S. Hrg. 108–473

U.S. TAX SHELTER INDUSTRY: THE ROLE OF ACCOUNTANTS, LAWYERS, AND FINANCIAL PROFESSIONALS

HEARINGS

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

NOVEMBER 18 AND 20, 2003

VOLUME 2 OF 4

Printed for the use of the Committee on Governmental Affairs

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AEF 16 / 28

QUADRA CAPITAL MANAGEMENT, L.P.
999 Third Avenue, Suite 4150 | Seattle, WA 98104 | (206) 442-9292 | Fax (206) 442-9291

FAX COVER SHEET

DATE:	September 21, 1996	TIME:	6:32 PM
TO:	Mr. Wolfgang Stolz UBS International	PHONE: FAX:	(44-171) 901-3439 (44-171) 956-9215
FROM:	Jeff Greenstein	PAGES:	3

Wolfgang,

The attached fax is following our conversation on Friday. I have prepared this for your review only. I am excited about the potential with this transaction especially given KPMG's active involvement.

Hope the attached memo is helpful in getting everything started.

Regards,

JG

UBS000003

09/23/96 08:37 FAX 206 442 9291 QUADRA CAPITAL 001

Permanent Subcommittee on Investigations
EXHIBIT #94a

AEF 16/ 257

Wolfgang -

In response to our conversation on Friday, I have tried to briefly review the proposed transactions. I spoke with both clients on Friday and I think we will increase the size slightly so that there will be both a $15 and $25 million dollar transaction. With regards to these transactions, they would like to initiate them as soon as possible. We have structured the trades so that we can extend slightly beyond the October 1st deadline. I should hear about the large transaction Tuesday morning. I spoke with them late Friday afternoon and they felt comfortable they would get final approval Tuesday. The other transactions that I mentioned are being reviewed with clients on Monday. I also spoke with KPMG and they are drafting a memo which briefly describes the rationale for entering into the various transactions.

Each transaction will involve two sets of trades involving UBS common stock and OTC options. The majority of the trades will occur in a offshore corporation/investment fund managed by Quadra. A smaller amount of trades will occur in a standard securities account for the client in which Quadra will have investment discretion. Quadra will control both accounts and as you suggested, we will deposit ample funds in the UBS account so that your credit committee will not have to be involved in the process. KPMG's memo will describe how the tax objectives are achieved based on how these two accounts are integrated for tax purposes.

Below I have tried to describe a sample $100 million transaction and what trades will occur in the different accounts. In both accounts we will most likely want to hedge any foreign currency exposure. There may be some minor adjustments and variations made for each client, but this example should provide the basics for establishing the accounts and collateral agreements. I would imagine the primary distinction will be in the client account and deal with whether or not the client wants to hedge the long stock and option positions on UBS or remain naked. This will vary based on a clients risk tolerance. These examples should reflect the first transaction example we reviewed involving the forward purchase, 90% puts and 95% barrier calls.

SAMPLE $100 million TRANSACTION

Investment Fund Transactions - managed by Quadra

Day 1 -	Deposit $5 in UBS trading account
Day 1 -	Purchase $100 mil UBS stock on a 50 day forward basis
	Purchase $100mil 50 day 90% OTC Put Option
	Sell $100mil 50 day 95% OTC Call Option w/ a 90% barrier (may split this into two separate transactions - will discuss later)
Day 51 -	Stock either called by UBS or put to UBS

Net credit of 6.10% will be deposited in the account until expiration.

UBS000004

Client Account Transactions - Quadra given investment discretion

Day 1 -	Deposit required funds in account at UBS
Day 1 -	Purchase $10 UBS stock (either forward 90 days or cash)
Day 1 -	OPTIONAL - Sell $10 mil 31 day 95% OTC Call (no barrier) OPTIONAL - Buy $ 10 mil 31 day 90% OTC Puts
Day 32 -	OPTIONAL - May enter 60 day hedge on the common stock using OTC puts or synthetic short stock created with OTC options.
Day 51 -	(same day as OPTION EXPIRATION in above example) Purchase $90 mil 45 day 110% OTC Calls (still uncertain as to strike)
Day 96 -	Position unwinds

In both the investment fund and client accounts the strike prices and term of the option may vary slightly, however, I think these trades provide a good sample transaction.

I would like to have all of the fees with the exception of any basic transaction fees paid from the Investment Account. As we have briefly discussed, Quadra and KPMG will have their fees tied to the performance of the transaction in the Investment Account. Accordingly, if the price of UBS stock falls through the 95% strike we could see our fees disappear if the stock hits the long put strike. To hedge our interests we will set-up a Quadra account and simply enter into a option position to hedge this possibility. In this account we should be able to aggregate Quadra's exposure for all similar transactions. While it may appear confusing, it should be relatively simple to do and I will review the specifics with you when we speak next.

Wolfgang, I have been told by KPMG that they see significant opportunity with this transaction at least through 1997. I think this will be pretty straightforward to execute and I was glad to hear that you will be able to basically accommodate any size that we can do. Once we establish the process for setting up the accounts, option agreements and various transactions it should be relatively easy to replicate. Please keep this fax EXTREMELY CONFIDENTIAL and not distribute it. If you need something that can be distributed I will prepare a similar memo.

I will call you Tuesday morning to review where everything is. If you are traveling, please give me a call at your convenience so that we can make sure everything gets done properly.

UBS000005

3/N

TO: TANIA SALIM, UBS Derivatives legal
FROM: JEFF GREENSTEIN, QUADRA Capital
pages: 3
44-171-901-2898

Tania -

I am writing this from an airplane so I hope you can read it. I reviewed the basic put, call and digital options and I think everyth looks fine. However, I think the additional call option embedded in trade might need to be revised slightly.

One thought might be to refer to this additional option as a "Contingent Premium." For example, th definition in the call could be:

Option Premium - 7% (CHF 84.70) plus any Contingent premium payment as defined herein.

— SEE INSERT —

You may need to clean-up the legal terms and language, but I think this concept might get us there.

I appreciate your assistance and I doubt they will get any more confusing than this. I will give you a call early in the day (your time) to answer any questions you might have.

Regards

-digital.

09-NOV-1996 17:39 FROM UBS LTD. TO 90012064429291 P.01

Facsimile Message

Pelco
Bermuda

To:	Jeff Greenstein
Company:	Quadra Capital Management, L.P.
Recipient Fax No:	001 206 442 9291 — Tel No: 001 206 442 9292
From:	Tania Salim
Return Fax No:	0171 901 2898 — Tel No: 0171 901 0308
Date:	9th November, 1996
Subject:	Documentation — Page 1 of 37

Dear Jeff,

I attach clean final drafts of the documentation for (with the exception of the Deposit Agreement which has not changed since last Thursday) for your final review. I have made some general tidying up amendments and also revised the Strike Price provision to hopefully make it clearer and also to incorporate "market disruption" language to cover the possibility of the closing price of the shares being disrupted. Unfortunately, in that I could not contact Wolfgang or the trader on Friday for their final sign-off these confirmations are subject to any comments they may have (although I do not anticipate any).

I attach also the digital barrier option with upside knockout confirmation for your review which is also being reviewed by the relevant parties within UBS. However, I take your point from our conversation yesterday that owing to the complexity of some of the features in these transactions it is perhaps a better way forward if you and I agree on the drafting of some of the provisions early on rather than waiting for everyone in UBS to have commented before you see them.

As I explained yesterday, my intention is to have everyone agreed on so that I can use it as a standard for all of the other trades so, I would be grateful for any further comments at your earliest convenience so that I can provide you with final documentation as soon as possible.

As discussed, I detail below my initial draft of the "Strike Price" language and the "[Additional Strike Amount]" for your review.

"

Strike Price. — CHF 1,149.50 provided that if, on any Exchange Business Day prior to the Expiration Date, the Closing Price of the Shares (as defined below) is less than or equal to 1,149.50 per share, then the Strike Price shall be CHF1,089.00.

[~~Additional Strike~~ Amount]: Contingent Premium — On 18 November, 1996 the Calculation Agent shall determine the average trading price for the Shares on the Exchange for that day, such determination shall be "the ~~Additional Strike Price~~ Contingent Premium". stet

THIS PAGE CONTAINS REDACTED MATERIAL

UBS000055

09-NOV-1996 17:48 FROM UBS LTD. TO

Facsimile Message (continued)

Rider 1

On 3rd December, 1996

The Calculation Agent shall then calculate the excess, if any, ~~in~~ which the Closing Price ~~on Nov. 29th~~ exceeds the Contingent Premium Strike Price as ~~determined on Nov 18th~~. Any excess amount per share shall be paid to the ~~Bu~~ Seller ~~on Valuation Date Dec 3rd~~

Provided however no Contingent Premium shall be paid if the Closing Price of the Shares on any Exchange Business Day from and including Nov. 18 to and excluding Nov 29 is less than or equal to 99 per cent of the Contingent Premium strike price.

by

On 29 November, 1996 the Calculation Agent shall ascertain the Closing Price of the Shares for that day (the "Closing Price").

INSERT

by the 3rd

The Calculation Agent shall then calculate the difference, if any, between the Additional Strike Price and the Closing Price [and such amount, if positive shall be added to the Strike Price for the purposes of the Settlement Price]. Provided that;

(i) the Closing Price of the Shares on any Exchange Business Day from and including 18th November, 1996 to and excluding, 29th November, 1996 is not more than or equal to 99 per cent. of the Additional Strike Price; and

(ii) the Closing Price is in excess of the Additional Strike Price.

At all other times, the Additional Strike Amount shall be zero.

For the purposes of "Strike Price" and "Additional Strike Amount"; "Closing Price of the Shares" on any Exchange Business Day shall mean..........(Jeff same language as put and calls).

I have put "Additional Strike Amount" in brackets as I hope to think of a less clumsy definition. Also, please confirm whether my understanding is correct, that if the "Additional Strike Amount" is a positive amount it will be added to the Strike Price and used to calculate the Settlement Price is thereby reflecting the premium. Or should we just have an additional Settlement Price concept? I would think that in that your intention is that this feature be part of the transaction it would be best to tie it into the original Strike Price. Let me know what you think.

Finally, please confirm the relevance of "Financing Charge" in this trade.

Please let me have any comments by fax on the above for Monday morning (my time - if possible). Or, if you would like to discuss any of the above with me I will be in the office until 5.30 pm today or contactable at home later this evening or tomorrow evening (tel: 0171 709 7191). I will let you see all the other documentation for for your open on Monday but I would prefer if you did not allow any third parties to review the documentation before I have "UBS" sign-off which should be by close of business (our time) on Monday.

Kind regards,

Tania Salim

Derivatives Legal Group

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QUADRA CAPITAL MANAGEMENT, L.P.
999 Third Avenue, Suite 4150 | Seattle, WA 98104 | (206) 442-9292 | Fax (206) 442-9291

FAX COVER SHEET

DATE:	January 22, 1997	TIME:	9:10 AM
TO:	Dr. Chris Donegan UBS International	PHONE: FAX:	(44-171) 901-4589 (44-171) 956-9215
FROM:	Jeff Greenstein	PAGES:	4

Chris,

In reference to our discussion this morning I have provided a description of the dilemma regarding how Quadra purchases the digital option to hedge its exposure to UBS bearer shares. Additionally, I have included a summary prepared by our counsel Skadden Arps regarding potential UK related securities transactions we discussed.

As you might recall, Quadra has historically purchased a digital option in conjunction with the various UBS transactions entered by its clients for which it acts as investment adviser. I anticipate we will probably purchase similar digital options on similar trades in the future. The rationale for Quadra's purchase of these digital options is to hedge its fees relating to the accounts it manages. Specifically, if the price of the underlying stock were to fall significantly there would not be the funds available in the account to pay Quadra's investment advisory fees. Should this happen the digital option would compensate Quadra for lost fees. Conversely, if the stock does not fall then Quadra will collect its investment advisory fees. Included in those fees is the are sufficient proceeds to pay for the cost of the digital.

The dilemma lies in paying the upfront premium to cover the digital costs. This may get somewhat difficult should the volume of transactions increase. Accordingly, I would like to find a solution whereby Quadra can utilize some type of credit facility. I have spoken with Wolfgang and Chris Stainbrook about creating a digital option whereby the premium is paid at the options expiration. Apparently this is relatively straightforward, however we need to have credit facilities so that UBS is comfortable with our delayed payment. Possible comfort might be gained by Quadra depositing a meaningful portion of the digital cost in cash and/or pledging the investment advisory fees we receive from the related or other accounts. I am hopeful that as our relationship continues to grow we will be able to establish our own credit facilities so as to simplify the process by eliminating the party who

Permanent Subcommittee on Investigations
EXHIBIT #94c

assists in financing the digital purchases. This is a relatively important issue and one that I would like to resolve as soon as possible. I recognize the challenges of working through your internal structure and appreciate your assistance in this matter.

With regards to the UK transactions we discussed, I have included a memo prepared by our counsel Skadden, Arps, Slate, Meagher & Flom which briefly describes two potential transactions which might be applicable for your clients situation. I should preface this summary with the fact that the lead partner, Charles Morgan, has done extensive work in this area in the UK and is confident the transactions should apply, however, he would like to review some of the intricacies of the trades with his UK counterparts. These trades were employed for years by U.S. security firms and investors and were only recently eliminated by complex straddle and wash sale rules. Very few countries have adopted such complex tax rules and thus these trades should be possible. The second trade involves basis shifting as a result of "coupon stripping." Based on our earlier discussions, it appears as though the straddle transactions would appear to be relatively straightforward transactions and definitely consistent with GED's normal derivative business. In essence they could be structured trades with volatile equities, baskets, or indices.

Given the size contemplated, it may be that many transactions must be structured for an individual client. Moreover, this process might continue for extended periods if deferring recognition is the objective. Accordingly, this strategy would definitely involve more than a single transaction and instead would resemble a standard investment management account with specific investment objectives. Along these lines, Quadra could add value to this process in a number of ways including discretionary asset management and administering the account. In this case, UBS will be utilized to execute the various transactions in a manner similar to that of the current accounts. Obviously we are very flexible and would like to work with you in the development and management of these account.

Hopefully this information is helpful prior to your upcoming meeting. The next step, as described in the attached memo, is to spend some time with lawyers resolving some of the intricacies of the trades. For example, should the straddle transactions be done in the same or related accounts?

Please give a call when you get a chance.

cc. Wolfgang Stolz

From: Chris Donegan <don>
Date: Mon, 16 Jun 97 10:20:52 +0100
To: chris@gedzch, adam, staddon, helen
Subject: Quadra - Feedback
Cc: wolfgang, ronny@gednyc, ruwan

Guys,

Wolfgang and I had an excellent business trip with Quadra last week. We met some impressive prospective clients and look forward to in excess of a CHF 1 billion (notional) in new business before year end.

One thing became crystal clear on this trip. The Quadra guys are very smart, and considering the fees generated for this business, they have an agenda to minimise our spreads and obtain any concessions at all in any department (documentation, margin etc.) that they can.

It is therefore very important that these guys are controlled, and that we can strengthen our position at every stage of the process (from pricing options, stock sales, securing favourable collateral terms, and making our documentation as tight as possible).

To prevent Quadra arbitraging us (i.e. Jeff calls Chris Stainbrook with one request and Wolfgang with another) please DO NOT RESPOND to direct enquiries from Jeff, Brian or Norm without checking with Wolfgang or myself first.

This continues to be great [relatively] low risk for GED. Please help us manage it effectively.

thanks

Don

Permanent Subcommittee on Investigations
EXHIBIT #94d

UBS000209

From: Chris Donegan <don>
Date: Mon, 21 Jul 97 16:57:36 +0100
To: ramy
Subject: Quadra : UBS Trades - background
Cc: wolfgang, ruwan, ronny@gednyc

Ramy,

FYI,

Ronny (and Stainbrook) are 100% on top of the risk issues associated with this business (and we have recently have a large number of conversations about how to manage this and reduce it).

However, thus far Wolfgang and I have not had an explicit conversation with you re: the overall structure and purpose of the trade. This e-mail addresses this (for your benefit).

Basic Premise : Creating Capital Losses For a US Person

• A US person is taxed on the basis of beneficial ownership of assets.

• Under certain circumstances, the basis of ownership is maintained for tax purposes but not economically.

A simple example of this is where a US person holds a bond and swaps away the coupons.

Under this scenario the bond (as a taxable asset) falls in value (i.e. value minus coupons) and a capital loss is allowed. However the US Person still benefits ecomically from the swap and so the losses are not real but only tax relevant.

UBS000210

Permanent Subcommittee on Investigations
EXHIBIT #94e

The "UBS Trade" uses provisions in the US Tax Code to create a synthetic tax loss via a trading strategy in UBS shares.

Legal / Tax Risk to UBS : minimal as UBS has no direct role. Investor nakes his decision based on *"should do"* legal opinion and his own counsel. Clients are high quality

etc.) and smart. UBS makes no recommendation or solicitation. UBS New York Private banking is now referring clients to Quadra based on our last trip.

Legal Opinions : Brown and Wood, KPMG (

), Skadden Arps (have hired them and tney nave not finalised yet but are positive).

P&L : 2.5 - 3%

Business To Date : Approx $20m P&L

Wolfgang and I will be happy to provide further explanation if you require after reading the below.

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Trade Mechanics

A US person ("Investor") buys a call warrant in an offshore company ("SPV") which entitles the holder to 80% of the company's assets. This creates a shared tax base between the SPV and Investor.

The SPV invests in UBS stock (via a stock purchase with delayed settlement). The Investor is therefore deemed to have beneficial ownership of the UBS stock.

The SPV also invests in a call/put arrangement with UBS on the

UBS stock. The reason for this is to hedge the SPV's economic exposure to the shares whilst creating a good chance for the SPV to make money. (This is the most complex component of the trade from a risk perspective.)

Exercise of the put option between UBS and the SPV is treated for US tax purposes as a *redemption* of stock. The redemption proceeds are deemed to be a dividend from UBS. This dividend is taxable as income. (actually there are no net proceeds as the SPV borrowed cash to buy the shares, so the only real financial transaction here is financing).

Similtaneous with the redemption; the US person buys a call option on UBS stock. The call option is for a number of shares equal to the number of shares redeemed. This has the effect of creating the impression that the number of shares owned (or attributed to) the Investor remains constant throughout the trade.

At maturity the Investor sells their call option and realises a loss this net loss is offsetable against capital gains.

Numerical Example (tax calculation)

Theoretical Cost of shares to SPV - $100
SPV Redemption dividend - $100 (taxable income)
Value of shares on sale/termination of call option - zero
Capital Loss Arising - $100

<u>Other Details</u>

The customer posts collateral to cover the marginal credit risk on the synthetic forward. This is because the put/call is struck out of the money and carries market risk. This is essential for the tax treatment to succeed.

The customer however is "guaranteed" not to lose on this risk position in a seperate arrangement with Quadra - who have put their fee up as part of the collateral. To ensure that Quadra can deliver on their guarantee Quadra, as a seperate trade, have entered into a put/call transaction to cover the market risk their customers have on the UBS share price. This obviously costs them, but is better than taking the risk on losing their fee.

Don

From: Chris Donegan <don>
Date: Tue, 2 Sep 97 17:19:45 +0100
To: ruwan
Subject: Credit Request For Quadra
Cc: wolfgang, ramy, staddon, helen

Ruwan,

here is the request. We will trade $48m tomorrow and $150m by next Thursday.

For further trades this facility would be extremely helpful. Thanks.

Don

QUADRA CAPITAL MANAGEMENT, L.P.

Introduction.

Over the past year UBS London branch ("UBS") has entered into structured derivatives transactions with Quadra Capital L.P. ("Quadra") and related entities, one element of which involves Quadra buying a "digital option" from UBS. The premium for this digital option has thus far been paid to UBS up front. Quadra would like to modify this structure by paying for the digital option at maturity (in 60 days) and pledge collateral to cover the credit exposure arising during this period.

Structure and Proposed Collateral

Under the terms of the transaction, Quadra receives an arrangement fee from an offshore company in 60 days time. The ability of the company to pay these fees depends entirely on the performance of option contracts (the "company hedge") that the company has entered into with UBS. The company hedge will either pay out, generating sufficient funds to pay Quadra, or it will not (i.e. it has a digital payout). To cover their risk to the performance of the company hedge. Quadra enter into an equal and opposite contract with UBS (the "digital" option referred to above).

Quadra would like to use the value of their digital option, combined with their rights to receive fees from the company as collateral to cover the premium for the digital option.

See Figure a) below.

Application of Collateral

Quadra will assign to UBS by way of security its rights to receive fees from the company. The value of this assignment is contingent on the company having sufficient funds to meet the fee payment. This will always be the case, except where the company hedge does not perform. In this situation the digital option will (by definition) pay out and UBS will pay Quadra an amount under the digital option net of the premium owed.

To ensure complete security, UBS will therefore hold both the digital option and the fee assignment.

Quadra's right to receive fees may be encapsulated in a warrant issued by the company.

See Figure b) below.

Credit Approval

John Staddon from the Derivatives Legal

To proceed therefore, two credit policy decisions are required :

1. In the context of this transaction is UBS willing to accept a combination of a digital option (written by UBS) and the assignment of a fee, as collateral to cover the 60 day credit exposure for the digital option premium ?.

2. Where the fee payment is encapsulated in a warrant issued by the company is the analysis the same ?.

PRIVILEGED MATERIAL HAS BEEN REDACTED FROM THIS PAGE

ïgure a) Structure and Proposed Collateral

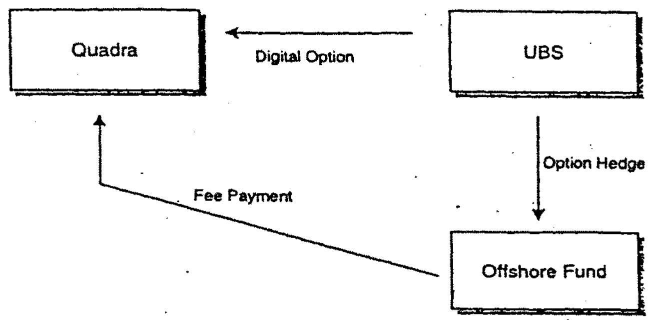
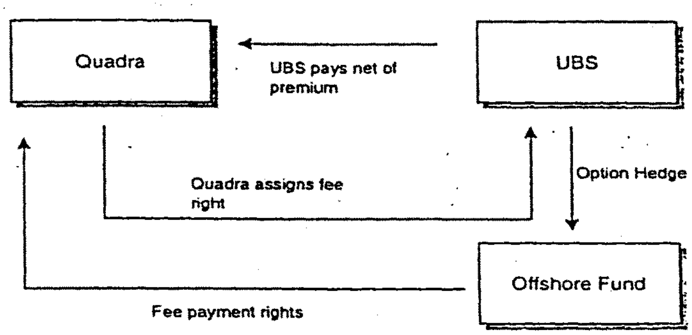


Figure b) Application of Collateral



Author: Gregg W. Ritchie at KPMG_WARNER_CENTER
Date: 1/19/1998 5:17 PM
Priority: Normal
TO: Dale A. Affonso at KPMG_Las_Vegas
TO: Richard J. Bloom at KPMG_Short_Hills
TO: Carolyn B. Branan at KPMG_Charlotte
TO: David Cohen at KPMG_Chicago
TO: Edmond H. Desany at KPMG_Burlington
TO: Jeffrey A. Eischeid at KPMG_Atlanta2
TO: Laurence Foster at KPMG_NYO_Tax
TO: Randall A. Hamilton at KPMG_Des_Moines
TO: R. J. Heath at KPMG_N_Virginia
TO: Mark C. Hutchison
TO: Dennis A. Ito at KPMG_SAN_FRANCISCO3
TO: Michael Magee at KPMG_Short_Hills
TO: George H. McCrimlisk at KPMG_LOS_ANGELES2
TO: John W. Monaco at KPMG_Norfolk
TO: Katherine A. Pace at KPMG_Orlando
TO: Robin M. Paule
TO: Gary N. Powell at KPMG_Denver3
TO: Steven Protass at KPMG_NYO_Tax
TO: Eugene G. Schorr at KPMG_NYO_Tax
TO: Neil J. Tendler at KPMG_Short_Hills
TO: B. Michael Watkins at KPMG_Philadelphia
TO: Howard J. Weiner at KPMG_COURTHOUSE2
CC: Randall S Bickham at KPMG_Palo_Alto
CC: Robert D Simon at KPMG_Denver4
CC: John B Harris at KPMG_Denver2
Subject: FLIP Opinion Letters
------------------------------------ Message Contents ------------------------------------

I have previously sent to each of you a copy of the draft opinion for the FLIP strategy that your respective clients have executed. Given the upcoming busy season, I strongly suggest that you make every attempt to finalize these opinions and return them to us for final review. Furthermore, I am convinced that it is in our best interest to issue these opinions PRIOR to the merger. Given the uncertainty of the level of review (their version of DPP-Tax, etc) required by E&Y for such opinions, I would make every attempt to issue prior that date.

Please let me know where you are in the process and if you need additional guidance.

Proprietary Material
Confidentiality Requested

KPMG 0034176

Permanent Subcommittee on Investigations
EXHIBIT #94g

Author: Gregg W. Ritchie at KPMG_WARNER_CENTER
Date: 2/4/98 5:44 PM
Priority: Urgent
Receipt Requested
TO: Robert D Simon at KPMG_Denver4
TO: John B Harris at KPMG_Denver2
Subject: Updated OPIS Letter

------------------------------- Message Contents -------------------------------

Attached is the most recent draft of the new 302 product using the LLC structure and a new swap instrument. Please spend time reviewing it prior to our conference call on Friday.

Due to the extraordinary pressure surrounding this product, this draft must not be shared with anyone else inside or outside of the Firm. In particular, this should not be given or discussed with DPP-Tax until our working group has had a chance to fully explore any issues.

_______________ Forward Header _______________

Subject: Updated OPIS Letter
Author: Randall S Bickham at KPMG_Palo_Alto
Date: 2/4/98 4:00 PM

Here is the version of the OPIS letter that we should send to BoB and John.

Randy

Couldn't meet until following week

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #94h

KPMG 0047176

Author: Gregg W. Ritchie at KPMG_Warner_Center
Date: 2/24/98 8:37 PM
Priority: Normal
TO: Randall S Bickham at KPMG_Palo_Alto
TO: Mark Watson at KPMG_Dallas
Subject: Re[3]: OPIS

------------------------------------ Message Contents ----------------------------

fyi

______________________________ Forward Header ______________________________

Subject: Re[3]: OPIS
Author: Robert D Simon at KPMG_Denver
Date: 2/24/98 2:16 PM

Thank you for responding so quickly to my message.

While it is stated that many of the features of OPIS were developed in response to the concerns of DPP Tax and myself, very few of these concerns were addressed in any form. The bottom line is not my "wish list", but the requirements of U.S. federal income tax law.

I am pleased that you consulted all of the named tax professionals both within and without KPMG. My point was that as the purported technical adviser, I should have been involved in these consultations and material meetings rather than circled back to at the end of the process.

I was surprised to hear your comment that OPIS was not being marketed, since I have already received a phone call regarding a technical question from a PFP partner who said he was presenting the product to his client.

I am looking forward to a live telephone conversation to clarify this matter.

______________________________ Reply Separator ______________________________

Subject: Re[2]: OPIS
Author: Gregg W. Ritchie at KPMG_Warner_Center
Date: 2/23/98 9:16 PM

As you and I have discussed, the OPIS product was developed in response to your and DPP-Tax's concerns over the FLIP strategy. We listened to your input regarding technical concerns with respect to the FLIP product and attempted to work solutions into the new product. As you will recall, the FLIP product was put back on the shelf by Larry DeLap as a result of several issues he raised (many of which were brought to his attention by you). The OPIS strategy has been designed to address DPP-Tax's concerns with the prior product as well.

The draft memo of the LLC product which you sent to Larry DeLap should never have been submitted to him as neither the concept nor its implemention had been fully developed. In fact, following Pfaff's departure from the Firm, the entire process relating to the FLIP product was not handled in an ideal manner. I take the responsibility for much of this as I had not properly taken full ownership of the product. As you know, we now have a better mechanism for taking ownership of these types of products through the CaTS practice and the

Author: Gregg W. Ritchie at KPMG_Warner_Center
Date: 2/23/98 9:16 PM
Priority: Normal
TO: Robert D Simon at KPMG_Denver
BCC: Randall S Bickham at KPMG_Palo_Alto
BCC: Douglas K. Ammerman at KPMG_Orange_County
Subject: Re[2]: OPIS
------------------------------------ Message Contents ------------------------

As you and I have discussed, the OPIS product was developed in response to your and DPP-Tax's concerns over the FLIP strategy. We listened to your input regarding technical concerns with respect to the FLIP product and attempted to work solutions into the new product. As you will recall, the FLIP product was put back on the shelf by Larry DeLap as a result of several issues he raised (many of which were brought to his attention by you). The OPIS strategy has been designed to address DPP-Tax's concerns with the prior product as well.

The draft memo of the LLC product which you sent to Larry DeLap should never have been submitted to him as neither the concept nor its implemention had been fully developed. In fact, following Pfaff's departure from the Firm, the entire process relating to the FLIP product was not handled in an ideal manner. I take the responsibility for much of this as I had not properly taken full ownership of the product. As you know, we now have a better mechanism for taking ownership of these types of products through the CaTS practice and the new FCS Designated Service.

As the product owner of the OPIS product, I solicited input from a variety of sources; including Brown & Wood, Presidio, Rick Solway, Richard Smith, and others. Furthermore, we circled back to your concerns after the opinion had been drafted in order to solicit your (and John's) responses to our ideas. Your comments from our conference call relative to the draft opinion were taken into consideration and appropriate modifications made. I made the same decisions relative to input received from the other sources.

It is critical for the CaTS and FCS practice for this product to now be evaluated by DPP-Tax, and any required modifications be developed. I have made the decision to submit the product to DPP for their review at this time. While the product may not meet all of the requirements of your "wish list", we must balance priorities with the needs of the practices.

I thank you for the time you have dedicated to the review of the draft opinion and for the input you provided. I apologize for the confusion over each person's role in the development and support of this product. However, I believe that the changing landscape of the CaTS, Financial Capital Strategies, and tax advantaged practices has contributed to this lack of clarity.

As far as its current status, you should note that OPIS is NOT being marketed by anyone- PFP or otherwise. In fact, I am not aware of anyone outside of a very small group of people (including you, Randy, John, Rick Solway, and Richard Smith) who know anything about the product. The PFP practice has only been told that we are working on a new version of a product which should accomplish similar results to the FLIP product. It is this type of issue which mandates the need for the CaTS team to take ownership of the OPIS product to prevent the abuse of its marketing.

I am in Montvale all week at the FCS Boot Camp and then CaTS training in Dallas. I will try to reach you again by telephone when I return to LA.

Reply Separator

Subject: Re: OPIS
Author: Robert D Simon at KPMG_Denver
Date: 2/23/98 3:31 PM

I am very concerned over the development of the new capital loss product ("OPIS). I have tried to reach you by telephone to discuss this matter, but without success.

As the technical leader of the team, a significant part of my role is to develop new products with Bob Pfaff. Last November, Pfaff and I (with input from Harris and Larson) essentially put together an LLC (partnership) version of a capital loss product, which Pfaff subsequently presented to leaders of the IS practice. A draft memo was circulated among our group, and was submitted to Larry DeLap. While Larry did feel that the LLC structure was a significant improvement, he was concerned that, at its core, the product was similiar to FLIP (which had ramifications for tax shelter registration purposes, among other things). Our group decided that what needed to be done was to prepare a short memo to Larry which distinguished the LLC product from FLIP.

When our group (Pfaff, Larson, Bickham and the two of us) last spoke in November, you assigned to Randy the task of preparing a short memo (to DeLap) which would highlight the differences between it and the FLIP product. The target date for the delivery of this memo was two weeks.

Since that discussion, neither John Harris or I have been kept in the loop with respect to the development of the product. In mid-December, John and I were notified after-the-fact (via memorandum) by Randy that an important meeting had been held (among Randy,Larson, R.J. Ruble of Brown & Wood, and yourself). We were advised that a variety of technical "conclusions" had been reached and that certain aspects of the deal had been changed. This memorandum also contained "assignments" for many of the participants of the meeting with respect to certain technical issues. In addition, the idea of sending a short, succinct memo to Larry was scuttled in favor of a formal opinion (to be delivered in mid-January).

I was concerned that a meeting of this kind had been held without prior notification (to John Harris and I). Nevertheless,I did deliver comments with respect to some of the "conclusions" that had been reached. Neither J.Harris nor I heard anthing more regarding the development of this product until a week and a half ago, when we finally received a draft opinion from Randy. During this time, I have had to field many calls from KPMG practitioners who believed (erroneously) that I would know what was going on with the development of the product. Perhaps I am missing something here (and I would appreciate your input), but it seems to be that (i) the development of the product should have been done by the entire technical team, and (ii)the technical leader should be involved in all stages of development of a tax product. Instead, much time has been wasted preparing an opinion on a product that I believe is flawed. I have no doubt that working together, we could have come up with a better product.

I would have rather discussed these issues with you over the telephone, but time is of the essence since OPIS is apparently already being marketed (according to a PFP partner who is presenting OPIS to his client).

I look forward to discussing this matter with you.

Author: Gregg W. Ritchie at KPMG_Warner_Center
Date: 2/24/98 12:45 PM
Priority: Normal
TO: Randall S Bickham at KPMG_Palo_Alto
TO: John B Harris at KPMG_Denver2
TO: Robert D Simon at KPMG_Denver4
BCC: Mark Watson at KPMG_Dallas
BCC: Douglas K. Ammerman at KPMG_Orange_County
Subject: Re: OPIS

------------------------------------ Message Contents ------------------------------------

Thanks for reducing your comments on the OPIS draft opinion to writing. I have made comments to your memo on the attached. Randy, please make sure that you address the issue raised on the new Rev Rul. John, did you ever get a response to the 465 issue (not mentioned on the attached) from Kelliher?

____________________________ Reply Separator ____________________________

Subject: OPIS
Author: Robert D Simon at KPMG_Denver4
Date: 2/23/98 12:04 PM

Attached is a summary of my comments with respect to the OPIS product.

KPMG 0047178

KPMG Peat Marwick LLP

To Gregg Ritchie - KPMG, Los Angeles
Randy Bickham - KPMG, Palo Alto
John Harris - KPMG, Denver

Date February 23, 1998

From Robert D. Simon
KPMG Peat Marwick LLP

Steno lm
Ref p\users\moon\simon\memos\opis

I thought it might be useful to summarize some of my comments with respect to OPIS. You will undoubtedly recall that Larry DeLap charged us with the development of (i) a product that could be the subject of a more likely than not opinion and (ii) a product that was sufficiently different from the FLIP transaction that we could justify registering the current product (but not FLIP). I believe that in its current state, the product fails on both counts. I disagree on your conclusion. We believe we can write a more likely than not and expect DPP to agree. Furthermore, Presidio has offered to register the product in the event that we conclude this is necessary.

If OPIS is not exactly the FLIP product, it is, in the words of J. Harris, "son-of-FLIP." In my view, OPIS incorporates very few of the positive features of the LLC product previously submitted to Larry DeLap. The omission of these features is significant not only in a substantive sense, but because many were in direct response to concerns raised by L. DeLap and G. Bloom. Obviously, we are probably not going to have a product unless these concerns are addressed. All of the features in the LLC product were vetted and cleared with Bob Pfaff and J. Larson; indeed; B. Pfaff presented the revised product to a group of international tax leaders in December.

