



MANAGED FUNDS ASSOCIATION

June 26, 2007

CC:PA:LPD:PR (Notice 2007-18)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20044

Ladies and Gentlemen:

In accordance with Notice 2007-18, this letter supplements the views expressed by the Managed Funds Association ("MFA") in its letter dated August 10, 2006 concerning the possible application of section 4965 to tax-exempt organizations that are passive investors in private investment funds, including hedge funds.

MFA is the voice of the global alternative investment industry. Its members include professionals in hedge funds, funds of funds and managed futures funds. Established in 1991, MFA is the primary source of information for policymakers and the media and the leading advocate for sound business practices and industry growth. MFA Members represent the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the over \$1.5 trillion invested in absolute return strategies.

In general outline, section 4965 imposes penalty excise taxes and reporting obligations with respect to any entity within an enumerated class of tax-exempt organizations that is or becomes a "party" to a "prohibited tax shelter transaction". In Notice 2006-65, the Internal Revenue Service (the "Service") and the Department of the Treasury (the "Treasury") solicited comments with respect to section 4965.

Although the investment fund managers represented by MFA generally do not knowingly participate in "prohibited tax shelter transactions", for the reasons summarized in MFA's original comment letter, they nevertheless have a significant interest in the question when a tax-exempt investor will be treated, for purposes of section 4965, as a "party" to transactions (including investments) undertaken by the fund. Accordingly, in its original comment letter, MFA requested interim guidance concerning the definition of a "party" to a "prohibited tax shelter transaction".

In Notice 2007-18, the Service and the Treasury announced that, pending the issuance of further guidance, a tax-exempt entity will be treated as a "party" to a transaction if it (1) facilitates the transaction by reason of its tax-exempt, tax indifferent or tax-favored status; or (2) is identified in published guidance by type, class or role, as a party to a prohibited tax shelter transaction. Notice 2007-18 also states that published guidance may also identify which tax-exempt entities, by type, class or role, will *not* be treated as a party to a prohibited tax shelter transaction.

In Example 2, as set forth in section III B of Notice 2007-18, these principles are illustrated in the context of an investment partnership, with both taxable and tax-exempt partners (i.e., investors), that participates in a prohibited tax shelter transaction. The Example concludes

that the tax-exempt investors are not “parties” to the transaction since they did not facilitate the transaction by reason of their status and have not been identified by type, class or role as parties to a prohibited tax shelter transaction in published guidance issued by the Service.

In MFA’s view, the first prong of the interim guidance should resolve most if not all of the issues under section 4965 confronting the investment fund managers represented by MFA. Further guidance is needed, however, with respect to the second prong of the guidance, which involves the designation of tax-exempt entities by type, class or role that will be treated either as a “party” to a prohibited tax shelter transaction or *not* as a party to a prohibited transaction. In addition, Notice 2007-18 indicates that the Service and the Treasury will propose regulations that will define the term “party” under section 4965 to include tax exempt entities that enter into prohibited tax shelter transactions that reduce their liabilities for applicable federal taxes.

For the reasons set forth in its original comment letter, MFA urges the Service and the Treasury to issue guidance that, where the “role” of a tax-exempt entity is limited to that of a passive investor in a hedge fund or other private investment fund, the tax-exempt entity will *not* be treated as a party to any transaction (or investment) undertaken by the fund if tax-exempt entity does not (1) facilitate the transaction by reason of its status or (2) have the power to direct the fund to engage in any specific transaction or make any specific investment. For the reasons also set forth in its original comment letter, MFA believes that the following should be disregarded where the preceding two factors are satisfied:

(a) the receipt by the tax-exempt investor from the fund of securities law related disclosures of the fund’s investment objectives and strategies;

(b) the conduct by the tax-exempt entity of customary due diligence activities before making its investment in the fund;

(c) the receipt by the tax-exempt entity of period reports of the fund’s investment results during the course of its investment;

(d) the receipt by the tax-exempt entity of other information with respect to the fund or its investment therein from any source, including, for example, disclosures pursuant to section 3.02 of Notice 2006-16 and any similar future published guidance; and

(e) the filing by the fund of a Form 8886 with respect to any transaction or investment by the fund.

In addition, in MFA’s view, if the test outlined above is satisfied, a passive tax-exempt investor in a private investment fund such as a hedge fund should not be treated as party to transactions and investments by the fund under any regulations that are issued to address cases where a tax-exempt entity “enters” into a prohibited tax shelter transaction that reduces its liability to for applicable federal taxes.

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MFA stands ready to respond to any questions you may have with respect to this letter and specifically requests the opportunity to meet with representatives of the Service and Treasury to discuss these important issues.

Respectfully submitted,

A handwritten signature in cursive script that reads "John G. Gain".

John G. Gain, President