



Current Issues Affecting Private Equity Funds

2023 Financial Services Tax Conference

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Shaping the future:
**convergence
& collaboration**
2023 Financial Services Tax Conference

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Agenda

01**Treaty Platforms – Current & Future****02****Private Equity Structuring and GP Issues****03****Creating Portfolio Value**

01

Treaty Platforms

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Investment Platforms

What do we want to achieve?

- Block ECI/Trading Income / CAI
- Non-resident capital gains exemptions
- Dividend, interest & royalty withholding tax reduction
- Mitigate Tax Return Filing Requirements
- Portfolio company cashflow and tax efficiency

How do we achieve our goals?

- Domestic law exemptions and rulings
- Treaty and similar (EU/AIF) benefits
- Personnel and substance and limitation on benefits
- Corporate headquarters redomiciliation and financing structures



Investment Platforms

Tax Initiatives and Anti-Avoidance/Deferral Rules

ATAD I (Interest Expense Limitation)

ATAD II (Anti-Hybrid Rules)

ATAD III (Shelf Companies)

DAC6 (Cross-Border Tax Arrangements)

Pillar Two (GloBE Tax) / CAMT (US Minimum Tax)

CFC / PFIC / PHC / AET / ECI / CAI / UBTI

Investment Vehicles

LP / LLC / REIT / RIC (BDC) / Blocker Corporations

Luxembourg SCS / SCSp / SCA / S.à r.l. / RAIF

Singapore VCC

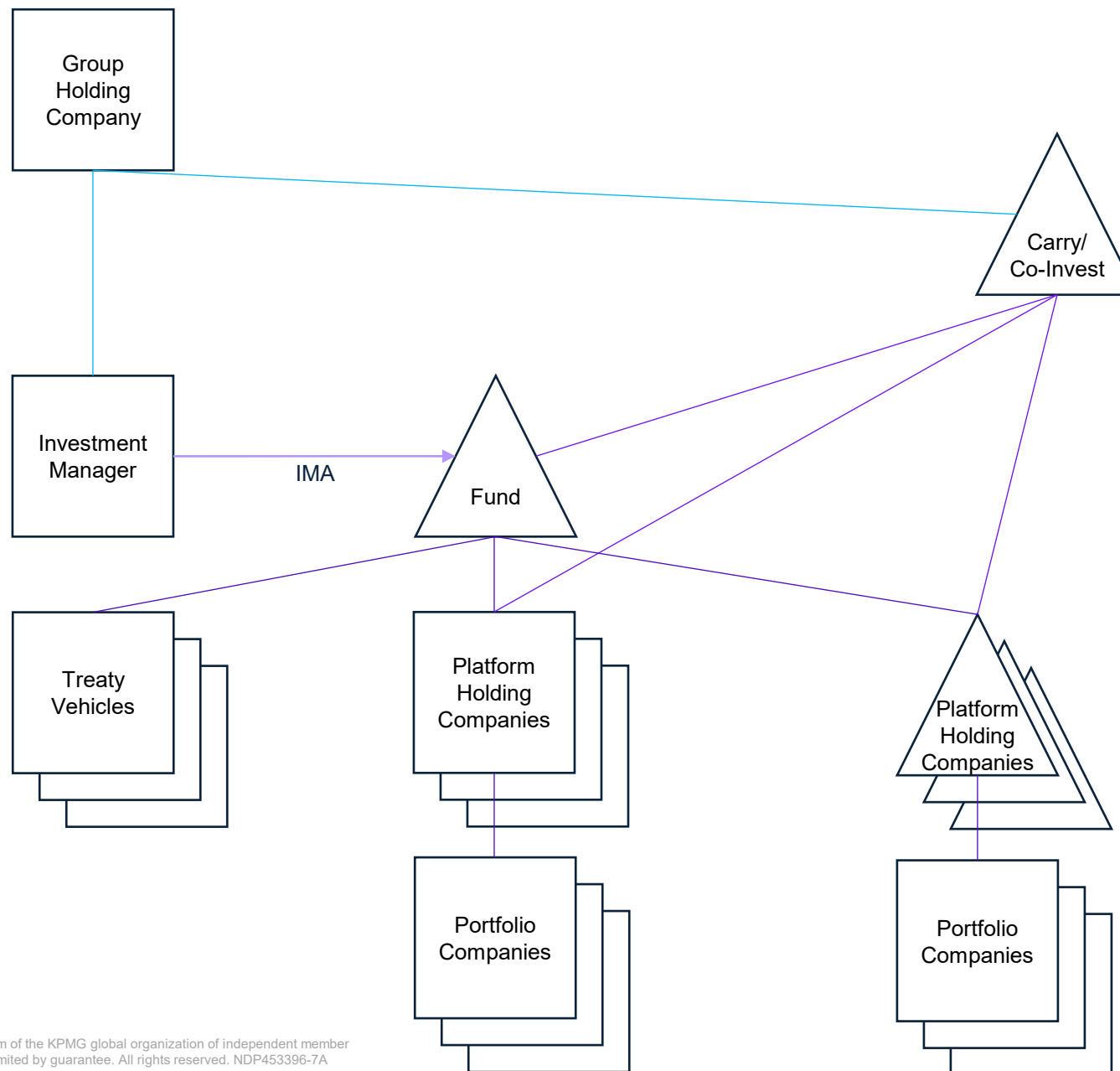
QHAC / s110 / Luxembourg/UK SV

ICAV

Investment Platforms



**No matter how large
a fund structure is,
bring it back to basics
(and then find the
complexities)**



02

Private Equity Structuring and GP Issues

Preparing for GP Stakes Transaction

Sponsors are attributing more value to management companies rather than carry vehicles

