

January 23, 2007

Memorandum to Our Investment Management Clients

**Senate Finance Committee Approves
New Annual Limits on Deferred Compensation**

On January 17, 2007, the Senate Finance Committee approved by a unanimous voice vote a package of \$8 billion in tax incentives for small businesses which were fully offset by revenue raising provisions, including a provision to impose a new limitation on the amount of annual compensation that may be deferred by a “participant” in a nonqualified deferred compensation plan subject to Section 409A of the Internal Revenue Code (a “Nonqualified Plan”). The Senate currently is scheduled to vote on January 24 as to whether these tax proposals passed last week by the Senate Finance Committee as the Small Business and Work Opportunity Act of 2007 (the “2007 Tax Bill”) are to be included in the existing bill being considered by the Senate to increase the federal minimum wage.

The 2007 Tax Bill would limit the aggregate amounts permitted to be deferred by a “participant” under a Nonqualified Plan to the lesser of (1) \$1 million, or (2) the average annual compensation that the “participant” derived from the employer sponsoring the Nonqualified Plan (or a predecessor or related entity to the employer) that was includible in the participant’s gross income for the five-year period preceding the year for which the limitation is being determined.¹

On January 22nd, the Senate Finance Committee released the proposed statutory language for the 2007 Tax Bill, together with a Report describing the provisions of the 2007 Bill. Based on the proposed statutory language and the accompanying Report, it is uncertain how the proposed amendments to Section 409A would apply to the typical fee deferral arrangements entered into between offshore investment funds and the U.S. based managers of such funds.

The amendment to Section 409A contained in the 2007 Tax Bill is proposed to be effective for amounts deferred in taxable years beginning on or after January 1, 2007.² Therefore, the proposed amendment should not have any effect on any pre-2007 fee deferrals, including the earnings thereon. The 2007 Tax Bill also directs the Treasury Department to issue guidance allowing existing outstanding deferral elections to be modified on or before

¹ Failure to satisfy this new statutory requirement would result in the current taxation of all non-forfeitable amounts deferred under the Nonqualified Plan for all taxable years. In addition to this current income inclusion, the amount of such income would be subject to a penalty tax equal to 20 percent of the amount of this income plus interest on the underpayments that would have occurred if the compensation had been taxable in the year in which it was first deferred.

² For this purpose, it is likely that an amount would be considered to be deferred in a taxable year beginning on or after January 1, 2007 if it is earned after such date even though the deferral election was actually made in 2006.

December 31, 2007 to reduce deferrals for post-2006 years to the extent necessary to satisfy the requirements of the proposal.

We are monitoring the progress of the 2007 Tax Bill and will keep you informed of such progress.

Please call Peter Pront (212-574-1221), Daniel Murphy (212-574-1210) or James Cofer (212-574-1688) if you have any questions regarding the 2007 Tax Bill.

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