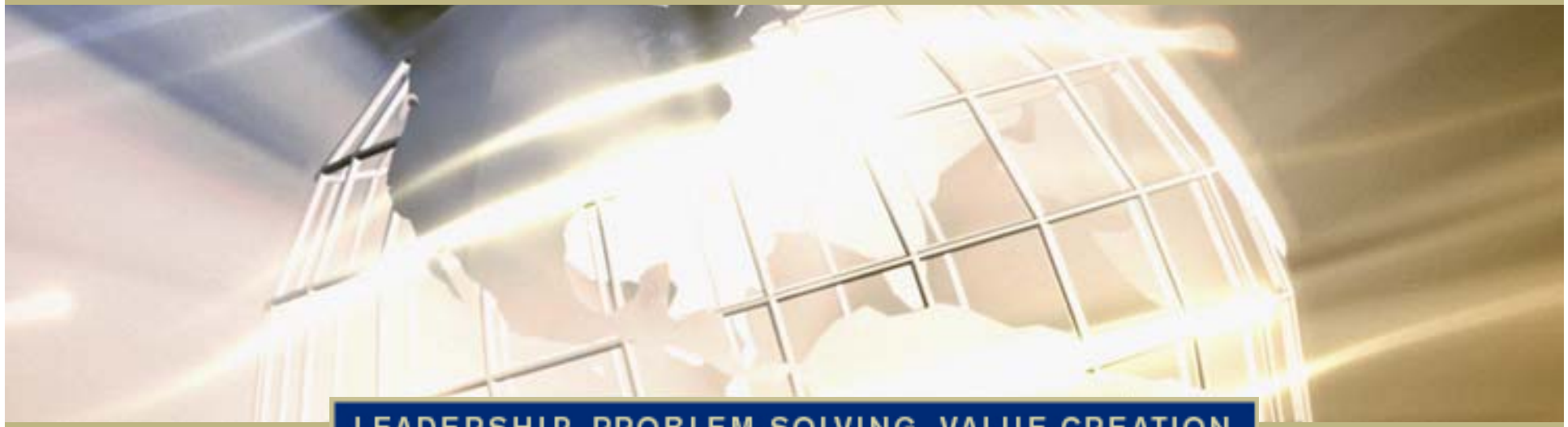


# Inbound and Outbound US Private Equity Deal Structuring



LEADERSHIP. PROBLEM SOLVING. VALUE CREATION.

**Ernesto R. Perez**  
Managing Director  
Alvarez & Marsal Tax Advisory Services, LLC  
1111 Brickell Avenue, 11<sup>th</sup> Floor  
Miami, Florida 33131  
[eperez@alvarezandmarsal.com](mailto:eperez@alvarezandmarsal.com)



ATLANTA • CHICAGO • DALLAS • DENVER • HOUSTON • LOS ANGELES • MIAMI • NEW YORK • PHOENIX • SAN FRANCISCO • FRANKFURT • LONDON • MILAN • PARIS • HONG KONG

## Contents

- Inbound – Private Equity Funds Investing in U.S. LLCs: Foreign Investors and Structures that Cater to Them
  - Major US tax issues
- Outbound from the US private equity transactions to acquire European real estate operations
  - Major US tax issues

## Background

- Private Equity Funds are usually organized as U.S. Limited Partnerships.
  - Investors include Non-U.S. treaty investors, non-treaty investors and non-U.S. governments and their controlled entities.
  - Let's consider how non-U.S. investors are affected if the Fund invests in an LLC; and how the investment might be structured to minimize the adverse impacts under various U.S. regimes.
-

## The Nature of LLC's

- Flow through (tax transparent) entities for U.S. tax purposes.
- Federally and in most states, they bear no income tax; all taxable income flows through to investors.
- Members of an LLC (and partners in a Fund partnership which owns an LLC) are treated as engaged in business wherever the LLC is so engaged.
- One layer of tax, at the investor level.
- Character of income or gain earned by LLC flows through to its members.

## The Goals of the Foreign Investor

- Foreign investors almost universally dislike having the Fund directly invest into an operating LLC.
- This would cause the foreign investor to have U.S. source effectively connected income from LLC operations (“ECI”), which is subject to net income tax and reporting obligations in the U.S.
- If a treaty applies, the U.S. business activity generally will be treated as a “PE” and income “attributable to” the U.S. PE will be subject to U.S. net basis taxation.

