

From: Richard Kahn <[REDACTED]>
To: Jeffrey Epstein <jeevacation@gmail.com>
Subject: re: Tax Alert: Strategies to Address New York City's Unincorporated Business Tax Hedge Fund Audit Attack
Date: Fri, 16 Dec 2011 13:58:04 +0000

Interesting article i thought you would like

Richard Kahn
HBRK Associates Inc.
301 East 66th Street, Suite 10F
New York, NY 10065
tel [REDACTED]
fax [REDACTED]
cell [REDACTED]

From: Sadis & Goldberg LLP Tax Group <[REDACTED]>
Reply-To: <[REDACTED]>
Date: Thu, 15 Dec 2011 10:13:39 -0500 (EST)
To: Richard Kahn <[REDACTED]>
Subject: Tax Alert: Strategies to Address New York City's Unincorporated Business Tax Hedge Fund Audit Attack

 Sadis & Goldberg LLP

Sadis & Goldberg LLP

Tax Alert

Strategies to Address New York City's Unincorporated Business Tax Hedge Fund Audit Attack

December 15, 2011

By **Steven M. Etkind and Alex Gelinas**

Introduction:

Certain management companies of hedge funds have recently been audited in connection with positions they took with regard to New York City Unincorporated Business Tax ("**UBT**"). The audits target the New York City tax benefits that principals of entities which serve as the general partner of hedge funds located in New York City have been able to derive in past years.

Typical Management Company Structure:

For many years, management companies of hedge funds have structured their businesses so that one legal entity (often referred to as the "**Investment Manager**") receives the management fees from a hedge fund and a second entity, often organized as an out-of-state

tax partnership or limited liability company (the "**General Partner**"), receives an incentive allocation from the hedge fund, consisting of capital gain income or other investment or trading income (the "**Incentive Allocation**"). The splitting of the management of hedge funds between two separate legal entities was undertaken in part because UBT has historically been imposed on management fees earned in New York City, but usually not on Incentive Allocations. Such tax treatment of the Incentive Allocation was approved in a statutory amendment to the UBT law more than 15 years ago. However, in light of recent developments discussed below, it may be time for investment management companies to revisit these structures to add more economic substance to the split of the management entities.

New York City Dept. of Finance Attack:

To date, Investment Managers have generally deducted the same expenses reported for Federal income tax purposes (to the extent permitted under the NYC Administrative Code) in computing their taxable income which is subject to UBT. It has been reported that, in a change of practice, the New York City Department of Finance ("**NYC Dept. of Finance**"), in some recent audits, has proposed disallowing some of the expenses deducted by Investment Managers. Disallowed expenses result in an increase in UBT. NYC Dept. of Finance is disallowing a portion of the expenses of the Investment Manager entity because it now considers the disallowed expenses as attributable to earning the Incentive Allocation which the General Partner receives from the hedge fund.

NYC Dept. of Finance has also indicated that it believes that Section 482 of the Internal Revenue Code, of 1986, as amended (the "**Code**"), supports the position taken by NYC Finance. In general, Section 482 of the Code allows the IRS to reallocate income and losses between entities that are controlled by the same interests in order to prevent the evasion of taxes or to more clearly reflect the economic income of such entities.

Prior Attacks on Incentive Allocation Structures:

Prior attacks on the Incentive Allocation took the form of attempts to amend statutory provisions. In 2010, New York State Governor Patterson's proposed budget included a statutory amendment to tax nonresidents on the Incentive Allocation they received from an investment fund located in New York State. Numerous tax bills introduced at the Federal level have also contained statutory amendments to treat the Incentive Allocation as compensation income for services. To date, such statutory changes have not been adopted. Unlike these earlier efforts, no change in statutory law is required to enable the NYC Dept. of Finance to assert its new position in a tax audit of a hedge fund manager's UBT returns.

Strategies to Address the NYC Dept. of Finance Attack:

There may be ways that hedge fund managers can modify their management structure to reduce the likelihood of success by the NYC Dept. of Finance in an audit to increase the amount of UBT payable.

First (and most obvious), the investment management company could move all of its operations out of New York City.

Second, the principal(s) of the General Partner could dispose of all or a substantial portion of their equity interests in the Investment Manager, the entity which receives the management fee, to persons, such as employees of fund management, who do not own or control the entity which receives the Incentive Allocation. Alternatively, or in addition, the principal(s) of the General Partner could make gifts of interests in the General Partner or the Investment Manager to family members or to trusts established for such family

members. The rationale for this divestiture strategy is that Section 482 of the Code and similar tax principles are more likely to be successfully asserted by the NYC Dept. of Finance if the asserted reallocation of expenses was between commonly owned or controlled entities.

With the U.S. federal estate and gift tax law currently scheduled to reduce the current five million dollar gift tax exemption to the one million dollar level on January 1, 2013, now would be a good time to address possible restructurings to minimize the NYC UBT audit tax risk in connection with general estate planning.

We encourage you to contact Steven M. Etkind at [REDACTED] or Alex Gelinas at [REDACTED] with any questions or to discuss your particular circumstances.

U.S. Treasury Circular 230 Notice: Any U.S. federal tax advice included in this communication is not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal tax penalties.

The information contained herein was prepared by Sadis & Goldberg LLP for general informational purposes for clients and friends of Sadis & Goldberg LLP. Its contents should not be construed as legal advice, and readers should not act upon the information in this Tax Alert without consulting counsel. This information is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with Sadis & Goldberg LLP. Electronic mail or other communications with Sadis & Goldberg LLP cannot be guaranteed to be confidential and will not create an attorney-client relationship with Sadis & Goldberg LLP.

Sadis & Goldberg Publications Keep You Informed.

Sadis & Goldberg offers a wide range of client publications to keep you abreast of legal news. Stop by the Library page on our website at <http://www.sglawyers.com/hedgefundworld/library.aspx> to see our full library of client alerts and publications. For further information about Sadis & Goldberg publications, please contact Cheryl Lee Spratt, Director of Marketing, at [REDACTED]

Sadis & Goldberg LLP
551 Fifth Avenue, 21st Floor
New York, NY 10176
[REDACTED]

[Forward email](#)



This email was sent to [REDACTED] by [REDACTED] | [Update Profile/Email Address](#) | Instant removal with [SafeUnsubscribe™](#) | [Privacy Policy](#).

Sadis & Goldberg LLP | 551 Fifth Avenue, 21st Floor | New York | NY | 10176