- As a result, in anticipation of a GP stakes transaction, any costs that can be appropriately accounted for by the carry vehicle may increase the value of the management company
- One such example is compensating management company employees with profits interests out of the carry vehicle instead of paying them wages from the management company
- This results in greater value ascribed to the management company due to less compensation expense but lower value in the carry vehicle

Profits Interest Forfeiture

Rev. Proc. 2001-43

- If an unvested interest is a profits interest on the date of grant, the transfer is not a taxable event if:
 - The partnership and service provider treat the service provider as a partner from date of grant;
 - No compensation deduction is taken by the partnership or any partner; and
 - The requirements of Rev. Proc. 93-27 are met
- If an unvested interest is forfeited, because the holder was treated as a partner from the date of grant, such holder will likely have been allocated income
- Some partnership agreements provide for “forfeiture allocations” to reduce such holder’s capital account generally reducing any capital loss upon forfeiture

Super-charged Profits Interest

Profits interest with a “catch-up” feature

- Intended to meet requirements of Rev. Proc. 93-27
 - Most importantly, no liquidation value upon grant (i.e., no entitlement to current value, only future appreciation)
- First economic profits allocated to profits interest holder to ‘catch-up’ to certain capital ownership

Example:

- Partnership is worth \$100m and would like to grant Individual a 10% interest
- A 10% capital interest would give rise to \$10m compensation income to Individual upon grant
- Rather than issuing a capital interest, consider granting a 10% profits interest with no liquidation value where future economic profits are first allocated to the Individual until Individual is entitled to 10% of the partnership’s value
 - First \$11m profit is allocated to Individual to ‘catch-up’ to 10% ownership

03

Creating Portfolio Value

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Tax portfolio value creation

Tax is an important part of value creation, especially in current market

- ✓ **Focus on:**
 - Immediate cashflow, EBITDA, and/or margin (cost savings) impact across ALL areas of tax
 - Identifying, quantifying, and (where advisable) maximizing tax credits and attributes
 - Risk mitigation & exit readiness
 - Tax planning opportunities (including US and global tax reform)
- ✓ **Cannot disrupt the business or management**
- ✓ **Complements operational value creation**

Deal professionals, operational professionals, and portfolio companies highly supportive

Topics considered

 Property tax	 Trade & tariff	 Sales & use tax	 Other indirect taxes if applicable	 Transaction tax	 Other business and tax opportunities	 Foreign jurisdiction compliance
 State & local (direct) tax	 Credits & incentives	 Transfer tax	 Federal tax	 Accounting methods	 Accounts receivable	 Accounts payable
 Structuring	 VAT	 Unclaimed Property	 Compensation	 Payroll tax	 Inventory	 Cash forecasting

Portfolio company attributes that can lead to tax savings

Tax portfolio value creation is **industry agnostic**, but we generally see the greatest opportunities in:



Manufacturing, retail, industrials, and other heavily regulated industries



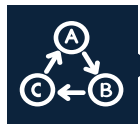
Companies with cross-border activity



Profitable (or near profitable) companies



Importers and exporters



Multi-state companies



Companies that are acquisitive, newly acquired, or planning for disposition

Trigger events (example)



Activities that can lead to tax opportunities

- International or domestic expansion
- New or recurring capital expenditures
- Job creation or high turnover
- Mergers and acquisitions
- Research activities
- Software development or customization
- Any high state income tax liability, high growth companies
- Companies that recently negotiated tax incentives
- Credits with onerous documentation burdens
- Consolidation of facilities
- Spin-offs
- Company-wide training initiatives

Current opportunities benefiting many PCs – Summer 2023

Interest expense deduction limitation planning (163(j))

- Highly leveraged PCs negatively impacted by expansion of limitation (EBITDA to EBIT) and high interest rate environment ([WSJ article](#))
- PE firms ascribe no value to 163(j) limitation
- Planning activities can offset limitation
- Applies to profitable & NOL PCs

R&D: mandatory capitalization & credits

- New rules require mandatory capitalization of R&E expenses for tax purposes
- Changes bad for many companies ([WSJ article](#))
- Planning, modeling, & R&D credits can help offset
- Many PCs not taking R&D credit

Employee Retention Tax Credit

- Payroll tax (top-line) credit worth up to \$26K/eligible employee
- Changes to ERC make it broadly applicable
- Many PCs are not aware of or taking full advantage of credits
- Quick feasibility diagnostic can assess potential value
- Documentation very important

Q&A

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Thank you!

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