



August 20, 2008

Original by Overnight Courier

Mr. Robert Herz  
Chairman  
Financial Accounting Standards Board  
40 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 4

**Re: FIN 48--Application to Nonpublic Enterprises**

Dear Chairman Herz:

For the reasons discussed in this letter, Managed Funds Association (“MFA”)<sup>1</sup> respectfully requests that the Financial Accounting Standards Board (“FASB”) adopt a rule providing that FIN 48<sup>2</sup> will not be applied to nonpublic enterprises other than those that are consolidated entities of public enterprises that apply U.S. generally accepted accounting principles (“GAAP”). Alternatively, MFA requests that the implementation of FIN 48 be delayed for such nonpublic enterprises until the relevant issues, including those discussed in this letter, can be fully reconsidered and the convergence project of FASB and the International Accounting Standards Board (“IASB”) on accounting for income taxes is completed.

In its letter to FASB dated January 12, 2007, MFA joined other organizations in requesting that the effective date of FIN 48 be delayed so that it would take effect only with respect to fiscal years beginning after December 15, 2007. In the intervening months, MFA members have devoted substantial attention to issues related to the implementation of FIN 48 to private investment funds and their experience has prompted MFA to submit this letter.

The hedge funds and other private investment funds represented by MFA (collectively “private investment funds”) generally are private investment pools who securities are exempt

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<sup>1</sup> MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$2 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

<sup>2</sup> FIN 48 refers to FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*.

from registration under the Securities Act of 1933, as amended, and are exempt from the definition of investment company under the Investment Company Act of 1940, as amended. To qualify for these exemptions, interests in the funds cannot be distributed in a public offering and can be sold only to persons that meet financial standards intended to ensure that investors are limited to sophisticated individuals and institutions of the type that both Congress and the Securities and Exchange Commission (“SEC”) have determined do not require the level of governmental protection made available under the federal securities laws to other investors, including so-called retail investors.<sup>3</sup> By complying with these exemptions, private investment funds are not required either to register their offerings with the SEC or comply with certain regulatory and other requirements that are applicable to public companies (including mutual funds and other investment companies registered with the SEC under the Investment Company Act of 1940). Private investment funds that have U.S. investors (other than certain tax-exempt entities) are almost universally organized as partnerships<sup>4</sup> and they generally allow investors to invest on a quarterly, monthly or more frequent basis and to redeem some or all of their investment (and receive cash therefor) quarterly or monthly. Investments and redemptions are typically based on a private investment fund’s net asset value (“NAV”).

MFA’s reasons for requesting that private investment funds and other nonpublic enterprises be exempted from FIN 48 are summarized below.

1. FIN 48 was adopted to provide for increased relevance and comparability in financial reporting of income taxes and to provide enhanced disclosures of information about the uncertainty in income tax assets and liabilities.<sup>5</sup> MFA defers to the FASB and the SEC with respect to the need for FIN 48-type disclosures in the case of enterprises that offer shares of stock or other securities to the investing public.

Those institutions and individuals that invest in private investment funds do not fall within this category. The private placement memorandum of a private investment fund typically discloses the tax risks of an investment in such fund. Investors typically conduct extensive due diligence before investing in a private investment fund; they are typically assisted by their own lawyers, accountants and other advisers; and they often request, and receive, additional information if they believe that such information is material to their investment decision. Moreover, many of these sophisticated investors have ongoing contact with the managers of the

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<sup>3</sup> While many advisers to private investment funds have registered with the SEC under the Investment Company Advisers Act of 1940, the private investment funds themselves are structured to comply with the exemption requirements of the Investment Company Act of 1940, as well as the Securities Act of 1933 and the Securities Exchange Act of 1934.

<sup>4</sup> Foreign persons and U.S. tax-exempt entities generally invest in hedge funds and other private investment funds through foreign corporations.

<sup>5</sup> FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109 (No. 281-B, June 2006, p. 2).

private investment funds in which they choose to place funds. Thus, both in the pre- and post-investment phases, these investors differ significantly from members of the investing public for whom public disclosures, including those of the type contemplated by FIN 48, are virtually their **only** source of information and **only** means to compare one investment with another. In short, MFA does not believe that investors in private investment funds need the types of disclosures that FIN 48 contemplates and, further, to the extent they do wish detailed disclosures concerning uncertain tax positions, they have the ability to obtain them.<sup>6</sup> Thus, in the case of private investment funds, the mandatory application of FIN 48 seems unnecessary.

2. In addition to the questionable need for mandatory application of FIN 48 to private investment funds, there is, as described below, no question that the compliance burden will be substantial.

a. As noted, private investment funds with U.S. investors are generally organized as entities that will be treated as “partnerships” for Federal income tax purposes. As a result, a private investment fund is not itself a “taxpayer”. It files an annual information return with the Internal Revenue Service (“IRS”) and each investor in the fund pays tax on its pro-rata share of the income of the fund. Thus, while fund personnel have historically focused significant substantive attention on issues surrounding the proper measurement and allocation of taxable items in a “partnership” environment, it has generally been unnecessary for fund personnel to devote substantial time and energy to traditional FAS 109 accruals. For this reason, private investment funds, and other businesses that have historically been conducted as partnerships, are incurring significant costs and resource allocation issues in preparing to comply with, and complying with, FIN 48.

