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MEMORANDUM

TO: Clients and Friends

FROM: McQuadeBrennan, LLP

DATE: June 3, 2010

RE: Proposed Legislation on the Taxation of Carried Interest

On Friday, May 28th the House passed HR 1935, which includes a provision that would regulate the taxation of carried interest. (Carried interest refers to the sharing of profits between the general partner and limited partners of the partnership, whereby a general partner receives a greater share of the profit than the capital they had at risk.)

Traditionally, carried interest has assumed the character of the underlying income of the partnership. Thus, carried interest from the sale of public or private securities, for example, is taxed at a 15% capital gains rate because the partnership's income arises from investment activities that give rise to capital gain income. Under the bill, 75% of carried interest would be taxed at the ordinary income rates and 25% would be taxed as capital gain, without regard to the character of the underlying income. The justification for this change is primarily to raise revenue for the Federal Treasury, as opposed to a policy play that would argue that the profits received by fund managers are essentially their compensation for operating the partnership and having invested successfully. This provision would significantly affect venture capital and private equity fund managers, as well as certain other general partners of publicly traded partnerships.

The National Venture Capital Association (NVCA) has been lobbying hard against these changes, but, according to recent comments, they believe some sort of hybrid taxation of carried interest will likely become law. Although the proposed legislation is changing almost daily, the NVCA message is having an impact; the initial version of the bill was much less favorable (100% taxation as ordinary income) than the current version of HR 1935. The Senate is expected to take up this bill within the next two weeks.

We will send an update after the Senate votes on the legislation.

Contact Melody Twigg at mtwigg@mcquadebrennan.com or (202) 296-3306 with your questions regarding this issue. Melody is a Senior Tax Consultant at McQuadeBrennan, LLP.

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