MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

December 8, 2009

The Honorable Charles B. Rangel
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Dave Camp
Ranking Member
House Committee on Ways and Means
341 Cannon House Office Building
Washington, D.C. 20515

Re: Managed Funds Association's Comments with Respect to Certain Revenue Offsets in the Tax Extenders Legislation

Dear Chairman Rangel and Ranking Member Camp:

We understand the House of Representatives may soon consider the Tax Extenders Act of 2009 (H.R. 4213) (the "Extenders Legislation"), which includes proposals that would change the tax treatment of so-called "carried interest" and provisions included in the "*Foreign Account Tax Compliance Act of 2009*" (H.R. 3933) ("FATCA"). Managed Funds Association ("MFA")[1] appreciates Congress's efforts to address these important tax policy issues. However, we urge you to give careful consideration to the potentially serious and negative consequences on U.S. capital markets, job growth and capital formation in the United States at a time when our nation's unemployment rate stands at a near-record high and our economy remains extremely fragile.

We discuss below our views with respect to the use of carried interest and provisions of FATCA as revenue offsets in the Extenders Legislation. In addition, we have also set forth our perspective regarding another tax measure that members of Congress have introduced recently for consideration in the context of job creation legislation.

Carried Interest. The Extenders Legislation would re-characterize carried interest as compensation for services, thereby changing its nature as a share of the net profits generated by a business that may include capital gains to entirely ordinary income. In addition, the Extenders Legislation would make these changes effective in 2010. While most hedge fund income is now taxed at ordinary income rates[2], MFA strongly opposes a change in the treatment of carried

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies.

[2] In general, hedge funds invest in capital assets (such as stocks and securities) and hold them for less than one year (and thus a significant percentage of hedge fund income is now taxed as short-term capital gains (*i.e.*, at ordinary income rates). In addition, many hedge funds elect to be treated as "trader" under the Internal Revenue Code of 1986, as amended, and as a result their investments are treated on a marked-to-market basis (*i.e.*, taxed at ordinary income rates).

interest for two important reasons. First, the fundamental rationale behind a carried interest is that it represents the contributions of intellectual and sweat equity of a partner to a business enterprise. For more than fifty years, the Internal Revenue Code of 1986, as amended (the "Code"), has permitted partners in investment partnerships to pool the capital of investors with the skills of entrepreneurs in joint profit-making enterprises. To align interests and contributions to the partnership, the Code treats a partner's "carried" interest in the profits on the same terms as the other partners. Partners in a partnership should be treated similarly regardless of the form of their investment. Any legislative proposals that seek to change the fundamental tax treatment of partnerships under the Code should consider the damaging effect those proposals would have on the competitiveness of U.S. businesses, capital formation in United States, and ultimately, U.S. job growth.

In addition, unlike the Administration's broader proposal with respect to service partnership interests, the Extenders Legislation would impact only investment funds holding securities, commodities, derivatives, or real property. It is important to note that private investment funds, and in particular, hedge funds, remain providers of a significant amount of liquidity to U.S. capital markets. As you know, many troubled financial institutions currently hold impaired assets on their books and need to find buyers for those assets. Hedge funds and other private investment funds can play an important role in purchasing these assets, which would in effect provide these institutions with the capital necessary to rebuild their balance sheets and engage in increased lending activity. If Congress were to change the tax treatment of these investments, it would reduce or eliminate the incentives for hedge funds and other private investment funds to purchase those assets. We believe that now is not the time to impair an important source of liquidity to the U.S. financial system.

FATCA. The Extenders Legislation also includes the foreign account tax compliance provisions of FATCA as revenue offsets. MFA submitted a written statement and a comment letter on FATCA,[3] supporting Congress's objectives in preventing evasion of U.S. taxes through offshore activities, but cautioning that several provisions in FATCA would create significant administrative burdens that may threaten the global competitiveness of U.S. businesses and markets.

In our two prior submissions to the House Committee on Ways and Means, we identified aspects of FATCA that we believe Congress should modify in order to better achieve orderly compliance with the legislation while avoiding adverse tax treatment of transactions that have little or no potential for tax evasion. Most importantly, we explained that because many of the requirements under FATCA are complex (*e.g.*, sections 1471 and 1472 of FATCA, which create a foreign financial institution reporting regime; and section 501 of FATCA, which imposes a 30% withholding requirement on all substitute dividend payments paid under equity swap transactions on U.S. securities) and there was a limited amount time before those requirements were made effective, we were concerned about the ability of affected persons to comply with

[3] MFA submitted a written statement in connection with the hearing entitled "*Foreign Bank Account Reporting and Tax Compliance*" before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means, November 5, 2009, as well as a letter dated November 25, 2009 to Rep. Richard E. Neal and Rep. Pat Tiberi regarding FATCA. Copies of both submissions can be found on MFA's Web site at: www.managedfunds.org.

these requirements unless the Department of the Treasury promulgates comprehensive final regulations. We applaud Congress's amendments to the original provisions of FATCA relating to foreign financial institution reporting, which provide an effective date of December 31, 2012. However, we remain concerned that the effective date of the provisions with respect to the withholding requirements on substitute dividend payments of equity swaps remains 90 days after the enactment of the Extenders Legislation. Without regulations on this issue and the passage of a sufficient period of time to analyze and make the needed adjustments necessary to ensure full compliance, many legitimate business transactions may be adversely affected.

One Additional Consideration. Although unrelated to the expiring provisions, we believe that it is worth noting the imposition of a transaction tax on securities, futures and derivatives transactions as a revenue offset for any legislation is punitive on all investors (including retirement funds, pension funds and college endowments), since such a tax would be imposed directly on investor assets and not on the profits of "Wall Street firms". In our view, the "*Let Wall Street Pay for the Restoration of Main Street Act of 2009*" (H.R. 4191), which seeks to tax all financial transactions, would significantly increase the cost of capital and reduce the availability of credit in the United States, thus jeopardizing the ability of our economy to recover. Finally, this bill would put U.S. businesses at a competitive disadvantage globally.

We look forward to continuing to work with Congress to achieve an effective, balanced and workable approach to addressing these important tax policy issues. If you have any questions in the meantime, or if we can provide further information with respect to these, or other tax issues, please do not hesitate to contact David Landers, Lou Costantino, Carl Kennedy or me at (202) 367-1140.

Sincerely,

/s/ Richard H. Baker

Richard H. Baker
President and C.E.O.

cc: The Honorable Nancy Pelosi
The Honorable John Boehner