I am not unmindful of the fact that many of the features of the LLC product had an economic cost to the investor, however, each also had an important tax benefit. Of course, given a choice, Presidio would rather not incorporate features that increase the cost of the deal to the investor, and it is to their credit if they can get us to agree. However, like it or not, we do have different considerations. We are the firm writing the opinions. Ultimately, if these deals fail in a technical sense, it is KPMG which will shoulder the blame. Agree.

The following are some of my general observations:

(1) The use of debt, possibly the most critical departure from FLIP, was an integral component of the LLC structure. To paraphrase Bob Pfaff's words, the use of debt strongly enhanced the deal from a tax perspective, because it guaranteed that our NRAs were truly at risk. In OPIS, the use of debt has apparently been jettisoned. If we can not structure a deal without at least some debt, it strikes me that all the investment banker's economic justification for the deal is smoke and mirrors. (By the way, we still haven't received Presidio's investment analysis showing the economic upside of the FLIP product). If 10-25% of U.S. investor's investment is in the form of debt, Presidio should be able to conclude that the debt will likely be repaid. We thoroughly explored the ability to use debt in this context. However, after extensive discussion, we could not get comfortable that we could get any assurance that it would be repaid in a sufficient amount and a significant number of times that we could credibly argue it was true debt. Without such expectation of repayment, the instrument would fail. The Swap idea was a creative alternative to the use of debt.

(2) In my discussions with John Harris, one thing that John and I feel strongly about is that the entire business purpose for the deal hinges upon Presidio's investment analysis. Indeed, the opinion states that investor has reviewed the investment analysis before undertaking the transactions. For this reason, we believe that the investment analysis must be reviewed by us (whatever the terms of the ultimate deal) before we can sign off on it. Obviously, the investment analysis should be attached to any opinion submitted to L. DeLap. I fully agree. We have communicated this both to Presidio and DPP. We have been told this analysis is in process and will be provided with input from DB and DMG.

(3) The only thing that really distinguishes OPIS (from FLIPS) from a tax perspective is the use of an instrument that is purported to be a swap. I agree that the use of a swap has some interesting possibilities. However, the instrument described in the opinion is not a swap under I.R.C. §446. Rick Solway does not share your opinion. Indeed, when coupled with the NRA's preferred return (which Randy mentioned) a fairly strong argument could be made that the U.S. investor has nothing more than a disguised partnership interest. While this is always an issue (similar to the RR 82-150 issue in version 1), Richard Smith did not consider this a large risk. By the way, Bob Pfaff has stated on several occasions that the NRAs would be truly at risk for their investments (and I understood that there would be no preferred return). Without true economic risk, the NRAs true characterization is probably that of a service provider or debt holder (or possibly a preferred shareholder). Obviously, any of these characterizations would lead to the conclusion that the U.S.

investor is the equity holder (and the direct recipient of millions of dollars of income). Before OPIS can be implemented, Presidio has indicated that they must review the structure with their NRAs in order to determine whether the strategy is acceptable to them. They believe that the NRAs will like the new structure and will agree to live with their added investment exposure.

(4) If, upon audit, the IRS were to challenge the transaction, the burden of proof will be on the investor. The investor will have to demonstrate, among other things, that the transaction was not consummated pursuant to a firm and fixed plan. Think about the prospect of having your client on the stand having to defend against such an argument. The client would have a difficult burden to overcome, especially if all the transactions were carried out between him and the bank (and Presidio). The failure to use an independent 3rd party in any of the transactions indicates that the deal is pre-wired. This issue was a significant concern of G. Bloom (in the FLIP transaction). Nevertheless, the OPIS structure drops the concept (contained in the LLC memo) of using unrelated third parties to carry out at least some of the transactions. OPIS does not summarily dismiss this idea. In fact, we know of certain clients who executed the long trades in the FLIP transaction through their own brokers. This is possible also in OPIS. The opinion letter does not presuppose who will execute each phase (except with reference to the redemption and out of the money option purchase, as we have previously discussed). However, a significant strength of OPIS is that it will be marketed as an integrated investment strategy as designed by Presidio, the investment advisor. Given the integrated structure of the overall investment plan and the commensurate benefits which could be realized by a US person (due to added leverage), it did seem actually counterproductive for Presidio to NOT have

control over all aspects of execution. Such an investment plan would not be common without a coordinated execution strategy by the advisor.

(5) The concept of purchasing the long position several weeks before the establishment of the Cayman company (and the ensuing trades) was also eliminated without explanation. This was an important feature in that it put the holder at risk for at least several weeks. As a practical matter, there is already some lag time between the purchase of the long position and the other transactions. Indeed, Pfaff and Larson agreed to formalize a delay of several weeks. This is possible with the OPIS program (it is simply not addressed in the opinion). In fact, there is no objection from Presidio, KPMG, or the prospective clients. However, the client is actually at risk with respect to the long shares for the entire time that they own those shares. We cannot understand what possible benefit there may be from mismatching the timing of the purchase of the long shares from the indirect investment via the Cayman structure. Again, without a clear understanding of the benefit you hope to achieve, it seems counterproductive to structure this purchase in a way which would not be common in integrated market investment programs.

(6) There is no mention in the opinion of President Clinton's proposal prescribing regulatory authority on foreign built-in losses. The Administration is concerned that taxpayers are acquiring built-in losses incurred outside the U.S. taxing jurisdiction or are seeking to generate related income and loss in circumstances where the income is attributable to a foreign entity. Does this sound familiar? Any marketing of this transaction would have to directly address this proposal. Agreed.

This is specifically one of the reasons why this product must get off the shelf and into clients hands. As you know, the proposal currently has an effective date which will correspond to the date of enactment.

(7) I have always wondered about the relevance of the discussion on the dividends - received deduction. Putting aside its theoretical relevance, it does not seem that we could include it without also citing similar risk of loss concepts contained in Notice 98-5. The Notice deals with transactions (including total return equity swap) in which foreign tax credits are effectively purchased by a U.S. taxpayer. If the risk of loss concepts of Notice 98-5 were applied to OPIS, I doubt that the investor's ownership interest would pass muster. I must defer on this issue to Randy/Pfaff. If this is a new issue, obviously we must ensure that it has been properly assessed. I do not recall your raising this issue in our conference call.

(8) Nothing was done to shore up the status of the Cayman Islands company. As you may recall, the lack of any substance (to the Cayman company) was the primary objection of an attorney from a prominent firm (who was reviewing the FLIP product for his client). The LLC memorandum to DeLap suggested some possibilities in this regard. As it stands now, the Cayman company remains extremely vulnerable to an argument that it is a sham. This is an area which we have talked about for some time, but have been unable to achieve a realistic solution. However, OPIS does make more sense in that its structure is primarily an offshore investment partnership between the US person and an NRA. As such, it would not be uncommon for such an entity to have no employees, directors, or

assets (other than investment assets). There is still a desire to put some additional meat on the Cayman corp. however, that entity's purpose is to provide additional liability protection to the NRA, and to play the role of the manager of the LLC. In the US, such a structure for an investment portfolio (securities, real estate, etc) would not be uncommon without dedicated employees of the entities. The Cayman entities will continue to have local directors with the appropriate legal responsibilities and control.

(8) I generally agree with the abandonment of a pre-establishing holding period, so long as the purpose for its abandonment is not to compress the transaction within an even shorter period. It should be recognized that transactions which span a short period of time are more vulnerable to a step-transaction analysis. Because there is one favorable case involving a 110 day holding period, the LLC product used such period as a benchmark. The abandonment of a daily holding period requirement was done NOT to allow for shorter transaction periods. It was done, again, to make the strategy conform to an investment strategy. No credible investment strategy would be designed around daily holding periods, they are dependent on price movements of the investment. This will be built into our investment modeling and will make sense given our expectation of profit.

(9) No further attempt has been made to quantify why I.R.C. §165 should not apply to deny the loss. Instead, the argument is again made that because the law is uncertain, we win. Recognize that the Tax Court position in Fox (which adopted a primary profit motive test) is based upon dicta of the U.S. Supreme Court in National Grocery. As we discussed in our conference call, there simply is

nothing else to say on this topic. I believe John Harris agreed that, after his extensive review of this area, we could do no better. This however, is one element of why the strategy is only a "more-likely-than-not".

KPMG Peat Marwick LLP

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New York, NY 10154

Telephone 212-758-9700
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Date 3/16/98

Page 1 of 6

To LARRY DELAP

Organization 909-5699

Fax

From Jeff Stein

Department International Services

Tel 212-872-5597

Fax 212-872-6837

Subject

KPMG Peat Marwick LLP

707 Seventeenth Street
Suite 2300
Denver, CO 80202

Telephone (303) 296-2323
Fax (303) 295-8839

Date	March 13, 1998
To	Jeff Stein
Organization	KPMG - New York
Fax	(212) 872-6837
	Sandy Smith
	KPMG - Houston
	(713) 319-2102
From	Robert D. Simon
Department	International Services
Tel	(303) 382-7607
Fax	(303) 382-7457
Subject	OPIS

Jeff,

Sandy asked me to fax you any memos I had on the new product. The attached went to the entire working group (Pfaff, Ritchie, R J. Ruble of Brown & Wood, Bickham, and Larson). I believe that the OPIS product ("Son of FLIP") is a stripped down version of the LLC (partnership) structure. As I mentioned to you, the draft opinion that formed the basis for the OPIS opinion was drafted by John Harris (and run through an international contract). I have cc:mailed you a copy of John's earlier draft.

As you may know, the research on some of the real troublesome issues with respect to the product was done in large measure by John Harris (through an international contract), Margaret Lukes (IS), and myself. These issues included (i) whether U.S. investor's interest in the Cayman entity was disguised equity, (ii) the at risk rules, and (iii) the basis of shares held by U.S. investor.

Regards,
Bob

KPMG Peat Marwick LLP

DRAFT - For Discussion Purposes Only

To The Working Group

Date November 6, 1997

From Bob Simon, John Harris
Denver

Steno ml
Ref p:\users\lukes\wp\products\lcexec.doc

cc

Proposed LLC Structure

The following are the steps in the proposed LLC structure. Please note that at least two of the following three transactions, discussed in more detail below, should be accomplished with a third party: (1) A's purchase of foreign bank shares (i.e., the long position); (2) the purchase of a call option between the LLC and the Foreign Bank as part of LLC's hedge; and (3) A's purchase of the option to purchase Foreign Bank shares which occurs simultaneously with the redemption. While we believe that accomplishing the third transaction (the purchase of Foreign Bank option) with a third party generally is most desirable from a federal income tax standpoint, it may be difficult to ensure that the purchase of the option and the redemption occur simultaneously.

Step 1: Formation of Cayman LLC

Cayman LLC ("the LLC"), a Cayman limited life company, will elect to be treated as a partnership for U.S. federal income tax purposes.[1] The profits and loss interests in the LLC will be held as follows: 50% by NRA #1, 40% by NRA #2, and 10% by Cayman SPV, a Cayman corporation that is wholly owned by NRA #2. The NRAs and SPV will be the members of the LLC. The NRAs and Cayman SPV must be characterized as partners of a partnership for U.S. federal income tax purposes (with the attendant risks and rewards of equity ownership), rather than as holders of debt or service providers. For federal income tax purposes, NRA #1 and NRA #2 should each be nonresident aliens not engaged in a U.S. trade or business and Cayman SPV should be a foreign corporation not engaged in a U.S. trade or business.

The LLC will hold meetings in the Cayman Islands and will be in good standing under Cayman Islands law. The LLC will not permit any funds to lie "fallow" (i.e., uninvested) during its existence. The LLC will have the requisite number of directors and officers required under Cayman Islands law.

The Cayman SPV will be the manager of the LLC. A corporate manager is being suggested by legal counsel with the objective of subjecting only corporate assets, rather

[1] In the alternative, a Cayman Islands limited partnership or limited duration company may be utilized.

KPMG Peat Marwick LLP

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than the assets of a wealthy individual, to any fiduciary or third party liabilities that could arise from the manager's performance of its duties on behalf of the LLC.

Step 2: U.S. Person's Investment in Foreign Bank

U.S. Person ("A") is an individual investor who desires to make both a direct and an indirect investment in the stock of Foreign Bank ("FB"). A reasonably expects to earn a profit from such investment in excess of all transaction costs required to undertake the investment, exclusive of tax benefits. For this purpose, A will purchase directly 5x shares of FB stock, which A anticipates holding for 110 days or longer. This purchase will take place at least two weeks prior to the LLC's leveraged purchase of the FB shares, discussed below. After the LLC is formed, A will purchase a convertible bond from the LLC to acquire a 50 percent post-conversion profits and loss interest in the LLC. The convertible bond should have the characteristics of debt under general federal U.S. income tax principles. Accordingly, the bond should have a stated maturity date, and be evidenced by a note with stated interest at market rates (i.e., discounted from non-convertible bond market rates). The cost of the convertible bond would approximate the principal amount of the bond.

In addition, A will purchase an option from NRA #2 to acquire NRA #2's 40% direct interest in FB. A also will purchase an option to acquire 90% of NRA #2's Cayman SPV stock, allowing A to acquire a 9% indirect interest in FB. The latter option exists because an investor who owns an option to acquire the majority of the value of the LLC would also desire the power to control the corporate manager of the LLC. The options should be priced according to the amount of equity in FB that such options allow the option holder to acquire. Therefore, the cost of the option to acquire the 9% indirect interest should be approximately one-fourth of the cost of the option to acquire the 40% direct interest. The options would be exercisable only after a 60 day notification period, but would remain outstanding for a minimum period that covers the redemption transaction described below. Other than the 60 day notification period, there would be no other restriction on A's right to acquire, at his election, the FB stock or the Cayman SPV stock under the terms of the options.

Step 3: LLC's Investment in Foreign Bank

The LLC desires to make a leveraged purchase of 100x shares of FB stock because the LLC reasonably expects to earn a profit from its investment in FB (in excess of

KPMG Peat Marwick LLP

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transaction costs). The loan which allows the leveraged purchase will bear interest and will be evidenced by loan documents. The LLC must be considered the owner of the 100x shares for U.S. federal income tax purposes, and the loan should likewise be considered a true loan for U.S. federal income tax purposes. Settlement of the loan documents will occur immediately (i.e., no delayed settlement). The manager of the LLC (who will be unrelated to any of the other parties in the transaction) will have actual powers and responsibilities and will execute the loan documents and other documents in the Cayman Islands. The FB shares will be issued to and held by the LLC, which must be considered the owner of the shares under both local law and under U.S. federal income tax principles. It is anticipated that the LLC will hold the shares for a minimum period of 46 days. (A longer period would be preferable, however.)

In order to protect its leveraged investment position from a significant drop in the price of FB, the LLC will enter into certain hedging transactions.[2] LLC will sell European-style call options with a [DM/CHF price[3]] strike price and a [date] expiration date on 90% of its FB share position. These call option will be 5% in the money. Such call options will be written at a strike price which could qualify the call options as "qualified covered calls" within the meaning of Code Section 1092(c), if such calls had been written on an "established securities market." The strike price of these call options were adjustable downward by 5% if the FB share price were to close below [DM/CHF price] prior to the option's expiration.

Embedded within the call options will be an Asian-style option. [*Add comparison of Asian option with typical U.S. option*]

To further protect its position, LLC will also purchase a European-style put option from FB with a strike price of [DM/CHF price] per share and a [date] expiration date for 100% of its FB shares. This price will be significantly out of the money as that term is defined by Regulation Section 1.246-5(c)(2).

Step 4: Redemption

FB will redeem the 100x shares of its stock owned by the LLC at a point when it is economically desirable. Simultaneously, A will purchase a call option to acquire 100x

[2] The U.S. Person may also enter into a similar hedging transaction.
[3] *Needs to be defined in opinion.*

shares of FB stock (preferably on the established market in which such options with respect to the issued and outstanding stock of FB are regularly traded).

Author: Gregg W. Ritchie at KPMG_WARNER_CENTER
Date: 3/16/98 4:57 PM
Priority: Urgent
TO: Douglas J. Green at KPMG_NSS_Park
TO: Jeff Stein at KPMG_NYO_Tax2
CC: Douglas K. Ammerman at KPMG_Orange_County
Subject: Re: Simon Says

50/50%
OPIS

REDACTED

------------------------------------ Message Contents ------------------------------------

In preparation for our conference call tomorrow, I thought I should respond to several of the points Jeff makes below. I do not think it is appropriate for DeLap, Lanning or Wells to be involved at this point in this debate, so I have not sent this message to them.

The bottom line is, had we allowed Simon to continue to try to develop the OPIS product we would not have one. Period. I have lived with this product every day for the last 6 months trying to get it back on line- I think I should know.

The teamwork we all strive for was not possible in OPIS, and that was unfortunate. I hope through our discussion to be able to solve this type of problem going forward.

______________________________ Reply Separator ______________________________
Subject: Simon Says
Author: Jeff Stein at KPMG_NYO_Tax2
Date: 3/14/98 9:56 AM

By the way - anybody who does not have a copy of the Pfaff letter, let me know and I will fax it over to you. In addition in case you want a copy of the November 6, 1997 memo detailing the proposed LLC strucutre written by Simon to "The Working Group" which included Ritchie, Pfaff, Larson, Bickahm and R.J. Ruble of the law firm of Brown & Wood let me know and I will fax it over to you as well. As I said below, the OPIS strategy is a stripped dwon version of the LLC structure.

Incidentally, I failed to mention that the research on the most troublesome issues with respect to this product was done in large measure by Simon, Harris and Margaret Lukes (also IS). Those issues included:

a - Whether U.S. investor's interest in the Cayman entity was disguised equity, This issue was identified in Jan 1997 by a Price Waterhouse review of FLIP opinion- Simon didn't even work for us at that time. Pfaff and Larson made numerous changes to the FLIP product to allow it to continue to be sold. For the OPIS product, none of the above IS persons spent as much as sixty seconds looking at the issue. Since the "equity" issue now revovles around the swap instrument into a partnership, Bickham and I looked at this and got Richard Smith's approval of the structure.

b - The application of the at-risk rules and, John Harris has spent time on this issue for the OPIS product along with Bill Kelliher, Phil Weisner, and Richard Smith. We have a meeting in WNT on Wed to try to come to a conclusion. Simon has spent no time on this.

c - The basis of the shares held by the U.S. investor. I have no idea what this item relates to. There seems to be little technical issue here.

KPMG 0047189

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #94k

Frankly Doug - if you are the ultimate arbiter in this matter, I think you have all the facts you need at your disposal to make your decision. I will have a conversation if you and Greg feel it is necessary but that discussion would only result in a debate over the facts as presented below and Simon and Harris would need to be prresent on that call to represent what they have told me concerning their involvement in this product. **We must discuss this fully over the phone. Jeff's comments in this message are not in line with the facts, are inflammatory, and I hope are not discoverable by the IRS. If you don't believe that I will be forthright with you, you don't know me very well.**

Guys - Have a terrific weekend.

____________________________ Forward Header ____________________________

Subject: Simon Says
Author: Jeff Stein at KPMG_NYO_Tax2
Date: 3/14/98 9:46 AM

Bob/John/Larry - I've copied each of you on this because of your involvement up to this point, especially with regard to the technical issues that have arisen, on managing those rare personality flare ups and in coding discussions. I feel (not fear) the end is near.

After some - but not exhaustive - due diligence on my part over the last few days, here is what I was able to come up with as regards the involvement of IS in the OPIS strategy (son of FLIP). They are to be contrated with Opie and Flipper, two TV characters from the 60's. Obviously reasonable men can differ on both the facts and conclusions but I thought I'd take a stab at laying out at least my understanding which perhaps can serve as a working document for any discussions next week. I invite any of you to please reply and let me know where I am off base on any of this. Stay tuned. I have tried to be as honest and accurate as I can be and have toned down my normal pronation (not just a foot and running term Doug) towards exaggeration but have tried to at least add some humor. I, at least, found this funny.[1]

First of all, in terms of involvement you should all have a copy of an unsolicited letter to me from Bob Pfaff extolling the virtues of Bob Simon and which indicates how integrally involved Bob has been in the development of this strategy. From my law school days, I was always told to lead with strength and if you could get a third party to say how great your client was rather than having your client say that he was great - it would better serve you. Thus, Pfaff is my first character witness who may later be called to the stand to discuss specific factual allegations in this case. I believe that letter states that "Bob (Simon) contributed significantly to making it (the basis shift strategy) a better product with less risk for all concerned." **~~Pfaff's reference is to the FLIP product, not OPIS.~~ - Jeff should not be enthusiastic about what Bob might say on a witness stand.** So that's Exhibit A.

Just as a matter of background, in September or October of last year Bob Simon and Bob Pfaff began to have discussions on a successor to the FLIP transaction which was being marketed. These discussions took on an air of urgency when Larry Delap determined that KPMG should discontinue marketing the existing product. ~~It was Simon who forced this to occur~~. Simon and Pfaff met in late October and throughout November to tweak or redesign if necessary the old strategy - focusing

Proprietary Material
Confidentiality Requested

KPMG 0047190

on the Cayman partnership and adding features designed to lessen any Subpart F or other risks. They determined that whatever the new product, it needed a greater economic risk attached to it and should probably include a debt or convertible debt feature. During those 6 plus weeks, there were daily phone calls between Pfaff and Simon and numerous meetings. The involvement was significant and depending upon which IRS test we want to apply, Simon was big-time involved. The result of this effort was a message from Larry to me, Simon, Harris and Bickham that he would not approve what Simon had suggested. Now to the heart of the discussion.

OPIS at it's core (pardon the use of core - it is not a coding term of art) is really just an updated version of the basis shift strategy developed by IS and Pfaff. It is now - and don't take this the wrong way - a watered down version **Objection** (OBJECTION - OVERRULED) of what Pfaff and Simon came up with in November and which was presented to the IS leadership team by Pfaff in early December for their review and comments. It was Simon who wrote up the product for distribution to the leadership team and for circulation to Larry. **Again, as stated above, Larry bounced this effort--clearly Simon had not been creative enough. Furthermore, that memo was not to have been given to Larry since I knew it was not ready. Unfortunately, Simon ignored me.**

The use of a Cayman partnership instead of a Cayman corp came about through meetings Simon held with Pfaff. Although Pfaff had actually floated that idea back in July when he was still with KPMG, nobody ever pursued it. When FLIP was tabled, Simon brought it back on the table and showed Pfaff how we could achieve an even better structure with a Cayman LLC or partnership. **Agreed. However, we ultimately were not able to use the LLC and had to switch to a partnership.** By the way - you guys should feel free to call Pfaff to the stand and ask him to confirm or deny any of what I am saying as well as Simon's involvement.

As you may know, the Cayman entity (in both FLIP and OPIS) is "nominally, **not a phi beta cappa word**" owned by an NRA (nonresident alien). Under the FLIP structure, there was a real question as to whether an NRA was truly an equity holder. In particular, the NRA received a preferred return, was protected from risk, and in most respects looked like a service provider or debt holder. If that were true, either of those characterizations would have lead to a tax disaster. Simon was the one who suggested buttressing the NRA's position as an equity holder and although some of Simon's suggested improvements did not make their way into the ultimate OPIS product, others did. **Simon's comments on this topic were related to the earliest versions of the FLIP strategy. He raised this issue because he was trying to write an opinion on an early deal that was done this way. This problem in structure was cured early in 1997 and had nothing to do with OPIS.** I assume the same could be said of other team members who worked on this product. For example, I know that from discussions with Pfaff, the NRA will now have real economic risk and no longer has a preferred return. In addition, the NRA will hold both equity and debt.

In the FLIP structure, the U.S. investor bought a warrant to purchase 90% of the stock of a Cayman company for a price designed to include all the fees of the participants in the transaction. It was essential that the warrant be treated as an option to acquire stock in the Cayman company (for Section 302 purposes), without being treated as actual stock. Simon was the one who pointed out the weakness in having the U.S. investor purchase a warrant for a ridiculously high amount of money - well in excess of the strike price - which in no event would be exercised (since the investor also had a cash-settled option which would **enable** him to gain any upside in the Cayman company without paying the strike price of exercise). It was clear, we needed the option to be treated as an option for Section 302 purposes, and yet in truth the option was really -illusory- **again, I worry about your choice of words** and stood out more like a sore thumb since no one in his right mind would pay such an exorbitant price for such a warrant **36 people did, and several made alot of money.** Pfaff and Simon discussed alternatives and came up with the idea of having the U.S. investor purchase convertiable debt since the investor could be expected to pay at or near the principal amount for convertible debt. Eventually this was changed to a swap (in OPIS) but the idea was the same - to get a bunch (technical term) of money into Cayman corp in a manner which would have some economic substance without itself being equity. **As you will see from the "Simon" memo and my responses to him, the convertible debt idea was flawed from the beginning and could not work. To say that the Swap idea is the same indicates his ignorance of the product.**

There have been other changes to the strategy as well based on conversations that Simon has had with Pfaff but since Simon was effectively cut out of the loop in mid-December he has not been privy to everything that has transpired. **There have been NO changes to the OPIS product based on discussions between Pfaff and Simon. The changes that Jeff (presumably fed to him by Simon) are referring to relate to the old FLIP strategy.**

The FLIP strategy included a loan from a foreign bank to the Cayman company. The Cayman company then turned around and purchased shares in the same bank. Later, the shares were redeemed and magically, at the same moment, the U.S. investor (related to Cayman through the warrant) would buy an option for the equivalent amount of the shares from the Bank. In kicking the tires on FLIP (perhaps too hard for the likes of certain people **a thinny-veiled reference**) Simon discovered that there was a delayed settlement of the loan which then raised the issue of whether the shares could even be deemed to be issued to the Cayman company. Naturally without the shares being issued, they could not later be redeemed. **Again, this was an issue on an early 1997 deal that Simon reviewed. The strategy was changed in this regard long before Simon joined the Firm.** Under OPIS, the same simultaneous redemption is present, but settlement of the loan documents will occur immediately, i.e., no delayed settlement. Clearly Simon was very vocal in his concern over the delayed settlement issue and played the key role in eliminating it from the new and improved strategy.

Simon was also the one who suggested and prepared investor's representation letters which dealt primarily with the investor's economic expectations heading into the deal. Prior to that we had some 20 or so representations buried in a 50 page opinion. Because the investor himself was not making the representations, they were of dubious validity. Representation letters will now be issued on all OPIS deals and wherever possible in the old FLIP deals. **This is, perhaps, the most egregious of Stein/Simon's comments. Although I had a lesser part in the technical development of OPIS and FLIP, it was Gregg W. Ritchie who made this suggestion, not the ubiquitous Simon. I suggested that the representation letter format be used and we modeled it after the same letter I had designed for our old Investment Diversification Vehicle strategy. I have examples of this in letters to clients dating back to 1995 if you would like proof. While not a big point, it illustrates Simon's blow out of proportion role.**

Additionally, all of the time spent by John Harris on this project (and it is considerable) has been run through international services contracts. A very significant issue in OPIS is whether the partnership anti-abuse regulations apply. John is the author of that entire section, which was used word for word in the OPIS draft. Incidentally, although admittedly not entirely relevant is the praise that WNT had for that particular section. Indeed, the OPIS draft that Randy Bickham circulated was primarily taken from an earlier draft of a partnership structure that John Harris had worked on with Bob Pfaff before Bob left the Firm. **John Harris is, from what I can tell, the jewel of the Denver practice. If we could more effectively harness him, the FCS practice would be improved. Unfortunately, I still must say that most of John's efforts were done in re-writing the opinion on the FLIP product. While his drafting is excellent, he would be the first to admit that he had little direct input into OPIS. I would have liked to use him more and would like to explore this more fully when we talk.**

Finally, and although this may be considered by Greg as an admission against interest, it was Greg who stated in writing to I believe Bob Simon that the "the OPIS product was developed in response to your and DPP tax's concerns over the FLIP strategy. We listened to your input regarding technical concerns with respect to the FLIP product and attempted to work solutions into the new product". **For the record, I have forwarded to you my complete message to Simon. I think you will get a different impression than this out of context, incomplete excerpt.** I assume Greg does not mean that he worked those technical solutions into the product himself or with just Mr. Bickham. **Our technical solutions were made in concert with several people whom I think Stein cannot throw stones at- Bob Pfaff, RJ Ruble, John Larson, Richard Smith, Rick Solway. I was forced to rely on professionals who were able to get a solution- not just raise problems.** I will leave the discussion on Mr Bickham and the evaluation of his international technical skills made independently by two senior IS partners to another discussion. **As an aside, it is a shame that the IS practice could not find a way to work with Randy. Given their experience with Simon and Bickham, this may be endemic to that practice.**

In conclusion - The development of the OPIS strategy was a team effort with the primary technical thrust for the improved product coming from IS. **This must be the example of exaggeration Jeff refers to above.** Given the similarity of this product to FLIP and the extensive involvement of Simon and Harris working alongside Pfaff, I do not believe there is any credible claim that PFP invented a new strategy or product called OPIS and it would take an absolute disregard of the facts to reach such a conclusion. **PFP didn't claim to have invented a new strategy. However, the facts are that without the PFP practice, the IS practice would still be moaning about not having a product.** A I said above, FLIP is a watered down version of what Simon and Pfaff presented to the IS leadership team in December. I believe that all that has been accomplished over the past two months since Simon has been cut out is that as many of the expensive modifications that could be taken out of OPIS have been and one change has been made, that being the swap rather than the debt instrument (which adds nothing of substance). **I also believe that some of the features that gave this product more economic substance have also been eliminated but I will obviously defer to Larry who is the one who should opine on the relevant technical impact of the modifications and eliminations to the product.**

KPMG 0047193

Author: Jeff Stein at KPMG_NYO_Tax2
Date: 3/14/98 9:56 AM
Priority: Normal
TO: Gregg W. Ritchie at KPMG_Warner_Center
TO: Douglas J. Green at KPMG_NSS_Park
TO: Robert J. Wells at KPMG_EO_Montvale4
TO: John T. Lanning at KPMG_NSS_Park
TO: Larry DeLap at KPMG_Palo_Alto
Subject: Simon Says

------------------------------ Message Contents ------------------------------

By the way - anybody who does not have a copy of the Pfaff letter, let me know and I will fax it over to you. In addition in case you want a copy of the November 6, 1997 memo detailing the proposed LLC strucutre written by Simon to "The Working Group" which included Ritchie, Pfaff, Larson, Bickahm and R.J. Ruble of the law firm of Brown & Wood let me know and I will fax it over to you as well. As I said below, the OPIS strategy is a stripped dwon version of the LLC structure. Sent to DPP

Incidentally, I failed to mention that the research on the most troublesome issues with respect to this product was done in large measure by Simon, Harris and Margaret Lukes (also IS). Those issues included:

a - Whether U.S. investor's interest in the Cayman entity was disguised equity, No. Richard Smith.

b - The application of the at-risk rules and, New product by RS/PW/EWK

c - The basis of the shares held by the U.S. investor. ?

Frankly Doug - if you are the ultimate arbiter in this matter, I think you have all the facts you need at your disposal to make your decision. I will have a conversation if you and Greg feel it is necessary but that discussion would only result in a debate over the facts as presented below and Simon and Harris would need to be prresent on that call to represent what they have told me concerning their involvement in this product.

Guys - Have a terrific weekend.

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After some - but not exhaustive - due diligence on my part over the last few days, here is what I was able to come up with as regards the involvement of IS in the OPIS strategy (son of FLIP). They are to be contrated with Opie and Flipper, two TV characters from the 60's. Obviously reasonable men can differ on both the facts and conclusions but I thought I'd take a stab at laying out at least my understanding which perhaps can serve as a working document for any discussions next week. I invite any of you to please reply and let me know where I am off base on any of this. I have tried to be as honest and accurate as I can be and have toned down my normal pronation (not just a foot and running term Doug) towards exaggeration but have tried to at least add some humor.

First of all, in terms of involvement you should all have a copy of an unsolicited letter to me from Bob Pfaff extolling the virtues of Bob Simon and which indicates how integrally involved Bob has been in the development of this strategy. From my law school days, I was always told to lead with strength and if you could get a third party to say how great your client was rather than having your client say that he was great - it would better serve you. Thus, Pfaff is my first character witness who may later be called to the stand to discuss specific factual allegations in this case. I believe that letter states that "Bob (Simon) contributed significantly to making it (the basis shift strategy) a better product with less risk for all concerned." So that's Exhibit A.

Ha!

old strategy

Just as a matter of background, in September or October of last year Bob Simon and Bob Pfaff began to have discussions on a successor to the FLIP transaction which was being marketed. These discussions took on an air of urgency when Larry Delap determined that KPMG should discontinue marketing the existing product. Simon and Pfaff met in late October and throughout November to tweak or redesign if necessary the old strategy - focusing on the Cayman partnership and adding features designed to lessen any Subpart F or other risks. They determined that whatever the new product, it needed a greater economic risk attached to it and should probably include a debt or convertible debt feature. During those 6 plus weeks, there were daily phone calls between Pfaff and Simon and numerous meetings. The involvement was significant and depending upon which IRS test we want to apply, Simon was big-time involved. Now to the heart of the discussion.

OPIS at it's core (pardon the use of core - it is not a coding term of art) is really just an updated version of the basis shift strategy developed by IS and Pfaff. It is now - and don't take this the wrong way - a watered down version (OBJECTION - OVERRULED) of what Pfaff and Simon came up with in November and which was presented to the IS leadership team by Pfaff in early December for their review and comments. It was Simon who wrote up the product for distribution to the leadership team and for circulation to Larry.

Larry bounced this. We revived

The use of a Cayman partnership instead of a Cayman corp came about through meetings Simon held with Pfaff. Although Pfaff had actually floated that idea back in July when he was still with KPMG, nobody ever pursued it. When FLIP was tabled, Simon brought it back on the table and showed Pfaff how we could achieve an even better structure with a Cayman LLC or partnership. By the way - you guys should feel free to call Pfaff to the stand and ask him to confirm or deny any of what I am saying as well as Simon's involvement.

As you may know, the Cayman entity (in both FLIP and OPIS) is nominally owned by an NRA (nonresident alien). Under the FLIP structure, there was a real question as to whether an NRA was truly an equity holder. In particular, the NRA received a preferred return, was protected from risk, and in most respects looked like a service provider or debt holder. If that were true, either of those characterizations would have lead to a tax disaster. Simon was the one who suggested buttressing the NRA's position as an equity holder and although some of Simon's suggested improvements did not make their way into the ultimate OPIS product, others did. I assume the same could be said of other team members who worked on this product. For example, I know that from discussions with Pfaff, the NRA will now have real economic risk and no longer has a preferred return. In addition, the NRA will hold both equity and debt.

Pfaff wrote this change himself

In the FLIP structure, the U.S. investor bought a warrant to purchase 90% of the stock of a Cayman company for a price designed to include all the fees of the participants in the transaction. It was essential that the warrant be treated as an option to acquire stock in the Cayman company (for Section 302 purposes), without being treated as actual stock. Simon was the one who pointed out the weakness in having the U.S. investor purchase a warrant for a ridiculously high amount of money - well in excess of the strike price - which in no event would be exercised (since the investor also had a cash-settled option which would enable him to gain any upside in the Cayman company without paying the strike price of exercise). It was clear, we needed the option to be treated as an option for Section 302 purposes, and yet in truth the option was really illusory and stood out more like a sore thumb since no one in his right mind would pay such an exorbitant price for such a warrant. Pfaff and Simon discussed alternatives and came up with the idea of having the U.S. investor purchase convertiable debt since the investor could be expected to pay at or near the principal amount for convertible debt. Eventually this was changed to a swap (in OPIS) but the idea was the same - to get a bunch (technical term) of money into Cayman corp in a manner which would have some economic substance without itself being equity.

