 (single taxpayers) or $250,000 (married taxpayers) by:

  - Taxing “carried interest” (i.e., incentive allocation) as ordinary income and likely also subjecting the “carried interest” to self-employment tax (beginning in 2011).

  - Raising approximately $637 billion of additional revenue over the next 10 years from “upper-income” U.S. taxpayers by:

    - Reinstating (beginning in 2011) the 36% and 39.6% marginal tax rates;

    - Limiting the amount of certain itemized deductions (also taking effect in 2011); and,

    - Increasing the tax rate on long-term capital gains and qualified dividends to 20%.

- New York State Assemblyman Micah Kellner recently reintroduced proposed legislation (NYS Assembly Bill A2415), which would amend New York City’s Unincorporated Business Tax (“UBT”) to provide that a carried interest (i.e., incentive allocation) that is attributable to an “investment management services interest” relating to services performed in New York City would be subject to the 4% UBT (and taxed in the same manner as management fees currently are taxed), effective January 1, 2009.

- On December 16, 2008, New York Governor David A. Paterson included among his executive budget proposals a provision that would expand New York’s non-resident personal income tax to subject “carried interest” income earned by non-residents for performing “investment management services” for partnerships or other entities doing business in New York as New York source income taxable by New York State. This would affect the non-New York resident partners of hedge fund managers based in New York and also would be effective January 1, 2009.

If you have any questions regarding this Memorandum, please contact Ron Cima (212-574-1471), Peter Pront (212-574-1221), Dan Murphy (212-574-1210) or Jim Cofer (212-574-1688) of our Tax Group.

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