## The Goals of the Foreign Investor

- The IRS also treats any gain from sale of interest in the LLC as ECI, or income attributable to a U.S. PE.
- While the taxpayer could argue this is an exempt capital gain, the IRS will disagree. (Rev. Rul. 91-32)
- Uncertainty whether LLC interest held by non-U.S. individual is subject to U.S. estate tax.
- Foreign investor is required to file U.S. tax returns even if no income is allocated to it by the Fund from the LLC investment.

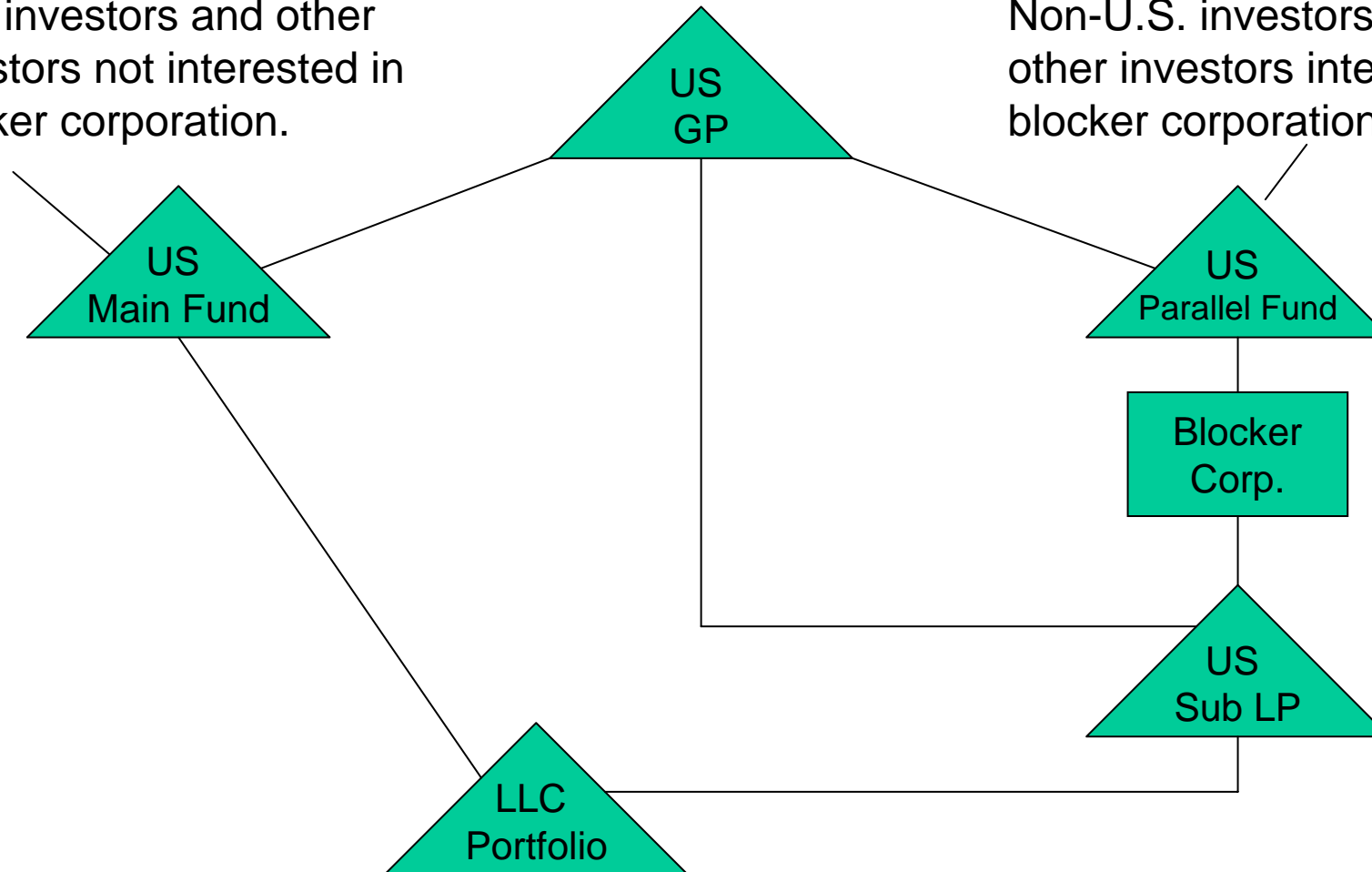
## The Goals of the Foreign Investor

- FIRPTA would apply to tax the foreign investor on any gain from sale of U.S. real property or real property interests by the LLC.
- Foreign corporate investors that have ECI are also subject to the “branch profits tax,” at 30% or lower treaty rates.
- Generally, there is NOT going to be any direct investment into LLC’s where the Fund has foreign investors. The documents will generally require use of “best” or “reasonable best” efforts to avoid generating ECI.