There have been other changes to the strategy as well based on conversations that Simon has had with Pfaff but since Simon was effectively cut out of the loop in mid-December he has not been privy to everything that has transpired.

The FLIP strategy included a loan from a foreign bank to the Cayman company. The Cayman company then turned around and purchased shares in the same bank. Later, the shares were redeemed and magically, at the same moment, the U.S. investor (related to Cayman through the warrant) would buy an option for the equivalent amount of the shares from the Bank. In kicking the tires on FLIP (perhaps too hard for the likes of certain people) Simon discovered that there was a delayed settlement of the loan which then raised the issue of whether the shares could even be deemed to be issued to the Cayman company. Naturally without the shares being issued, they could not later be redeemed. Under OPIS, the same simultaneous redemption is present, but settlement of the loan documents will occur immediately, i.e., no delayed settlement. Clearly Simon was very vocal in his concern over the delayed settlement issue and played the key role in eliminating it from the new and improved strategy.

it was eliminated earlier

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Absolutely not

some 20 or so representations buried in a 50 page opinion. Because the investor himself was not making the representations, they were of dubious validity. Representation letters will now be issued on all OPIS deals and wherever possible in the old FLIP deals.

Additionally, all of the time spent by John Harris on this project (and it is considerable) has been run through international services contracts. A very significant issue in OPIS is whether the partnership anti-abuse regulations apply. John is the author of that entire section, which was used word for word in the OPIS draft. Incidentally, although admittedly not entirely relevant is the praise that WNT had for that particular section. Indeed, the OPIS draft that Randy Bickham circulated was primarily taken from an earlier draft of a partnership structure that John Harris had worked on with Bob Pfaff before Bob left the Firm.

Opp wants it priced

Finally, and although this may be considered by Greg as an admission against interest, it was Greg who stated in writing to I believe Bob Simon that the "the OPIS product was developed in response to your and DPP tax's concerns over the FLIP strategy. We listened to your input regarding technical concerns with respect to the FLIP product and attempted to work solutions into the new product". I assume Greg does not mean that he worked those technical solutions into the product himself or with just Mr. Bickham. I will leave the discussion on Mr Bickham and the evaluation of his international technical skills made independently by two senior IS partners to another discussion.

See my entire message

RT & BLP.

In conclusion - The development of the OPIS strategy was a team effort with the primary technical thrust for the improved product coming from IS. Given the similarity of this product to FLIP and the extensive involvement of Simon and Harris working alongside Pfaff, I do not believe there is any credible claim that PFP invented a new strategy or product called OPIS and it would take an absolute disregard of the facts to reach such a conclusion. A I said above, FLIP is a watered down version of what Simon and Pfaff presented to the IS leadership team in December. I believe that all that has been accomplished over the past two months since Simon has been cut out is that as many of the expensive modifications that could be taken out of OPIS have been and one change has been made, that being the swap rather than the debt instrument (which adds nothing of substance). I also believe that some of the features that gave this product more economic substance have also been eliminated but I will obviously defer to Larry who is the one who should opine on the relevant technical impact of the modifications and eliminations to the product.

What I thought we were trying to achieve here was bringing the best minds we had in this Firm together in order to design the best product to go to market with. That we did and for the five or so months that Simon and Harris have been involved working with Pfaff, not once did anybody ask, including Sandy Smith who is ultimately responsbile for the financial results in that geopgraphy, who is going to pay IS for the time and effort being spent by the IS group in Denver. That was the same path we went down when Pfaff and Larson worked on the original FLIP strategy. To now say that the hundreds of hours that IS spent in designing this strategy was either nominal or does not rise to the level of substantial is not only offensive but I can guarantee you will not result in a greater sense of teamwork going forward as we attempt to better leverage ourselves with the FCS group.

What I thought we were trying to accomplish in creating that group was not having independent pockets of professionals spending time developing independent strategies that were not nearly as powerful as what we could accomplish working together as a team. That should be what we're trying to accomplish rather than this "mine is bigger than yours" thing that we seem to be experimenting with. Somebody tell me what we're doing here by suggesting a reward system that is based on anything but team. Truth be told on this one, IS has probably been responsible for 80% of the OPIS idea when you examine the final product and compare it to FLIP, along with what led to OPIS, who suggested the key modifications to the FLIP strategy, and the key product characteristics of OPIS. Let's just stay with our 50/50 deal and forget about the Ides of March.

new

From: Douglas J. Green
Sent: Monday, March 16, 1998 5:04 PM
To: John T. Lanning; Larry DeLap
Subject: Re[2]: OPIS

JTL LD F/Y/I DOUG

Forward Header

Subject: Re[2]: OPIS
Author: Gregg W. Ritchie at KPMG_WARNER_CENTER
Date: 3/16/98 3:57 PM

In response to Jeff's cc:mail messages concerning the involvement of the IS practice in the OPIS product, I thought it would be appropriate to forward to you the message below. Simon's message to me on Feb 23, 1998 was his complaint about not having any input into the development of the OPIS product. You can read his own words concerning this matter and come to your own conclusions.

I have also attached to this message the memo that Simon sent to me on Feb 23 detailing the concerns he has over the OPIS product that was ultimately developed without him (my comments to the points in his memo are underlined). You can see his conclusion in the first paragraph- he believes OPIS is neither a more-likely-than-not product nor sufficiently different from the FLIP product to get DPP comfortable with the registration issue. As we now know, DPP-tax disagreed with him on both points (subject to their review of the ACM aspects). His memo goes on to state that "...OPIS incorporates very few of the positive features of the LLC product previously submitted to Larry DeLap". These so-called "postive features" which he "vetted and cleared" with Bob Pfaff and John Larson were ultimately not used- each for very good reasons. I do not doubt that Bob Simon had many discussions with Bob Pfaff about trying to resurrect the FLIP strategy (that he, in large part, killed). However, as is plain to see, his contributions were not workable or necessary and were, for the most part, discarded. This probably accounts for his statements to Jeff that he had alot of contact with Pfaff.

I will discuss with each of you in detail the reasons why I handled this product in the way I felt was necessary. However, I would prefer not to do so in this forum.

Forward Header

Subject: Re[2]: OPIS
Author: Gregg W. Ritchie at KPMG_Warner_Center
Date: 2/23/98 9:16 PM

As you and I have discussed, the OPIS product was developed in response to your and DPP-Tax's concerns over the FLIP strategy. We listened to your input regarding technical concerns with respect to the FLIP product and attempted to work solutions into the new product. As you will recall, the FLIP product was put back on the shelf by

KPMG 0034394

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Larry DeLap as a result of several issues he raised (many of which were brought to his attention by you). The OPIS strategy has been designed to address DPP-Tax's concerns with the prior product as well.

The draft memo of the LLC product which you sent to Larry DeLap should never have been submitted to him as neither the concept nor its implemention had been fully developed. In fact, following Pfaff's departure from the Firm, the entire process relating to the FLIP product was not handled in an ideal manner. I take the responsibility for much of this as I had not properly taken full ownership of the product. As you know, we now have a better mechanism for taking ownership of these types of products through the CaTS practice and the new FCS Designated Service.

As the product owner of the OPIS product, I solicited input from a variety of sources; including Brown & Wood, Presidio, Rick Solway, Richard Smith, and others. Furthermore, we circled back to your concerns after the opinion had been drafted in order to solicit your (and John's) responses to our ideas. Your comments from our conference call relative to the draft opinion were taken into consideration and appropriate modifications made. I made the same decisions relative to input received from the other sources.

It is critical for the CaTS and FCS practice for this product to now be evaluated by DPP-Tax, and any required modifications be developed. I have made the decision to submit the product to DPP for their review at this time. While the product may not meet all of the requirements of your "wish list", we must balance priorities with the needs of the practices.

I thank you for the time you have dedicated to the review of the draft opinion and for the input you provided. I apologize for the confusion over each person's role in the development and support of this product. However, I believe that the changing landscape of the CaTS, Financial Capital Strategies, and tax advantaged practices has contributed to this lack of clarity.

As far as its current status, you should note that OPIS is NOT being marketed by anyone- PFP or otherwise. In fact, I am not aware of anyone outside of a very small group of people (including you, Randy, John, Rick Solway, and Richard Smith) who know anything about the product. The PFP practice has only been told that we are working on a new version of a product which should accomplish similar results to the FLIP product. It is this type of issue which mandates the need for the CaTS team to take ownership of the OPIS product to prevent the abuse of its marketing.

I am in Montvale all week at the FCS Boot Camp and then CaTS training in Dallas. I will try to reach you again by telephone when I return to LA.

______________________________ Reply Separator ______________________________

Subject: Re: OPIS
Author: Robert D Simon at KPMG_Denver
Date: 2/23/98 3:31 PM

I am very concerned over the development of the new capital loss product ("OPIS"). I have tried to reach you by telephone to discuss this matter, but without success.

As the technical leader of the team, a significant part of my role is to develop new products with Bob Pfaff. Last November, Pfaff and I (with input from Harris and Larson) essentially put together an LLC (partnership) version of a capital loss product, which Pfaff subsequently presented to leaders of the IS practice. A draft memo was circulated among our group, and was submitted to Larry DeLap. While Larry did feel that the LLC structure was a significant improvement, he was concerned that, at its core, the product was similiar to FLIP (which had ramifications for tax shelter registration purposes, among other things). Our group decided that what needed to be done was to prepare a short memo to Larry which distinguished the LLC product from FLIP.

When our group (Pfaff, Larson, Bickham and the two of us) last spoke in November, you assigned to Randy the task of preparing a short memo (to DeLap) which would highlight the differences between it and the FLIP product. The target date for the delivery of this memo was two weeks.

Since that discussion, neither John Harris or I have been kept in the loop with respect to the development of the product. In mid-December, John and I were notified after-the-fact (via memorandum) by Randy that an important meeting had been held (among Randy, Larson, R.J. Ruble of Brown & Wood, and yourself). We were advised that a variety of technical "conclusions" had been reached and that certain aspects of the deal had been changed. This memorandum also contained "assignments" for many of the participants of the meeting with respect to certain technical issues. In addition, the idea of sending a short, succinct memo to Larry was scuttled in favor of a formal opinion (to be delivered in mid-January).

I was concerned that a meeting of this kind had been held without prior notification (to John Harris and I). Nevertheless, I did deliver comments with respect to some of the "conclusions" that had been reached. Neither J.Harris nor I heard anthing more regarding the development of this product until a week and a half ago, when we finally received a draft opinion from Randy. During this time, I have had to field many calls from KPMG practitioners who believed (erroneously) that I would know what was going on with the development of the product. Perhaps I am missing something here (and I would appreciate your input), but it seems to be that (i) the development of the product should have been done by the entire technical team, and (ii) the technical leader should be involved in all stages of development of a tax product. Instead, much time has been wasted preparing an opinion on a product that I believe is flawed. I have no doubt that working together, we could have come up with a better product.

I would have rather discussed these issues with you over the telephone, but time is of the essence since OPIS is apparently already being marketed (according to a PFP partner who is presenting OPIS to his client).

I look forward to discussing this matter with you.

new

From: Richard J. Solway
Sent: Tuesday, April 14, 1998 1:44 PM
To: Larry DeLap
Subject: Re: OPIS examples & a structuring idea

Larry, FYI, I'm not there on the OPIS structure and have suggested to Gregg that it be presented to you and the committee in total, as I'm not at a more likely than not level. In addition, I'm in a very awkward position as a member of FCS and a reviewer; I can certainly deal with this objectively, but at a certain point Walter and Gregg are going to get very annoyed with my "conservatism." Plain and simple, the stated business rationale for OPIS, to leverage an equity investment further than is possible through a U.S. entity, is contradicted by the very limited risk/reward profile of the partnership's investment when taking into account the puts and calls.

I'm writing to keep you in the loop. I will keep working with Gregg so that he can present it to you separately. Best regards, Rick

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Author: Gregg W. Ritchie at KPMG_WARNER_CENTER
Date: 4/14/98 1:25 PM

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The other difficulty, of course, is the bank's need for security relative to the loan. The greater the investment risk in the Cayman entity, the less "security" the bank has relative to its loan. I will speak to Presidio to see if they have an idea of the boundaries on this issue.

I understand from Randy that you have now looked at the Presidio analysis and agree that an investor has a reasonable chance of making a reasonable profit from the trades. Your other point (stated below also) is that we should be able to make a reasonable argument about why an investor would entertain this investment verses either doing it directly or some other equity investment. This is a fair question which, I think, really addresses the business purpose for the strategy. I know that you and the committee have addressed this in the past relative to this genre of product and I hope that there continues to be enough substance to the structure to allow us to conclude it is more likely than not.

I am on my way to New York today and will try to call you again from the road.

__________ Reply Separator __________
Subject: OPIS examples & a structuring idea
Author: Richard J. Solway at KPMG_NYO_FinServ
Date: 4/13/98 7:34 PM

G & R,

KPMG 0034757

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #94m

FYI, we just now received a fax from John Larson. Lee will be out tomorrow and will review the examples on Wednesday. We'll then be back in touch with you.

One thought to improve the business purpose of the OPIS structure:

Instead of having DB buy and sell options on its own stock, why not have DB enter into a structured forward purchase contract (like the Bear Stearns' STAMPS) with a customer and lay this risk off with a similar contract to the OPIS partnership? The idea is that this provides DB with a viable way to hedge its risk and provides your U.S. investor with more upside and downside in the particular stock. This way DB does not worry about whether the stock in question goes up or down; I understand that under the current structure DB is loath to take on much risk related to its own stock.

For example, let's suppose your U.S. investor buys Intel or Yahoo or some other stock that has increased significantly in value in recent years. Then, this investor enters into the OPIS transaction. The partnership would enter into a collar transaction (likely structured as a forward contract with an embedded 20 percent band) to BUY the same stock from DB. Where would DB get the stock? Its equity derivatives group would find an investor who wants to sell the same stock and also defer the tax gain. Most or even all of the risk and a portion of the reward on this stock would be transferred, through DB, from the "selling" investor to your U.S. investor.

While this may have some merit, I am having great difficulty constructing a non-tax reason for having the partnership, rather than the U.S. investor directly, enter into the forward with DB. Perhaps there is some securities law benefit or regulatory reason DB would prefer to deal directly with a foreign partnership rather than directly with a U.S. investor.

I recognize I'm suggesting a pretty dramatic change, but I think this could potentially give rise to a transaction with better optics and improved substance.

Best regards, Rick

KPMG 0034758

kpmg Peat Marwick LLP

PFP

To OPIS Files
Silicon Valley

Date July 17, 1998

From Gregg Ritchie/Randall S. Bickham

Steno rsb
Ref c:\oholding\opinit\49day.doc

Tax Ownership by Cayman Entity

We have been asked by Presidio Advisors ("Presidio") and Deutsche Bank Securities ("DBS") to review our tax position on the holding period for Deutsche Bank ("DB") common stock in the context of our Offshore Portfolio Investment Strategy ("OPIS") product. Currently, the European-style options used in the strategy result in the redemption of the DB stock on day forty-nine, thereby resulting in a 49-day holding period.

The reason that Presidio and DBS have asked us to review our tax position is that the compulsory use of a 49-day holding period can negatively impact the financial returns earned by the Cayman entity. They have indicated to us that a holding period within a range, for example 30 to 60 days, would allow Presidio and DBS to better structure the timing and duration of the option and derivative contracts. From a perspective of maximizing the Cayman entity's expected return from its investment in DB stock and options, the optimal scenario is one whereby the liquidations of the Cayman entity's portfolio positions are timed to synchronize with the expiration of publicly-listed DB options. Based upon market liquidity considerations, this would allow for the optimal level of expected returns to the Cayman entity.

Current OPIS Opinion Letter Rationale

The basic notion of requiring a holding period to substantiate the Cayman entity's tax ownership of the DB stock is for purposes of better ensuring that the portfolio position is not viewed as being transitory in light of the collared position taken on the stock using the put/call options. In our OPIS opinion letter, we point out that the overriding prerequisites for tax ownership are possession of title and control. Only in the situation where the taxpayer has neither and both attributes are vested with one or more unrelated persons will the taxpayer not be considered the tax owner. In the OPIS context, the Cayman entity has both title and control over the DB stock. Consequently, one can view the holding period requirement as a mechanism to improve the "optics" of the transaction.

The original logic of using a 49-day holding period was to approximate the holding period required under the dividend-received deduction provisions under Code Section 243 (46 days plus three additional days to accommodate the weekly trading cycle for option contracts). Our OPIS opinion letter postulates that an alternative way of analyzing the tax ownership question (the Cayman entity's ownership of DB common stock) is by analogy to the Code Section 243 dividends received deduction ("DRD") rules. We note that although this analogy may be useful for our analysis, the DRD rules do not deny ownership of the stock for U.S. federal income tax purposes, they merely eliminate the right of the shareholder to claim a DRD. Thus, the DRD rules have no effect in the OPIS context on the taxpayer's holding period or ability to claim a gain or loss on disposition.

Discussion of Alternative Positions on Holding Period Logic

In reviewing our position, we have re-examined the legislative history contained in the Tax Reform Act of 1984 which extended the required holding period from 16 to 46 days and the new holding period rules incorporated in the foreign tax credit provisions. Based upon this review, we have concluded that our original conclusion should be updated to reflect the new holding period logic contained in the foreign tax credit provisions.

In extending the DRD holding period from 16 to 46 days, the primary targeted abuse that Congress was addressing was "dividend stripping" transactions. Using this strategy, corporations would undertake an investment strategy involving very short holding periods (but exceeding 15 days) for high-yielding stocks during which they would receive a quarterly dividend. Since the stock could be expected to decline in price by approximately the amount of the dividend, the corporate shareholder would end up with a short-term capital loss and dividend income subject to a DRD deduction (85 percent in 1984). The risks that the stock would decline in price could be reduced by writing in-the-money call options or by short sales of similar stocks. The typical "dividend stripping" transaction involved buying a stock shortly before the ex-dividend date and selling shortly thereafter. An active dividend-stripping program would typically involve 20 consecutive trades per year and would result in the generation of high after-tax rates of return.

In 1958, Congress thought that it had sufficiently discouraged tax-motivated dividend stripping by applying a 16-day holding period requirement. In 1984, the conference committee opted to increase the 16-day holding period to 46 days, half the period between the typical quarterly ex-dividend dates. It was concluded that the longer holding period would increase the risks associated with a dividend-stripping strategy and reduce the number of such transactions that a taxpayer could do during a year from a maximum of 22 (365 divided by 16) to a maximum of 7 (365 divided by 46). Whereas it was observed that it was doubtful that these changes would completely eliminate dividend-stripping strategies, the changes would keep it within tolerable levels.

Congress effectively had a two-fold agenda, to increase the shareholder's degree of market risk so as to discourage dividend stripping and to limit the opportunities for engaging in a dividend-stripping strategy. In light of the Congressional objective, within a somewhat unique economic context, it is questionable as to whether the logic of the 46-day holding period in the DRD context is sufficiently applicable to the OPIS context so as to provide a benchmark for establishing a requisite holding period for the DB stock investment.

In the Taxpayer Relief Act of 1997 ("TRA 97"), the DRD holding period logic was applied in the context of entitlement to foreign tax credits. Before TRA 97, although prior law imposed a holding period requirement for dividends-received deduction, there was no similar stock holding period requirement for claiming a foreign tax credit with respect to dividends. Consequently, it was possible for persons to engage in tax-motivated transactions designed to transfer foreign tax credits from those who could not benefit from the credit to those who could. In the Joint Committee on Taxation's General Explanation of Tax Legislation Enacted in 1997 ("Blue Book") it was noted that these tax-motivated transactions sometimes involved a short-term transfer of ownership of dividend-paying shares.

TRA 97 adds new Code Section 901(k) which denies a shareholder the foreign tax credits normally available with respect to a dividend for a corporation if the shareholder has not held the stock for a minimum period during which it is not protected from risk of loss. Under Code Section 901(k), the minimum holding period for dividends on common stock is 16 days, the pre-1984 DRD holding period. Where the holding period requirement is not met, the foreign tax credits for the foreign withholding taxes are disallowed (however a deduction for the foreign taxes paid is allowed).

As to protection against risk of loss, any period during which the shareholder has protected itself from risk of loss (under the rules of Code Section 246(c)(4)) is disregarded. The example contained in the Blue Book assumes that a taxpayer buys common stock and the day after the stock is purchased the taxpayer enters into an equity swap under which the taxpayer is entitled to receive payments *equal to* the losses on the stock. Referencing Treas. Reg. Section 1.246-3(d)(2), it was concluded that the taxpayer

kpmg Peat Marwick LLP

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OPIS Files
Silicon Valley
February 6, 2002

had protected itself against risk of loss. Generally, Code Section 246(c)(4) provides that the holding period of stock, for purposes of the DRD, is reduced for periods where the taxpayer (1) has an option to sell, (2) is under a contractual obligation to sell, (3) has made (and not closed) a short sale, or (4) is the grantor of an option (other than a "qualified covered call option") to buy substantially identical stock or securities.

Treas. Reg. Section 1.246-5(c)(2) provides that an option to sell (a put) that is significantly out of the money does not diminish the taxpayer's risk of loss on its stock unless that option is held as part of a strategy to substantially offset changes in the fair market value of the stock. The put option purchased by the Cayman entity has a strike price which is 10% out of the money. This would be the equivalent to being two benchmarks, or significantly out of the money as the term is used in Treas. Reg. Section 1.246-5(c)(2). Generally, a "qualified covered call" is a listed option that is granted more than 30 days prior to its expiration and is not "deep-in-the-money". Generally, an option is not deep-in-the-money if its strike price is not less than the highest available strike price below the closing stock price on the day preceding the sale of the option. *See* Code Section 1092(c)(4). The call options written by the Cayman entity are initially written at a price which was 5% in the money. The price of the call option is equivalent to being one benchmark in the money, (i.e., not deep in the money) *See* Code Section 1092(c)(4)(C). Accordingly, the Cayman entity should not diminish its risk of loss to the degree described in the DRD rules.

Conclusion

Based upon how the DRD holding period rules have been applied in the foreign tax credit context, we now believe that there is sufficient analogous authority to conclude that for U.S. federal income tax purposes the requisite holding period for the Cayman entity's DB stock could be reduced from 46 days to as little as 16 days.

As noted, Presidio and DBS have informed us that the Cayman entity can best maximize its expected investment return by allowing the selection of a unique holding period for each OPIS structure. The use of a range would effectively best balance the pricing of the options and derivatives used by the Cayman entity relative to its expected returns from its DB stock and option positions. In that we have concluded that the holding period benchmark could be reduced to 16 days for tax purposes, we believe that Presidio and DBS should use a range of 21 to 60 days as the holding period benchmark so as to be in a better position to enhance the investment return potential of the Cayman entity.

We have discussed our conclusions with the Brown & Wood attorney that is responsible for the Brown & Wood concurring opinion on the OPIS strategy, R. J. Ruble. He agrees with our conclusion and prefers the use of a range for the holding period because it better differentiates each OPIS investment.

Culley, Nancy K

From:	Jeffrey_C _Zysik@meomexc07 (Jeffrey C. Zysik) [Jeffrey_C._Zysik@meomexc07]
Posted At:	Wednesday, March 24, 1999 7.51 PM
Conversation:	OPIS, 318, and use of US Partnerships
Posted To:	PFP CaTS
Subject:	OPIS, 318, and use of US Partnerships

318_MEMO.DOC

____________________ Reply Separator ____________________ Subject: CATS
Author: B. Michael Watkins at KPMG_PHILADELPHIA Date: 4/1/98 5:47 PM

AN ISSUE THAT SEEMS TO BE EXPANDING IS THE ABILITY TO USE A PARTNERSHIP AS THE US INVESTOR IN AN 'OPIS' TYPE STRATEGY.A QUESTION I HAVE IS WHETHER THERE ARE ANY RESTRICTIONS ON WHO THE 'PARTNERS'MAY BE ,DO THEY HAVE TO HAVE SOME SPECIFIC RELATIONSHIP WITH THE OTHER 'PARTNERS'AND DO WE SUBJECT OURSELVES TO ANY HIGHER STANDARDS AS A RESULT OF FORMING A NEW PARTNERSIP AMONG A DIVERSE GROUP OF INVESTORS?

WE NEED TO MAKE SURE WE ARE ON SOLID GROUND WITH DPP BEFORE WE OPEN WHAT APPEARS TO BE A SUBSTANTIONAL FLOODGATE OF ADDITIONAL OPPORTUNITY.

APPRECIATE ANY THOUGHTS OR AUTHORITIES YOU MAY HAVE.THANKS.

GREGG RITCHIE REPLIES:

See attached memo. There does not need to be a relationship between the partners since the 318 test is made at the partner level. We should probably make sure that the entire practice knows about this (although, as I recall, we talked about it in Dallas). Let's post the memo to KMAN.

SEE ATTACHED MEMO.

KPMG Peat Marwick LLP

PFP

To Gil Bloom
WNT

Date February 11, 1998

From Randall S. Bickham
Palo Alto

Steno ft
Ref c:\data\bloom.doc

cc Gregg Ritchie

Section 318 Attribution

Assumptions: Partner 1 and Partner 2 have a 60% and a 40% interest, respectively, in a LLC which is treated as a partnership for U.S. tax purposes. The partnership ("Partnership") holds a warrant entitling it to acquire 90% of the outstanding stock of a Cayman corporation. The Cayman corporation owns 100 shares of common stock in a foreign corporation. There is a redemption of the 100 shares of foreign corporation stock and simultaneous with the redemption Partner 1 and Partner 2 purchase 100 shares of foreign bank common stock, 60 and 40 respectively.

Conclusions: Code Section 302 governs the treatment of amounts received by a shareholder from a corporation in redemption of the corporation's stock. Code Section 302(a) provides that a redemption by a corporation of its own stock will be treated as a distribution in part or full payment in exchange for such stock if Code Section 302(b) applies. Otherwise, if the redemption fails to meet such tests, Code Section 302(d) provides that such redemption is treated as a distribution of property to which Code Section 301 applies.

In light of the simultaneous purchases of the foreign corporation stock by Partner 1 and Partner 2, the redemption will be accorded dividend treatment under Code Section 301 as a result of the application the Code Section 318 attribution rules.

Cayman corporation's deemed ownership under the attribution rules will arise as follows. Code Section 318(a)(4) will cause the warrant to be deemed exercised. Hence, Partnership will be deemed to own 90% of Cayman corporation. Under Code Section 318(a)(3)(C), a corporation is deemed to own all stock owned directly or indirectly by any person that owns 50% or more of the value of its stock. Accordingly, because Partnership is deemed to own more than 50% of the shares of Cayman corporation through Partnership's warrant in Cayman corporation under Code Section 318(a)(4), Cayman corporation is deemed to own all foreign corporation shares that are deemed to be owned by Partnership. Per Code Section 318(a)(3)(a), a partnership is deemed to own stock owned by a partner in the partnership. Accordingly, the foreign corporation shares held by Partner 1 and Partner 2 are deemed to be owned by Partnership and, as a consequence, by Cayman corporation.

Consequently, based upon an application of the Code Section 318 attribution rules, after the redemption of its foreign corporation shares Cayman corporation will be deemed to own at least as many foreign corporation shares as it owned before the redemption. Therefore, the redemption of Cayman corporation's foreign corporation shares should not qualify under Code Section 302(b)(3) as a complete termination of Cayman corporation's interest in foreign corporation or as a substantially disproportionate redemption under Code Section 302(b)(2).

Under the Code Section 318 analysis discussed above, after the redemption Cayman corporation should be considered to own the same number of foreign corporation shares as it owned prior to the redemption. However, after the redemption Cayman corporation owned no foreign corporation shares directly. Moreover, because the redemption of Cayman corporation's foreign corporation shares should be treated as a distribution of a dividend for U.S. Federal income tax purposes, Cayman corporation's basis in those shares will not be recovered as would have been the result in a sale or exchange. Consequently, this basis should be accounted for in some equitable manner.

Treas. Reg. Section 1.302-2(c) provides that when stock is redeemed in a transaction which is characterized as a deemed distribution, proper adjustment of the basis of the remaining stock will be made with respect to the stock redeemed. Generally, where a shareholder has a portion of his shares redeemed and the redemption does not qualify for exchange treatment, the basis of the shares surrendered is added to the basis of the remaining shares. Where a shareholder surrenders all of his shares, but dividend treatment is still accorded as a result of the Code Section 318 attribution rules, such basis should be transferred to the shares of the related party whose attributive ownership caused the redemption to fail to qualify as an exchange. Accordingly, the basis should be allocated 60% to Partner 1 and 40% to Partner 2.

Example (2) of Treas. Reg. Section 1.302-2(c) indicates that the basis of the surrendered stock is allocated to the person whose stock was attributed to the distributee. In the example, Husband and Wife each owned 50% of the stock of Corporation. Husband's entire direct holding is redeemed by Corporation in a deemed distribution and the basis of Husband's redeemed shares is added to Wife's basis in her shares of Corporation. The regulation, as illustrated in Example 2, conveys the principle that the otherwise "disappearing basis" in such situations should shift to the stock held by the other shareholder(s) whose stock ownership in the redeeming corporation, through the operation of Code Section 318, caused the redemption to fail exchange treatment under Code Section 302(b).

Issue:

1. In applying the Code Section 318 attribution rules, it is not necessary for each Partner to have a 50% interest in Partnership in order to achieve dividend treatment under Code Section 302 in that the Partnership is treated as an entity for purposes of satisfying the 50% or more threshold.

2. In order to avoid application of the partnership anti-abuse rules, Partnership should have other activities apart from being merely the warrant holder, e.g. participating in other portfolio trades.

new

From: Richard J. Solway
Sent: Tuesday, April 14, 1998 1:44 PM
To: Larry DeLap
Subject: Re: OPIS examples & a structuring idea

Larry, FYI, I'm not there on the OPIS structure and have suggested to Gregg that it be presented to you and the committee in total, as I'm not at a more likely than not level. In addition, I'm in a very awkward position as a member of FCS and a reviewer; I can certainly deal with this objectively, but at a certain point Walter and Gregg are going to get very annoyed with my "conservatism." Plain and simple, the stated business rationale for OPIS, to leverage an equity investment further than is possible through a U.S. entity, is contradicted by the very limited risk/reward profile of the partnership's investment when taking into account the puts and calls.

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Author: Gregg W. Ritchie at KPMG_WARNER_CENTER
Date: 4/14/98 1:25 PM

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Author: Richard J. Solway at KPMG_NYO_FinServ
Date: 4/13/98 7:34 PM

G & R,

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Best regards, Rick

Page 3
Ms. Terry Hesseling
First Union National Bank
April 28, 1998

Correspondence Quality Review/ Routing Stamp

Signoff:	Name (print)	Initial	Date
Preparer:			
Reviewer:			
Partner:	G. RITCHIE		4/28/98
Signed by:			
No Review Required:			
Mailed by:			
Mailed via (US Mail, Fed Ex, etc.):			

Copies to: **(if not cc on correspondence face)**
Assurance Partner/Mgr: see letter
Tax Partner/Mgr:
Perf. Imp. Partner/Mgr:
Designated Reviewing Partners:
Local office (if any):
Nat'l Director/Office:
State Specialist/Office:
Other (specify):
Files:
Correspondence: CATS
Other (specify):

Index for PLS Electronic Search and Retrieval? Yes ___ No ✓
File location (folder or path) and name:
p:\users\gritchie\wp\cats\flip\frstunon.doc

Tax: Are there IRC §6662 issues? Yes ___ No ✓
If YES, document resolution:

KPMG 0047343

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #94q

KPMG Peat Marwick LLP

21700 Oxnard Street, Suite 1200
Woodland Hills, CA 91367
Telephone 818 227 6900
Telefax 818 702 0602

April 28, 1998

PRIVATE & CONFIDENTIAL
Ms. Terry Hesseling
CMG Personal Financial Consulting Group
First Union National Bank
NC1159
Two First Union Center
Charlotte, North Carolina 28288-1159

Dear Ms. Hesseling:

We are writing in order to memorialize the discussions you have had over the past several months with certain partners and managers at KPMG Peat Marwick LLP relating to an investment strategy designed by KPMG known as the Foreign Leveraged Investment Program (the "strategy"). As you know, several customers of First Union National Bank executed this investment strategy during 1997 with the assistance of Quadra Capital Advisors (the investment advisor). KPMG was hired by these customers to provide tax consultation services related to the strategy and to write a tax opinion letter.

In early October, 1997, KPMG made the decision to stop providing tax consultation services in connection with the strategy. At that time, KPMG informed you (and others within the CMG Personal Financial Consulting Group) of our decision and indicated that we would not be willing to continue to write tax opinion letters with respect to the strategy. This decision does not impact any of the clients who engaged us to provide such services in 1997.

We are aware that Quadra and, perhaps, other professional services firms are continuing to market the investment strategy (or a derivation thereof). We are also aware that the CMG team at First Union is continuing to present the strategy to your customers. You should be aware that KPMG will continue to decline to provide tax consultation and/or opinion writing services to any new or prospective clients with respect to this strategy. Furthermore, the KPMG Peat Marwick LLP name should not be associated with any marketing of the strategy which is undertaken by First Union employees.

We value the relationship that we have been able to build between our organizations and look forward to having the opportunity to continue to provide First Union customers

KPMG Peat Marwick LLP

Page 2
Ms. Terry Hesseling
First Union National Bank
April 28, 1998

with innovative and valuable strategies. If you should have any questions regarding this matter, please do not hesitate to contact me at (818)227-6905. I look forward to meeting you in person.

Very truly yours,

KPMG Peat Marwick LLP

Gregg W. Ritchie
Partner In Charge
Capital Transaction Strategies

cc: Mr. Jerry Licari, KPMG
Ms. Diane Stanford
Mr. Daniel Prickett

Author: Larry DeLap at KPMG_Silicon_Valley2
'ate: 4/28/98 5:34 PM
riority: Normal
Receipt Requested
TO: Gregg W. Ritchie at KPMG_Warner_Center
CC: Gilbert D. Bloom at KPMG_WNT
CC: Paul S. Lowry at KPMG_Boston
CC: Richard J. Solway at KPMG_NYO_FinServ
CC: Douglas K. Ammerman at KPMG_Orange_County
CC: Douglas J. Green at KPMG_NSS_Park
BCC: Larry DeLap at KPMG_Silicon_Valley2
BCC: Catherine Gaughan at KPMG_EO_599_Lex
BCC: James Wetzold at KPMG_EO_599_Lex
BCC: John T. Lanning at KPMG_NSS_Park
Subject: OPIS

------------------------------------ Message Contents ------------------------------------

Gregg -

As indicated in my voicemail, the tax advantaged transactions review board (sans Bloom) had another conference call this morning on the proposed OPIS product. The following summarizes the current position.

We believe a threshold issue is whether the investor has a reasonable expectation of a reasonable profit. The members of the review board do not necessarily agree on exactly what that means. However, we do agree that the expectation must be that of the investor. We also agree that the "reasonable profit" that is reasonably expected should take into account the risk involved. That is, the investor must reasonably expect a reasonable profit well above what he could achieve through a treasury bill investment. The presentation by Presidio on the investment aspects of the product should look at projections, based on the then current economic environment, and not just at hypothetical returns that could have been achieved in 1997. Beyond that, we believe that the investor should be advised in the engagement letter that he should seek independent advice as to the investment aspects of the transaction. This would highlight that the investor must consider more than just the hoped for tax benefits.

