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MEMO

TO: Jeffrey Epstein

FROM: Thomas Turrin, CPA

May 18, 2015

Re: Partnership Questions – Art Partnership

Jeffrey,

The Art Partnership (the "Partnership") as we discussed, is to be a partnership between Leon (personally) and the four 2011 grantor trusts administered by US Trust (the "Trusts"). The questions you raised dealt with (1) the potential tax effect of the contribution of encumbered works of art to the Partnership by Leon (from Narrows Holdings, LLC, a single member LLC owned by Leon) and (2) what happens to the tax basis of the works of art contributed to the Partnership upon Leon's death – step-up in basis.

The works of art to be contributed to the Partnership collateralize Leon's personal loan to Bank of America. It is assumed that Bank of America has signed off on the contribution of works of art to the Partnership. The loan agreement with Bank of America would be modified with help from legal counsel. It is assumed that there is no current or future shift in obligation (intended or unintended) for any part of the B of A loan from Leon to the Partnership.

1. Contribution of encumbered property to a partnership – The general rule is if encumbered property is contributed to a partnership and if the Partnership assumes any of the underlying liability, there is a deemed taxable distribution to the partner receiving debt relief. If there is no shifting of liability from Leon to the Partnership, there is no debt relief to Leon and no taxable deemed distribution.

2. The tax status of the Partnership - During Leon's lifetime, the Partnership will be a disregarded entity since the four trusts are grantor trusts. There are no tax consequences of transactions between an individual grantor and the grantor trusts. During Leon's lifetime, the Partnership will not file a partnership tax return. Any gains from sale of art to a third party would be reported and taxed directly on Leon's personal tax return. Any charitable contribution of art (if possible under the loan agreement) would be deducted on Leon's return.
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3. Upon Leon's death - Upon Leon's death, the Partnership ceases to be a disregarded entity and becomes a partnership for tax purposes. The four grantor trusts cease to be grantor trusts and become tax-paying – tax reporting trusts.

   Under IRC Section 1014(a)(1), the basis of Leon's percentage interest in the Partnership would be stepped up to fair market value at date of death. Assuming Leon owns 50% of the Partnership, the step-up in basis would apply to Leon's 50% interest (outside basis).

   The outside basis of Leon's 50% interest would be stepped up to fair market value based on a valuation of the partnership interest. Such valuation would be performed after an appraisal was completed of the works of art (and any other significant non-cash assets) in the partnership. In order to equalize the basis of the assets inside the Partnership to the newly stepped up outside basis, the Partnership would make an election under IRC Section 754 to step up the basis to 50% of the assets inside the Partnership. The assets inside the Partnership may consist of works of art, other partnership interests, securities and cash. Each of the non-cash assets in the Partnership would be subject to a 50% step-up.

   By contributing art to the Partnership and not owning 100% of such art at death, the step-up in basis is lost to the extent of the Trust's interest (assumed 50%) in the Partnership. However, 50% of the art not subject to step-up would have appreciated inside the Partnership for the benefit of the four trusts.