

A Recap on Carried Interest

Summary of Pending Legislation and Existing Sunset Provisions

On May 28, 2010, the U.S. House of Representatives passed the American Jobs and Closing Tax Loopholes Act of 2010 (H.R. 4213 or the "American Jobs Act"). This legislation directly impacts the tax treatment of "carried interest" and is now being considered by the U.S. Senate.

In its current form, beginning in 2011, the House bill would tax 50% of the carried interest allocable to general partners as ordinary income, and 50% as capital gains. In 2013 and beyond, 75% of carried interest would be taxed as ordinary income and 25% as capital gains. On June 24, 2010, the Senate failed for a third time to pass a procedural vote which would have sent the proposed carried interest legislation to the Senate for a full vote on the bill. The "American Jobs Act" will continue to be debated in the Senate, and since opposition to the bill did not stem from changes to carried interest tax legislation, these provisions will likely be included in future proposals.

In addition to the recharacterization of carried interest described above, applicable Federal tax rates are expected to increase at the end of 2010 due to the sunset provisions contained in the Jobs and Growth Tax Relief Reconciliation Act of 2003. The applicable Federal tax rate for ordinary income is scheduled to increase from 35% to 39.6%, while the applicable rate for capital gains is scheduled to increase from 15% to 20%. Additionally, qualified dividends, which are currently taxed at the capital gains rate, are scheduled to revert to being taxed at ordinary income rates beginning in 2011. However, the U.S. Treasury has recommended that qualified dividends continue to receive capital gains tax treatment, and it is expected that qualified dividends will be taxed at the 20% capital gains rate beginning next year.

Carried interest proceeds realized in 2010 are not subject to either the recharacterization of carried interest or the increased tax rates. As a result, investments sold in 2010 and dividends paid in 2010 will be subject to more favorable tax treatment under current law. Note, however, that dividends in excess of retained earnings may reduce the tax basis of an investment, so a tax advisor should be consulted.

Contact Lincoln International to Capitalize on Current Tax Rates

For private equity firms seeking to take advantage of current tax treatment, but not wanting to sell a particular investment in today's market, a dividend recapitalization can be a viable option. In a dividend recapitalization, a portfolio company raises debt capital and uses some or all of the proceeds to distribute a dividend to the company's owners. As noted above, qualified dividend distributions are currently subject to a maximum Federal tax rate of 15% until the end of 2010. Carried interest dividend proceeds to general partners will also be treated with the favorable qualified dividend tax treatment. To help clients evaluate the benefits of executing a dividend recapitalization this year, Lincoln International has developed a proprietary model to analyze the financial impact of a dividend recapitalization on limited partners, general partners and management.

Lincoln International continues to close dividend recapitalizations and other financings in as little as 60 to 90 days. The firm's Virtual Underwriting ProcessSM encompasses robust due diligence, detailed credit analysis, market-based structuring, comprehensive information materials and an efficient solicitation process, all with the goal of maximizing the certainty of closing a financing transaction on the best available terms.

For further information on Lincoln International's capital raising capabilities, or to discuss a specific situation, please contact:

Ron Kahn

Co-Head of Debt Advisory Group
(312) 580-6280

Bob Horak

Co-Head of Debt Advisory Group
(312) 580-2804


Franklin Harris

Co-Head of Financial Sponsors
(212) 277-8118



a portfolio company of
KPS CAPITAL PARTNERS, LP
has completed a recapitalization
\$20,000,000
Senior Credit Facility
\$78,000,000
Term Loans

Oaktree
has refinanced its portfolio company



\$55,000,000
Senior Credit Facilities
\$30,000,000
Senior Subordinated Notes




has recapitalized its portfolio company



with an investment from
RLJ Equity Partners, LLC

Platinum Equity
has refinanced its portfolio company



\$85,500,000
Senior Credit Facilities
\$50,000,000
Senior Subordinated Notes



has refinanced its portfolio company



\$6,700,000
Subordinated Debt
\$4,000,000
Preferred Equity