I still haven't heard from Smith/Wiesner/Kelliher on the section 465 issue. I have left messages for Smith and Wiesner to call me. It is imperative that we receive confirmation directly from those gentlemen that they are in agreement with the more-likely-than-not "at risk" write-up in the draft opinion letter.

The issue on Rev. Rul. 82-150 and the "swap" agreement with Limited Partner is more than just a matter of cleaning up the draft opinion letter later. We need to see a more convincing argument as to why the "swap" agreement doesn't convey sufficient benefits and burdens of ownership to cause the investor to have a direct ownership interest in Foreign LP.

Similarly, we need a better buttressed argument for the position that the loan from the bank to General Partner would not (or could not) be treated as an equity interest. Although you indicate, "The loan is made at arms length commercially reasonable terms", it seems to me unlikely a bank would make a loan in the ordinary course of business to a thinly capitalized entity with no assets other than assets acquired with the [illegible] a guarantee from, e.g., a substantial shareholder, but you indicate there are no guarantees in place).

As we discussed, you will complete a Level One Alliance form and forward to John Lanning and me for review.

As we also discussed, assuming the above hurdles are cleared, the transaction will be registered (by either Presidio or KPMG) as a tax shelter and the tax shelter registration number disclosed to investors.

If the product moves forward, we will need a tight engagement letter that, among other things, points out the investment and tax risks of the investment. If you have a preliminary draft of an engagement letter you would propose to use, please send to me. As we discussed, such an engagement letter should provide for the payment of our fee directly to us by the investor. About half the states (including California) prohibit commissions and referral fees (even from nonaudit clients) and I am concerned that receipt of our fee from a source other than the investor could be construed as a commission or referral fee.

Larry

Permanent Subcommittee on Investigations
EXHIBIT #94s

OPIS

Offshore Portfolio Investment Strategy Overview

June 1998

Summary of Key Presentation Points

- What is CaTS?
  - » Dedicated group within PFP with a charter of developing and marketing M&A products to high-wealth individuals
- Is OPIS a good fit relative to Investor's needs and risk profile?
  - » Overview of the technical considerations
  - » Discussion of business purpose doctrine
    - – "Reasonable expectation of reasonable profit" threshold requirement
    - – Impact of recent <u>ACM Partnership</u> case

Summary of Key Presentation Points

- The Seagrams/Dupont deal
  - » Amounts involved - $8.8 billion transaction/ Tax savings from strategy - $1.5 billion
  - » The need for Congressional action v. the IRS being able to litigate the issue
- Overview of the OPIS structure
  - » How attribution flows based upon Reg. Section 1.302-2(c)-Example 2
  - » Description of the OPIS structure and its key tax constructs

Technical Analysis

- How strong is the technical case under applicable law?
  - » Most tax products are based on a clever application of the tax rules in a situation in which they were *not* intended to apply
- Applicability of judicial doctrines that are intended to combat tax abuses?
  - » Business purpose/ Economic substance
- Risk of Penalties being applied?
  - » Importance of KPMG/B&W tax opinions

Technical Merits

- OPIS is a clever application of the 302 rules in a context that was *not* intended
- Our Opinion is technically solid
  - » DPP Opinion Committee review - *3 months*
  - » B&W concurring opinion
- What is the importance of Opinions?
  - » To avoid penalty exposure as provided for under the penalty regulation sections
  - » Individuals require "more likely than not" opinions to avoid Section 6662 penalties

Anti-Abuse Provisions
Judicial Doctrines

- Business purpose/ Sham transaction/ Economic substance/ ACM analysis
  |
- Step transaction
- Substance over form/ Agency
- <u>Section 269</u> - Use of controlled corporations to obtain tax benefits
- <u>Section 446(b)</u> - Clear reflection of income

Business Purpose/Economic Substance/ Sham Transaction

- Transactions are most subject to challenge if there is little or no pre-tax benefit - If taxpayer has no *meaningful opportunity* to earn a pre-tax profit
  - » Transaction will not be recognized if it has no business purpose other than avoiding federal taxes
- Transactions with tax benefits always have less favorable pre-tax yields
  - » No court has ever held that tax benefits cannot be considered when evaluating a transaction

Business Purpose/Economic Substance/ Sham Transaction

- An investment transaction where there is a ***reasonable expectation*** of earning a ***reasonable pre-tax profit*** should be respected - <u>even if transaction is principally tax motivated</u>

- No court has defined what constitutes a ***reasonable profit opportunity***
  - » 2% is generally thought sufficient and below 1% *de minimis* by tax community
  - » Capital market theory, however, suggests return should be commensurate with risks

ACM Partnership v. Comm.
T.C. Memo 1997-115 (1997)

- ACM had a clear *overall* business purpose, but an integral component of the construct was tax-motivated
  - » Court focused on the tax-motivated element and concluded that partnership had no valid business purpose and no realistic opportunity for a economic profit

- Court effectively held that the overall business purpose and economic substance of the transaction will not protect the tax-motivated element that is clearly severable

ACM Partnership v. Comm.

- Partners contributed $205 million used to purchase private placement Citicorp notes.
  - » Partner's relative partnership interests:
    - –ABN subsidiary (Kannex) - 83%
    - –Colgate subsidiary (Southampton) - 17%
    - –Merrill Lynch - less than 1% interest
- 3 weeks later, ACM sold Citicorp notes to third parties on the installment method
  - » $140 million in cash
  - » $35 million in 20 quarterly installments indexed to LIBOR ("LIBOR Notes")

ACM Partnership v. Comm.

- Under Temp. Reg. 15A.453-1(c)(3), when installment sale has contingent payments with no maximum selling price, but receivable over a fixed time period, basis is recovered ratably over the fixed time period:
  - » ACM recovered 1/6 of the basis ($29 million) in year of sale
  - » ACM recognized $111 million gain - allocated $92 million to Kannex & $19 million to Southampton
  - » ACM then had $146 million basis in the 20 LIBOR Notes with a value of $35 million
  - » ACM distributed to Southampton LIBOR Notes having a basis of $42 million as a return of capital which were sold at a $32 million loss

ACM Partnership v. Comm.

- ***Business purpose*** - ACM used the cash from the sale to purchase Colgate debt in the market off-balance sheet
- Colgate asserted that the LIBOR Notes functioned as a hedge against the Colgate debt held by ACM Partnership
- 2 years later, Colgate bought 50% of Kannex's ACM interest, ACM then redeemed the remaining 50% interest
- ACM sold the remaining LIBOR Notes recognizing a significant economic loss and a much larger tax loss

ACM Partnership v. Comm.

- Court found that the proceeds from the sale of the LIBOR notes exceeded the the costs of the investment by $5.4 million, a pre-tax return of 4.7%
  - » "*The taxpayer desired to take advantage of a loss that was not economically inherent in the object of the sale, but which the taxpayer created artificially through the manipulation and abuse of the tax laws. A taxpayer is not entitled to recognize a phantom loss from a transaction that lacks economic substance.*"

ACM Partnership v. Comm.

- Specifically the court held the following:
  - » the transaction lacked economic substance because Colgate had no realistic chance of realizing an economic pre-tax profit
  - » *the purchase and sale of the Citicorp notes for the LIBOR notes had no business purpose other than tax avoidance*
  - » the LIBOR Notes provided no effective risk management function
    - – *"nothing other than an elaborate tax avoidance scheme that had no economic substance"*
    - – *"there was no genuine expectation of anyone's part that they would"*

ACM Partnership v. Comm.

- Business purpose/ Economic substance
  - » Are there two independent tests or does economic analysis validate taxpayer's business purpose?
  - » ACM's business purpose for buying and selling Citicorp and LIBOR Notes as a hedge of Colgate debt was illogical
  - » Court observed that ACM acquired the LIBOR Notes for $1.3 million more than they could be resold to third party
    - – Interest rates would have to rise by 400-500 basis points for several years to make economic profit

Section 6662 Penalties

- TRA 1997 changed the definition of tax shelter to any entity, plan, or arrangement if a ***significant*** (v. principal) purpose is avoidance federal income tax
- A noncorporate taxpayer can avoid 6662 penalties for a tax shelter item by showing:
  - » substantial authority existed for the tax treatment; *and*
  - » taxpayer reasonably believed that the tax treatment was "more likely than not" the proper treatment - (tax opinion satisfies)
    - – However, tax opinion is not *per se* a guarantee that taxpayer had a reasonable belief...

Seagrams/ Dupont Strategy
Genesis for OPIS

- Bronfman wanted to monetize Seagrams 24% interest in Dupont (164.2 million shares) to invest in MCA.
- Dupont redeemed 156 million shares in exchange for $8.3 billion in cash & notes and *156 million in warrants worth $440 million*
  - » Warrants were out of the money, of value if Dupont stock appreciated 15% annually
  - » $6.0 billion gain x 35%= **$2.1 billion** v.
  - » $8.8 billion dividend x 7%= **$615 million**
- Reported in NYT & WSJ in May 1995 and legislation was introduced shortly thereafter

Section 318 Attribution

- Reg. Section 1.302-2(c)-Example 2
  - » H and W each own 50% of Corporation
  - » Stock purchased by H for $100 and 50% gifted to W
  - » H is paid $150 in redemption of his 50% interest
  - » 318 attribution results in dividend treatment
  - » H's $50 in unused basis is transferred to W
    - –W's new basis amount is $100
- OPIS is based upon same ***simple*** logic using option attribution in lieu of H&W attribution

What is OPIS?

- OPIS is an integrated investment strategy that is based upon an Investor taking a highly leveraged bullish position in Foreign Bank ("FB") securities over a 49 day period
  - » Direct purchase of FB stock and option
  - » Indirect purchase of return on FB securities - Swap & Option
- Investment Analysis provides Investor should have a "reasonable expectation of making a reasonable profit" on investment strategy
  - » Accordingly, the associated expectation of product cost is not 7%, but a profit with significant upside and a 7% downside

Summary of Investor Cash Flows

- Invests directly in FB stock and options - **5%**
- Enters into a swap with LP - **5.5%**
  - » Reference security is Cayman PS with payments equating to 90% of the returns earned by Cayman
- Purchase option from LP in GP
  - » Cost of the option - **.25%/** Exercise price - **.50%**
- Direct payment to Presidio - **1.25%**
- Purchase "day 49" call options - **1%**

Cayman Investments

- Purchases long position in FB stock equal to the amount of capital gain being sheltered
- Purchases European-style put options on 100% of position @ strike price of **90**
- ~~Purchases~~ Sells European-style call options on 90% of position @ strike price of **95**
  - » If stock trades below strike price, option is replaced by an option with a strike price of **91**-*significant impact on profitability*
- Embedded in call option is Asian derivative
  - » Return is based on the average closing price relative to pre-established benchmark

... of profit:

» Asian derivative

» 10% position not covered by the call option

» Redemption @ 95 v. 90

» Call right premium on barrier option net of payment for put option

- Optimal scenario is one where there ... significant increase in the aver... price during the 49 day tr... high price point on ...

[redacted]

KPMG 0002021

Author: Gregg W. Ritchie at KPMG_Warner_Center
Date: 6/4/1998 10:41 PM
Priority: Urgent
TO: Jeffrey A. Eischeid at KPMG_Atlanta2
TO: Tracie K. Henderson at KPMG_Atlanta2
TO: Dale R. Baumann at KPMG_WNT
TO: Neil J. Tendler at KPMG_Short_Hills
TO: B. Michael Watkins at KPMG_Philadelphia
TO: John H Gardner at KPMG_WNT
TO: Timothy P. Speiss at KPMG_Philadelphia
TO: Richard J. Bloom at KPMG_Princeton
TO: Deke G. Carbo at KPMG_New_Orleans
TO: Mark Watson at KPMG_Dallas
TO: David P. Zaudtke at KPMG_Minneapolis
TO: Robert A. Pedersen at KPMG_Chicago
TO: Robert M. Jordan at KPMG_St_Louis
TO: Randall S Bickham at KPMG_Palo_Alto
TO: Robin M. Paule at KPMG_Warner_Center
TO: John M Nuckolls at KPMG_San_Francisco
TO: Shannon L Liston at KPMG_San_Francisco
TO: Harvey L. Armstrong at KPMG_San_Jose
TO: Jeffrey Zysik at KPMG_WNT
CC: Douglas K. Ammerman at KPMG_Orange_County
CC: Dennis A. Ito at KPMG_San_Francisco
CC: William J. Goldberg at KPMG_Houston
CC: Carolyn B. Branan at KPMG_Charlotte
Subject: OPIS

---------------------------- Message Contents ----------------------------

I am pleased to tell you that the technical conclusions of the OPIS product have been approved by DPP Tax. The strategy has been approved based on virtually the same facts we presented to you in our technical session on April 20th. I plan to hold a 1 hour conference call next week to remind all of us of the details of the strategy and key points that we must communicate to prospective investors. I encourage you to review the material that Randy gave you at our meeting in Dallas prior to making contact with clients.

Jeff Zysik has led the effort in making our case for NOT registering the product as a tax shelter. Based on a memo prepared by Mark Ely, Eve Elgin, and Jeff Z, I expect that Larry will agree that the product does not meet the requirements of section 6111 relative to its registration. Assuming this news comes tomorrow, we should be immediately able to begin our marketing efforts.

The product tool kit is almost ready to go. I am working with Larry on the final touches of our engagement letter. You should note that Larry's current thinking is that all engagement letters must be sent to him for approval prior to execution by clients. I will post the new engagement letter on KMAN as soon as it is ready. We must not vary from the language in the sample letter (especially with respect to indemnification, etc) without advance approval from DPP.

You should also note the newest version of the Nondisclosure Agreement which will be posted on KMAN this weekend. You must ensure that all clients and targets execute this agreement prior to presenting the strategy to them. Furthermore, while we will, under limited circumstances, allow outside advisors to participate in reviewing the strategy, you should only do so with my or Randy Bickham's advance approval. If you believe this will be required for the client to execute the strategy, we will make a business decision relative to the specific individual and/or Firm involved. As a general rule, we should strenuously resist sharing this strategy with outside advisors. I am certain that we have a short time frame to market this strategy before legislation will be effective to shut it down. Accordingly, the less publicity, the longer the strategy may be available.

Presidio is meeting next week in New York with Brown & Wood to finalize the legal documents required to execute the strategy. I will let you know when they are ready to receive wire transfers from clients who want to open the trading strategy. We have indicated to DPP that each client will receive an analysis of the investment results expected given anticipated price increases BEFORE the client engages us. In general, client presentations should be coordinated with Presidio so that they may hear the investment strategy from them in the initial visit. John Larson and Kerry Moskalik have each of your names and will only respond to you for client visits (not other KPMG partners/employees). We need your help to keep control of the distribution of this strategy.

Several of you have asked whether it is appropriate for us to consider the payment of a referral fee with respect to the strategy. Per my conversation with Larry DeLap, referral fees are to be discouraged, but may be considered in exceptional cases. Any such fees which are contemplated must be approved in advance. Please send me a message with the facts and reasons why you believe such a fee would be in our best interests and the amount of the proposed fee. I will discuss it with you and DeLap to determine if we should make an exception.

I want to again acknowledge the exceptional efforts that Randy Bickham made in order to make this product a reality. The strategy was in the morgue and Randy, through his exceptional technical and writing skills and determination brought it back to life. Jeff Zysik has also played a critical role in bringing the resources of WNT and the TIC to bear on this product. Many thanks to Jeff for all of your efforts.

I know that I have forgotten something important in this message. I would appreciate your immediate attention to reviving the contacts you have made over the last few months and putting this product into our clients hands.

One final note of interest. Quadra Capital Advisors signed our confidentiality agreement today and will be presenting some of their proprietary strategies to us in the next few days.

From: Christopher Hirata
Sent: Tuesday, June 16, 1998 3:23 PM
To: 'Collins, Jeffrey S.'
Subject: RE: tax opinions

Jeff,

Please send the invoices to the Cayman companies care of their administrator, BankAmerica at:

BankAmerica Trust & Banking Corporation (Cayman) Limited
P.O. Box 1092
Fort Street
Grand Cayman, Cayman Islands
British West Indies

In addition, please send a copy of the invoices to me. At that point, the companies will remit payment for the invoices, or Quadra will rebate a portion of the advisorv fees we collected to cover the legal expenses.

I hope this answers your questions. If you need further clarification, please give me a call.

Regards,

Chris

-----Original Message-----
From: Collins, Jeffrey S. [SMTP:Collins_JS@pillsburylaw.com]
Sent: Tuesday, June 16, 1998 12:03 PM
To: 'chrish@qcm.com'
Subject: tax opinions

Chris: Per our conversation, I am sending out the revised tax opinions to Seattle today. With respect to the invoices we are sending to BankAmerica, we need to know some additional information -- ie, to whom the invoices should be sent, and what paperwork we need to complete. Can you please run this by Norm, or let me know whether we should talk to Norm or David Smith regarding these BankAmerica invoices? Thanks.

Permanent Subcommittee on Investigations
EXHIBIT #94u

QLS004562

KPMG Peat Marwick LLP

Personal Financial Planning

To CaTS Team

Date June 17, 1998

From Gregg W. Ritchie
Warner Center

Steno cas
Ref p:\users\gritchie\wp\cats\jun11fu.doc

cc Larry DeLap
Mountain View

June 11 OPIS Conference Call

The CaTS team held a conference call on June 11th to discuss several items associated with the OPIS strategy. The following is a list of the items discussed and certain follow-up required.

- *Engagement letter*. Larry DeLap has reviewed a draft of the engagement letter and certain changes are being made. We are still awaiting a response from DeLap and DPP Assurance related to the payment of the KPMG fee (in particular, the payer). Also, DeLap has requested that all engagement letters for OPIS be reviewed by him prior to execution by the client/target. GWR to follow-up with DeLap relative to the payment of our fees.

- *Use of Nondisclosure Agreements*. The standard Nondisclosure Agreement has been posted in the KMAN CaTS Conference in the OPIS file. It must be used in all cases when making a presentation to all clients/targets. Modifications to the agreement should be cleared with GWR or Zysik. Ideally, the agreement will be sent to the client/target in advance of the initial meeting.

  In rare cases, we may present the strategy to a non-public (non audit) client for their consideration. In such case, we should not use a Nondisclosure Agreement. This is due to the potential impact on tax shelter registration under Section 6111(d) and, more importantly, the impact on the corporation's ability to rely on our opinion letter to protect against section 6662 penalties. For further information, see Treas. Reg. 1.6664-4(e)(B)(iii).

- *Referral fees*. While KPMG policy may allow for the payment of referral fees to third parties who identify a target, payment should be discouraged in most cases. Referral fees will not be permitted in any cases where the target is already a KPMG client. As a general rule, the market for referral fees approximates 10% of the total fee paid by a client with respect to a tax strategy. Due to the sensitivity of this issue, proposed referral fees must be submitted to GWR along with a brief description of why the payment is warranted. GWR will clear with DeLap for appropriate cases. Referral fees will never be paid to existing KPMG audit clients. GWR to check with DeLap for additional firmwide guidelines (if any).

- *Presidio capacity*. Due to the long delay in obtaining approval of OPIS, it is likely that Presidio will be unable to immediately meet the client demand. Accordingly, CaTS team members should immediately submit to GWR the name and notional amount of clients/targets who are ready to initiate the strategy. We will consult with Presidio and rank these opportunities by deal size and other relevant criteria. Presidio will make presentations and begin to set up accounts to clients/targets on the basis of this list (i.e., the "Organ Donor" List). CaTS team members must manage the expectations of the clients/targets relative to timing.

- *Outside Advisors*. We should discourage clients/targets from having their incumbent lawyers/CPAs/etc. review the strategy from a technical perspective. This will help to prevent the spread of the strategy to competitors and other advisors who may not protect its confidentiality. Clients/targets may have full access to Brown & Wood should they wish to obtain input from a legal perspective. In those rare cases where the client/target will not proceed with OPIS without technical review by their advisors, CaTS team members should provide the name and affiliation of the advisor to GWR, Watson, or Bickham. In appropriate cases, the advisor may be included in the technical review provided they will execute our Nondisclosure Agreement. *This does not apply to investment advisors who are to provide the client/target with advice concerning the investment aspects of the strategy. Clients/targets are to be encouraged to seek such advice from outside investment advisors.*

- *Presidio involvement and analysis*. To the extent possible, a representative from Presidio Advisors should be invited to attend every initial client visit. In some cases, this will not be possible. It is appropriate for KPMG personnel to be involved in the initial client meetings without Presidio, provided that no investment is made prior to the client/target meeting with Presidio. Furthermore, Presidio will provide to clients/targets an analysis of the expected profit from the investment transactions given the expected price movement of the stock *prior to the client/target's investment.*

- *Tax Shelter registration*. The Firm has concluded that OPIS does not meet the definition of a tax shelter and, therefore, registration is not required under IRC section 6111(c). Any further inquiries on this subject should be referred to GWR.

- *Legal documents*. Presidio is working with Brown & Wood and other lawyers in the drafting of the required legal documents. Furthermore, they are in the process of working with Deutche Bank (and their outside counsel) in drafting the required loan documents. Presidio has indicated they expect the drafting process to be completed by the third week in June.

- *Reporting Requirements*. Robin Paule has drafted a memorandum concerning the reporting requirements relative to the OPIS investment on Form 5471. We have posted her memorandum to our KMAN conference. This memorandum will be expanded to include any other reporting responsibilities which may be imposed on the client/target. These requirements must be communicated to all clients/targets prior to their execution of the strategy (regardless of whether KPMG is their tax preparer).

- *Substantial underpayment penalties*. Our communication to clients/targets relative to potential substantial underpayment penalties must be accurate and consistent. Zysik and Bickham to review the provisions of Treasury Reg. 1.6662-4 and prepare a brief memorandum describing the use of our tax opinion letter to provide protection from penalties. This memorandum will be posted to our KMAN conference. For additional information concerning penalties, consult the materials concerning the tax opinion letter product that can be found in the Penalty Opinion Letters folder in KMAN (Services/Tax Services/Tax Hot Products/Tax Planning Strategies).

- *Prospective legislation*. It is possible that legislation will be enacted which will significantly impact or eliminate OPIS. John Gardner to coordinate the evaluation of the status of the legislation proposed by the Administration earlier this year and keep the team informed. In the event that there were a change in the tax law (or other relevant authority) which rendered the strategy ineffective and a client/target had not completed the strategy, it is unclear whether KPMG would be able to refund some or all of the fees paid by the client. GWR to follow-up with DeLap to see if such action would violate the rules relative to contingent fees. In any case, clients/targets must be informed in all initial client visits that the law in this area can change at any time and may have a severe impact on the strategy.

- *Face-to-face meetings*. The team agreed that all meetings with clients/targets related to OPIS will take place in person. There will be no meetings undertaken by telephone.

- *Representation letters.* To offer any protection to a client, as a pre-requisite, a tax opinion must (1) consider all facts and circumstances and (2) not be based upon unreasonable factual or legal assumptions. So that these preliminary requirements may be met, clients will be asked to sign a letter indicating their agreement with the facts stated in the opinion. Furthermore, they will be asked to sign a letter making certain representations to KPMG on which we will rely, in part, in reaching our conclusions. Clients/targets must be made aware of this requirement in all initial client visits (it will also be disclosed in the engagement letter).

- *KPMG tax opinion letter.* The tax opinion letter for each client will be prepared immediately following the execution of the strategy. The draft opinion letter will be forwarded to the engagement team which executed the strategy and they will modify it for the client's facts. The engagement team will obtain the client's concurrence with the factual section of the letter and their representation letter. Upon completion, the opinion letter will be forwarded to the technical team (to be named later) for their review. *Sample tax opinion letters will not be made available to clients or their advisors prior to execution of the strategy.*

kpmg Peat Marwick LLP

Personal Financial Planning

To CaTS Team

Date June 17, 1998

From Gregg W. Ritchie
Warner Center

Steno cas
Ref p:\users\gritchie\wp\cats\jun11fu.doc

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kpmg Peat Marwick LLP

Page 3
CaTS Team
February 6, 2002

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- ***Face-to-face meetings.*** The team agreed that all meetings with clients/targets related to OPIS will take place in person. There will be no meetings undertaken by telephone.

- ***Representation letters.*** To support the conclusions of our tax opinion letter, clients will be asked to sign a letter indicating their agreement with the facts stated in the opinion. Furthermore, they will be asked to sign a letter making certain representations to KPMG on which we will rely, in part, in reaching our conclusions. Clients/targets must be made aware of this requirement in all initial client visits (it will also be disclosed in the engagement letter).

- ***KPMG tax opinion letter.*** The tax opinion letter for each client will be prepared immediately following the execution of the strategy. The draft opinion letter will be forwarded to the engagement team which executed the strategy and they will modify it for the client's facts. The engagement team will obtain the client's concurrence with the factual section of the letter and their representation letter. Upon completion, the opinion letter will be forwarded to the technical team (to be named later) for their review. *Sample tax opinion letters will not be made available to clients or their advisors prior to execution of the strategy.*

Author: Deke G. Carbo at KPMG_NEW_ORLEANS
Date: 6/23/98 3:16 PM
Priority: Urgent
TO: Gregg W. Ritchie at KPMG_Warner_Center
TO: William J. Goldberg at KPMG_Houston
CC: William F Miranda at KPMG_DALLAS3
Subject: OPIS

------------------------------ Message Contents ------------------------

Gregg and Bill:

Just wanted to let you know that a client that was introduced to me Bill Miranda of the Dallas office has engaged Coopers to implement its equivalent of an OPIS transaction.

The reason cited for the selection of Coopers was that, although it appeared to the client that the idea originated with KPMG, Coopers was the first to contact them about the strategy and, accordingly, they felt obliged to engage Coopers.

I thought you would both want to know that Coopers appears to have been "faster to market" than us. Client also said that Coopers indicated they were registerinbg as a tax shelter.

While I do not know what size transaction the client will implement, I do recall that the amount of gain contemplated to be recognized in 1998 was $40 to $60 million.

If you want any client details, I suggest you contact Bill Miranda in Dallas as he has the client contact (214) 754-2100.

Deke

new

From:	Larry DeLap at KPMG_Silicon_Valley2
Sent:	Wednesday, August 05, 1998 12:06 PM
To:	Watson, Mark T; Guinan, John M
Cc:	Eischeid, Jeffrey A; Ammerman, Douglas K; Zysik, Jeffrey C
Subject:	OPIS Memo to PFP Partners

Mark -

See my changes attached.

In order to try to make sure we are all on the same page, I would like to seek the "sign off" of John Guinan. If John has any significant changes. Jeff has a number where I can be reached tomorrow evening.

John -

I will be on vacation starting first thing tomorrow morning. Can you please provide any comments directly to Mark Watson. If, after reading the attachment, you believe it would be preferable that you talk to me first, Cathy Gaughan has a phone number where I can be reached. If Cathy should be unavailable, Jim Wetzold and Rachel Hedley also have the number.

Larry

________________________ Forward Header ________________________

Subject: OPIS Memo to PFP Partners
Author: Jeffrey Zysik at KPMG_WNT
Date: 8/5/98 5:40 PM

Gentlemen, attached is the first attempt at a memo to the PFP partners about the status of OPIS and their ability to market and sell OPIS (and other innovative strategies). Please provide me (Mark Watson) your comments at your earliest convenience and I will finalize the memo.

Thanks. . .

Mark Watson (I am using Jeff Zysik's computer)

Permanent Subcommittee on Investigations
EXHIBIT #94x

KPMG Peat Marwick LLP

PFP

To PFP Partners

Date August 5, 1998

From Doug Ammerman
Orange County

Steno jg
Ref c:\pfp\misc\opis.doc

OPIS and Other Innovative Strategies

In an effort to help you meet your FY'99 goals, we have decided to give every PFP *partner* the opportunity to market and sell the Offshore Portfolio Investment Strategy (OPIS) and our other innovative strategies. In order that our innovative strategies can be properly implemented, designated members of the Innovative Strategies team (listed below) will be available to assist you with technical and implementation issues. Also, because of the sensitive nature of many of our innovative strategies, a "product owner" will be designated for certain innovative strategies (e.g., OPIS). This individual will be responsible for monitoring the marketing, selling, and implementation of his or her specific product(s), and must approve, with DPP-Tax concurrence, *all* engagement letters and opinion letters issued for such product(s) *before* the letters are sent to clients/targets and *before* a commitment is made to deliver the product to the client/target. The current product owners for OPIS, and REDACTED are listed below.

In an effort to keep you knowledgeable about our current and new innovative strategies, we will hold periodic video conferences to introduce new strategies and provide a training course on our most popular strategies at the January TMS. In addition, because of the time sensitive nature of OPIS and the apparent confusion associated with this strategy, a discussion of the status of OPIS, and what must be done to market and sell the strategy, follows.

OPIS

The technical issues associated with OPIS have been settled and approved by DPP-Tax. However, the following three issues remain to be settled before OPIS can be sold to additional clients/targets:

- Independence
- Capacity
- Contingent fee

We are working with Presidio to resolve these remaining issues and expect to have a final resolution on or before August 14, 1998. We will communicate such resolution to

KPMG Peat Marwick LLP

Page 2
PFP Partners
February 5, 2002

you as soon as possible. In the meantime, while you can discuss OPIS with your clients/targets that have gains of at least $20 million (subject to their signing a confidentiality agreement), you may not sell or implement the transaction at this time. Also, keep in mind that the transaction takes approximately 90 days to complete. Thus, once we are able to sell and implement OPIS, clients generally must enter into the transaction before October 1, 1998 in order to complete the entire transaction in 1998.

Independence

OPIS involves the purchase of stock in a foreign financial institution. Currently, the only institution participating in the transaction is a KPMG audit client (i.e., the only investment option for the client/target is the stock of an audit client). As a result, DPP-Assurance feels there may be an independence problem associated with our participation in OPIS and has indicated that, in order to solve the independence problem, the client/target must have the option to purchase the stock of at least one nonaudit client. Accordingly, Presidio, the investment advisors who implement OPIS, is working to secure at least one additional financial institution (that is not a KPMG audit client) to participate in OPIS. Until such an institution has been secured, KPMG cannot participate in selling or implementing OPIS.

Capacity

The foreign financial institution currently participating in the OPIS transaction is not able to execute any additional OPIS trades (i.e., the institution has reached its capacity). Thus, until one or more additional foreign financial institutions agree to participate in OPIS, clients/targets will not be able to implement the strategy.

Contingent Fee

In the past, KPMG's fee related to OPIS has been paid by Presidio. According to DPP-Tax, this fee structure may constitute a contingent fee and, as a result, may be a prohibited arrangement if the client/target purchasing OPIS is an audit client or a person in a position of significant influence over an audit client (e.g., the CEO of an audit client or a 20 percent or greater shareholder of an audit client). In addition, contingent fee arrangements are completely prohibited in 19 states. Thus, in order to avoid a contingent fee arrangement (and the problems associated therewith), KPMG's fee must be a *fixed* amount and be paid directly by the client/target. This revised fee arrangement

KPMG Peat Marwick LLP

Page 3
PFP Partners
February 5, 2002

must be used on all future OPIS engagements regardless of the client or the state in which the services are provided. Further, current OPIS engagements that have not been implemented should be renegotiated such that KPMG's fee is fixed and paid directly by the client/target.

Designated Innovative Strategies Team Members

Randy Bickham, *Senior Manager* (Mountain View)
650-404-5385

John Gardner, *Senior Manager* (WNT)
202-467-3870

Brent Lipschultz, *Senior Manager* (WNT)
202-530-6874

Shannon Liston, *Senior Manager* (New Orleans)
504-584-1079

Justin Ransome, *Manager* (WNT)
202-467-3800

Mark Watson, *Partner* (WNT)
202-467-2433

Current Product Owners

OPIS Jeff Eischeid, *Partner* (Atlanta)
404-222-3180

REDACTED

---------------------------- Forwarded with Changes ----------------------------
From: Jeffrey Zysik at KPMG_WNT
Priority: Urgent
Date: 8/5/98 5:40PM
To: Larry DeLap at KPMG_Silicon_Valley2
*To: Douglas K. Ammerman at KPMG_Orange_County
*To: Jeffrey A. Eischeid at KPMG_Atlanta2
Receipt Requested
•Subject: OPIS Memo to FFP Partners

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=21552
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=21552
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: RE: OPIS Memo to PFP Partners
Sent: 1998-08-11 23:08:45.093
Date: 1998-08-11 23:09:03.607
X-Folder: OPIS

FYI.

-----Original Message-----
From: Guinan, John M
Sent: Tuesday, August 11, 1998 6:01 PM
To: Watson, Mark T
Cc: Jones, Paul N
Subject: RE: OPIS Memo to PFP Partners

I find it difficult to understan the argument that the OPIS product would be sold in this time frame since the product was never approved by DPP Tax or DPP Assurance. There maybe is a bigger issue here than this product. We are putting the firm at risk with this memo since it lays out all the concerns we have had from an indepenedence prospective. A few weeks are a best guess as to what it will take to get counsel to work with our partner to renegotiate the arrangement with Presidio. Until the arrangement is renegotaited you should not issue the memo as drafted. If you believe some advice is necessary then it should be limited to the "OPIS product is not yet approved for marketing or sale"

-----Original Message-----
From: Mark T Watson
Sent: Thursday, August 06, 1998 7:57 PM
To: John M Guinan; Jeffrey A Eischeid; Larry DeLap; Michael A Conway; John S Baumann; J. T Strange; John T Lanning
Cc: Douglas K Ammerman; Jeffrey C Zysik
Subject: RE: OPIS Memo to PFP Partners
Importance: High

John, the primary purpose of this message is to clear-up the substantial confusion among PFP partners as to under what conditions we can market and sell OPIS. I am receiving numerous calls every day as to where we stand on OPIS. I don't think we can wait a "few weeks" to inform our partners about the matters discussed in the memo. If we don't act immediatley, there may be instances where OPIS (and other "products") are marketed and sold in violation of DPP-Tax/Assurance guidelines.

-----Original Message-----
From: Guinan, John M
Sent: Thursday, August 06, 1998 2:33 PM
To: Watson, Mark T; Guinan, John M; Eischeid, Jeffrey A; Larry DeLap at KPMG_Silicon_Valley2; Conway, Michael A; Baumann, John S; Strange, J. T; Lanning, John T
Cc: Ammerman, Douglas K; Zysik, Jeffrey C
Subject: RE: OPIS Memo to PFP Partners

Jeff-- the OPIS memorandum must not be released. It represents a road map to many of the issues we have been trying to work through with all parties. If this memorandum were to get out, you have to assume our competition and others will get their hands on it. The release of the memorandum would be damaging to the firm and the potential opportunities that OPIS may offer to the firm.

The delay of a few weeks in launching the OPIS product isn't worth the damage and cost to the firm.

______________________________ Reply Separator __________________________________
Subject: RE: OPIS Memo to PFP Partners
Author: Jeffrey A Eischeid at KPMG_US
Date: 8/6/98 7:54 AM

Mark - Looks fine to me. I'd simply move your second paragraph after "Contingent Fee" to immediately before "Independence" (i.e. after the three issue bullets).

-----Original Message-----
From: Larry DeLap at KPMG_Silicon_Valley2
Sent: Wednesday, August 05, 1998 3:06 PM
To: Watson, Mark T; Guinan, John M
Cc: Eischeid, Jeffrey A; Ammerman, Douglas K; Zysik, Jeffrey C
Subject: OPIS Memo to PFP Partners

Mark -

See my changes attached.

In order to try to make sure we are all on the same page, I would like to seek the "sign off" of John Guinan. If John has any significant changes, Jeff has a number where I can be reached tomorrow evening.