## Accommodating Structure – Historic Fund Blocker

U.S. investors and other investors not interested in blocker corporation.

Non-U.S. investors and other investors interested in blocker corporation.

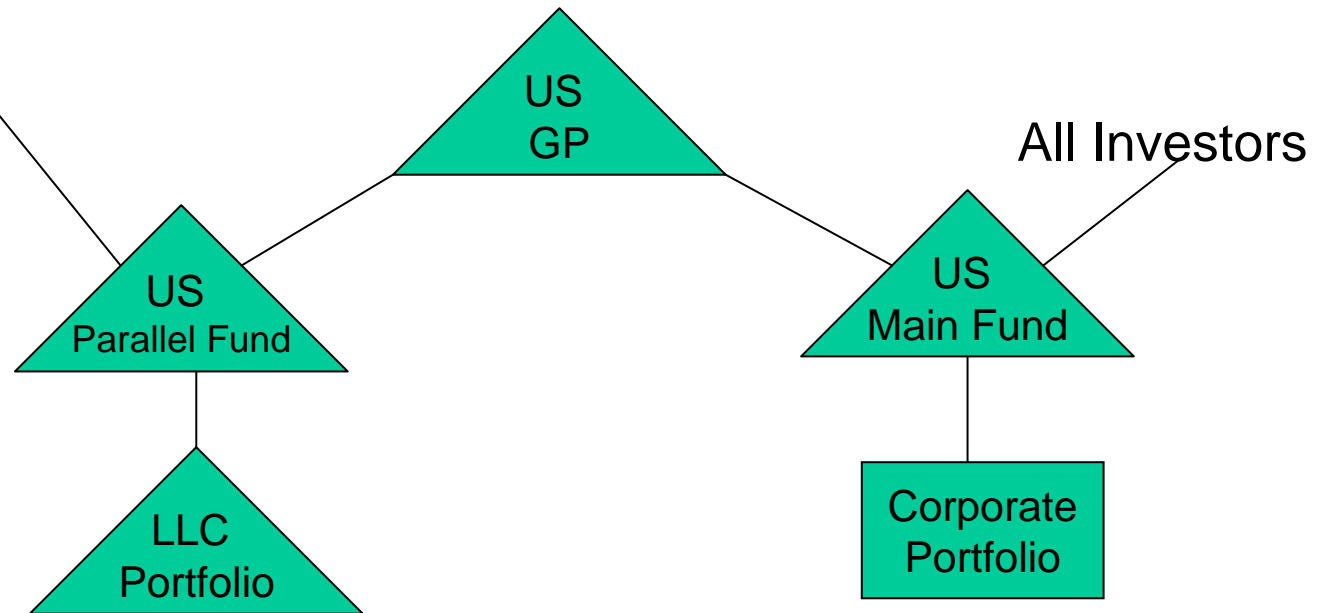




## Accommodating Structure – Alternative Structure

Non-U.S. Investors  
who want a Blocker

Blocker Corp,  
U.S. or Foreign



## Exit Issues – Possible Exits for the Fund

- Sale
    - LLC is sold
      - One-shot sale of LLC/Assets
      - Partial sales of separate lines of business/assets
    - Fund's interest in LLC is redeemed/sold
  - Tax –free reorganization/corporate formation
    - Much less likely exit form for LLC investment
  - IPO
-

