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ATTORNEY CLIENT PRIVILEGED COMMUNICATION

TO: Jeffrey Epstein
Alan Dlugash

FROM: Erika Kellerhals

DATE: August 29, 2014

RE: Application of EDC Credit to Section 1294 Deferral

It has recently been determined that an investment that was to have been made in the name of Financial Trust Company, Inc. ("FTC"), an Economic Development Commission ("EDC") beneficiary, via The Haze Trust ("THT"), was inadvertently titled in the name of Jeffrey Epstein, individually. It is further noted that THT was formed incorrectly as a grantor trust, of which Mr. Epstein was both the grantor and the beneficiary. Due to the contemporaneous nature of the formation of both FTC and THT and the clear recollection of the parties involved in the formation of the entities, the conclusion that THT was, at all times, intended to be the owner of the investment and wholly owned by FTC is reasonable.

Shortly after its formation in 1999, The Haze Trust made investments in several hedge funds, including Highbridge Capital Corporation ("HCC"). These investments generated substantial income, much of which was passive foreign investment company ("PFIC") ordinary income and capital gain. A qualified electing fund election ("QEF") was made with respect to such investment.

Although a United States shareholder in a QEF is currently taxed on its undistributed earnings, the shareholder may elect annually to defer the payment of the tax on those earnings, subject to an interest charge. IRC §1294(a)(1). Specifically, Section 1294(a) provides for the extension of payment of any "undistributed PFIC earnings tax liability." This term is defined as "the excess of the tax imposed for the taxable year over the tax which would be imposed without regard to the inclusion in gross income under Section 1293 of the undistributed earnings of a qualified electing fund." IRC §1294(b)(1). Undistributed earnings with respect to any qualified electing fund, is the excess of (1) the amount includible in gross income by reason of Section 1293(a) over (2) the amount not includible in gross income as previously taxed amounts under Section 1293(c). For the years 1999 through 2006, a Section 1294 election was made with respect to the investment in HCC. During the years 2007 through 2012, the taxes were paid currently on the PFIC income generated.

On July 15, 2014, an order to liquidate THT's interest in HCC, effective August 31, 2014, was entered. The liquidation of the interest will result in the termination of the election to extend the

date for payment of tax, and all taxes previously deferred for the 1999 through 2006 years will become due.

Two questions have arisen with respect to the liquidation of the HCC investment, namely, (1) did a transfer of the interest in HCC from the grantor to Southern Financial, LLC ("SF"), as of March 23, 2013, cause the termination of the Section 1294 election resulting in the tax liability becoming due and owing by the grantor as of 12/31/14?, and (2) if the transfer did not result in the termination of the election, is the deferred tax that will be due and owing from SF in 2014 eligible for the EDC credit? Each question is addressed below.

We have concluded, based upon our research, that the transfer of the interest in HCC from the grantor to SF did not terminate the Section 1294 election.

It should be noted that at all times relevant to this analysis, SF was wholly owned by Southern Trust Company, Inc., an S corporation, which was wholly owned by Jeffrey Epstein. Termination of a Section 1294 extension does not apply in the case of a transfer in a transaction, with respect to which gain or loss is not recognized (in whole or in part), and the transferee in the transaction succeeds to the treatment under Section 1294 of the transferor. IRC §1294(c)(2). It is anticipated that through Regulations, this relief will be provided only in a transaction where the transferee takes a carryover basis in the stock received and is subject to United States tax on a subsequent transfer of the stock. See HR Rep. No. 795, 100th Cong. 2d Sess. 278 (1988). The transfer of the ownership of the PFIC investment to SF would be a non-recognition transaction under IRC § 351. The IRS has not issued regulations yet for the non-recognition exception. However, in this case, there is no avoidance of the ultimate amount of tax that will be due since the grantor is still a U.S. Virgin Islands ("USVI") resident. So, the non-recognition transaction would be compliant with the guidelines of the House Report cited.

Having determined that the transfer from the grantor to SF did not result in a termination at the time of transfer, the remaining question is whether the tax due in 2014 from the liquidation of the HCC investment is eligible for the EDC credit. As noted above, despite the incorrect titling and tax treatment of the investment, it was intended that THT be owned by FTC. All relevant returns have been filed for the years 2006 through 2012 and no amended returns will be filed. The PFIC income was incorrectly reported on Jeffrey Epstein's Forms 1040. It was intended that the PFIC income be earned by FTC.

For purposes of this Memorandum, the PFIC income was USVI sourced or effectively connected income at the time it was earned, and, therefore, would be eligible for the EDC credit. As the investment is now owned by SF, which also has EDC benefits, and which succeeded to all of the assets of FTC, it follows that any tax due would also be eligible for the credit.

Title 29, Chapter 12, Section 713b of the Virgin Islands Code provides that each applicant, who is granted an industrial development certificate, shall have its income tax liability, for income derived from the business or industry for which the certificate is granted, reduced on a current basis. We note that we have found no case law or statutory authority on point with respect to our conclusion. Therefore, it is possible that the position could be challenged by the Virgin Islands Bureau of Internal Revenue.