John -

I will be on vacation starting first thing tomorrow morning. Can you please provide any comments directly to Mark Watson. If, after reading the attachment, you believe it would be preferable that you talk to me first, Cathy Gaughan has a phone number where I can be reached. If Cathy should be unavailable, Jim Wetzold and Rachel Hedley also have the number.

Larry

______________________________ Forward Header __________________________________
Subject: OPIS Memo to PFP Partners
Author: Jeffrey Zysik at KPMG_WNT
Date: 8/5/98 5:40 PM

Gentlemen, attached is the first attempt at a memo to the PFP partners about the status of OPIS and their ability to market and sell OPIS (and other innovative strategies). Please provide me (Mark Watson) your comments at your earliest convenience and I will finalize the memo.

Thanks. . .

Mark Watson (I am using Jeff Zysik's computer) << File: Forward.txt >> << File: opis.doc >>

new

From:	Jeffrey Zysik
Sent:	Monday, June 29, 1998 6:47 PM
To:	Dale R. Baumann; Randall S Bickham; Deke G. Carbo; Jeffrey A. Eischeid; John H Gardner; Tracie K. Henderson; Robert M. Jordan; Gregg W. Ritchie; B. Michael Watkins; Mark Watson; Jeffrey Zysik; Neil J. Tendler; Kyle A Wissel; Timothy P. Speiss; Robert A. Pedersen; Harvey L. Armstrong; Robin M. Paule; Shannon L Liston; John M Nuckolls
Cc:	Larry DeLap
Subject:	OPIS Engagement Letter

cont fee.dot

The approved OPIS engagement letter has been added to the OPIS toolkit located in the CaTS workgroup in Kman. Please note that every engagement letter was be sent to Larry DeLap for DPP sign off.

In addition, please review the attached draft memo concerning delivery of OPIS to targets who reside in jurisdictions with accountancy rules that prohibit contingency fees. Once this memo has been reviewed by DPP, it will be posted in final form to the OPIS toolkit. Please look for and consult the final memo prior to commencing an OPIS engagement.

KPMG 0009700

Permanent Subcommittee on Investigations
EXHIBIT #94z

KPMG Peat Marwick LLP

PFP

To CaTS Team Members

Date June 28, 1998

From Gregg Ritchie/Jeffrey C. Zysik

Steno jcz

Ref p:\users\sbutler\wp\zysik\products\pfp\opis\contfee.doc

OPIS Engagements - Prohibited States

In order to avoid even the appearance of impropriety, OPIS engagements will not be provided to clients from certain States whose accountancy rules prohibit contingent fees. The following States' rules prohibit contingency fees:

Alaska	Connecticut	District of Columbia
Florida	Hawaii	Idaho
Louisiana	Maryland	Mississippi
Montana	Nebraska	New Hampshire
New Jersey	New Mexico	Puerto Rico
Rhode Island	South Carolina	Virginia
Washington	West Virginia	

If you have an OPIS candidate resident in one of these jurisdictions, then:

1) **The engagement letter cannot be *signed* in that jurisdiction, and must be *signed* in a jurisdiction that does not prohibit contingency fees;**

2) **The engagement cannot be managed in that jurisdiction, and must be managed from a jurisdiction that does not prohibit contingency fees; *or***

3) **The largest amount of services under the engagement must be performed in a jurisdiction that does not prohibit contingency fees.**

Provided one of the above requirements is met, it is KPMG's policy that the engagement is subject to the accountancy rules of the jurisdiction in which the specified activity took place. However, in keeping with our policy to avoid even the appearance of impropriety, it is preferable that all aspects of the engagement (administration, management, and delivery) take place in a jurisdiction that does not prohibit contingency fees.

Any questions regarding the content of this memo should be directed to Gregg Ritchie (818)227-6905 or Jeff Zysik (202)739-8659.

Proprietary Material
Confidentiality Requested

KPMG 0009701

Eischeid, Jeffrey A

From:	Zysik, Jeffrey C
Sent:	Monday, June 29, 1998 6:46 PM
To:	Eischeid, Jeffrey A; Henderson, Tracie K; Pedersen, Robert A; Baumann, Dale R; Randall S Bickham at KPMG_Silicon_Valley2; Carbo, Deke G; Gardner, John H; Jordan, Robert M; Ritchie, Gregg W; Watkins, B M; Watson, Mark T; Zysik, Jeffrey C; Tendler, Neil J; Wissel, Kyle ; Speiss, Timothy P; Harvey L Armstrong at KPMG_Silicon_Valley; Paule, Robin M; Burgess, Shannon L; Nuckolls, John M
Cc:	Larry DeLap at KPMG_Silicon_Valley2
Subject:	OPIS Engagement Letter

The approved OPIS engagement letter has been added to the OPIS toolkit located in the CaTS workgroup in Kman. Please note that every engagement letter was be sent to Larry DeLap for DPP sign off.

In addition, please review the attached draft memo concerning delivery of OPIS to targets who reside in jurisdictions with accountancy rules that prohibit contingency fees. Once this memo has been reviewed by DPP, it will be posted in final form to the OPIS toolkit. Please look for and consult the final memo prior to commencing an OPIS engagement.

[THIS LETTER IS TO BE USED ONLY WITH RESPECT TO NON-ATTEST CLIENTS AND ONLY IN JURISDICTIONS THAT PERMIT THE RECEIPT OF CONTINGENT FEES.]

PRIVATE & CONFIDENTIAL

Dear ;

The purpose of this letter is to define the role of KPMG Peat Marwick LLP ("KPMG") in the proposed participation of the [*investor*] (the "Entity") in an investment strategy (the "Strategy") and to confirm our understanding of the terms of our engagement to assist the Entity and Presidio Advisors LLC ("Presidio") as a tax advisor in connection with the Entity's participation in the Strategy. For purposes of this letter, references to the "Entity" shall be deemed to include the owners of the Entity (the "Owners"), and such Owners shall be deemed individual parties hereto for all undertakings and agreements of the Entity contained herein. The Owners of the Entity (or their authorized representative) shall execute this letter in their individual capacity, as well as their capacity as officers, directors, or employees of Entity. The background for your participation in the Strategy and the role of KPMG are as follows.

Background

1. KPMG understands that the Entity intends to engage Presidio, a registered investment advisor, to provide the Entity with investment advisory services and trading strategies designed to permit the Entity to acquire both directly, and indirectly, a position in the shares of a foreign bank.

2. KPMG understands that Presidio will facilitate the purchase of shares and options in a foreign bank. The purchase of the foreign bank shares and options will involve full economic risk to the Entity in the stock market movement (up or down) of the foreign bank securities. The Entity may realize either profits or losses based upon the movement of the foreign bank shares. No one has provided the Entity or the Owners with any assurances or guarantees that they will make money in any of these transactions. The Entity and Owners are at all times subject to market risks for both reward and loss. We recommend that the Entity and Owners seek independent advice

concerning the investment aspects of the proposed transactions. The Entity and Owners acknowledge that they understand that they must have a reasonable expectation of achieving a reasonable profit from the Strategy (separate and apart from any tax benefits realized) and that the Entity and Owners have received appropriate investment advice concerning the Strategy (from Presidio and/or other qualified investment advisors).

3. . The Entity intends to enter into a total return swap agreement with respect to an offshore investment company in connection with the Strategy.

KPMG's Role as Tax Advisor

KPMG has agreed to provide the Entity with tax consultation services concerning the U.S. federal income tax consequences of the various transactions that may be undertaken with respect to the Strategy. KPMG agrees that, upon the request of the Entity, we will provide the Entity with a tax opinion letter. The Entity and Owners acknowledge that any tax opinion issued by KPMG would not guarantee tax results, but would provide that the tax treatment described in the opinion is "more likely than not" to occur. If such opinion is requested, it will be based upon, and will be contingent upon, certain facts and representations of the Entity and the Owners.

Any tax opinion issued by KPMG in connection with the Strategy is to be used solely by the Entity for the purpose of evaluating the U.S. federal tax consequences of the Strategy and is not to be used or relied upon by any other party or distributed to any other party.

The Entity acknowledges that KPMG has communicated that certain information reporting requirements imposed by the Internal Revenue Code of 1986 may apply as a consequence of the Entity's participation in the Strategy. Such reporting requirements will be set forth in an memorandum from KPMG to the Entity prior to any investment in the strategy.

The Entity acknowledges and agrees that Presidio will pay fees on the Entity's behalf to KPMG in consideration of tax consultation services provided in connection with the Strategy.

Liability

By approving this arrangement, the Entity and Owners, jointly and severally agree to indemnify KPMG and its affiliates, partners, principals, directors, officers, employees, agents and controlling persons (collectively, ~~the~~" Indemnified Parties") from and against all losses, claims, damages, and liabilities, including reasonable attorney's fees and other expenses or costs of litigation (collectively, "Damages"), to which the Indemnified Parties may become subject under any applicable federal or state law or other statutes, common law, or otherwise, and arising, directly or indirectly, from this engagement as the result of any assertion by the Entity or an Owner (or any family member or creditor of an Owner) of the Entity. The Indemnified Parties shall not be indemnified to the extent such Damages directly and immediately result from KPMG's bad faith or gross negligence. In the event any Indemnified Party is requested pursuant to subpoena or other legal process to produce documents relating to this engagement in judicial or administrative proceedings to which such Indemnified Party is not a party, you shall reimburse the Indemnified Party at standard billing rates for the Indemnified Party's professional time and expenses, including reasonable attorney's fees, incurred in responding to such requests.

KPMG's aggregate maximum liability to Entity and Owners arising for any reason relating to KPMG's performance of services hereunder, except to the extent determined to have resulted from the intentional or deliberate misconduct of KPMG personnel, shall be limited to fifty thousand dollars ($50,000.00).

KPMG shall have no liability to Entity, or Owners, for any special, incidental or consequential damages, including without limitation loss of profits, even if KPMG has been advised of the possibility of such damages.

The Entity and Owners will not directly or indirectly refer to KPMG or any of its affiliates in any printed, audiovisual, on-line or other advertising or promotional material prepared or distributed by or for you without KPMG's specific advance review and prior written approval. The provisions of this paragraph shall survive the expiration of this Agreement.

In the event that any term or provision of this Agreement shall be held to be invalid, void, or enforceable, then the remainder of this Agreement shall not be effected, impaired or invalidated, and each such term and provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

Page 4~~42~~
July 6, 1998~~June 22, 1998~~

Please indicate your agreement to the above terms and understandings by signing the enclosed copy of this agreement and returning it to us.

Sincerely,
KPMG Peat Marwick LLP

Gregg W. Ritchie
Partner

Enclosure

ACCEPTED:

Entity

*Name:*______________________________

Title:______________________________ **Date:**______________

Owner (or Authorized Representative)

Name:

Title:______________________________ **Date:**______________

PRIVATE & CONFIDENTIAL

Dear ,

The purpose of this letter is to define the role of KPMG Peat Marwick LLP ("KPMG") in the proposed participation of [name of investor] (Client") in an investment strategy (the "Strategy") and to confirm our understanding of the terms of our engagement to assist Client as a tax advisor in connection with Client's participation in the Strategy. For purposes of this letter, references to "Client" shall be deemed to include the owners of Client (the "Owners"), and such Owners shall be deemed individual parties hereto for all undertakings and agreements of Client contained herein. The Owners of Client (or their authorized representative) shall execute this letter in their individual capacity, as well as their capacity as officers, directors, or employees of Client. The background for your participation in the Strategy and the role of KPMG are as follows.

Background

1. KPMG understands that Client intends to engage Presidio, a registered investment advisor, to provide Client with investment advisory services and trading strategies designed to permit Client to acquire both directly, and indirectly, a position in the shares of a foreign financial institution to be selected by Client from alternative investee financial institutions offered by Presidio.

2. KPMG understands that Presidio will facilitate the purchase of shares and options in a foreign financial institution. The purchase of the foreign financial institution shares and options will involve full economic risk to Client in the stock market movement (up or down) of the foreign financial institution securities. Client may realize either profits or losses based upon the movement of the foreign financial institution shares. No one has provided Client or the Owners with any assurances or guarantees that they will make money in any of these transactions. Client and Owners are at all times subject to market risks for both reward and loss. We recommend that Client and Owners seek independent advice concerning the investment aspects of the proposed transactions. Client and Owners acknowledge that they understand that they must have a reasonable expectation of achieving a reasonable profit from the Strategy (separate and apart from any tax benefits

realized) and that Client and Owners have received such investment advice concerning the Strategy (from Presidio and/or other qualified investment advisors).

3. Client intends to enter into a total return swap agreement with respect to an offshore investment company in connection with the Strategy.

KPMG's Role as Tax Advisor

KPMG has agreed to provide Client with tax consultation services concerning the U.S. federal income tax consequences of the various transactions that may be undertaken with respect to the Strategy. KPMG agrees that, upon the request of Client, we will provide Client with a tax opinion letter. Client and Owners acknowledge that any tax opinion issued by KPMG would not guarantee tax results, but would provide that the tax treatment described in the opinion is "more likely than not" to occur. If such opinion is requested, it will be dependent on appropriate facts and representations of Client and the Owners.

Any tax opinion issued by KPMG in connection with the Strategy is to be used solely by Client for the purpose of evaluating the U.S. federal tax consequences of the Strategy and is not to be used or relied upon by any other party or distributed to any other party.

Client acknowledges that KPMG has communicated that there are certain information reporting requirements imposed by the Internal Revenue Code of 1986 that might be considered applicable to Client's participation in the Strategy.

Our professional fees are based on the complexity of our role and on the value of the services that we provide, rather than directly on the hours we spend. We will bill you a fee of a minimum of $________ in consideration of tax consultation services provided in connection with the Strategy. During the latter part of the engagement, we will agree with you an additional amount for our services. The amount of our fee is not dependent on the amount of Client's investment in the Strategy, the investment results of the Strategy, the tax opinion expressed, nor on the amount of any tax savings projected or achieved by Client or Owners.

Liability

By approving this arrangement, Client and Owners, jointly and severally agree to indemnify KPMG and its affiliates, partners, principals, directors, officers, employees, agents and controlling persons (collectively, the " Indemnified Parties") from and against all losses, claims, damages, and liabilities, including reasonable attorney's fees and other expenses or costs of litigation (collectively, "Damages"), to which the Indemnified Parties may become subject under any applicable federal or state law or other statutes, common law, or otherwise, and arising, directly or indirectly, from this engagement as the result of any assertion by Client or an Owner (or any family member or creditor of an Owner) of Client. The Indemnified Parties shall not be indemnified to the extent such Damages directly and immediately result from KPMG's bad faith or gross negligence. In the event any Indemnified Party is requested pursuant to subpoena or other legal process to produce documents relating to this engagement in judicial or administrative proceedings to which such Indemnified Party is not a party, you shall reimburse the Indemnified Party at standard billing rates for the Indemnified Party's professional time and expenses, including reasonable attorney's fees, incurred in responding to such requests.

KPMG's aggregate maximum liability to Client and Owners arising for any reason relating to KPMG's performance of services hereunder, except to the extent determined to have resulted from the intentional or deliberate misconduct of KPMG personnel, shall be limited to fifty thousand dollars ($50,000.00).

KPMG shall have no liability to Client, or Owners, for any special, incidental or consequential damages, including without limitation loss of profits, even if KPMG has been advised of the possibility of such damages.

Client and Owners will not directly or indirectly refer to KPMG or any of its affiliates in any printed, audiovisual, on-line or other advertising or promotional material prepared or distributed by or for you without KPMG's specific advance review and prior written approval. The provisions of this paragraph shall survive the expiration of this Agreement.

In the event that any term or provision of this Agreement shall be held to be invalid, void, or unenforceable, then the remainder of this Agreement shall not be affected, impaired or invalidated, and each such term and provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

Please indicate your agreement to the above terms and understandings by signing the enclosed copy of this agreement and returning it to us.

Sincerely,
KPMG Peat Marwick LLP

Partner

Enclosure

ACCEPTED:

Client

________________ ___________
*Name:*_________________________________

Title:_________________________________ **Date:**________________

Owner (or Authorized Representative)

____
Name:

Title:_________________________________ **Date:**________________

QUADRA ASSOCIATES, LLC

July 7, 1998

BY HAND

Mr. Randy Bickham
Guest c/o New York Palace Hotel
455 Madison Avenue (@50th Street)
New York, New York 10022

Dear Randy,

Enclosed is the tax opinion which, as we discussed earlier today, should be kept in the strictest of confidence.

Please call me once you have had a chance to review the opinion.

Sincerely,

LS

Larry B. Scheinfeld

LBS/msg

Enclosure

cc: Gregg W. Ritchie (by Federal Express w / copy of enclosure)

500 Madison Avenue 32nd Floor New York, New York 10022 Tel: 212-849-8140 Fax: 212-849-8181

Proprietary Material
Confidentiality Requested

KPMG 0010018

Permanent Subcommittee on Investigations
EXHIBIT #94bb

Writer's Direct Line: (415) 983-1826
E-Mail: taylor_gr@pillsburylaw.com

July 2, 1998

____
____
____
____

Dear __________:

You have requested our opinion regarding the U.S. federal income tax consequences of certain securities transactions concluded by you (hereinafter "Investor").

Investor has sought capital appreciation by investing in securities of Union Bank of Switzerland and in a warrant of ______________ (hereinafter "______________"). Union Bank of Switzerland (hereinafter "Foreign Bank") is Switzerland's largest bank and its shares are publicly traded. Foreign Bank is highly profitable, on a worldwide basis. ______________ made a leveraged purchase of Foreign Bank shares. Investor's investment in the warrant of ______________ provided Investor with the potential for appreciation equivalent to owning Foreign Bank shares on margin, but with less risk (and without the negative impact of the related liability on Investor's balance sheet).

FACTS

1. Investor purchased a warrant (the "Warrant") for 85% of the shares of ______________, a Cayman Island investment company wholly owned by ______________, an Isle of Man company (hereinafter "Foreign Person"). The Warrant had a 5-year term and was not exercisable until 90 days after it was purchased. The Warrant could be sold back to ______________ after an initial 60-day period. The cost of the Warrant was 4% of the amount of ______________'s investment ("Notional Amount") in the Foreign Bank shares that ______________ purchased (see below). Investor paid an investment advisory fee that was 3% of the Notional Amount to QA Investments, LLC (hereinafter the "Investment Manager") for arranging these transactions. The Investment Manager is unrelated to Investor, ______________ or Foreign Bank and is registered under the 1940 Investment Advisors Act.

As its investment in ______________, Foreign Person contributed cash equal to 1% of the Notional Amount and received _____ ordinary shares. In addition, Foreign Person purchased a Class B warrant from ______________ to acquire an additional _____ ordinary shares of ______________, in consideration of a $_____ investment, and a $_____ loan.

Upon exercise of the Warrant, Investor would own 85% of ______________'s stock then outstanding. The Warrant remains outstanding until September 30, 2002, a period that at least covers the purchase and sale or redemption of the shares. The Warrant's strike price is $53.55 per share, which represents 4.55% of the Notional Amount. At the earliest Warrant exercise date and at all times thereafter, the Warrant could be either in or out of the money, depending on the market value of the Foreign Bank shares and other assets held by ______________ on the exercise date.

2. ______________ had commitments in place to partially finance its share purchase. Using these financial commitments, ______________ purchased the Notional Amount of shares of Foreign Bank on a foreign stock exchange, at market price. The shares were held for a 50-day period, and the interest costs were approximately _____% of the Notional Amount. ______________ has represented that neither it, nor Foreign Person, own or has owned, actually or constructively, any other Foreign Bank shares.

3. ______________ did the following, in order to protect itself from a significant drop in price of the shares of Foreign Bank:

(a) ______________ wrote 50-day over-the-counter call options on its Foreign Bank shares on a foreign exchange. The terms of these over-the-counter call options provided that, to the extent that the daily price of the Foreign Bank stock increased over certain defined thresholds, additional premiums had to be remitted to ______________, as the writer of the options, as discussed below. The premium for such a call was approximately % of the Notional Amount. The calls were "European-style" options, and therefore could only be exercised on their date of expiration.

(b) Additionally, if the value of the Foreign Bank shares significantly declined over the term of the call, such call options contained a "knockdown" feature that provided that the written call option would be rewritten at a lower strike price. The threshold for the rewriting of the call option's strike price was at an aggregate price of 95% of the Notional Amount, and, if breached, the strike price would be rewritten at 90.25%. The premium for this knockdown feature was taken into account in determining the initial premium for the call options, as described above in paragraph 3(a).

(c) Embedded within the call option was a digital option feature ("RECAP"). The RECAP option provided for payment of an additional premium to ______________ for each day the share price of Foreign Bank closed above certain pre-defined thresholds. These thresholds were established to

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correspond to a gradual appreciation of the underlying stock price by 10% over a seven-week holding period. The purpose of the RECAP was to enable ______________ to benefit from its view that the Foreign Bank share price would gradually rise over the near term. The level for the first week was 102.5% of the original purchase price of the Foreign Bank shares. This level rose to 105% for the second and third week. For the fourth and fifth weeks, the level was 107.5% and 110% for the sixth and seventh weeks. The aggregate daily additional premium payable to ______________ if the share price exceeded the relevant threshold was approximately .405% of the Notional Amount. Since the warrant entitles Investor to acquire 85% of ______________'s shares (which in turn represent 85% of the net asset value of ______________), the pro rata indirect proceeds to Investor were approximately .35% of the Notional Amount per day that the threshold levels were reached or exceeded. The cost of the RECAP was taken into account in determining the initial premium for the call options, as described above in paragraph 3(a).

(d) ______________ also purchased 50-day put options with respect to 100% of its Foreign Bank shares at an aggregate strike price of 90% of the Notional Amount. The aggregate cost of these puts was approximately _____% of the Notional Amount.

Transaction costs for execution of all the above trades, plus the ultimate sale of the Foreign Bank shares, have been included in the above prices.

4. As detailed on the attached schedule entitled "Analysis of Investment Activity" (Exhibit 14), when the trades are viewed omitting the RECAP option, either ______________ makes a ____% profit if the share price of Foreign Bank stays above the 95% knockdown threshold, or loses ____% if the threshold is breached. The RECAP recovers its costs if its thresholds are hit on any six individual days.

Summarizing the transactional structure, ______________ started with a cash infusion of _____%. Based on the transactions of Day one, ______________ received another _____% in cash. On Day 50 it owed _____% in interest and owed either 5% or 10% as the differential between the purchase price of the shares and its ultimate sale price (either 95 if the original call was still in place or 90 based on the knockdown call or the put). As such, it either had _____% or _____% left after these trades. ______________ had professional fees and expenses of 1.3% that were payable at this point. The prorated share of the RECAP payout that accrues to Investor was .35% a day. The RECAP must have hit 20 days (20 x .35 = 7%) for Investor to have had a value in the ______________ greater than its initial investment of 7%. Based on an analysis of Foreign Bank share prices since January 1, 1991, this would occur 12% of the time. However, for the three months ended August 13, 1997, this 20-day threshold was exceeded 66% of the time. Due to the interplay of the Class A Warrant and the put premium, if the RECAP hit less than 10 days, the amount of the put value would have been less than the RECAP payout. In this situation, the Investment Manager indicated it would make up any shortfall.

5. On ___________, 1998, Foreign Bank redeemed the Foreign Bank shares held by ______________, in an independently negotiated transaction. In addition, Investor elected to put the Warrant on .

6. Simultaneous with the transactions described above, Investor directly invested in Foreign Bank equity, mirroring the leverage offshore, through the purchase of options on shares of Foreign Bank. Under this program, the number of options purchased equaled the number of Foreign Bank shares redeemed by Foreign Bank. In this manner, the number of Foreign Bank shares owned by Investor has remained constant with the number of such shares owned by ______________.

7. On ______________, Investor purchased _____ shares of Foreign Bank, and held those shares for a period ______________. On ___________, 1998, Investor sold most of its shares. Approximately ___% of the Foreign Bank shares have been retained, for long-term investment, by Investor.

8. Investor has represented that it has pursued this transaction for the dual purposes of achieving significant tax benefits and making a profit on the transactions. Investor has represented that it would not have implemented these transactions, no matter how great the potential tax benefit, unless it believed it had a realistic opportunity to make an acceptable profit in excess of all cash outlays, taking into consideration all transaction costs.

SUMMARY OF OPINION

Based on the facts above, and on the discussion and analysis below, we are of the opinion that, under current U.S. federal income tax law, it is more likely than not (i.e., there is a greater than 50% likelihood) that, if challenged by the Internal Revenue Service (the "Service"), Investor will be allowed to add ______________'s tax basis of $_______ in its redeemed Foreign Bank stock to Investor's cost basis in its Foreign Bank stock and options of $_______ in calculating Investor's capital loss on the sale of its Foreign Bank stock and options. No taxable income should be recognized by Investor as a result of the redemption of ______________'s Foreign Bank stock.

The redemption by Foreign Bank of ______________'s Foreign Bank stock should be treated as a distribution qualifying as a dividend under sections 301 and 316 of the Internal Revenue Code of 1986, as amended (the "Code" or "IRC"). Foreign Bank has earnings and profits that are more than sufficient to cover this dividend. The redemption was not an exchange for purposes of Code section 302(a) (or under Code section 1001), because Investor's ownership of Foreign Bank stock and options are attributed to ______________, under the ownership attribution rules of Code section 318, and none of the four tests in Code section 302(b) are met. Because ______________ no longer directly owns any Foreign Bank shares after the deemed distribution, its basis in such shares is allocated to Investor's Foreign Bank stock, pursuant to Regulations section 1.302-2(c), and to its options under Regulations section 1.61-6.

We also believe that it is more likely than not that the following potential issues (as well as pending legislation) do not apply to change any of our conclusions stated herein, i.e., the "step transaction" doctrine, the "agency" doctrine, the "sham transaction doctrine," Code sections 269, 482, 1059 and 1091, nor the provisions governing controlled foreign corporations, passive foreign investment companies or foreign personal holding companies. Further, the capital loss recognized by Investor upon its sale of the Foreign Bank stock will, more likely than not, be considered to have a U.S. source. Finally, we conclude that, in the event that any conclusions stated in this letter are determined to be incorrect, no penalties should be imposed.

ANALYSIS

A. Redemption of ______________'s Foreign Bank shares.

1. Provisions of section 302.

Under section 302(a), a redemption by a corporation of its own stock is treated as a distribution, in part or full payment in exchange for such stock, if the redemption satisfies one of the tests of section 302(b). In this event, the redemption will qualify for capital gain treatment under section 1001, provided the redeemed stock is a capital asset of the stockholder.

If a redemption does not qualify for exchange treatment, section 302(d) provides that such redemption is treated as a distribution of property to which section 301 applies. Thus, the redemption will be treated as a dividend, and taxable as ordinary income, to the extent of the earnings and profits of the redeeming corporation.

Section 302(b) provides four circumstances under which a redemption qualifies for exchange treatment: a redemption "not essentially equivalent to a dividend," a redemption which is a "substantially disproportionate" redemption of stock, a redemption which completely terminates a shareholder's interest in the corporation, and a redemption from a noncorporate shareholder in partial liquidation of the corporation.

2. <u>Stock ownership attribution rules of section 318.</u>

Under section 302(c), the stock ownership attribution rules of Code section 318 apply in determining whether the redemption meets one of the four tests of section 302(b). Section 318(a)(3)(C) provides that a corporation is deemed to own all stock owned directly or indirectly by any person owning 50% or more of the value of its stock ("Related-Party Attribution").

Under section 318(a)(4), a person owning an option to acquire stock is considered as owning such stock ("Option Attribution"). The Service has expanded on this rule in Revenue Ruling 68-601, 1968-2 C.B. 124, which states that warrants are options within the meaning of section 318(a)(4), and Revenue Ruling 89-64, 1989-1 C.B. 91, which provides that an option under section 318(a)(4) includes an option only exercisable after a period of time have lapsed.

3. <u>Application of sections 302 and 318.</u>

Under the Option Attribution rule, Investor is treated as owning 85% of the equity of _____________, because Investor owns warrants which, if exercised, would represent 85% of the then issued and outstanding shares of _____________. Because Investor is deemed to own more than 50% of _____________'s stock, under the Related-Party Reverse Attribution rule (section 318(a)(3)(C)), _____________ is in turn treated as owning all of the shares that Investor actually owns, and _____________ is also treated as owning, under the Option Attribution rule, the Foreign Bank Shares that would be acquired upon exercise of the call options held by Investor.

Investor acquired ____ Foreign Bank shares and options on _____ Foreign Bank shares (simultaneously with the redemption of _____________'s _____ Foreign Bank shares). As such, _____________ is deemed to own Foreign Bank stock representing the same percentage of shares that it owned before the redemption, resulting in no net reduction in its equity ownership of Foreign Bank.

In the absence of the attribution rules, _____________ would have effected a complete termination of its interest in Foreign Bank under section 302(b)(3), resulting in exchange treatment under section 302(a). However, as a result of the attribution rules, _____________'s percentage ownership in Foreign Bank remains the same following the redemption. Consequently, the redemption does not qualify as a complete termination of _____________'s interest in Foreign Bank, nor are any of the other three tests of section 302(b) satisfied. Accordingly, the redemption should be treated as a dividend distribution from Foreign Bank to _____________.

This conclusion is supported by the Supreme Court's decision in <u>U.S. v. Davis</u>, 397 U.S. 301 (1970), where the Court held that the section 318 attribution rules must be applied, specifically in the case of a section 302(b)(1) issue (redemption not essentially equivalent to a dividend). In its decision, the Court reiterated that the attribution rules apply to sections 302(b)(2) and (b)(3) (redemption is substantially disproportionate, or a complete termination of interest) as well. Furthermore, the decision cited legislative history, holding that the presence or absence of a tax avoidance motive is irrelevant in considering the characterization of a stock redemption under section 302(b)(1). This should also hold true for the other categories of redemptions under section 302(b). The Service has cited Davis, with approval, in numerous rulings, including Revenue Rulings 80-26, 1980-1 C.B. 66, and 81-289, 1981-2 C.B. 82.

Notwithstanding the Supreme Court's decision in Davis, the court in Robin Haft Trust v. Commissioner, 510 F.2d 43 (1st Cir. 1975), rev'g and remanding 61 T.C. 398 (1973), supplemented, 62 T.C. 145 (1974) held that the attribution rules of section 318 should be disregarded in testing redemption for dividend equivalency in situations where family hostility is present. The court reasoned that the presumption of continuing influence over corporate affairs was negated by family conflict.

However, in Revenue Ruling 80-26, the Service ruled that it will not follow the decision in Haft. It reasoned that such an interpretation of the mechanical attribution rules was inconsistent with the legislative history of section 318 as well as the language and rationale of Davis. In addition, the Service noted that the attribution rules were meant to be mechanical and objective, in contrast to the confusion of the prior law. The conclusion reached was clearly that the mechanical determination of attribution must be followed, irrespective of the facts and circumstances of a particular case.

B. **Investor's basis in Foreign Bank stock.**

Because the redemption of all of ______________'s shares is treated as a dividend distribution, ______________'s basis is not recoverable, as it would have been if the redemption qualified for exchange treatment. As ______________ no longer has actual ownership of any Foreign Bank shares, absent a specific provision, its basis in the redeemed shares would "disappear."

This issue is, however, addressed by Treasury Regulations section 1.302-2(c), which provides that when stock is redeemed in a deemed distribution, "proper adjustment of the basis of the remaining stock will be made with respect to the stock redeemed." In the case where the only remaining shares owned by the shareholder redeeming its shares are those owned through attribution, the basis adjustment should be applied to the shares owned indirectly or constructively. Example 2 of the Regulation demonstrates this result in a Husband/Wife context. The Example states that when Husband and Wife each own 50% of the stock of a Corporation and Husband's entire direct holding is redeemed by Corporation in a deemed distribution, the basis of Husband's redeemed shares is added to Wife's basis in her shares of Corporation.

Both the courts and the Service have accepted this approach. For example, in Levin v.

Commissioner, 385 F.2d 521 (2d Cir. 1967), the Second Circuit held that a complete redemption of the taxpayer's directly owned stock in a closely held corporation was a deemed distribution under section 302(d), because the shares owned by the taxpayer's son were attributed to her, under section 318. The court rejected the taxpayer's argument that this caused her basis to disappear, resulting in an unconstitutional direct tax, remarking in dicta that the taxpayer's basis did not disappear, but was added to her son's basis, pursuant to Treasury Regulations section 1.302-2(c).

The Service has extended this rule beyond the family attribution context. In Private Letter Ruling 8327091, the Service ruled that it was proper to shift the basis from a trust whose shares were redeemed to the income beneficiaries. While there are no cases addressing the consequences of transferring basis in the corporate attribution context, we believe that the Service would have no authority to challenge such a transfer, absent a prospective change in the law or Regulations. ?

Commentators have also endorsed this approach. In their treatise, Professors Bittker and Eustice stated that:

> If the shareholder retains no shares after the redemption, the regulations sanction a transfer of the basis to the shares of a related taxpayer, at least if those shares were attributed to the redeemed shareholder and were, therefore, responsible for the seller's inability to offset the basis of the redeemed shares against the amount received for them. Ordinarily, the transfer of the redeemed shareholder's basis to shares owned by a related person is a reasonable adjustment.

B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders 6th ed., at ¶ 9.22[2] (footnotes omitted) (emphasis added).

Because the Regulations endorse this approach in a related context and there is no authority to the contrary, we believe that _______________'s basis in its redeemed shares is properly allocable to the shares owned by Investor. The only remaining issue is whether there should be an allocation of the portion of the basis of _______________'s shares to the options in Foreign Bank owned by Investor, since these options also give rise to the section 318 attribution. Treasury Regulations section 1.61-6 provides that when a taxpayer disposes of property that is part of a greater whole, the basis of the whole is allocated between the part sold and the part retained, in proportion to their relative fair market values. As a result, we believe that Investor should allocate the basis arising for _______________'s redeemed Foreign Bank stock between Investor's Foreign Bank shares and options, based on their respective fair market values on the date of the redemption.

C. Other issues.

1. _______________ should be treated as a shareholder of Foreign Bank.

a. Common law standard.

In the landmark decision Esmark, Inc. and Affiliated Companies v. Commissioner, 90 T.C. 171 (1988), aff'd per curiam, 886 F.2d 1318 (7th Cir. 1989), the Seventh Circuit affirmed the Tax Court's holding that Esmark's exchange of subsidiary stock for its own stock qualified for nonrecognition treatment under then-existing Code section 311. Due to liquidity problems, Esmark decided to restructure by disposing of its stock in Vickers, a wholly owned holding company. Esmark entered into an agreement with Mobil Oil ("Mobil") that essentially provided that Mobil would purchase Esmark shares pursuant to a tender offer. In turn, Esmark agreed to redeem the Esmark stock acquired by Mobil in exchange for Vickers stock. The shares of Esmark were recorded and issued on the day Mobil completed its Esmark tender offer. The Esmark shares were then transferred to Esmark in exchange for the Vickers shares, later that same day.

Relying on section 311 of the Internal Revenue Code of 1954, Esmark did not report gain on its transfer of Vickers stock to Mobil Oil in return for its own stock. Section 311, as it then read, provided that a corporation is not required to recognize gain on a transfer of its property in a significant redemption of its own stock. The Service urged the court to apply the step transaction doctrine to the facts and to find that Esmark was required to recognize gain since the stock exchange was part of a prearranged plan. The Service urged the court to focus on the substance rather than the form of the transaction, viewing the transaction as a sale of Vickers stock to Mobil for cash, with the sale proceeds being used to redeem Esmark's stock from its shareholders. In rejecting the Service's argument, the Tax Court found that although Mobil's tender offer was part of a plan, the existence of a plan alone did not justify the application of the step-transaction doctrine. According to the Tax Court, the Service had not identified any meaningless or unnecessary steps that were to be disregarded. The court further found that the shareholders were more than mere third-party beneficiaries of the agreement between Mobil and Esmark; they had independent claims against Mobil based on its tender offer. The court also was unpersuaded by the Service's assertion that Mobil's ownership of Esmark stock was "too transitory to be recognized for tax purposes," and concluded that a continuity of interest requirement was not contained in section 311.

