MorrisonCohen LLP

Law Firm to the Middle Market℠

Client Alert

Year-End Opportunities: Accelerating Realization

November 26, 2012 – The presidential election is over and a few undeniable truths have emerged. One of those truths is that taxes are going up across the board.

Absent further tinkering, due to the expiration of the Bush administration tax cuts, in 2013: (i) the capital gains rates will generally rise from 15% to 20%, (ii) the top ordinary income rate will rise from 35% to 39.6% and (iii) dividends will no longer be taxed at capital gains rates. In addition, some of the tax increases added by the federal health care law in 2010 will take effect in 2013, such as the 3.8% surtax on net investment income (e.g., interest, dividends and capital gains) and the increase in the Medicare Hospital Insurance tax, both applicable to higher income individuals ($250,000+ joint filers). The bottom line: if nothing is done by 2013, the aggregate tax on capital gains will rise by 8.8% and the aggregate tax on dividends will rise by 28.4% (39.6% plus 3.8% minus 15%).

When facing an increase in tax rates, the popular advice is to accelerate income and defer deductions. The drive to accelerate income by selling liquid securities has already begun -- note the tumble in the price of Apple shares immediately after the election. However, not every investment is liquid. Private equity funds typically hold investments for 3 to 7 years. Moreover, sales by private equity funds are often run through an auction process that takes several months.

The timing problem facing private equity funds right now is made more acute due to the threat of carried interest legislation. Undoubtedly, any upcoming tax bill proposed by the current administration will include a proposal converting carried interest into ordinary income in 2013.

We welcome the opportunity to consider the options available to our clients to accelerate income and realize value on illiquid investments in 2012, prior to the tax rate increases and likely carried interest legislation that will take effect for 2013. In particular, recapitalizations and extraordinary dividends present possible solutions to the timing problems faced by private equity funds. Of course, the benefits and detriments of these approaches depend on the portfolio company, the fund's investors and the fund documents.

For further information regarding these and other tax issues, please contact:

Isaac P. Grossman
Partner & Chair, Tax
Tel: 212.735.8735
Email: igrossman@morrisoncohen.com