

From: Richard Kahn <[REDACTED]>
To: Jeffrey Epstein <jeevacation@gmail.com>
Subject: Fwd: TRA
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Sent from my iPhone

Begin forwarded message:

From: lawrence delson <[REDACTED]>
Date: July 28, 2014 at 3:30:22 PM EDT
To: "[REDACTED]" <[REDACTED]>
Subject: TRA
Reply-To: lawrence delson <[REDACTED]>

Rich

From Rich Joslin

Founders own partnerships that generate management fees (MFP) and partnerships that generate incentive allocations of PE fund profits (IAP). Founders wish to sell a portion of their MFP and IAP interests to the public.

A purchaser of a partnership interest will have a tax basis in the partnership equal to the consideration provided to the founders. Founders will recognize tax gain to the extent that the consideration received exceeds their tax basis in the MFP and IAP.

There can be a substantial difference in the tax basis of the purchaser's tax basis in MFP and IAP and the tax basis of the assets held by MFP and IAP, particularly if there is a premium placed on the intangible value of the management team in place, ie goodwill. If MFP and IAP make the Section 754 election whereby the basis of the purchaser's partnership interest is assigned to the purchaser's proportionate share of assets held by MFP and IAP, thereby giving rise to a tax basis adjustment to all partnership assets. This basis adjustment will apply solely with respect to purchaser, and will have no effect on the remaining interests held by the Founders. . The consideration is applied to each asset to adjust asset tax basis to equal fair market value. To the extent that consideration exceeds the fair value of the assets, the excess may be considered goodwill under Section 197 which may be amortized over 15 years by MFP (there is no goodwill created by IAP). Amortization of Section 197 intangibles will give rise to tax deductions by MFP allocable solely to the purchaser and will reduce the aforementioned inside/outside disparity and give rise to tax savings at ordinary income tax rates to the purchaser.

The public in the case of Apollo is Apollo Global Management (AGM) which is a publicly trade partnership. AGM holds an interest in IAP through a partnership interest and holds MFP interest through a corporate blocker. The blocker ensures that any management company income is taxed to the corporation and that the public owners of AGM receive a dividend on any profits earned and distributed by the blocker. Given the 754 election by Apollo, the acquisition of a portion of the Founder's interest in MFP to gives rise to a Section 197 intangible that provides future tax benefits of amortization deductions.

The generation and subsequent use of this valuable tax attribute is central to a Tax Receivable Agreement. As the purchaser receives a tax benefit for the use of the tax attribute, i.e. the Section 197 amortization, the purchaser is obligated to pay to the Founder's 85% of said tax benefit. The

measurement of tax benefit is based on a "with or without" approach whereby corporate tax is calculated with and without the Section 197 amortization. Apollo make a payment under the TRA on or around April 15 following year end.

Given that the TRA payment arises from the original sale by the founders to the public, the treatment of the TRA payment is considered additional consideration paid by the purchaser to the founder. This gives rise to an iterative calculation that the assets of MFP are stepped up to fair value and any amount of consideration in excess of fair value generates a Section 197 intangible. This additional Section 197 intangible is a tax attribute that is then subject to the Tax Receivable Agreement. Since payments of consideration are made over two or more tax years, the purchase is an installment purchase/ sale that gives rise to the application of Section 483 which treats a portion of an installment payment, ie consideration, to be treated as interest income, ie time value approach. While this interest may be deducted currently, it is not treated as consideration which gives rise to a basis step-up and thus is not impact the tax receivable agreement.

Given that there was no basis in the Apollo entities by the Founders in 2007 when the original sale took place, there was no purpose to elect installment treatment. The founders have adopted the "open transaction" approach whereby recognition applies when payments are received or fixed given that the fair market value of the stream of TRA payment obligation cannot be reasonably ascertained at the date of sale. If a "closed transaction" approach was asserted, there would need to be a valuation of the value of the TRA and immediate income recognition by the Founders. In such a scenario, the value of the TRA payments would be treated as consideration by Apollo and thereby give rise to a portion to be treated as a Section 197 intangible.

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