On appeal, the Service argued that the economic realities of the arrangement should be respected rather than the form of the transaction. According to the Service, Mobil did not possess any true indicia of ownership and therefore should not be regarded as having held the Esmark stock for purposes of section 311. Further, the Service argued that Mobil's shareholder status was incidental to the transaction. The Seventh Circuit affirmed the Tax Court's finding that Mobil was the beneficial owner of the Esmark shares acquired in the tender offer. The Tax

Court found that the tender offer and redemption had substance and consequently Mobil was not to be disregarded as a mere conduit. Accordingly, the court respected the form of the transaction, including Mobil's status as a shareholder and held in favor of the taxpayer.

In the Esmark case, Mobil was treated as the beneficial owner of Esmark stock although it owned the stock for less than one day. Clearly then, ______________ should be treated as the beneficial owner of Foreign Bank stock as it will hold such stock for at least 45 days and will have all incidents of ownership during such time. The ownership of Foreign Bank stock and the subsequent redemption have economic substance.

Similarly, in Standard Linen Service Inc. v. Commissioner, 33 T.C. 1 (1959), the Tax Court held that a purchase/redemption transaction was a partial liquidation and not a sale of assets. In Standard Linen, Alsco Corporation wanted to acquire Model Corporation's linen supply assets held by a wholly owned subsidiary. Alsco agreed to purchase Model stock from Model shareholders with the understanding that it would be allowed to immediately transfer the stock to Model for the linen supply assets. The Service argued that the steps of the transaction were interdependent steps in an overall plan which ultimately resulted in a sale of assets by Model to Alsco. Additionally, the Service argued that Alsco's ownership of Model's stock was transitory.

The Tax Court concluded that each step of the transaction should be recognized and given its full tax effect, and that the real character of the transaction was a sale of stock followed by a partial liquidation. The analysis of the Tax Court reasoned that the sale of stock had substance, and that the primary purpose for the sale was that the shareholders wanted to dispose of their stock interests. As a result, the court noted, the shareholders were entitled to avail themselves of the opportunity to sell their stock directly to Alsco rather than having their stock redeemed directly by Model.

Revenue Ruling 83-38, 1983-1 C.B. 76 states the Service's position in situations similar to the one involved in the Esmark case. The ruling holds that the provisions of former section 311(d) do not apply to a parent corporation's distribution of subsidiary stock in exchange for parent stock, when the holder of such parent stock purchased this parent stock not with the intent of acting as a shareholder of the parent, but with the intent of using the parent stock to obtain the subsidiary stock in the exchange. However, Revenue Ruling 95-71, 1995-2 C.B 323 has obsoleted Revenue Ruling 83-38, due to the repeal of section 311(d).

In Revenue Ruling 78-197, 1978-1 C.B. 83, following the Tax Court's decision in Palmer v. Commissioner, 62 T.C. 684 (1974), aff'd on another issue, 523 F.2d 1308 (8th Cir. 1975), the Service concluded that it will treat a redemption from a charity as resulting in income to the donor only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption. In Palmer, the taxpayer had voting control of both a corporation and a tax-exempt private foundation. Pursuant to a single plan, the taxpayer donated shares of the corporation's stock to the foundation and then caused the corporation to redeem the stock from the foundation the following day. The Service took the position that the substance of the transaction was a redemption of the stock from the taxpayer, taxable under section 311, followed by a gift of the redemption proceeds by the taxpayer to the foundation. Rejecting this argument, the Tax Court treated the transaction according to its form. The court reasoned that the foundation itself was not a sham, the transfer of the stock to the foundation was a valid gift, and the foundation was not bound to proceed with the redemption at the time it received title to the shares. The court noted that although the redemption was imminently anticipated, the foundation, and not the donor, was the shareholder that ultimately approved the redemption. As a result, the foundation and not the donor, was the redeeming shareholder.

Similarly, ______________ ~~will be~~ the actual owner of the Foreign Bank shares at the time of redemption and should be respected as a shareholder of Foreign Bank. Covered call and put options will be ~~written,~~ giving the parties the option to buy or sell to third parties at specified prices, but at ~~no~~ point will there be any formal or informal agreement or understanding that Foreign Bank will ~~redeem~~ ______________'s shares (although Foreign Bank does have a general stock buy back program, which it executes in accordance with its internal, unpublished, procedures).

In Revenue Ruling 74-87, 1974-1 C.B. 72, three shareholders owned shares representing 10% of X corporation. Pursuant to a partnership agreement, the three shareholders contributed all their shares to a partnership formed by them, in exchange for interests in the partnership equal to the value of the stock transferred. Subsequently, as part of an overall plan, X corporation redeemed its stock held by the partnership, using appreciated real estate on which X corporation's plant was located, as the payment for its shares. In an arm's-length transaction, the partnership then leased the real estate back to X corporation for a period of years. The Service ruled that a transfer by three shareholders of their stock in a corporation, aggregating 10% in value of the corporation's stock, to a partnership formed by them will be disregarded, where the partnership was formed as part of a plan to have the corporation transfer appreciated real property to the partnership in complete redemption of the aggregate 10% interest.

The Service concluded that the transaction will be treated as a redemption of each individual shareholder's stock, followed by a contribution of the appreciated property to the partnership, resulting in the termination of the shareholder's interests under section 302(b)(3) and the recognition of gain by the corporation under section 311(d)(1). The Service reasoned that the ownership of X stock by the partnership was transitory and illusory since, as part of an overall plan, the partnership surrendered X stock for the property of X corporation. The Service pointed out that this transitory step must be disregarded as being wholly without substance. Consequently, the Service treated the transaction as a redemption by X corporation of the stock held by the three shareholders followed by a contribution to the partnership by the three shareholders of the real property received upon the redemption of their X stock.

However, Revenue Ruling 74-87 is not cogent authority for disregarding ______________ as a shareholder of Foreign Bank. First, the ruling predates the holdings set forth in Esmark and Revenue Ruling 78-197. Furthermore, Revenue Ruling 74-87 disregards the existence of the partnership as a distinct legal entity, separate and apart from its owner/partners. Instead, the partnership's income and deductions are treated as directly earned or incurred by the partners.

______________ should be treated as a "C" corporation (i.e., "nontransparent" entity) and as a clearly distinct entity from its shareholders. For example, in Revenue Ruling 88-32, 1988-1 C.B. 113, Y corporation shareholders transferred their Y shares to a newly formed X corporation in exchange for X shares. As part of the same plan, X sold significant amounts of the Y stock in which X recognized gain or loss. Thus, X's ownership of the Y stock was respected and not attributed to the former Y shareholders. Accordingly, the Service has demonstrated that it will respect a contribution of stock to a C corporation and the C corporation's status as a shareholder. Thus, ______________'s ownership of Foreign Bank stock and its status as a shareholder should be respected. The facts of the instant transaction make this even more likely since the Foreign Bank stock was not contributed to ______________, but rather was purchased by ______________ directly from Foreign Bank.

In Revenue Ruling 68-388, 1968-2 C.B. 122, the Service ruled that an estate cannot avail itself of the waiver of attribution provided in section 302(c) by selling its stock to a beneficiary (the mother of the corporation's only shareholder), for cash she receives from a simultaneous redemption of the stock. The reason for the transfer was to have the mother file a waiver of attribution agreement, thus qualifying the redemption for capital gain treatment. Under these facts, the Service reasoned that the transfer of stock from the estate to the mother, along with the simultaneous redemption, will for tax purposes be considered transitory and without economic substance. Thus, the corporation was considered to redeem the stock from the estate. By contrast, ______________ has substantial economic risk as a shareholder of Foreign Bank (as will Investor, as a shareholder and option holder of Foreign Bank). Since, in the instant case, Foreign Bank is a publicly traded company, which subjects ______________ and Investor to risk as shareholders of Foreign Bank, the present case is distinguishable from Revenue Ruling 68-388.

b. "Equity Risk" -- section 246(c)(4) and Treasury Regulations section 1.246-5.

______________ will write call options on the shares it holds in Foreign Bank. Additionally, ______________ will purchase put options on such shares. These measures serve to hedge some of the risk of holding Foreign Bank shares, but may raise issues as to ______________'s ownership of these shares for U.S. tax purposes. Nevertheless, applying the principles found in the dividends received deduction rules, ______________ should be treated as the owner of the Foreign Bank shares.

A dividend is defined in section 316, in part, as a distribution of property made by a corporation to its shareholders. Section 243 generally provides a dividends-received deduction ("DRD") for dividends received by a corporate shareholder. However, section 246(c) denies the benefits of the dividends received deduction to corporate shareholders that hold the stock of an investment corporation for 45 days or less during the 90 day period beginning on the date that is 45 days before the date on which the stock becomes ex-dividend, with respect to that dividend. This arbitrary 45-day holding period indicates Congressional belief, that after a period of 45 days, a taxpayer should be considered a shareholder for purposes of receiving the DRD with respect to a particular dividend. As a result, it reasonably follows that "shareholder" status should generally be granted to taxpayers who satisfy a 45-day holding period. Consequently, it would be difficult to argue that ______________ does not "own" Foreign Bank stock, if ______________ holds Foreign Bank stock for at least 45 days within the 90-day period bracketing the redemption of the Foreign Bank shares.

Regulations section 1.246-5 provides for a reduction in the 45-day holding period for any period during which a taxpayer has diminished its risk of loss by holding positions with respect to substantially similar or related property. A taxpayer has a diminished risk of loss on its stock by holding positions with respect to substantially similar or related property if changes in the fair market values of the stock and the positions are reasonably expected to vary inversely.

Generally, section 246(c)(4) provides that the holding period for stock, for purposes of the DRD, is reduced for periods where the taxpayer has diminished risk of loss from an option to sell, or through the granting of an option to buy. However, pursuant to section 246(c)(4) a "qualified covered call" is not considered an option that diminishes the taxpayer's risk. Further, Regulations section 1.246-5(c)(2) provides that an option to sell (a put) that is significantly "out of the money" should not be treated as diminishing the taxpayer's risk of loss on its stock, unless the option is held as part of a strategy to substantially offset changes in the fair market value of the stock.

For purposes of section 246(c)(4), a "qualified covered call" is defined as a call option which is:

(i) listed on an established securities market;

(ii) granted for more than 30 days; and

(iii) not deep-in-the-money at the time of issuance.

Treasury Regulations section 1.1092(d)-l(b)(l)(iv) provides that established securities markets will generally include a foreign securities exchange that, under the law of the jurisdiction where it is organized, satisfies requirements that are analogous to the regulatory requirements under the Securities Exchange Act of 1934. Examples of foreign exchanges that satisfy the Secretary's requirements are: London International Financial Futures Exchange; Marche a Terme International du France; International Stock Exchange of the United Kingdom and the Republic of Ireland; Frankfurt Stock Exchange; and Tokyo Stock Exchange.

Section 1092(c)(4) provides that "deep-in-the-money" means an option having a strike price lower than the lowest qualified benchmark. For example if Foreign Bank shares could be written in five (5) dollar increments, shares selling for forty (40) dollars would have options with strike prices of thirty-five (35), forty (40), and forty-five (45) dollars. Similarly, shares selling for forty-two (42) dollars would have options with strike prices of forty (40), forty-five (45) and fifty (50) dollars. The lowest qualified benchmark for options written for a period of not more than ninety (90) days is generally <u>the highest strike price which is less than the stock price</u>. For example, when the stock price is forty-two (42) dollars, a less than 90-day option written with a strike price of forty (40) dollars or more would be a qualified covered call, but an option with a strike price of thirty-five (35) would not.

______________'s option was written at an exercise price of CHF , which was 95% of the initial share price, provided that, if on any Exchange Business Day prior to the Expiration Date, the Closing Price of the shares was equal to or less than CHF per share then the exercise price would be 90.25% of the initial share price. In evaluating whether this option sufficiently diminished the taxpayer's risk, it is important to note the exceedingly high share price of Foreign Bank. Examples provided in the regulations typically deal with shares with prices ranging between forty (40) and one hundred (100) dollars. Given that the Foreign Bank shares trade at prices closer to one thousand (1,000) dollars, it is appropriate to view these examples in terms of percentage rather than as strict benchmarks. Thus, if the share price is at fifty (50) dollars and the options are at (45), a 10% discount would satisfy this standard. As such, an option written at 95% of the initial price should not be viewed as sufficiently diminishing risk of loss, and should be viewed as tantamount to a qualified covered call.

A put option is generally considered significantly "out-of-the-money" if it is greater than one benchmark below the current price of the stock. <u>See</u>, by negative inference, Treasury Regulations section 246-5(c)(2)(i) and Code § 1092(c)(4). For Foreign Bank shares, one benchmark would be at least one hundred (100) Swiss francs ("CHF"). For instance, if the stock is selling at CHF 1210, an option at CHF 1100 should be considered significantly "out-of-the-money."

On May 27, 1993, the Treasury issued Proposed Regulations section 1.246-5. In the preamble to the Proposed Regulations, the Treasury indicated that whether a taxpayer has diminished its risk of loss on stock by holding an option depends on the degree of risk protection that the option affords. Specifically, Proposed Treasury Regulations section 1.246-5(b)(3) provided that "an option diminishes the taxpayer's risk of loss on its stock if decreases in the fair market value of the stock are expected to be offset substantially by increases in the fair market value of the option." Typically, this situation will generally occur only when an option to sell is "in-the-money." The proposed regulation went on to state that options to sell that are significantly "out-of-the-money" will not be treated as diminishing the taxpayer's risk of loss on its stock.

Proposed Treasury Regulations section 1.246-5 was finalized by Treasury on May 17, 1995. The final regulations maintain the language that "an option to sell that is significantly out of the money does not diminish the taxpayer's risk of loss on its stock." Treasury Regulations section 1.246-5(c)(2) did, however, add a further caveat, i.e., where an "out-of-the-money" option is held as part of a strategy to substantially offset changes in the fair market value of the stock, the Treasury can consider that option to reduce the taxpayer's risk. Although Treasury has indicated that a determination needs to be made on a case-by-case basis (and cases have yet to interpret what would be considered to be a strategy under Treasury Regulations section 1.246-5(c)(2)), some guidance may be derived from prior rulings and cases.

In Revenue Ruling 80-238, 1980-2 C.B. 96, the Service held that where the taxpayer is not in a risk-free position, or where the element of investment risk is not greatly reduced or eliminated (for example in the case of "in-the-money" call options), the DRD holding period should not be reduced. Although this ruling was issued prior to Treasury Regulations section 1.246-5(c)(2), it captures the spirit of section 1.246(c)(4): which is that where a taxpayer is not in a risk-free position, or in situations where the element of investment risk has not been greatly reduced, the DRD should be available. For example, if the taxpayer were to write a call option and sell a put ("forward conversion") at the same strike price, the taxpayer would be shielded against loss regardless of the movement of the stock. Essentially, the call and put options would function as a synthetic short position and insulate the long position, analogous to a "short-against-the-box" transaction. For example, in Progressive Corporation v. U.S., 970 F.2d 188 (6th Cir. 1992), it was determined that the taxpayer's holding period for purposes of the DRD should be reduced for the period that the taxpayer held forward conversions on shares of stock where dividends were paid. However, where the taxpayer purchases an out-of-the-money option to sell, without writing a call option with the same strike price, a degree of risk exists such that the taxpayer is subject to loss and therefore the holding period should not be reduced.

Additionally, the plain language of section 246(c)(3) was enacted to reduce a taxpayer's holding period for any period during which the taxpayer is in both a long and short position. S. Rep. No. 85-1983, at 28-29 (1958), 1958-3 C.B. 922, 949-50. See also Treas. Reg. § 1.246-3(d)(2), not amended to reflect changes made by Pub. L. Nos. 99-514, 98-369. This would lend support to the assertion that the types of transactions to which Treasury Regulations section 1.246-5 was intended to apply are those where the taxpayer is substantially free of risk, either as a result of entering into a short position or by substantially creating a synthetic short position.

In the proposed transaction, ______________ will hold the Foreign Bank stock for more than 45 days. Thus, ______________ should be considered a shareholder under the criteria established by Congress for a taxpayer to be considered a shareholder for purposes of the dividends received deduction. Further, ______________'s holding period should not be "tolled" due to its hedges since the hedges involved do not fall within the definition of a diminished risk of loss as set forth in section 246, in conjunction with the definitions set forth in section 1092 and the regulations thereunder.

2. **Application of the step transaction doctrine.**

The step transaction doctrine is a judicially created concept, which treats a series of separate steps as a single transaction when the steps are considered integrated parts of a single plan. The purpose of the step transaction doctrine is to prohibit the breaking down of an integrated transaction into independent steps or, conversely, to combine separate steps in determining tax consequences. The substance of each of a series of steps is recognized and the step transaction does not apply, if each step has independent economic significance, is not subject to attack as a sham, and is undertaken for valid business purposes.

If the step transaction doctrine were to be applied to the present situation, Foreign Bank's redemption of its stock held by ______________ and Investor's disposal of its Foreign Bank stock and options might be integrated into a single transaction. As a result, the holdings of Investor would not be attributed to ______________ when determining the treatment of ______________'s redemption under section 302. Without the attribution of Investor's stock and options, ______________'s redemption would be a complete termination of its interest in Foreign Bank and would qualify as an exchange under section 302(b)(3). This would absorb ______________'s basis in its Foreign Bank stock, leaving none to be allocated to Investor's Foreign Bank shares.

A seminal step transaction doctrine case is Zenz v. Quinlivan, 213 F.2d 914 (6th Cir. 1954). In that case, the taxpayer wished to sell her stock in a corporation in which she was the sole stockholder. Because the buyer did not want to purchase all of her stock, they agreed that she would sell him part of her stock and the corporation would redeem her remaining shares. While the district court held that the distribution of substantially all of the earnings and surplus of a corporation was essentially equivalent to a dividend, the Sixth Circuit reversed and found that the redemption and sale steps were part of an integrated plan to liquidate the taxpayer's holdings in the corporation, and therefore, the redemption was not essentially equivalent to a dividend.

While courts have not agreed on a single test or standard for determining when and how to apply the step transaction doctrine, there have developed three tests. These are the "binding commitment" test, the "mutual interdependence" test, and the "end result" test.

a. Binding commitment test.

The binding commitment test, introduced in Commissioner v. Gordon, 391 U.S. 83 (1968), is the most narrow of the tests. Under this standard, steps are integrated when a binding commitment is present. Otherwise, courts will usually apply one of the other tests. Because there will not be any agreements between or among the parties in the transaction (i.e., between Investor, ______________, and Foreign Bank), this test should not apply.

b. Mutual interdependence test.

The mutual interdependence test requires inquiry as to whether, on a reasonable interpretation of objective facts, the steps of a series of transactions are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series. See King Enterprises, Inc. v. U.S., 418 F.2d 511 (1969). In Associated Wholesale Grocers, Inc. v. U.S., 927 F.2d 1517 (10th Cir. 1991), the court applied the mutual interdependence test to integrate the transactions then at issue. The facts in that case involved the taxpayer's sale, by means of a taxable merger, of a subsidiary (which owned stock of a second-tier subsidiary and other assets) to an unrelated corporation, followed immediately by a purchase by the seller of all the assets previously owned by the merged subsidiary, except for the stock of the second-tier subsidiary. The taxpayer characterized the two transactions in accordance with their form and recognized a loss on the taxable merger. The Service, by integrating the two transactions, characterized the transactions as a liquidation of the subsidiary on which no loss was recognized by the taxpayer. In holding for the Service, the court found that the merger step was entirely contingent on the sale of assets, as evidenced by the fact that the Agreement of Merger stated that it would terminate if the Plan of Reorganization (the terms of which included the sale of assets step) was not effectuated. The court also based its holding on the short period of time between the steps, because virtually no time passed between the effectiveness of the steps.

In American Bantam Car Co. v. Commissioner, 11 T.C. 397 (1948), the Tax Court refused to apply the step transaction doctrine in holding that a transfer of property to a controlled corporation was tax-free even though the transferors were subsequently divested of the requisite controlling ownership interest through assignment of shares to underwriters. Shares of common stock were to be transferred to the underwriters upon their placement of preferred stock in the corporation. The court distinguished two prior cases in which the mutual interdependence test was used to apply the step transaction doctrine. In the prior cases, the assignment of shares received in a reorganization was not discretionary and the taxpayer was bound unconditionally. In American Bantam Car, however, the taxpayers had complete ownership of the shares received and the subsequent assignment was merely part of a general plan. The court stated that "[a]t most, there was an informal oral understanding of a general plan contemplating the organization of a new corporation, the exchange of assets for stock, and marketing of preferred stock of the new corporation to the public." Id. at 405. A mere informal oral understanding of a general plan is insufficient to result in the application of the step transaction doctrine.

In McDonald's of Illinois v. Commissioner, 688 F.2d 520 (7th Cir. 1982), the Seventh Circuit reversed the Tax Court's holding that the transactions at issue should not be stepped together. The taxpayers merged their restaurant franchises into McDonald's in exchange for McDonald's stock which was unregistered when received but would be registered (and, hence, transferable) shortly thereafter. While the taxpayers fully intended to and eventually did dispose of their McDonald's stock, they were under no legal obligation to do so. McDonald's, desiring a stepped up basis in the assets acquired, argued that the step transaction doctrine was applicable and, therefore, the continuity of interest requirement for reorganization was not satisfied. The Tax Court in McDonald's of Zion v. Commissioner, 76 T.C. 972 (1981) had applied the mutual interdependence test and held that the discretionary nature of the sale by the taxpayers and the fact that the merger was not contingent on the subsequent sale indicated that the transactions were not interdependent. The Seventh Circuit reversed, stating that the Tax Court's interpretation of the mutual interdependence test looked more like the binding commitment test. Instead, the court applied the step transaction doctrine to combine the merger and the subsequent sale because the facts indicated that the merger would not have taken place if the taxpayers would not have been able to dispose of their stock.

The facts in Penrod v. Commissioner, 88 T.C. 145 (1987) also involved the acquisition by McDonald's of franchises in exchange for McDonald's stock. The key difference from McDonald's of Zion was that the taxpayers did not originally intend to dispose of their stock. The court rejected the Service's claim that the merger and subsequent sale should be stepped together. The court looked at the intent of the parties in applying the mutual interdependence test and held that the step transaction doctrine did not apply.

We do not believe that the steps in the instant transactions would be found to be mutually interdependent. In Associated Wholesale Grocers, the step transaction was applied because the sale contract stated that it would terminate if the merger was not effected and because there was virtually no time between the steps. In the instant situation, the redemption transaction occurred whether or not Investor disposed of its Foreign Bank stock and options, and is independent thereof. Also, although the transactions did occur within a relatively short period of time, Investor has held some Foreign Bank stock, and it is anticipated that Investor will continue to hold the Foreign Bank stock for an indeterminately long time period. Moreover, as in American Bantam Car, ______________ had complete ownership of the Foreign Bank shares and any subsequent purchase of Foreign Bank shares by Investor cannot be said to have been more than part of a general plan. Not only was Investor not bound to directly purchase or sell Foreign Bank stock and options, Investor could have decided never to make a direct investment in Foreign Bank stock and options (because, for example, it did not expect the Foreign Bank stock price to have the potential for future appreciation). Although Investor would gain a tax benefit from a direct investment in Foreign Bank stock and options purchased when ______________ stock was redeemed, it cannot be said that the investment in Foreign Bank by ______________ would have been fruitless without that parallel investment made by Investor, and vice versa. At most, there was an informal, oral understanding of a general plan, which included the option that Investor could also make a direct investment in Foreign Bank. Furthermore, as stated above, there were no formal or informal agreements, which made the transactions dependent or contingent on each other. Unlike McDonald's of Zion, it cannot be said that ______________'s investment in Foreign Bank stock or the subsequent redemption would not have taken place without Investor's investment in Foreign Bank. Finally, Investor was under no compulsion to buy or sell its Foreign Bank shares and options.

It should be noted that the Service, in Revenue Ruling 79-250, 1979-2 C.B. 256, added an additional "business purpose" element to the mutual interdependence formulation, i.e., each step must be undertaken for a separate business purpose. This ruling has since been modified by Revenue Ruling 96-29, 1996-1 C.B. 50 which emphasizes that the central holding in Revenue Ruling 79-250 is the unique status of reorganizations under section 368(a)(1)(F) and that Revenue Ruling 79-250 is not intended to reflect the application of the step transaction doctrine in other contexts. The courts have also been inconsistent in the degree to which they have analyzed or even acknowledged the importance of business purpose in the step transaction analysis. See Associated Wholesalers, supra. Because each of the transactions undertaken by the parties is supported by a reasonable expectation of profit, we believe that if business purpose was analyzed in this context, this could only reinforce a conclusion that the steps are not interdependent.

c. End result test.

The "end result" test, which is the most frequently used of the three tests, combines purportedly separate business transactions into a single transaction when it appears that they are really component parts of a single transaction, intended from the outset to be taken for the purpose of achieving the ultimate result. This test makes intent a necessary element for the application of the step transaction doctrine. See Brown v. U.S., 782 F.2d 559 (6th Cir. 1986).

i. Application in redemption transactions.

The cases dealing with stock redemptions have applied this test, finding an integrated transaction when "the redemption occurs as part of a plan which is firm and fixed and in which the steps are clearly integrated." Niedermeyer v. Commissioner, 62 T.C. 280 (1979); Leleux v. Commissioner, 54 T.C. 408 (1970); Bleily & Collishaw v. Commissioner, 72 T.C. 751 (1979). The fact patterns in many of these cases address whether shareholders involved in several different redemptions of their stock have had in place an integrated plan with respect to such redemption, causing such shareholders to qualify for sale treatment with respect to the redemptions.

In Bleily & Collishaw, the taxpayer corporation, a construction contractor, owned 30% of a subcontractor with which it did business. The other shareholder of the subcontractor wanted sole control and taxpayer agreed to sell all of its shares to the corporation. The subcontractor did not have enough cash to repurchase the shares at the time, but expected to earn sufficient funds over the next six months. The parties agreed that the subcontractor would repurchase all of the stock held by taxpayer as funds became available. In integrating the transactions, the court held that there was a firm and fixed plan to redeem all of taxpayers shares and upheld the taxpayer's exchange treatment on each partial redemption transaction.

Roebling v. Commissioner, 77 T.C. 31 (1981) involved the redemption of a company's preferred stock as part of a recapitalization. To this end, the company redeemed a set number of shares each year. The taxpayer offered to and did have a portion of her shares redeemed each year to the extent that other preferred shareholders did not offer their shares for redemption. A provision to this effect was included in the corporation's articles of incorporation. The Tax Court found that there was a firm and fixed plan to redeem all of the shares of taxpayer, and upheld the taxpayer's exchange treatment.

The courts have found a series of redemptions to be part of a single integrated plan in other cases, including U.S. v. Carey, 289 F.2d 531 (8th Cir. 1961); Tiffany v. Commissioner, 16 T.C. 1443 (1951); Monson v. Commissioner, 79 T.C. 827 (1982); and Howell v. Commissioner, 26 T.C. 846 (1956). In all of these cases, a complete termination of the taxpayer's interest was the end result of the transactions and capital gain treatment was appropriate. In Howell, where some of the taxpayers did not have a complete termination, however, a fixed and firm plan was not found, and those shareholders received dividend treatment.

In many other redemption cases, the courts did not find a fixed and firm plan. In Niedermeyer, taxpayers owned a portion of the common stock and preferred stock of a closely held corporation. They sold their common stock to a corporation which was controlled by their sons. Three months later, they donated their preferred stock to a charity, as they had done previously. The taxpayers claimed that these dispositions effected a complete termination of their interest in the corporation and should be integrated into a single transaction. The Tax Court disagreed, finding that there was no indication of a fixed and firm plan in this case. The court said that while a plan does not "need to be in writing, absolutely binding, or communicated to others," such factors tend to show a plan which is fixed and firm.

In Leleux, the court reached a similar conclusion. Following an accident for which the corporation faced potential liability, taxpayers decided to redeem as much of their stock as possible. While the parties never adopted a formal plan, taxpayers claimed that there was a "gentleman's agreement" to redeem their stock. Over a three-year period, a series of redemptions occurred which decreased taxpayers' interest in the corporation from 86.3% to 53.5%. However, the court held that the redemptions were essentially equivalent to a dividend, because there was not a fixed and firm plan with clearly integrated steps. In addition, the court noted that there was a lack of intent to terminate the shareholders' interest.

In Johnson v. Commissioner, 78 T.C. 564 (1982), the taxpayer owned stock in a corporation that underwent a reorganization following a dispute between its two major shareholders. As part of the reorganization, taxpayer received new common shares and a large cash distribution. In addition, the agreement between the two major shareholders required one of the major shareholders to tender an offer to purchase the new common shares of all of the other shareholders. The other major shareholder was required under the agreement to tender its stock pursuant to this offer. Taxpayer, however, decided to sell a portion of his new common stock to the major shareholder and tried to characterize the income from the reorganization and sale as deriving from a single transaction. The Tax Court held that these transactions were not part of an integrated plan because the taxpayer was under no obligation to tender his shares.

Other cases in which the court refused to find an integrated plan include Benjamin v. Commissioner, 66 T.C. 1084 (1976) and Johnston v. Commissioner, 77 T.C. 679 (1981). However, Niedermeyer is significant as the only case where the court refused to integrate the steps of a transaction when a complete termination of interest occurred.

The Service has ruled on this issue as well. In Revenue Ruling 77-226, 1977-2 C.B. 90, taxpayer corporation purchased $1 million of shares in X corporation following X corporation's announcement that it would repurchase its shares. X corporation then redeemed 20% of the purchased shares, and taxpayer reported the proceeds as a dividend and claimed a dividends received deduction. Two weeks later, taxpayer sold the remaining shares on the open market, claiming a capital loss due to the carryover of basis from the previously redeemed shares. Without explanation, the Service held that these two transactions were part of an integrated plan, and must be considered together. Accordingly, the taxpayer was denied the dividends received deductions and suffered no loss on the later sale.

The step transaction doctrine was also applied in General Counsel Memorandum 39290, where taxpayer purchased $3 million in shares of a merger target and then surrendered his stock for $1.5 million cash and $2 million in acquirer stock pursuant to the merger. Taxpayer characterized the $.5 million in gain as a dividend eligible for the dividends received deduction. Taxpayer then sold its remaining stock within three months on the open market for an amount roughly equal to its basis. Taxpayer had engaged in a pattern of similar transactions in prior years. The Service ruled that the facts show that the taxpayer had the intent to dispose of all of its shares soon after the merger and therefore, the transactions should be integrated. In support of this conclusion, the Service noted that most of the gain was from the dividend that it claimed it received, while the gain, if any, from an increase in the price of the stock would be "minuscule."

Both Revenue Ruling 77-226 and GCM 39290 ignore the fact that the sales following the redemptions were voluntary and thus unrelated. Both fact patterns are similar to the facts in Johnson where the taxpayer sold some of the stock received in a recapitalization. The court there held that there were separate transactions because the taxpayer was under no obligation to redeem his shares; so should the taxpayers in Revenue Ruling 77-226 and GCM 39290. Arguably, the result in GCM 39290 would have been different, had the taxpayer's past conduct not indicated the existence of a plan.

ii. Application to instant transaction.

Whether the end result formulation of the step transaction doctrine is applicable turns on whether the transactions entered into by ______________ and Investor are part of a "fixed and firm" plan such that they should be integrated into a single transaction. The case law does not provide any absolute standards as to what constitutes a fixed and firm plan, but provides some guidance. While a formal written plan is not required (Niedermeyer), a mere "gentleman's agreement" is insufficient to find a fixed and firm plan (Leleux). However, as the decisions in Esmark and Standard Linen make clear, the existence of a plan alone does not justify the application of the step transaction doctrine.

In general, the intent to act in accordance with a plan is important. This intent can be demonstrated by looking at whether the transactions have an independent business purpose. If a transaction does not have economic significance apart from another transaction, this is evidence that the transactions were intended to be part of an integrated plan. On the other hand, the fact that the transactions have an independent economic significance should generally be supportive, although not conclusive, that the step transaction doctrine does not apply. We believe that the transactions entered into by Investor should be treated as having independent economic significance.

The courts and Service also consider the past and present actions of the parties to be indicative of a plan. In GCM 39290, the Service relied heavily on the past conduct of the taxpayer in finding the existence of a plan. In Niedermeyer, where the taxpayer had made sporadic charitable contributions, the court refused to find the existence of a plan. The court in Leleux pointed out that the corporation did not take action to formalize the plan, as it could have

Generally, the cases in which a plan was found involved taxpayers whose actions were in accord with the existence of a plan. In Roebling, the taxpayer and the redeeming corporation built the plan into the corporation's articles of incorporation. They then acted in conformity with the plan, over a 12-year period. The parties in Bleily & Collishaw agreed on a course of action and acted in accordance with that plan.

Here, there is no history of conduct among the parties to indicate that they were acting in accordance with a plan. Furthermore, Investor did not liquidate its entire holdings in Foreign Bank and still has the benefits and risks associated with the ownership of those shares. Because neither Investor nor ______________ was under any obligation to have its shares redeemed or to sell its shares, the independence of the redemption transaction should be respected.

Another distinguishing factor from all of the cases and rulings cited above, is that two different taxpayers sold their stock in two distinct transactions. The step transaction doctrine is generally not applicable to contemplate the attribution of one shareholder's disposition to a related shareholder under the attribution rules of section 318. This argument is supported by the fact that the redemption from ______________ preceding the sale by Investor has independent economic significance.

Based on the above analysis, we believe it is more likely than not that the step transaction doctrine should not apply to the transactions entered into by Investor and ______________.

3. **Application of the agency doctrine.**

Under the agency doctrine, if applicable, ______________ would be recharacterized as Investor's agent in effecting the various transactions. ______________ would be treated as a mere representative of Investor, and its actions would lack independent significance. Consequently, Investor would be deemed the true owner of the Foreign Bank stock purchased by ______________. Investor would be deemed to have received the constructive dividend received by ______________.

The Supreme Court has addressed the issue of whether an agency relationship existed and affected tax results of a transaction in a number of cases. In Commissioner v. Bollinger, 485 U.S. 340 (1988), a taxpayer engaged in rental real estate development, both in an individual capacity and through a series of partnerships. Since state usury law limited the rate of interest that could be charged to non-corporate debtors, at the request of the taxpayer, Bollinger formed a wholly owned corporation to be the nominal borrower. An agreement provided that the corporation would hold title to the property as the partnership's nominee and agent solely to secure financing. The partnership had sole control of and responsibility for the property and was the principal and owner during financing, construction and operation. The corporation itself had no assets, liabilities or bank accounts. In every case, the lenders regarded the partnership as the owner of the property and were aware that the corporation was acting as an agent of the partnership in holding record title. Further, the partnerships reported the income and losses generated by the property on their partnership tax returns and actively managed the properties.