b. In the case of many private investment funds the compliance burden will be quite significant as many of these funds engage in multiple portfolio trading strategies that are more active and more diverse than many public investment funds. For example, a private investment fund may routinely need to address tax issues for a broad range of investments such as the following in order to accurately prepare its annual information return: original issue discount and market discount; regulated futures contracts, credit derivatives, equity swaps and other notional principal contracts; wash sales; straddles and interest and carrying costs associated with straddles; and payments in lieu of dividends. In addition, review is required to ensure that non-U.S. funds do not pursue investment

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<sup>6</sup> In its letter to the FASB dated May 30, 2008, the Private Company Financial Reporting Committee (“PCFRC”) stated that, based on its research, “private company financial statement users find the accounting matters and disclosures encompassed by FIN 48 to be largely irrelevant to their purposes and decision making activities.” MFA believes that, for the reasons stated above, private investment funds provide a compelling illustration of the correctness of PCFRC’s analysis.

strategies within the United States that could generate “effectively connected” taxable income or “unrelated business” taxable income. Regrettably, there is little official guidance from the IRS with respect to many of these types of investments and, in the hedge fund context, these investments occur with a rapidity and diversity that exceeds the volume and complexity of traditional tax issues faced by other enterprises, both public and private.

c. Many private investment funds make investments outside the United States, including in emerging markets. FIN 48 will require these funds to make an additional layer of judgments concerning uncertainties in the tax laws of other countries.

In view of the foregoing, MFA believes that private investment funds will bear greater compliance burdens than many of the other enterprises that are subject to FIN 48. While burdens such as these properly must yield to compelling considerations of public interest in appropriate cases, MFA believes that the marginal benefits gained from application of FIN 48 to private investment funds are outweighed by the costs and difficulty of compliance.

3. Private investment funds need to determine NAV with reasonable frequency, both to establish a price for investments and redemptions, and also for other purposes. As a result of the fiduciary nature of the NAV calculation, and economic fairness to investors that subscribe and redeem at that amount, MFA believes there are substantial questions whether FIN 48 analyses should be reflected in the NAV of a private investment fund and, if so, as to how those analyses should be reflected.

Specifically, in evaluating the adoption of FIN 48, fund managers are likely to consider not only the requirements of GAAP, but also if and how FIN 48 is adopted for purposes of determining NAV. Some private investment funds, within their governing documents, allow for the investment manager to make “GAAP conforming changes” for purposes of financial reporting. In other words, management may elect to have an NAV honored for subscription and redemption purposes that differs from the NAV determined for GAAP purposes. To the best of our knowledge, managers rarely utilize their discretion to allow for such divergence. As managers contemplate the potential effects of a FIN 48 accrual (such as accruing for an uncertain position that they expect will ultimately be reversed upon expiration of a statute or expected future guidance from a taxing authority), those afforded with such flexibility in the fund's governing documents may elect to exercise their discretion. The possible, yet regrettable, outcome would be that NAV as reported in GAAP financial statements would lose relevance to those investors whose primary concern may be the NAV used for subscription and redemption transactions.

Moreover, as different funds may make different judgments on one or more of the tax issues potentially deriving from trading strategies for which there is no clear guidance, MFA

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believes that there is reasonable cause to question whether, in the case of private investment funds, FIN 48 will result in the degree of comparability contemplated by the FASB.

MFA recognizes that the SEC has considered a number of issues related to this point and, in the case of publicly-traded investment funds concluded that FIN 48 analyses should be reflected in NAV in order to give members of the investing public greater disclosure.<sup>7</sup> Significantly, however, the SEC explicitly stated that its guidance was "limited to assessing tax positions reflected in NAV calculations subject to the Investment Company Act of 1940 and the rules thereunder and should not be applied by analogy in other cases." MFA believes that there are differences between public and private investment companies that warrant a different conclusion with respect to private investment funds and MFA is prepared to make a more comprehensive submission on this point if the FASB believes that it would be of assistance in analyzing MFA's request.

4. The PCFRC letter to the FASB also states that the FASB and the IASB are working on a convergence project on accounting for income taxes and that this may significantly affect accounting for income taxes, including FIN 48. The convergence project and its potentially significant effect provide further support for adopting an exemption for private investment funds from FIN 48 or, at least, delaying the application of FIN 48 to private companies.

Accordingly, MFA respectfully requests that the FASB exempt private companies, including investment funds, from the requirements of FIN 48. Alternatively, if an exemption from FIN 48 is not adopted, the MFA respectfully requests that the effective date of FIN 48 be further postponed pending full reconsideration of the relevant issues and completion of the convergence project for the FASB and the IASB on taxes.

MFA would welcome the opportunity to respond to any questions you or your colleagues may have.

Respectfully submitted,



John G. Gaine  
Special Counsel

cc: Russell G. Golden, Director, FASB (*By Email Only*)

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<sup>7</sup> Letter from the SEC to Fidelity Investments, Massachusetts Financial Services Company and Oppenheimer Funds, Inc. re: *Implementation of FASB Interpretation no. 48 (June 28, 2007)*, 2007 WL 2050333 (available at [www.sec.gov/divisions/investment/fin48\\_letter\\_062807.htm](http://www.sec.gov/divisions/investment/fin48_letter_062807.htm)).