Introduction

Private equity and venture capital is a relatively new discipline. While some form of investment in private enterprises has existed throughout the ages, not until after World War II did contemporary private equity take root.[1] Since its early origins, the industry has reinvented itself by surviving through turbulent boom-bust cycles such as the LBO buyout era, the bursting of the Internet bubble, and the credit crunch of 2007. While in the midst of the credit crunch, deal flow was down 50 percent from 2008 and 65 percent from 2007, private equity funds still managed to invest over $43 billion during one of the hardest times for the industry.[2] Funds and opportunistic investors with an eye for early-stage business are the backbone of this resilient industry. Private equity and venture capital funds[3] are foreign or domestic entities that primarily invest in non-publicly held enterprises. The investment can range from simple preferred stock or debt to synthetic equity or derivatives. Funds usually exist for a set number of years and eventually wind up their affairs as investments are sold. Throughout their life cycle, these funds and their investors are naturally represented by various professionals, including tax advisers. A number of very interesting issues come up in this area of the tax law that constantly challenge those tax advisers who make a living by helping funds and their investors. This book covers many of those tax issues in an attempt to assist those advisers in navigating the thicket of rules and regulations that permeate this area of the law.

The work of the private equity tax adviser, such as a private equity tax lawyer, is challenging but unorthodox. A private equity tax lawyer, like most transactional lawyers, usually does not go to court, does not write briefs, and does not present oral arguments before a jury. In fact, a private equity tax lawyer would often be oblivious to where the local district courthouse is. Fortunately, good transactional lawyers usually possess skills that clients desire—knowledge of transactional-related laws, research skills, ability to optimize structures for tax purposes, and generally the foresight to shelter the client from future tax-related headaches. One skill that is most essential to a transactional tax lawyer, or any other practitioner that works in this field, is the ability to spot and resolve potential tax problems. After all, clients, like most of us, do not want to spend their time and money arguing with the IRS over a problem that could have been avoided. To spot issues, the tax lawyer must know a lot of tax law. Unfortunately, no tax lawyer can know and remember all of the law.

This is where this book can help. The book covers and muses over a significant number of tax issues that come up in private equity and venture capital transactions. Despite the

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1. For a brief but thoughtful discussion on the history of private equity, see http://en.wikipedia.org/wiki/History_of_private_equity_and_venture_capital.

2. *See* the 2010 Pitchbook (Annual Private Equity Breakdown 2010), http://www.pitchbook.com/library/PitchBook_PE_Breakdown_2010.pdf.

3. The term "private equity" as used in this book includes the term "venture capital." For most practical purposes, including tax issues, venture capital is a subset of private equity where the investor usually obtains equity in an early-stage company.

breadth of addressed issues, however, this is not a typical treatise and does not purport to provide an in-depth background discussion of the law, terminology, or fundamental concepts related to the taxation of private equity funds. Other authors have done a tremendous job of doing these things.[4] Rather, this book is a practice tool that can be used by law firm tax practitioners, accountants, and in-house tax counsel in advising clients in private equity transactions. The book takes the form of a catalog of tax issues related to private equity funds. The issues are outlined thematically and discussed, and solutions to problems are suggested when possible. Moreover, the book offers citations to in-depth discussions and other authority pertinent to a particular issue, which could help readers in developing their own solutions.

The book was prompted by the realization that private equity taxation spans across many chapters of the Internal Revenue Code (IRC or the Code), and practitioners who attempt to tackle it must be proficient in specific areas of corporate, partnership, and inbound and outbound international taxation. Moreover, given the breadth of the tax areas that come into play in private equity transactions, and the great variety of issues, spotting the issues can be a Sisyphean task, and a task that if not completed adequately could cause grief for both the client and the practitioner. Thus, a reference list of issues with related discussions can be helpful when a new deal comes in the door.

When that happens, the lawyer could quickly run through the headings in this book as a checklist for reviewing the transaction. The tax issues discussed are organized in the following manner. Chapter 1 covers issues at the fund level—these are issues that occur at the time of forming the fund, investing in the fund, withdrawing money from the fund, or winding up the fund. Chapter 2 discusses issues that are prevalent at the operating company level—these are issues that come up when the fund invests in an operating company, lends money to the operating company, or unwinds its investment in the portfolio company. Chapter 3 covers issues peculiar to international inbound deals, which can occur when foreign or domestic funds invest in U.S. operating companies or the fund has foreign investors. Chapter 4 covers issues peculiar to international outbound deals: the issues that arise when domestic and foreign funds invest in foreign operating companies. Some issues overlap these categories; whenever that is the case, the author has attempted to the best of his ability to duly note so. Generally, the sections of each chapter name and describe a specific issue and its import, discuss the pertinent authority, and end with a list of helpful reading sources when the author is aware of such sources. At the end of the book are several appendices filled with checklists, outlines, and other useful tools for your practice, as well as a bibliography that collects all the reference works mentioned throughout the book. Hopefully, the information discussed here will be useful. Writing it was certainly helpful, educational, and fun for the author.

4. *See, e.g.*, ANDREW W. NEEDHAM, PORTFOLIO 735-2ND: PRIVATE EQUITY FUNDS (BNA Tax & Accounting); MARTIN D. GINSBERG & JACK S. LEVIN, STRUCTURING VENTURE CAPITAL, PRIVATE EQUITY, AND ENTREPRENEURIAL TRANSACTIONS (2006).