Using the six-part test established in National Carbide v. Commissioner, 336 U.S. 422 (1949), the Supreme Court held that the corporation was a bona fide agent of the taxpayer and partnerships and rejected the contention of the Service that the corporation was the true owner of the real estate developments. The six "National Carbide factors" applied were:

(1) whether the corporation operates in the name and for the account of the principal;

(2) whether the agent corporation binds the principal by its actions;

(3) whether the corporation transmits money received for the account of the principal to the principal;

(4) whether the receipt of income is attributable to the services and assets of the principal and not the agent;

(5) whether the corporation is a true agent; that is, whether its relations with its principal are dependent on the latter's ownership of the agent; and

(6) whether its business purposes are the carrying on of the normal duties of an agent.

The Court found that the genuineness of the agency relationship was adequately assured in this instance because (1) the relationship was set forth in a written agreement at the time each development was begun; (2) the corporation acted as an agent and not principal with respect to the development for all purposes; and (3) the corporation held itself out as an agent and not as principal in all dealings with third parties related to the assets.

In Cottage Savings v. Commissioner, 499 U.S. 554 (1991), the taxpayer was a savings and loan association which had large unrealized losses from its portfolio of long-term, low-interest home mortgages. Due to regulatory constraints, the taxpayer was unable to sell the loans without the risk that the resulting losses would result in regulatory closure of the savings and loan. As an alternative, the taxpayer's regulator proposed that the taxpayer trade participation in various mortgages in their loan portfolios with other savings and loans with the intention that such trades would be treated as recognition events for federal income tax purposes. As a result, the taxpayer traded a package of participation interests in its loan portfolio for similar interests in the portfolios of four other savings and loans.

The Service contended that the trades were not tax recognition events, arguing in part that the trades had no economic effect. The Service argued that the taxpayer's partners in the trade were merely acting as its agents resulting in the taxpayer retaining de facto ownership in the "transferred" interests. In finding for the taxpayer, the Supreme Court held that the transactions did have economic effect because (1) there was no evidence that the parties had acted other than at arm's length and (2) the taxpayer had not retained de facto ownership. The Court reasoned that because the mortgages traded involved different mortgagors and different properties securing the mortgages, there was in fact an exchange of legally distinct properties giving rise to a true economic effect for tax purposes.

In a recent case, Northern Indiana Public Service Co. v. Commissioner, 97-1 U.S.T.C. ¶ 50,474 (7th Cir. 1997), the Seventh Circuit Court of Appeals addressed the agency issue as well. At issue was whether a foreign subsidiary of the taxpayer carried on sufficient business activity so as to require separate recognition of its borrowing and lending transactions with its parent company, which would result in tax exempt treatment under the U.S./Netherlands tax treaty. The Service took the position that the treaty was inapplicable, claiming that the subsidiary was a mere conduit or agent in the borrowing and interest paying process. The Tax Court rejected the Service's argument and held that the subsidiary was cognizable for tax purposes and, therefore, the payments were tax exempt under the treaty.

In affirming the decision, the Court of Appeals approved the Tax Court's reliance on a line of cases, discussed below--Moline Properties v. Commissioner, 319 U.S. 436, Hospital Corp. of America v. Commissioner, 81 T.C. 320, Ross Glove Co. v. Commissioner, 60 T.C. 569, Bass v. Commissioner, 50 T.C. 595, Nat Harrison v. Commissioner, 42 T.C. 601--for the principle that "so long as a foreign subsidiary conducts substantive business activity--even minimal activity--the subsidiary will not be disregarded for federal tax purposes, notwithstanding the fact that the subsidiary was created with a view to reducing taxes."

In Moline Properties, supra, petitioner sought to have gain on sales of its real property treated as the gain of its sole stockholder, and its corporate existence ignored as merely fictitious. The corporation was originally organized as a security device in connection with realty owned by the sole shareholder. The activities of the corporation included assumption of a certain obligation of the sole shareholder, the defense of certain condemnation proceedings and the institution of a suit regarding property. The expenses of the suit were paid by the sole shareholder. Petitioner corporation had no books or bank accounts and owned no other assets. In holding that the corporate entity was to be respected, the court stated:

> Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity.

Hospital Corp. of America, supra, involved a Cayman Islands subsidiary created to negotiate and perform a management contract with a Saudi Arabian Hospital. The Service contended that this was a sham corporation and should be disregarded for federal tax purposes. The Tax Court held that the use of a separate corporation for ease of assignment of responsibility or for keeping a separate accounting of the profits is a valid business purpose. Further, the corporation actually carried on "some minimal amount of business activity" in the year in question, and its identity was recognized by third parties. As a result, the court held that the corporation should be respected for federal tax purposes. Similarly, in Ross Glove Co., supra, the Tax Court held that a Philippine corporation was organized for the valid business reasons of manufacturing and accumulation of funds for foreign expansion and, therefore, was to be respected as a distinct entity.

In the seminal case of Court Holding Co., 324 U.S. 331 (1945), the taxpayers' wholly-owned corporation negotiated for the sale of an apartment house, which was the sole asset of the corporation. Upon determining that a significant two-level tax liability would be triggered from the sale of the apartment house by the corporation and distribution of the proceeds to the two shareholders, the corporation distributed the apartment house to the shareholders as a tax-free liquidating distribution (as permitted under then-current law), who then immediately sold the apartment house to the ultimate purchaser, and reported only one level of taxable gain. However, the Supreme Court imposed a second level of taxation by imputing the gain on sale of the property to the corporation under a conduit analysis pursuant to the following often-quoted language from the court's opinion:

> "The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title."

324 U.S. at 334. Although Court Holding specifically addressed the avoidance of two levels of tax by distribution of property from a corporation to its shareholders immediately prior to consummation of a previously negotiated sale, the rationale set forth by the Supreme Court has been applied on an equal basis to property contributed by controlling shareholders to a corporation for purposes of offsetting anticipated gain on an immediate sale of the property by the corporation with accumulated net operating losses ("*NOLs*") of the corporation. See Abbott v. Commissioner, 23 T.C.M. (CCH) 445, aff'd per curiam, 342 F.2d 997 (5th Cir. 1965); Palmer v. Commissioner, 44 T.C. 92 (1965), aff'd per curiam, 354 F.2d 974 (1st Cir. 1965).

Here, the Service may seek to argue under Court Holdings that Investor should be treated as the "true" seller of Foreign Bank stock redeemed from _______________.

Notwithstanding the potentially broad application of the rationale of the Court Holding, Abbott and Palmer line of cases, the Tax Court in Rollins v. Commissioner made clear that "[t]he conduit analysis does not mean that a controlling shareholder can be taxed on the gain from the sale of property where the corporation has actually sold the property following a genuine contribution of the property." See Rollins v. Commissioner, 66 T.C.M. (CCH) 1869, 1891 (1993); Anderson v. Commissioner, 92 T.C. 138, 164-165 (1989). This normally leads to a three-party inquiry when a corporation sells property "contributed" to it by one of its shareholders, viz. (1) whether the shareholder controls the corporation; (2) whether the corporation actually sold the property; and (3) whether the contribution of the property to the corporation was genuine.

Here, Investor at no time "controls" _____________ (Investor holds the Warrant with respect to ______________ but such Warrant does not entitle it to vote or otherwise exercise control), ______________ bought the Foreign Bank stock with substantially all its own funds and then later sold the Foreign Bank stock, receiving the proceeds therefrom for its own account. Investor did not "contribute" the Foreign Bank stock to ______________. Thus, a Court Holding argument seems entirely misdirected.

In Bass, supra, the Tax Court, using the "ground rules" established in Moline Properties and National Carbide, held that the corporate entity established by the taxpayer was to be respected. According to the court, such rules are established by

> innumerable court decisions, which make it clear that a taxpayer may adopt any form he desires for the conduct of his business and that the chosen form cannot be ignored merely because it results in a tax saving. However to be afforded recognition, the form must be a viable business entity, that is, it must have been formed for a substantial business purpose or actually engage in a substantive business activity.

Nat Harrison, supra, also involved a contention by the Service that a corporate entity should be disregarded. In its opinion, the Tax Court stated that "[w]hether the primary reason for its existence and the conduct of business was to avoid U.S. taxes or to permit more economical performance of contracts through the use of native labor, or a combination of these and other reasons, makes no difference in this regard. Any one of these reasons would constitute a valid business purpose for its existence and conduct of business as long as it actually conducted business."

Based on the above line of reasoning, the Northern Indiana court went on to state that "these cases engender the principle that a corporation and the form of its transactions are recognizable for tax purposes, despite any tax avoidance motive, so long as the corporation engages in bona fide economically based business transactions."

In conclusion, it is unlikely that an application of the National Carbide agency factors to the instant transaction would result in a finding of agency. In the instant case, no indicia exist of a principal/agent relationship between Investor and ______________. Investor, ______________ and Foreign Bank will act independently of one another. ______________ will not operate in the name of Investor, has no authority to bind Investor by its actions, will not transmit or receive funds on behalf of Investor, will not receive income attributable to services or assets of Investor, and will not act as a true agent or have as its business purpose the carrying out of normal duties of an agent. Furthermore, unlike the facts in Bollinger, where a written agreement to act as agent existed, there are no agency agreements involved and no party will act as the agent of another or hold itself out as an agent in dealings with third parties. Moreover, as in Cottage Savings, there is no question that the parties are acting at arm's length and that the transactions between them have both legal and economic significance. Finally, consistent with the facts in Northern Indiana and related case law cited therein, _____________ will carry on substantive business activity in the form of its purchase and hedging of Foreign Bank shares. Thus, we are of the opinion that the agency doctrine should not be applied to the anticipated transactions.

4. Sham transaction/economic substance doctrine.

Transactions having no purpose or effect other than to reduce taxes will not be recognized for tax purposes. However, transactions which have a business purpose and economic substance will be respected, notwithstanding a taxpayer's purpose to reduce taxes.

In Frank Lyon Co. v. United States, 435 U.S. 561, 583-84 (1978), state and federal regulations precluded a bank from financing its headquarters building by conventional means. Therefore, according to a plan, the Frank Lyon Co. obtained the financing, took title to the headquarters building, and leased it back to the bank. The bank's rental payments were equal to Frank Lyon's principal and interest payments on the mortgage. The bank had an option to repurchase the building by taking over the mortgage and paying Frank Lyon's $500,000 initial investment. Focusing in large part on the fact that Lyon alone (and not the bank) was liable on the promissory notes, and that such obligation exposed the well-being of Lyon's business to real and substantial risk, the Supreme Court held that "where, as here, there is a genuine multiple-party transaction with economic substance that is compelled or encouraged by business or regulatory realities, that is imbued with tax independent considerations, and that is not shaped solely by tax-avoidance features to which meaningless labels are attached, the Government should honor the allocation of rights and duties effectuated by the parties."

Following Lyon, the courts have applied a two-part test to determine whether a transaction should be disregarded as a sham. In order for a transaction to be disregarded, "the court must find that the taxpayer was motivated by no business purpose other than obtaining tax benefits in entering into the transaction, and that the transaction has no economic substance because no reasonable possibility of profit exists." See Rice's Toyota World v. Commissioner, 752 F.2d 89, 91 (4th Cir. 1985), aff'g 81 T.C. 184 (1983). Although Rice's Toyota World set forth a two-part test, taxpayers typically have not been successful in merely showing that a transaction had some business purpose where the transaction lacked economic substance. However, the courts have generally respected transactions having a reasonable profit potential. Since many of the previous cases dealing with this issue are in the partnership context, see generally W. McKee et al., Federal Taxation of Partnerships and Partners ¶ 1.05[2][c] (2d ed. 1990) (hereinafter "McKee Treatise").

Under the second prong of the test (the "economic substance" prong), courts have typically examined the participants' evaluation of the transactions to determine whether the taxpayers had a non-tax economic motive. In many cases, the courts have found economic substance where the taxpayer conducted due diligence on the transaction, obtained qualified legal, accounting or appraisal assistance and/or prepared sound projections of the economic viability of the transaction. See Torres v. Commissioner, 88 T.C. 702 (1987) where a sale-leaseback was found to have economic substance where the transaction was structured so that "(t)he end-user leases existing at the time of the transaction and the high likelihood of profitably [re-leasing] the equipment for a substantial period of time following the termination of the initial leases would clearly leave a reasonable investor feeling confident that a substantial profit would be forthcoming during the term of the deal." See also Levy v. Commissioner, 91 T.C. 838 (1988) (economic analysis indicated reasonable prospect of profit supported by taxpayer's familiarity with computers and the leasing business and desire to diversify investment portfolio); and Pearlstein v. Commissioner, T.C.M. 1989-621 (thorough investigation, which included lawyers, accountants and expert appraisers, provided evidence that the taxpayer had a creditable profit motive).

Alternatively, in a number of cases transactions were found not to have economic substance. In Goldstein v. Commissioner, 364 F.2d 734 (2d Cir. 1966), the taxpayers borrowed funds at 4%, prepaid the interest expense and invested the money in Treasury Bills at 1-1/2%. With contemporaneous projections of an economic loss, the court found no profit motive or business purpose aside from the desire to obtain a tax benefit from the transaction. Both the Second Circuit and the Tax Court undertook a sophisticated economic analysis of the transaction to rebut the taxpayers' argument that if interest rates changed dramatically it was feasible that a capital gain would result.

In Sheldon v. Commissioner, 94 T.C. 738 (1990), the taxpayer engaged in a series of 11 "repo" transactions involving Treasury Bills, where under the law then in effect the interest expense was deductible currently, while the interest income was deferred until the T-Bill settled. Economically, Sheldon lost $60,000 on the 1981-82 transactions, but made $18,000 on the 1982-83 transactions. The court held that all 11 transactions lacked economic substance, in spite of the gain from the later transactions. "The potential for gain here, however, is not the sole standard by which we judge, and in any event, is infinitesimally nominal and vastly insignificant when considered in comparison with the claimed deductions. Moreover, there was insufficient potential in any gain to offset the losses locked in for the 1981 transactions."

Although both the Goldstein and Sheldon cases involved financing transactions with tax avoidance motives, in both cases the courts resisted the conclusion to characterize the transactions as shams, since they involved multiple parties. Rather, the courts struck down the transactions only after subjecting them to a rigorous and quite sophisticated financial analysis in the search for some profit motive.

Some courts have indicated that they would consider whether the profit motive for a transaction was greater or less than the tax motive. See Fox v. Commissioner, 82 T.C. 1001

(1994); Estate of Baron v. Commissioner, 83 T.C. 542 (1984), aff'd, 798 F.2d 65 (2d Cir. 1986); see also McKee Treatise ¶ 1.05(2)(c). However, a transaction may not be disregarded solely because its principal purpose was to avoid or evade tax. Goldstein v. Commissioner, 364 F.2d. 734 (2d. Cir. 1966). Congress has precluded such a broad test for disallowance by incorporating the "significant purpose" test only into specific Code sections (e.g., section 6662(d)(2)(c)(iii), discussed below). Long-standing judicial authority has also recognized that "any one may so arrange his affairs that his taxes shall be as low as possible." Helvering v. Gregory, 69 F.2d 809 (2d Cir. 1934). See also Cottage Savings Association v. Commissioner, discussed above, involving a transaction executed solely for tax purposes.

ACM Partnership v. Commissioner, T.C.M. 1997-115, decided March 5, 1997, has certain parallels to, and significant distinctions from, the present situation. ACM involved a foreign partnership that engaged in contingent installment sales transactions of notes that shifted income to a foreign partner and generated a capital loss to its U.S. partner Colgate-Palmolive (the party that incurred all the costs). The Tax Court found that at the time it entered into the partnership, Colgate's only real opportunity to earn a profit *in excess of transaction costs* was through an increase in the credit quality of the issuers of the LIBOR notes, or a 400-500 basis point increase in three-month LIBOR interest rates. The court found that the impact of credit quality was immaterial as the lenders were all extremely highly rated at the time of the transaction. Moreover, the court did a six-year review of three-month LIBOR rates and did not find an increase of even 300 basis points in the necessary time frame. Interest rates would have had to rise by at least 400-500 basis points, to a level of 13% or more, soon after the partnership acquired the LIBOR notes and be expected to remain at that level throughout the five-year life of the notes in order for Colgate to earn a sufficient return from the notes to cover transaction costs of the investment strategy. Since the analysis of the historical data showed no reasonable basis for expecting a profit, the court ruled against ACM. The court stated: "[w]e do not suggest that a taxpayer refrain from using the tax laws to the taxpayer's advantage. In this case, however, the taxpayer desired to take advantage of a loss that was not economically inherent in the object of the sale, but which the taxpayer created artificially through the manipulation and abuse of the tax laws. A taxpayer is not entitled to recognize a phantom loss from a transaction that lacks economic substance."

It should be noted that ACM was a Tax Court memorandum decision. Memorandum decisions are generally cases decided upon factual determinations alone (or involving issues that are considered settled in the law or of limited interest). As such, they are not decided by the full court and have less value as precedent. Also, ACM has filed for redetermination on the basis that the judge's analysis did not take into account all the profit potential from the transactions, so it may ultimately be reversed in favor of the taxpayer.

Unlike ACM, the present facts reveal that Investor has a distinct profit motive to its transactions. Investor reviewed ~~the economics~~ underlying each of the transactions described herein, and believed that it had a good probability of earning an acceptable profit from these transactions, in excess of all associated fees and costs and without regard to tax benefits. This belief was buttressed by contemporaneous historical analysis showing numerous recent instances where Investor would have earned a profit in excess of all fees and costs. See Ex. 15, entitled "RECAP Option Description." As Exhibit 15 illustrates, using a similar seven-year historical analysis similar to that relied upon by Judge Laro in ACM, the redemption transaction would have resulted in a pre-tax profit to Investor, in excess of all costs, 12% of the time. During any 50-calendar day period during this seven-year period, the RECAP options would have hit the pre-defined threshold on at least 20 days. This is based on certain conservative assumptions, including that investors are indifferent to the share price of Foreign Bank and the surrounding circumstances. However, Investor wishes to control the timing of its investment so as to take advantage of favorable circumstances (e.g., the announcement of a restructuring or the buy recommendation of a major security firm like Merrill Lynch or Lehman Brothers) or after a recent decline in share prices, as opposed to a recent run-up. Once timing is considered, the probability of profit increases. Further, in evaluating the most recent 12 month period for which numbers have been calculated, the profit percentage was 23.2%. For the most recent 3 month period for which numbers have been calculated, the profit percentage jumped to 66.1%. Clearly there are valid business reasons for entering into a transaction with such profit potential, with many instances of doubling the investment over a 50-day period.

While ACM was silent on what particular probability is needed (the court only concluded that it must be greater than zero) it is clear that the current facts are vastly superior to the installment transaction facts at issue in ACM, as Investor had as high as a 66.1% probability of profit. Thus, we believe that under the present state of the law, it is more likely than not that the "sham transaction" doctrine should not apply, since Investor had a reasonable chance of making a reasonable profit.

5. **Applicability of section 269.**

Under section 269, if a person acquires control of a corporation, or if a corporation acquires property of another corporation for the principal purpose of evading or avoiding income tax by claiming the benefit of a deduction, credit or other allowance that would otherwise not be available, then the benefit may be disallowed. This provision gives the Service broad powers, if it can prove that the principal purpose of the acquisition is the evasion or avoidance of federal income tax. Therefore, in order to prevent Investor from succeeding to ______________'s basis in its redeemed Foreign Bank stock, the Service must establish that Investor acquired control of ______________ through the purchase of its warrants and that such acquisition was made for the primary purpose of securing a tax benefit.

We believe that section 269 does not apply to prohibit Investor from assuming ______________'s basis in its redeemed Foreign Bank stock. Section 269(a) and Treasury Regulations section 1.269-1(c) defines control as the "ownership of stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote or at least 50% of the total value of shares of all classes of stock in the corporation." Although warrants are deemed exercised for purposes of section 302, there are no provisions providing for the same treatment under section 269. Because Investor merely owns warrants entitling it to purchase shares of ______________, and does not actually own any stock in ______________, it did not "acquire control" of ______________ within the meaning of section 269. The second part of section 269 relates to corporation acquiring "property" of another independent corporation in a carryover basis transaction. Here, no "carryover basis" transaction took place and thus the second part of section 269 is inapplicable. Thus, the disallowance rules of section 269 are inapplicable and thus the further question of whether the warrants were purchased for the purpose of evading or avoiding tax need not be addressed.

6. **Applicability of section 482.**

Section 482 allows the Service to allocate gross income, deductions, credits or allowances between or among organizations, trades or businesses "owned or controlled directly or indirectly by the same interests" if the Service "determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of such organizations, trades or businesses." The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining the true taxable income from the property and business of a controlled taxpayer, using the standard of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

The first issue is whether Investor and ______________ are under common control. As stated above, Investor merely owns warrants entitling it to purchase shares of ______________, and does not actually own any stock in ______________. Section 482 only addresses direct and indirect ownership, and does not mention constructive ownership, which includes attribution through warrants (which are generally treated as options). Option attribution has not been specifically legislated.

However, even if "control" could be established, the Service would have to show that the allocation of ______________'s basis to Investor or the failure to allocate ______________'s dividend income to Investor is an evasion of taxes or does not clearly reflect the income of ______________ and Investor. For the reasons set forth elsewhere herein, we believe that the transactions should be considered to have the requisite separate existence and substance to withstand attack under section 482. Further, the technical rules of section 302(b)(2) govern the basis shift and are expressly mandated in the regulations.

7. **"Clear reflection of income".**

Under Code section 446, the IRS has authority to reallocate items of income or expense that do not "clearly reflect income." Generally "in most cases, generally accepted accounting practices will pass muster for tax purposes" (Thor Power Tool Co. v. CIR, 439 U.S. 522, 540 (1979)), and further, the IRS has no authority to reject a tax accounting treatment explicitly authorized by Congress; nonetheless, this provision does give the IRS "much latitude for discretion." For example, in Ford Motor Co., 102 T.C. 87 (1994) the taxpayer was forced to utilize, for tax purposes, the same treatment as had been employed for financial statement purposes in expensing "structured settlements" (i.e., lawsuit installment settlement payouts). The Tax Court stated that the taxpayer's standard of proof in "clear reflection" cases was to "clearly show that the Commissioner's action was arbitrary, capricious or without sound basis in fact or law." Having so stated, however, the court went on to also require that the Commissioner's method "clearly reflect income" (i.e. reflect "true economic costs" or the "proper matching of income and expense"). Id. at 104. The Ford Motor case is distinguishable from the instant facts since it concerned distortion of net income caused by fully deducting, currently, payments extended over a long period of time.

In the present context, the IRS might seek to argue that, although the capital loss deduction is expressly sanctioned by statutory provisions, it results in a "distortion" of income as viewed through economic or accounting precepts and thus should be disallowed or deferred. Such arguments, though possible, should, more likely than not, fail. As Peninsula Steel Products & Equipment Co. v. Commissioner, 78 T.C. 1029 (1978) and other cases demonstrate, if a taxpayers treatment of an item is explicitly sanctioned by statutes or regulation, the IRS may not invoke the "clear reflection" doctrine to require the use of another method. See, e.g., Hallmark Cards v. Com'r, 90 T.C. 26, 31 (1988). Here, the capital loss deduction and the basis shift has express statutory authorization. Further, for the IRS to seek to force the taxpayer to defer recognition of the capital loss, whilst otherwise permitting the taxpayer to utilize a cash method of accounting, would likely be found by a court to be an abuse of IRS discretion, inasmuch as it results in a odd "hybrid" tax accounting method with no other result than the maximization of reported income. See, e.g., Sol C. Siegel Productions, 46 T.C. 15 (1966), acq. 1967-2 C.B. 3; Morgan Guaranty Trust Co. of N.Y. v. U.S., 585 F.2d 988 (Ct. Cl. 1978); Ansley-Sheppard-Burgess Co., 104 T.C. 367 (1995).

8. Applicability of section 1059 -- adjustments to basis from extraordinary dividends.

Section 1059 provides that corporate shareholders must reduce the basis of the stock they hold by the "nontaxed portion" of any "extraordinary dividends" paid thereon. Note that under section 1059(a)(1), the payee does not reduce its basis below zero. However, to the extent that this limitation prevents a reduction of basis, the payee must recognize gain upon a subsequent disposition of stock upon which an extraordinary dividend has been paid. Code § 1059(a)(2). The taxable portion of the dividend is the portion of such dividend includible in gross income, reduced by the amount of any dividends received deductions under sections 243, 244 and 245. The non-taxed portion is the excess of the total amount of the dividend over the taxable portion. Essentially, the nontaxed portion is equal to the amount of the dividends received deduction. As a result, if the redemption of ______________'s Foreign Bank shares was deemed an extraordinary dividend under section 1059, there would be a risk that Investor may not be able to increase its own basis in the Foreign Bank shares by the full amount of the basis ______________ had in its redeemed Foreign Bank shares. Nevertheless, as discussed below, section 1059 does not apply, because the dividend received by ______________ will be includible in the gross income of ______________, and such dividend will not qualify for the DRD.

Section 1059 was enacted as part of the Tax Reform Act of 1984. The legislative history of the section is comprised of Committee Reports. See H.R. No. 98-861, at 800 (1984); General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 ("1984 Blue Book"), at 136. In particular, the 1984 Blue Book clarifies that section 1059 was specifically enacted to address transactions involving "dividend stripping" and was intended to stop them. The Blue Book describes a dividend strip as follows; a corporate taxpayer purchases stock prior to the ex-dividend date for an impending dividend. The taxpayer then collects the dividend and proceeds to sell the stock as soon as it has been held for a period sufficient to qualify for the DRD. Generally, the price of the underlying stock will have been diminished by the amount of the dividend; as a result, the sale produces a capital loss for the taxpayer. Such loss is used to offset other capital gains so that the result is a conversion of fully taxable capital gains into ordinary income which are taxed at a low effective rate due to the availability of the DRD. Congress attacked this transaction in a variety of ways in the 1984 Act. The DRD holding period was extended to 46 days, and the DRD holding period was also suspended in cases where the taxpayer eliminated the existence of economic risk through certain hedging transactions, and section 1059 eliminated the opportunity for a capital loss immediately following the receipt of the dividend.

Based on the 1984 Blue Book and Committee Reports, it is clear that section 1059 was enacted only to stop dividend stripping by domestic corporations who could avail themselves of the DRD. A transaction organized by the Chrysler Corporation is cited as an example of the type of transaction that the then new rules were targeting. Nothing exists in the legislative history that indicates that section 1059 was ever intended to extend to situations other than domestic dividend payments that qualify for the DRD.

Further support for the position that Congress could not have intended to apply section 1059 to foreign corporations receiving foreign source income is provided by some of the absurd results that would follow. If, for example, a CFC received a dividend from another foreign corporation that was Subpart F income to its U.S. shareholder, section 1059 would apparently subject the U.S. shareholder to double taxation by reducing the CFC's tax basis in the dividend paying shares. Additional examples may be found in the foreign tax credit area as well as the FPHC rules.

The Tax Relief Act of 1997 amended section 1059 to require a corporate shareholder to recognize gain immediately with respect to any redemption treated as a dividend (in whole or in part) where the non-taxed portion of the dividend (under the DRD) exceeds the basis of the shares surrendered, if the redemption is treated as a dividend due to options being counted as stock ownership. In addition, the Act requires immediate gain recognition wherever the basis of the stock with respect to which any extraordinary dividend was received would otherwise be reduced below zero.

This provision is aimed at corporate stock redemption transactions, such as the one entered into by Seagram Co., which are structured to get dividend treatment for what otherwise would be a sale giving rise to taxable capital gain. These deals were designed to allow corporate taxpayers to benefit from the dividends received deduction.

Thus, there is nothing in the 1997 Act to suggest that Section 1059 should apply to reduce _______________'s tax basis in its Foreign Bank shares.

9. <u>Applicability of section 1091 wash sale rules.</u>

Section 1091 states that taxpayers are prohibited from claiming a loss from the sale of stock or securities if they acquire the same or substantially identical stock during the period beginning 30 days before and ending 30 days after the loss transaction occurred. Section 1091 does not contain any rule covering "wash sales" where related parties undertake different parts of the transactions (i.e., section 1091 addresses only the "taxpayer" but c.f. section 7701(f)). Thus, strictly speaking, the proximity in time of _______________'s acquisition of Foreign Bank stock to Investors disposition of Foreign Bank stock and options is irrelevant for section 1091 purposes. However, such did not take place, in any event, within the "proscribed" 61 day period. Additionally, Investor's disposition of Foreign Bank stock and options did not in fact occur within the "proscribed" section 1091 interval as to Investors purchase and sale of both stock and options.

10. Effect of the Tax Relief Act of 1997.

The Tax Relief Act of 1997 added section 1259, entitled "Constructive Sales Treatment for Appreciated Financial Positions," to the Internal Revenue Code. The section essentially provides that if the requirements for a constructive sale of *appreciated property* are met, the taxpayer will recognize gain in a constructive sale as if the position were sold at its fair market value on the date of the sale and immediately repurchased.

A taxpayer is treated as making a constructive sale of an appreciated position when the taxpayer (or in certain circumstances, a person related to the taxpayer) does one of the following: (1) enters into a short sale of the same property, (2) enters into an offsetting notional principal contract with respect to the same property, or (3) enters into a futures or forward contract to deliver the same property. Further, to the extent provided in the Treasury Regulations, a taxpayer is treated as making a constructive sale when it enters into one or more other transactions, or acquires one or more other positions, that have substantially the same effect as any one of the transactions described. The provision is effective for constructive sales entered into after June 8, 1997.

At present the law does not address situations where a "collar" exists. However, it is anticipated that the Treasury regulations, when issued, will provide specific standards for determining whether constructive sales exist that take into account various factors with respect to the appreciated financial position. However, even if drafted to include the type of "collar" that is contemplated in the instant transaction, these regulations should have no practical effect since the securities initially involved will not be appreciated. Thus, even if section 1259 were to be applied, there would be no gain to be recognized.

11. Provisions concerning controlled foreign corporations.

Generally, a U.S. shareholder of a foreign corporation is taxed on the foreign corporation's income only when the income is distributed to the U.S. shareholder. Thus, absent laws to the contrary, a U.S. shareholder who controlled a foreign corporation could defer U.S. income tax by having the foreign corporation accumulate income in a jurisdiction with little or no tax. In order to prevent this type of deferral, Congress enacted sections 951-964, commonly referred to as subpart F. Under the subpart F rules, a U.S. shareholder that owns 10% or more of the total combined voting power of all classes of voting stock of a CFC is currently taxed on his pro rata share of the "subpart F income" and "earnings invested in U.S. property" of the corporation, even if the corporation does not make actual distributions.

Pursuant to section 957(a), a foreign corporation is a CFC, if more than 50% of either the total combined voting power of all classes of its stock entitled to vote, or the total value of all its stock, is owned, or considered owned, by "U.S. shareholders." section 951(b) defines a "U.S. shareholder" as a U.S. person who owns, or is considered to own (via attribution rules contained in section 958(b)), 10% or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation. The constructive ownership provisions of section 958(b) provide that the attribution rules of section 318(a) shall apply to the extent the effect is to treat a U.S. person as a U.S. shareholder or to treat a foreign corporation as a CFC. Under section 318(a)(4), an option held by a U.S. shareholder is treated as exercised for purposes of determining whether a foreign corporation is a CFC.

Section 954(a) provides that Subpart F income includes "foreign personal holding company income" ("FPHCI"). FPHCI includes dividends, interest, royalties, rents, annuities, and other types of passive income. Thus, the dividend income that ______________ is deemed to earn from the redemption of its Foreign bank constitutes Subpart F income. If ______________ is a CFC and Investor is considered to be a U.S. shareholder of ______________, then Investor would be required to include its proportionate share of this dividend in its income for U.S. federal income tax purposes.

"Foreign Person" is ______________'s sole direct shareholder. However, because the ______________ Warrant is deemed exercised under the attribution rules of section 318(a)(4), Investor would, for purposes of determining if ______________ is a CFC, be considered to own 85% of ______________'s stock. Thus, ______________ is a CFC, since Investor is considered to own more than 50% of the total vote and value of ______________'s stock. However, since Investor does not have direct ownership of ______________'s stock, within the meaning of section 958(a), Investor should not have to include in income any Subpart F income attributable to ______________. Treasury Regulations section 1.951-1(a)(2) states that a U.S. shareholder "[w]ho owns (within the meaning of section 958(a)) stock in [a CFC] on the last day" of the taxable year of the CFC must include in income that CFC's Subpart F income. Section 958(a) provides that stock owned means stock owned directly and stock owned through foreign entities. Section 958(a) does not include stock owned constructively under section 958(b). Thus, since Investor does not and did not have any direct ownership of ______________'s shares, Investor should not be required to include in income any portion of ______________'s Subpart F income.

Despite the above analysis, the Service in Revenue Ruling 82-150, 1982-2 C.B. 110, held the purchase of an option to acquire stock was in substance a purchase of the stock because exercise of the option was considered to be virtual certainty. In exchange for all the stock, a foreign individual contributed $100,000x to a foreign corporation. A U.S. person paid the individual $70,000x for the option to purchase all of the stock for an exercise price of $30,000x. Additionally, the remaining 30% of the underlying purchase price of the securities was to be furnished by the option holder upon exercise. Thus, the option holder had (or would) furnish 100% of the funds used to capitalize the corporation that were at risk. Reflecting the fact, inter alia, that it appeared extraordinarily unlikely that the market value of the stock would fall below $30,000x before the option expired, the Service concluded the option purchaser had assumed the risks of an equity investor because, in substance, it had or would furnish 100% of the funds used to capitalize the corporation that were at risk. Therefore, the Service concluded that the benefits and burdens of stock ownership had been shifted to the option purchaser and any Subpart F income of the foreign corporation (now a CFC) should properly be included in the U.S. person's (now a U.S. shareholder) income.

Here, Investor paid only 4% as an option premium, an amount more consonant with a typical option. Further, the warrant exercise price was not "deep in the money" at the time of warrant purchase, which would make its exercise more probable if this were the case. Thus it is clear that the benefits and burdens of stock ownership have not passed to the Investor prior to the exercise of the Warrant.

12. Provisions concerning passive foreign investment companies.

The Subpart F rules discussed above, only deal with the taxation of investment income earned by U.S. shareholders through foreign corporations, when, generally, the U.S. ownership is concentrated and closely held. Thus, the Subpart F provisions do not limit the deferral of U.S. shareholder level tax available through investment in widely held foreign investment companies. In 1986, to prevent the deferral of income from widely held investments in foreign corporations, Congress enacted Code sections 1291-1296, which provide special rules requiring U.S. shareholders to pay an accelerated tax or an interest charge on certain passive investment income earned by a PFIC, which is otherwise deferred from U.S. federal income taxation.

Under section 1296(a), a foreign corporation is a PFIC if (1) 75% or more of its-gross income is passive or (2) 50% or more of the value of its assets generate passive income (the income or assets test). Unlike the subpart F rules, there are no minimum shareholder ownership requirements and no de minimis rules. In applying the income and assets tests, there is a "look through" to the income and assets of any foreign corporation in which the potential PFIC owns 25% or more of the stock. If the combined income and assets (disregarding the 25% stock interest as an asset and any dividends paid on the stock as income) do not meet the threshold tests, then the corporation will not be classified as a PFIC.

Two alternative taxation regimes are provided for PFIC shareholders. One allows tax to be deferred but requires the payment of interest when tax is finally imposed. The other, which only applies when elected, taxes undistributed PFIC income to the shareholders as it is earned by the corporation.

Under the first regime, an interest charge is imposed when a PFIC shareholder recognizes gain on a sale of his stock or receives an extraordinary distribution. Interest is computed as if the gain or distribution had been included in gross income ratably over the period that taxpayer held the stock. The interest rate is the rate for underpayments of tax. These types of PFICs are known as "non-qualified funds."

