



Morgan Lewis

ADVANCED TOPICS IN
PRIVATE FUND PRACTICES
CONFERENCE

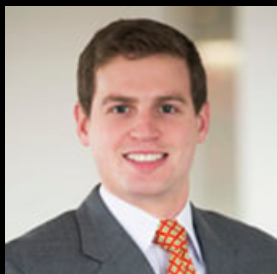
Manager and Investor Perspectives

BOSTON

Thursday, June 13, 2024

Tax Updates

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Overview of Recent Tax Developments

Enforcement trends and priorities – IRS audit resources and campaigns regarding investment funds

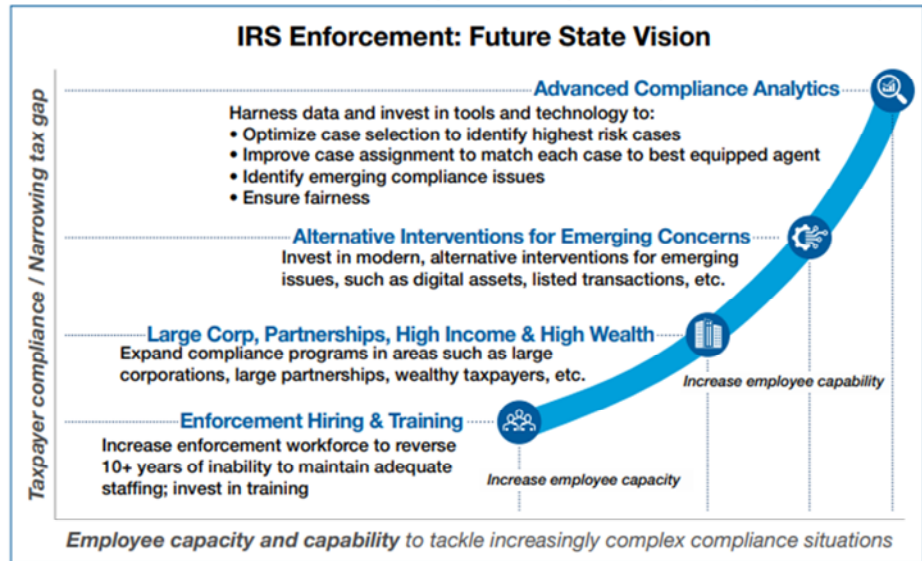
YA Global and ECI exposure for non-US investors

Withholding matters relating to non-US partners

Enforcement Trends & Priorities: Understanding IRS Initiatives

- Significantly increase audit rates of partnerships with assets of more than \$10 million;
- Leverage audit initiatives and campaigns to drive specific results:
 - ✓ Pursue multimillion-dollar partnership balance sheet discrepancies;
 - ✓ Bolster the Self-Employment Tax Initiative;
 - ✓ Focus on treatment of specific assets, and industries, that generate deductions and losses;
- Strengthen efforts for collection and enforcement of high-income individual taxpayers; and
- Utilize artificial intelligence (AI) and robots and increase the scope and number of staff.

Exhibit 2: Transformation initiatives narrow the tax gap while driving up employee capacity and capability



Enforcement Trends & Priorities: Initiatives Impacting the Industry

"The IRS will: Increase audit rates by nearly ten-fold on large, complex partnerships with assets over \$10 million."

– IRS IRA Strategic Operating Plan (Apr. 2024).

New unit focused on pass-through entities

- Housed in the LB&I division but leverages all resources available
- IRS working to fill 3,700 new positions nationwide to work in this unit

Examinations of the 76 largest US partnerships underway

- AI used to identify these potential risks for noncompliance
- Cross-section of industries including hedge funds and investment firms
- Used as a learning tool to prepare to expand reach

Continued Leverage of Campaigns & Initiatives

- Sports Partnership Campaign (Jan. 2024)
- Aircraft Campaign (Feb. 2024)
- Outreach on balance sheet discrepancies between years – 480 compliance alerts as of Oct. 2023

High-Net-Worth Focus

- High-income, high-wealth individuals who have not filed returns or paid tax debt
- Sent 125,000 letters and recovered \$520 million from ~1,600 people

SECA Campaign – Status

Current Pending Cases

- *Denham Capital Management LP v. Commissioner*, No. 9973-23
 - Tried in Boston, April 23, 2024
- *Sirius Solutions L.L.P. v. Commissioner*, No. 11587-20
 - Requested entry of decision in favor of Commissioner so that it might contest the holding in *Soroban*, 161 T.C. No. 12 (Nov. 28, 2023) in the Fifth Circuit
- *Soroban Capital Partners LP v. Commissioner*, Nos. 16217-22, 16218-22
 - Parties working on stipulations
 - Petitioner-taxpayer may submit the case under Rule 122 (submission without trial)
- *Point72 Asset Management, L.P. v. Commissioner*, No. 12752-23

Other Developments

- Many cases pending in Exam and Appeals
- Proposed regulatory guidance to be issued soon according to the IRS