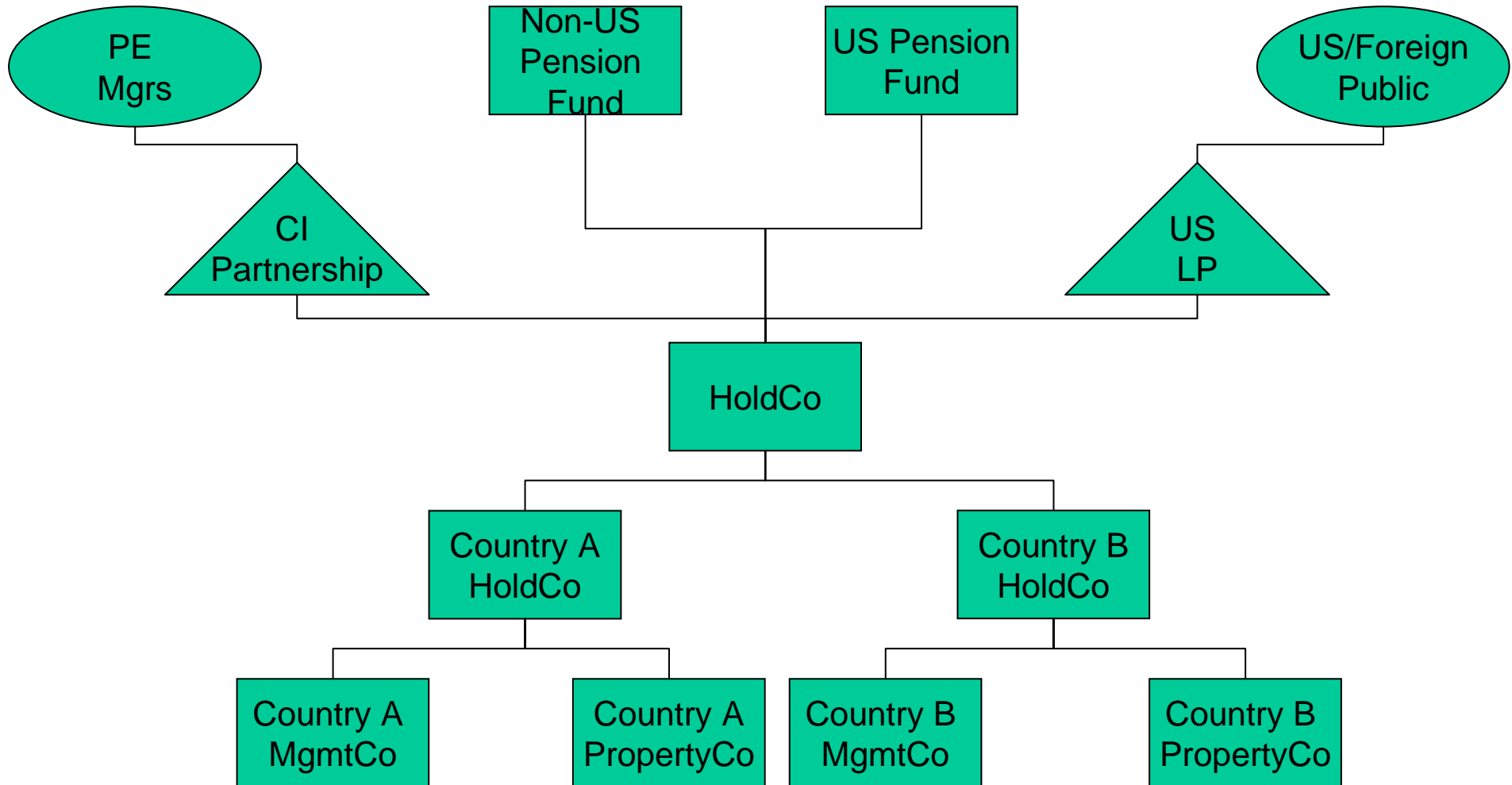
## Exit Issues – Sales Sale of Blocker

- Gains recognized on sale of a blocker generally are tax-free to its owners (subject to FIRPTA)
  - Impediments to sale of blocker
    - Purchaser does not get a step-up for the blocker's investment in the LLC.
    - Purchaser is acquiring an unnecessary extra layer of potential liabilities, etc.
  - Accordingly purchaser may be unwilling to acquire blocker

## Blocker Scenario - Using Leverage to Reduce Taxable Income

- First issue – debt versus equity characterization; a question of fact, based on all of the facts and circumstances
  - Portfolio debt
  - Treaty eligibility
  - Earnings stripping limitations (Section 163(j))
  - Limitation under Section 267(a)(3)
  - Applicable High Yield Discount Obligations limitations
  - Limitation of benefit under Section 279
-

## Possible Outbound Structure



## Major US Issues

- Debt push down
  - Avoidance of adverse CFC/PFIC consequences
  - Hybrid entity planning
  - Unrelated business taxable income
  - Section 338 election
  - Compliance
-

## Additional US Issues

- Local country labor law issues
  - Repatriation of earnings (Dividends/Interest/Rents)
  - Exit strategy
  - Availability of foreign tax credits for investors
  - Preserving capital gain treatment for investors
  - Location of the holding company
  - Due diligence
-

## **CIRCULAR 230 DISCLOSURE**

**As provided in Treasury Department Circular 230, any tax advice in this communication is not intended or written by Alvarez & Marsal Tax Advisory Services, LLC to be used, and cannot be used, by a client or any other person or entity for the purpose of avoiding tax penalties that may be imposed on any taxpayer. This presentation is intended only for the use of the addressee and may contain information that is privileged and confidential.**

---