IRS Littlejohn Data Breach: Background

- Between 2018 and 2020, Charles Littlejohn, a former IRS contractor, accessed and stole tax records while working on an IRS project that permitted his access to IRS data bases.
 - In all, Littlejohn disclosed: More than 8,000 annual income tax returns; Returns related to approximately 7,600 individuals and 600 entities; Tax return information that affected approximately 18,000 individuals; and Tax return information that affected approximately 73,000 businesses.
- This was the largest unauthorized disclosure of tax information in history.
- The DOJ has specific statutory duties to crime victims, but the DOJ sought and received approval to provide an “alternative notification” by creating a website directed to victims.
- Federal law also requires that the Secretary of the Treasury notify affected taxpayers of the inspection or disclosure.
 - Notification required as soon as “practicable.”
 - Notification must include date of the offense, the events that occurred, and the taxpayer’s rights.

IRS Littlejohn Data Breach: IRS Notification Actions

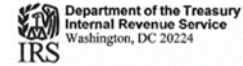
April 2024 Notifications

- No personalized details regarding what specific tax returns or return information was disclosed or the tax years impacted.
- Directed victims to the DOJ website and an IRS email address but provided no additional points of contact, and the letter was unsigned.

May 2024 Supplement

- Identified the limits on its ability to provide full information at this time.
- Provided IRS's next steps for identifying and notifying additional taxpayers.

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Date: 04/12/2024



Dear [REDACTED]:

We are providing you this letter to notify you that an Internal Revenue Service (IRS) contractor has been charged with the unauthorized inspection or disclosure of your tax return or return information, between 2018 and 2020.¹

We have enclosed copies of Internal Revenue Code (IRC) Section 7431 and the criminal charge with this letter. IRC 7431(a) provides for civil claims for unauthorized disclosure of return information.

The Department of Justice is prosecuting this matter and has provided information about the Crime Victims' Rights Act and the status of this criminal case at [Justice.gov/criminal-vns/case/united-states-v-charles-littlejohn](https://www.justice.gov/criminal-vns/case/united-states-v-charles-littlejohn). If you have any questions about your rights under the Crime Victims' Rights Act, please email the Department of Justice at CRM-PIN.Victims@usdoj.gov.



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

PRODUCT GOVERNMENTAL
LIAISON AND DISCLOSURE

This is a supplement to the 7431 Notification (Letter 6613) that you received from the Internal Revenue Service, which alerted you to the unauthorized disclosure of your tax return information by an IRS contractor. As you may know, the IRS contractor, Charles Edward Littlejohn, pled guilty to the unauthorized disclosure of return information in October 2023 and was sentenced to five years in prison earlier this year.

To begin with, it should be stressed that this incident was unacceptable. Any improper access or disclosure of confidential taxpayer information is unacceptable, and it is completely at odds with the IRS's values and the agency's commitment to taxpayers.

We recognize that this incident has created a difficult situation for many taxpayers, including individuals as well as business entities. We also recognize that it is incumbent on the IRS not only to protect confidential taxpayer information, but also to address matters to the fullest extent possible when any such information is unlawfully disclosed.

We write to you today to update you on our efforts in this regard, and to provide to you what information we can regarding this incident, within the confines of the law. We will update you periodically as additional information becomes available. As noted in our initial letter, you can always contact us with specific inquiries via our dedicated email address for this incident (Notification.7431@irs.gov).¹

***YA Global* and ECI Exposure for Non-US Investors**

On November 15, 2023, the Tax Court released its opinion in *YA Global v. Commissioner*, finding that YA Global, a Cayman fund, was engaged in a US trade or business, and was liable for failing to withhold US tax on effectively connected income (ECI) allocated to its non-US investors.

YA Global's activities were found not to be eligible for the safe harbor for non-US persons who invest or trade in stock or securities, including debt securities.

The facts of the case were unusual, but the decision may have implications for other funds, particularly funds that engage in activities that might be viewed as originating debt or that might otherwise be viewed as a financing business.

YA Global and ECI Exposure

YA Global made loans, including convertible loans, and entered into standby equity distribution agreements. It described itself as providing underwriting services, with YA Global itself receiving commitment fees, and entered into hundreds of transactions over the years in question.

The decision also focused on whether the fund manager might be an agent of YA Global. The court concluded that the filing by YA Global of annual partnership tax returns, absent a separate filing of IRS Form 8804 reporting US business activities, did not start the running of applicable statutes of limitations.

YA *Global* and ECI Exposure

The IRS is continuing its campaign, announced in June 2021, focusing on whether foreign investors participating in inbound (into the US) lending transactions are engaged in a US trade or business and are subject to US tax filing and payment obligations.

The IRS campaign may include continued focus on more typical strategies and structures with respect to loan origination, potentially including season-and-sell, offshore-adviser, tax-treaty-based and leveraged-blocker arrangements.

Withholding Matters Relating to Non-US Partners



Investment fund partnerships have backstop withholding obligations with respect to transfers of partnership interests by non-US partners, and as a result should ensure receipt of required certifications or other documentation reflecting any secondary transfers.



The market has continued to evolve on certifications and documentation for these purposes in secondary transactions.