The second regime applies to PFIC shareholders who elect to treat the corporation as a qualified electing fund ("QEF"). QEF shareholders are currently taxed on their respective share of the PFIC's income as it is realized by the corporation. Generally, QEF shareholders are not burdened with the special taxes or interest charges of the non-qualified funds.

The dividend income that ______________ was deemed to earn from the redemption of its Foreign Bank stock constitutes passive investment income under section 1296(b). If ______________ is a PFIC, and Investor is considered to be a shareholder of ______________, Investor would be required to choose whether to elect to be treated as a QEF and potentially include its proportionate share of this dividend in its income for U.S. federal income tax purposes, or become a non-qualified fund and pay a deferred tax amount plus interest when such dividend is distributed.

______________'s only direct shareholder is Foreign Person. However, under section 1297(a)(4), the Warrant may be considered exercised to the extent provided by regulations. Under Proposed Regulations section 1.1291-1(d), options are considered PFIC stock (unless the PFIC is a pedigreed QEF) "for purposes of applying section 1291 and these regulations to a disposition of the option." Since more than 50% of the value of ______________'s assets may generate passive income, ______________ would likely be a PFIC. However, since Investor does not have a direct ownership of ______________'s shares within the meaning of section 1293(b), Investor should not have to include in income any passive investment income earned or distributed by ______________. Since the Warrant was sold by Investor for cash back to ______________ in the same tax year that it was acquired, no interest charge should be imposed on the gain recognized by Investor with respect to that sale.

13. **Source of capital loss from Investor's sale of Foreign Bank shares and options.**

For the reason discussed below, Investment Company's capital loss from the sale of its Foreign Bank shares and options is, more likely than not, under existing law, U.S. source income.

Section 865 provides rules for determining the source of income from the sale or disposition of personal property. Stock is personal property. In general, the source of gain realized on the sale of personal property is determined by reference to the residence of the seller. Accordingly, gain realized on the sale of personal property by a U.S. resident seller is ordinarily U.S. source. On July 8, 1996, the U.S. Treasury Department issued Proposed Regulations section 1.865-1, which provides that the source of losses on disposition of portfolio stock are allocated under Income Tax Regulations section 1.861-8. "Portfolio stock" is defined as a less than 10% stock position, clearly the case here. Thus, under Income Tax Regulations section 1-861-8 (and specifically section 1.861-8(e)(7)), Investment Company would be required, by the Proposed Regulations, to treat capital loss on the sale of its Foreign Bank shares and options as foreign source loss, since dividends received on Foreign Bank shares and options would be foreign source income in the hands of Investment Company, under Code section 862(a)(2). Although this conclusion requires a determination of the prior three years' sources of income of Foreign Bank, pursuant to Code section 861(a)(2)(B), a review of Foreign Bank's published financial statements results in the conclusion that its dividends should be treated as "foreign source" for these purposes. In the recent case of International Multifoods Corp. v. Commissioner, 108 T.C. 579 (1997), the Tax Court, even in the face of the July 8, 1996 proposed section 865 regulations, held that loss on the sale of a majority interest in a foreign company should be treated as U.S. source. The Tax Court went so far as to hold that the 1986 Act amendments rendered Code sections 861 and 862 (and, in particular, Regulations section 1.861-8(e)(7)), inapplicable to post-1986 losses on the sale of non-inventory personal property. The Tax Court reasoned that section 865 seeks to determine the source of gain by reference to the residence of the Seller and section 865(j)(1) directs the IRS to issue regulations to carry out this purpose. Thus, absent final regulations, the general "residence" source rule should prevail. It is our view that, should a "portfolio" capital loss be realized under existing law by Investor, the Tax Court at least would hold the loss to be U.S. source. Furthermore, the Proposed Income Tax Regulations under Code section 865 are likely invalid, insofar as Proposed Income Tax Regulations section 1.865-1 purports to govern "portfolio" losses on stock and option dispositions by section 1.861-8, which the Tax Court in International MultiFoods Corp. has now held inapplicable to post-1986 losses on stock and option dispositions, i.e., the general residence source rule should prevail on losses. Therefore, the source of the capital loss realized by Investor from the sale of the Foreign Bank shares and options would, more likely than not, be considered U.S. source income under existing law, as defined in the MultiFoods case (and taking into account the likely invalidity of the Proposed Regulations).

This issue should have no impact on the utilization of the capital loss by Investment Company for U.S. federal income tax purposes, but rather only its classification as to source.

D. Applicability of section 6662(b)(2).

Section 6662(b)(2) provides for a 20% underpayment penalty for taxpayers if there is a "substantial understatement" of income tax on the return: generally where the amount of the understatement exceeds 10% of the correct tax--see Code § 6662(d)(1).

1. **Non-tax shelter context.**

Outside the tax shelter context, this penalty is not imposed if there is substantial authority for a return position giving rise to the understatement,[1] or if there is a reasonable basis for the position and it is adequately disclosed to the Service (however, in the case of a multi-party financing transaction, the tax treatment must "clearly reflect income." See Code § 6662(d)(2)). In addition, this penalty is not imposed if there was reasonable cause for the underpayment and the taxpayer acted in good faith. Code § 6664(c)(1).

There is substantial authority for a position if the weight of authority in support of the position is substantial in relation to the weight of authority in opposition to the position. "Authorities" for this purpose include (but are not limited to) applicable provisions of the Code; proposed, temporary and final regulations; revenue rulings and revenue procedures; court cases; Congressional intent as reflected in committee reports; private letter rulings and technical advice memoranda issued after October 31, 1976; and actions on decision and general counsel memoranda issued after March 12, 1981. The weight of an authority depends upon its relevance and persuasiveness, and the type of document. Treas. Reg. § 1.6662-4(d)(3).

Outside the tax shelter context, a taxpayer qualifies for the reasonable cause and good faith exception to the substantial understatement penalty if, on the basis of all facts and circumstances, the reliance was reasonable and in good faith. The Treasury regulations do not specifically set forth when reliance will be deemed reasonable and in good faith. The regulations provide, however, that "[r]eliance on . . . professional advice . . . constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith." Treas. Reg. § 1.6664-4(b)(1).

---

1 There is considered to be substantial authority for a return position if substantial authority is present on either the last day of the taxable period covered by the taxpayer's return, or the day the return is filed. Treas. Reg. § 1.6662-4(g)(1)(i)(A), § 1.6662-4(d)(3)(iv)(C). This rule applies in all contexts (e.g., regardless of whether the transaction is a "tax shelter," and regardless of whether the taxpayer is a corporation).

The regulations also set forth certain general opinion requirements ("General Opinion Requirements") that must be satisfied in order for reliance on tax advice, including opinion letters, to be considered reasonable and in good faith. Treas. Reg. § 1.6664-4(c)(1). The General Opinion Requirements (all of which must be satisfied) are as follows:

a. The opinion was based on all pertinent facts and circumstances, including the taxpayer's purposes (and the relative weight of such purposes) for entering into the transaction and for structuring the transaction in a particular manner. In addition, reliance on an opinion will not be considered reasonable if the taxpayer fails to disclose a fact that it knows or should know to be relevant to the proper tax treatment of an item.

b. The opinion was based on the law as it relates to those facts and circumstances.

c. The opinion was not based on any unreasonable factual or legal assumptions (including assumptions as to future events).

d. The opinion did not unreasonably rely upon the representations, statements, findings or agreements of the taxpayer or any other person. For example, the opinion must not be based upon a representation or assumption that the taxpayer knows or has reason to know is unlikely to be true.

Although we have located no court case that has construed the General Opinion Requirements (which were issued in August 1995; see T.D. 8617), numerous judicial decisions have relied upon similar principles in holding that a taxpayer's reliance upon the advice of a tax professional qualified for the reasonable cause and good faith exception to the substantial understatement penalty. See, e.g., Mauerman v. Commissioner, 22 F.3d 1001 (10th Cir. 1994) (the substantial understatement penalty was not imposed where a physician reasonably relied in good faith upon his independent tax advisor); Vorsheck v. Commissioner, 933 F.2d 757 (9th Cir. 1991) (the taxpayers' reliance on their tax accountants precluded imposition of the substantial understatement penalty); Heasley v. Commissioner, 902 F.2d 380 (5th Cir. 1990) (the taxpayers' efforts to assess their proper tax liability by consulting an accountant and their limited experience in tax matters precluded the application of the substantial understatement penalty); Daoust v. Commissioner, 67 T.C.M. (CCH) 2914 (1994) (the negligence and substantial understatement penalties were not imposed where the taxpayers reasonably relied upon professional advisors); English v. Commissioner, 65 T.C.M. (CCH) 2160 (1993) (the negligence and substantial understatement penalties were not imposed where the taxpayers relied upon the advice of their accountants on a complex tax matter).

The U.S. Supreme Court also reaffirmed the right of a taxpayer to rely upon the substantive advice of the taxpayer's accountant or attorney to avoid penalties in United States v. Boyle, 469 U.S. 241 (1985) (which distinguished between reasonable reliance on professionals to avoid filing deadlines, which did not constitute "reasonable cause," and reasonable reliance on professionals as to questions of substantive law, which would). According to Boyle:

> When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a "second opinion," or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place.

Id. at 251. See also Chamberlain v. Commissioner, 66 F.3d 729, 732 (5th Cir. 1995) and Betson v. Commissioner, 802 F.2d 365, 372 (9th Cir. 1986), each of which invoked Boyle, supra, in overturning a negligence penalty where the taxpayer had reasonably relied upon the advice of a tax expert.

In addition to our review of the relevant documents and other facts of which we became aware, you have represented to us that you have provided us with all other facts and circumstances that you know or have reason to know are pertinent to this opinion letter and that all assumptions or representations on which this opinion relies are reasonable. Therefore, we believe that the General Opinion Requirements should be satisfied in this case.

2. In the context of tax shelters.

Special rules for the substantial understatement penalty apply in the case of positions that are attributable to "tax shelters." Under section 6662(d)(2)(C)(iii), a "tax shelter" is a partnership or other entity, investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is to avoid or evade federal income tax.

In the case of a taxpayer other than a corporation participating in a "tax shelter," understated tax attributable to a "tax shelter position" will not be taken into account in determining whether an understatement is substantial only if there both was substantial authority for the position ("substantial authority test")[2] and the taxpayer reasonably believed, at the time the return was filed, that the position was more likely than not the proper position ("more-likely-than-not test"). Code § 6662(d)(2)(C)(i); Treas. Reg. § 1.6662-4(g)(1)(i)(B). The taxpayer may satisfy the reasonable belief standard either on the basis of its own analysis or by reliance on an opinion of a qualified tax professional. Treas. Reg. § 1.6662-4(g)(4). The penalty also will not apply, even if the understatement is considered substantial, if the taxpayer acted with reasonable cause and in good faith. <u>See</u> Code § 6664(c)(1).

CONCLUSION

Our conclusions, stated throughout this letter, are summarized under "Summary of Opinion" on page 5.

Our conclusions are based on the completeness and accuracy of the above-stated facts and assumptions. If any of the material facts stated above are not entirely complete or accurate, we should be informed immediately, as the inaccuracy or incompleteness will likely have a material effect on our conclusions. We have relied upon the relevant provisions of the Internal Revenue Code of 1986 as amended, the regulations thereunder and the judicial and administrative interpretations thereof, which are subject to change or modification by subsequent legislative, regulatory, administrative or judicial decisions. Any such changes also could have an effect on the validity of our conclusions. We do not assume any obligation to update our advice in light of any subsequent changes or modifications to the law or regulations or any judicial and administrative interpretations thereof.

Very truly yours,

Pillsbury Madison & Sutro LLP

[2] See footnote 2, above.

List of Exhibits

1. Confirmation of Purchase of Foreign Bank shares by Investor.

2. Subscription Agreement for ordinary shares of ______________.

3. Investment Advisory Agreement between QA Investments, LLC and ______________.

4. Ordinary Share Purchase Warrant of ______________ issued to Investor.

5. Confirmation of Purchase of Foreign Bank shares by ______________.

6. Deposit Agreement between Foreign Bank and ______________.

7. Confirmation of Call Option between Foreign Bank and ______________.

8. Confirmation of Put Option between Foreign Bank and ______________.

9. ISDA Master Agreement and Schedule.

10. ______________'s 1997 Statement of Operations.

11. Confirmation of Call Option between Foreign Bank and Investor.

12. Confirmation of sale of Foreign Bank shares by Investor.

13. Schedule Showing:

    a. Calculation of Investor's 1997 return (unrealized loss) on its ______________ warrants.

    b. Investor's cost of purchasing and selling its Foreign Bank call options.

    c. Investor's 1997 investment gain (loss) on Foreign Bank securities.

d. Calculation of Investor's tax basis and 1997 capital loss on sale of its Foreign Bank shares and options.

14. Analysis of Investment Activity

15. RECAP Option Description

KPMG Peat Marwick LLP

Financial Services

21700 Oxnard St. Suite 1200
Woodland Hills, Calif 91367

Telephone 818-227-6900
Fax 818-702-0602

Date	July 10, 1998	Page 1 of 3
To	Larry DeLap	
Organization	KPMG Mountain View	
Tel	650-404-5352	
Fax	650-960-0746	
From	Gregg W. Ritchie	
Department	Tax Services	
Tel	818-227-6905	
Fax	818-227-6964	
Subject	**Quadra deal**	

Attached is the diagram on the Quadra version of the deal. Randy will give you a hard copy of the legal opinion.

6/12/98

COMPARATIVE REVIEW
FLIP INVESTMENT STRUCTURES

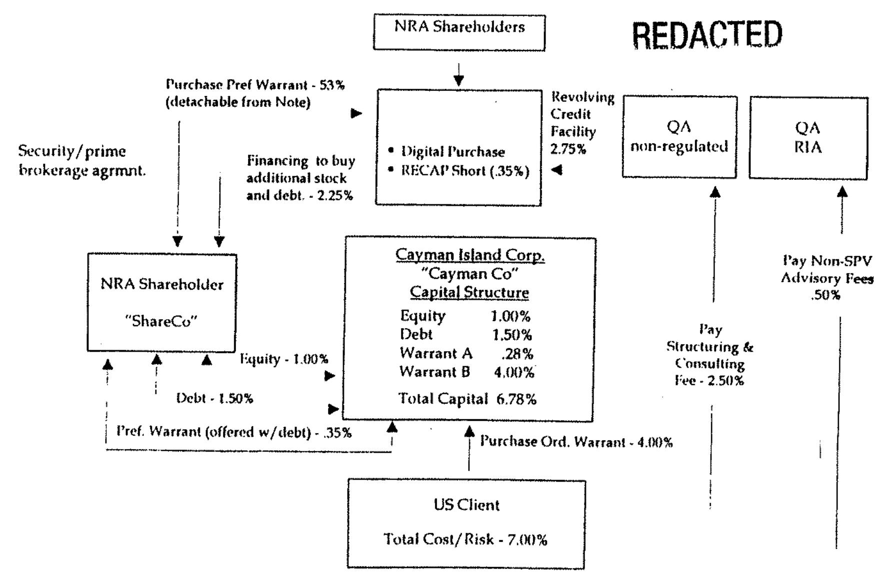
Structure utilized by KPMG - 1997	*Structure utilized by Quadra - 1998*
• Single warrant held by US taxpayer.	• Two warrants. One held by foreign person, one held by US taxpayer.
• No debt issued by SPV.	• SPV issues debt to foreign person.
• Foreign person contributes lesser of 1% of notional or $250,000.	• Foreign person contributes 1% of notional, not limited.
• Exercise strike price of warrant set at a future variable price.	• Exercise strike price of warrant predetermined.
• Put strike price of warrant equates to majority of initial equity of the SPV.	• Put strike price equates only to profits of SPV.
• Foreign person's return fixed at inception.	• Foreign person's return dependent on company profitability.
• US taxpayer participates in all SPV profits.	• US taxpayer participates pro-rata in SPV profits.
• Warrant cost 7.0% of notional investment.	• Warrant cost 4.0% of notional
• No advisory fee.	• Advisory fee of 3.0%

KPMG 0047341

6/12/9

Cayman Island Financing Structure

REDACTED



From Larry DeLap at KPMG_Silicon_Valley2
From: Larry DeLap at KPMG_Silicon_Valley2
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: OPIS
Sent: 1998-09-01 15:44:00.000
Date: 1998-09-01 21:41:54.933
X-Folder: OPIS
X-Attachments: Attachments\opisdlap.doc; Attachments\opisngag[3].doc; Attachments\opis.ppt; Attachments\nondiscl.doc; Attachments\fopis_rb.doc

One of the products currently being marketed by the CaTs group of PFP is the Offshore Portfolio Investment Strategy ("OPIS").

I am attaching, for your information, some material on OPIS, including a draft opinion letter and a standard engagement letter.

OPIS should be marketed only to individuals. It should not be marketed to corporations.

OPIS has a high degree of investment and tax risk. Accordingly, it is essential we get a signed engagement letter from the client before he invests any funds in the strategy. The standard engagement letter attached is to be used. On a case by case basis, it is okay to increase the maximum liability from the $50,000 indicated in the standard letter, but not to an amount in excess of our fee for the engagement. Any other change in the standard letter should be cleared with me. (If, based on experience, we make some revisions to the standard letter, I will communicate that to you.)

The product owner of OPIS is Jeff Eischeid, Atlanta. If you have any marketing related questions on OPIS, please call Jeff. Any professional practice questions or concerns on the product should be directed to me.

Larry

PRESIDIO ADVISORS, LLC
1735 - 19TH STREET, SUITE 300
DENVER, COLORADO 80202

TELEPHONE (303) 295-1314
FACSIMILE (303) 295-1371

VIA FACSIMILE (404) 222-3434

DATE: September 11, 1998

TO: Jeff Eischeid
KPMG – Atlanta

FROM: Bob Pfaff

SUBJECT: **AGREEMENT REGARDING PRESIDIO's OPIS DOCUMENTS**

Dear Jeff:

The purpose of this memorandum is to document, in summary fashion, our agreement regarding Presidio's OPIS documents and KPMG's ownership of the OPIS tax technology.

Our basic agreement is as follows:

Presidio will make its documents available to KPMG to provide to Quadra to execute OPIS transactions on a limited basis:

1. To the extent of KPMG's OPIS demand in excess of Presidio's capacity between now and September 30, 1998;
2. KPMG grants Presidio the right to use its tax technology to execute OPIS transactions with third parties (other than Big Five accounting firms), as long as such transactions do not interfere with Deutsche Bank capacity;
3. After October 2, 1998, the original KPMG-Presidio agreement will be reinstated. The clear understanding of such agreement is that KPMG and Presidio will operate with each other in good faith on a right of first-refusal basis.

Permanent Subcommittee on Investigations
EXHIBIT #94ee

CONFIDENTIAL
P41915

KPMG Peat Marwick LLP

303 Peachtree Street, N E
Suite 2000
Atlanta, GA 30308

Telephone 404 222 3000

Telefax 404 222 3050

September 14, 1998

PERSONAL & CONFIDENTIAL
Mr. Jeffrey L Greenstein
Quadra Advisors, LLC
999 Third Avenue, Suite 4150 I
Seattle, Washington 98104

Dear Jeff:

This letter shall serve as the Operating Agreement setting forth the terms of KPMG Peat Marwick LLP's ("KPMG") agreement with Quadra Advisors, LLC ("Quadra") regarding a foreign leveraged investment strategy (the "Strategy") and certain other tax advantaged strategies.

I. Commercial Exploitation of the Strategy

A. KPMG and Quadra shall work together from time to time in connection with implementation of the Strategy and certain other tax advantaged strategies (each collectively defined herein as a "Strategy Transaction") for individual investors, which may include limited liability companies, family limited partnerships, or trusts established by such investors (each referred to herein as "Investor"). Any Investor for whom GAAP basis financial statements are prepared shall be advised to discuss accounting for the Strategy with their independent accountants..

B. KPMG's Compensation:

KPMG and Quadra shall enter into separate contracts with each Investor and fees payable to KPMG or Quadra will not be dependent on the services of the other. Investor and KPMG will mutually agree on KPMG's fee, which shall reflect the complexity of KPMG's role and value of KPMG's services. Such fee will not be dependent on the amount invested in, investments results of, nor on tax savings projected or achieved from, the Strategy.

For the purposes of this Agreement, the transaction shall be defined as all aspects of the engagement through the conclusion of KPMG's delivery of services. KPMG shall not receive a fee from Quadra for any Strategy Transaction, either directly or indirectly.

KPMG Peat Marwick LLP

Mr. Jeffrey I. Greenstein
Quadra Advisors, LLC
September 14, 1998
Page 2

II. Quadra's Commitments

A. Quadra shall use reasonable efforts to refer opportunities for accounting, tax, and consulting services to KPMG.

B. In each Strategy Transaction, if the Investor implementing the Strategy is offered an opportunity to acquire a position in the shares of foreign entities that are clients of KPMG for which independence is required, Quadra shall ensure that the investor implementing the Strategy is offered an opportunity to acquire a position in the shares of multiple alternative foreign entities, which shall include a balance among foreign entities that are clients of KPMG for which independence is required and non-clients of KPMG for which independence is not required. KPMG shall designate to Quadra foreign entities that are clients of KPMG for which independence is required.

C. Quadra's development costs shall be borne by Quadra.

III. KPMG's Commitments

A. KPMG may from time to time introduce Quadra to its clients who are considering the implementation of the Strategy.

B. KPMG shall maintain the confidentiality of tax products developed by Quadra, subject to legal and regulatory disclosure requirements.

C. KPMG's development costs shall be borne by KPMG.

IV. Term of the Operating Agreement

This Agreement shall have a term of twelve (12) months, running from the date of Quadra's counter-signature below, and the term may be extended by mutual written agreement. Notwithstanding the foregoing, either party may terminate this Agreement at any time upon thirty (30) days prior written notice thereof.

V. No Creation of a Joint Venture

By execution of this agreement, KPMG and Quadra agree that they are not engaged in any actual or implied form of joint venture.

Please indicate your agreement to the foregoing by signing the enclosed copy of this letter and returning it to us.

Very truly yours,

KPMG PEAT MARWICK LLP

Jeffrey A. Eischeid
Partner

JAE:tst
cc: Larry B. Scheinfeld
David L. Smith
FFP.FFPSUBNOFFSUGAGTQA.DOC

ACCEPTED:

Quadra Advisors, LLC

Jeffrey I. Greenstein — 9/28/98 **Date**

September 14, 1998

PERSONAL & CONFIDENTIAL
Mr. Larry B. Scheinfeld
Quadra Advisors, LLC
590 Madison Avenue, 32nd Floor
New York, New York 10022

Dear Larry:

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B. KPMG's Compensation:

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By execution of this agreement, KPMG and Quadra agree that they are not engaged in any actual or implied form of joint venture.

Please indicate your agreement to the foregoing by signing the enclosed copy of this letter and returning it to us.

Very truly yours,

KPMG PEAT MARWICK LLP

Jeffrey A. Eischeid
Partner

JAE:tst
JAE\ALTA.DOC

ACCEPTED:

Quadra Advisors, LLC

______________________________ ______________

Name: **Date**
Title:

new

From: Larry DeLap
Sent: Tuesday, September 15, 1998 1:26 PM
To: Tracie K Henderson
Cc: Peder R Johnson; Jeffrey A. Eischeid; William E. Albaugh; Douglas K. Ammerman
Subject: Re: OPIS

Tracie -

Because of the tougher tax shelter substantial understatement penalty rules and the higher business purpose threshold for C corporations, we should not be marketing OPIS to C corporations.

Larry

__________________________ Reply Separator __________________________________

Subject: OPIS
Author: Tracie K Henderson at KPMG_US
Date: 9/15/98 7:09 PM

Larry -

I have an OPIS prospect who would like to do a $20 million OPIS inside a closely-held (family owned) C corp. We do not audit. Can we do it?

Thanks,
Tracie

Union Bank of Switzerland
Global Equity Derivatives

A. Cayman Island Investment Fund Transactions

I. Purchase of UBS Bearer shares on a forward basis

buyer:	Cayman Island Investment Fund of Client A-F
seller:	UBS London Branch
underlying:	UBS Bearer Shares
maturity:	50 days forward
currency:	CHF
notional amount:	as outlined above

II. Purchase of Puts

buyer:	Cayman Island Investment Fund of Client A-F
seller:	UBS London Branch
underlying:	UBS Bearer Shares
maturity:	50 days
currency:	CHF
strike:	90%
notional amount:	as outlined above

III. Sale of Barrier Calls

seller:	Cayman Island Investment Fund of Client A-F
buyer:	UBS London Branch
underlying:	UBS Bearer Shares
maturity:	50 days
currency:	CHF
strike:	95% which is reduced to 90% once the stock reaches 95% until maturity
notional amount:	as outlined above

Permanent Subcommittee on Investigations
EXHIBIT #94ii

Union Bank of Switzerland
Global Equity Derivatives

Result

net Credit of transaction I + II + III:	6.25% of notional amount
cash deposit by client:	minimum 3.75% of notional amount
maximum counterparty risk:	10% of notional amount (= difference between strikes). The client will deposit 10% in cash with UBS London as collateral of the transaction

B. Client Account Transaction

I. Purchase of UBS Bearer shares on a forward basis

buyer:	Client A-F
seller:	UBS (acts as broker)
underlying:	UBS Bearer Shares
currency:	CHF
settlement:	2 days value, shares hold with UBS London as custodian
notional amount:	10% of notional amounts outlined above

The following transactions for the Client Account are OPTIONAL and will be decided when due:

Day 1:	Sale of 31 days 95% Calls (no barrier) on 10% of notional amounts outlined above. Purchase of 31 days 90% Puts on 10% of notional amounts outlined above.
Day 32:	Sale of 60 days Calls (no barrier) on 10% of notional amounts outlined above; strike as stock price at that time. Purchase of 60 days Puts on 10% of notional amounts outlined above; strike as stock price at that time.
Day 51:	Purchase 45 days 110% Calls (no barrier) on 90% of notional amounts outlined above
Day 96:	Position unwind

QUADRA CAPITAL MANAGEMENT, L.P.
999 Third Avenue, Suite 4150 / Seattle, WA 98104 / (206) 442-9292 / Fax (206) 442-9291

FAX COVER SHEET

DATE:	September 25, 1996	TIME:	11:24 PM
TO:	Dr. Chris Donegan UBS International	PHONE: FAX:	(44-171) 901-4589 (44-171) 956-9215
FROM:	Jeff Greenstein	PAGES:	4

Chris,

Wolfgang suggested that I provide you some counterparty and account information regarding the proposed securities and options transactions in UBS shares. As Wolfgang may have mentioned the initial interest level in this transaction has been somewhat overwhelming.

As you might recall each transaction will involve basically two sets of securities and option transactions whereby Quadra Capital Management will have investment discretion over the accounts. In each case we will be able to provide you with a copy of the Investment Advisory agreements enabling Quadra to enter the trades on behalf of the particular client.

The first set of transactions will involve the U.S. Client ("Client") directly purchasing shares and options in UBS stock. While the exact nature of this set of transactions may vary slightly on a client by client basis, these will primarily be long purchases of stock along with potentially a long call option and long put option. The size of these transactions should be approximately 5-10% in dollar value relative to the transactions done in the account of the Investment Fund. My guess is that these stock purchases can be done through a standard brokerage account. We would like to set up these accounts and purchase the stock prior to October 1st. I have provided below a list of the clients that we would like to initiate this process for.

The second set of transactions will occur in a Cayman Island based Investment Company whereby Quadra has been hired by the company's board to act as investment advisor. Almost all of the assets in the company will be generated as a result of the company selling a warrant to the same U.S. Client described above to acquire at least 80% of the value of the offshore company. The actual shareholders until the warrant has been exercised will be various non-U.S. investors and companies. As in the case of most offshore investment funds, their interest in the offshore company will be minimal compared to the overall assets. We are currently in the process of setting these accounts up with our attorneys and hiring BankAmerica Cayman to act as the Administrator. I should be able to provide you with complete details and documentation in the next several days. Provided we comply with the purchase of shares described in the client account, we should be able to affect the forward stock and option transactions in this account several days following the first of October.

For those Clients where we have firm orders we have established their names and our in the process of incorporating them. The other clients would like to purchase shares but have not yet committed to purchasing the warrants on the offshore company. In the event they elect to use the offshore Investment Company it should be relatively easy to set-up since we will have the process down from the other clients. We have several additional clients that I should be able to confirm early Thursday. I have listed the proposed amounts, but are reluctant to disclose their names until I have received a firm order. Suffice it to say, I am highly confident these will become firm orders by the close of business today.

Client 1

U.S. Client:	Stock Purchase:	$ 2.5 mil
Offshore Co:	Investment Co. Purchase:	$ 25 mil

See attached KPMG description

Client 2

U.S. Client:	Stock Purchase:	$ 1 mil
Offshore Co:	Investment Co. Purchase:	$ 15 mil

Client 3 (will provide details in morning)

U.S. Client:	Stock Purchase:	$ 3 mil
Offshore Co:	Investment Co. Purchase:	$ uncertain

Client 4 (tent. waiting for firm order Thursday)

U.S. Client:	Stock Purchase:	$ 11 mil
Offshore Co:	Investment Co. Purchase:	$ 110 mil

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Client 5 (tent. will know Thursday afternoon)

U.S. Client	Stock Purchase:	$ 2.5 mil
Offshore Co:	Investment Co. Purchase:	$ 25 mil

Chris, the contemplated option and stock transactions should be relatively straightforward. In the event you have any questions with the information provided by KPMG/Peat Marwick, they are willing to provide you with whatever information is necessary to get you comfortable. Also, we will provide you with all the information necessary to get comfortable as it pertains to these clients of Quadra's.

I am excited about the business opportunities involving these accounts and additional clients that are contemplating similar trades. Additionally, I am hopeful that we will have a fair number of transactions utilizing the swap structure that we put in place this summer. In fact we better because the legal bills are starting to come in! I will give you a call when I arrive in the morning and look forward to answering any questions you might have. It may be a little later than normal since almost midnight.

09/25/96 22:2_ FAX 206 442 9291 QUADRA CAPITAL → UBS DONEGAN ☑004/004

[redacted] Peat Marwick LLP

50 West San Fernando Street
San Jose, CA 95113

Telephone 408 279 2000
Telex 171415 PMMSJC UD

Telefax 408 287 5054

September 25, 1996

Mr. Jeffrey L. Greenstein
UBS Securities
999 Third Avenue, Suite 4150
Seattle, Washington 98104

Dear Mr. Greenstein:

has been a client of KPMG for many years.

If we need to provide any other information with respect to please let me know and we will be pleased to do so.

Sincerely,

KPMG Peat Marwick LLP

Harvey Armstrong

Harvey L. Armstrong
Partner

HLA:ca\ubs-doc

[redacted]

THIS PAGE CONTAINS REDACTED MATERIAL

KPMG Peat Marwick LLP

345 Park Avenue
New York, NY 10154

Telephone 212 758 9700
Telex 428038

Telefax 212 758 9819

September 25, 1996

Jeffrey I. Greenstein
Quadra Capital Management L.P.
999 Third Avenue
Suite 4150
Seattle, Washington 98104

Dear Jeff:

Attached is a copy of the facts and summary sections of the KPMG opinion.

Please call me with any questions.

Sincerely yours,

David Lippman-Smith

KPMG Peat Marwick LLP

KPMG DRAFT: 9/3/96

FACTS:

USCO purchases a warrant for 80% of Target

Target is a corporation which will be organized under the laws of the Cayman Islands, B.W.I. and wholly-owned by Foreign Person, a resident of [Country 2]. USCO will purchase from Target a warrant entitling USCO to acquire a specified number of newly-issued shares of Target. Upon exercise of the warrant, USCO would own 80% of Target's only class of stock then outstanding.

Target purchases shares of Foreign Bank

Target will purchase shares of Foreign Bank at fair market value directly from Foreign Bank and/or its executives. Target will borrow up to 100% of the purchase price for the shares. Neither Target nor Foreign Person own or plan to own any other Foreign Bank shares. Target will hold the shares for a minimum period of 46 days.

In order to protect itself from a significant drop in the price of shares of Foreign Bank, it is contemplated that Target will hedge its risk as follows:

1. Target will write qualified covered call options on Foreign Bank shares.
2. Target will purchase put options on Foreign Bank shares at a price that is significantly out-of-the-money.

It is anticipated that Foreign Bank will be the counterparty to the above option contracts.

USCO purchases Foreign Bank shares and options

On the same day Target purchases Foreign Bank shares, USCO will purchase 10% of the amount of shares purchased by Target. USCO will hold its Foreign Bank shares for 12 weeks or longer. why?

Redemption of shares by Foreign Bank

Target will offer its Foreign Bank shares for redemption by Foreign Bank at fair market value. Such redemption may take place through the exercise of the put options held by Target or the call options held by Foreign Bank (both described above). Based on

KPMG Peat Marwick LLP

KPMG DRAFT: 9/3/96

US Entity Corporation
September 3, 1996
Page 3

SUMMARY

Based on the hypothetical facts assumed above, and the discussion and analysis below, we are of the opinion that under current U.S. Federal income tax law, it is more likely than not that US Entity will be allowed to add Target's basis in its redeemed Foreign Bank stock to US Entity's basis in its Foreign Bank stock in the following manner. Foreign Bank's redemption of Target's Foreign Bank stock should be treated as a distribution qualifying as a dividend under Sections 301 and 316 of the Internal Revenue Code of 1986, as amended (the "Code") provided that Foreign Bank has sufficient U.S. type earnings and profits for the year of the redemption. This redemption should not qualify as an exchange for purposes of Code Section 302(a) (and hence will not be reportable as a sale or exchange under Code Section 1001) because US Entity's ownership of Foreign Bank stock and options will be attributed to Target under the ownership attribution rules of Code Section 318 and none of the four tests in Code Section 302(b) will be met. Because Target no longer will own directly any Foreign Bank shares after the deemed distribution, its basis in such shares will be allocated to US Entity's Foreign Bank stock pursuant to Regulation Section 1.302-2(c) and possibly to its options under Regulation Section 1.61-6.

In arriving at our conclusion we have considered certain potential issues which might affect the tax results described herein. However, as discussed below, it does not appear that the step transaction doctrine, the agency doctrine, the sham transaction doctrine, Code Sections 269, 1059, and 1091, the provisions governing controlled foreign corporations, foreign personal holding companies, nor pending legislation will apply to these transactions. Further, we believe the loss US Entity might recognize upon its ultimate disposition of Foreign Bank stock would normally be expected to have a largely U.S. source.

From: Chris Donegan <don>
Date: Thu, 26 Sep 96 14:21:02 +0100
To: Quadra
Subject: QUADRA TRADE

Wolfgang,

as I understand the deal it has 2 parts.

1. UBS trades with an ONSHORE US client - a Quadra LP account. This trade is the purchase of UBS stock and optional purchase of a call and put.

2. UBS trades with an OFFSHORE CAYMAN TRUST which is adminsitered by QUADRA. The trust buys a 50 day forward on UBS stock, a put option and sells a call to UBS.

The credit risk on the call is collaterised by cash collateral from the TRUST.

Do not yet understand the tax rationale for the trade. I will speak to Jeff/KPMG. Legal and operational issues will be addressed today with Staddon and Adam.

Don

new

From: Randall S Bickham at KPMG_Silicon_Valley2
Sent: Wednesday, September 30, 1998 6:42 AM
To: Eischeid, Jeffrey A; Henderson, Tracie K; Taylor, Theresa S
Subject: Documents

Importance: High

Forward.txt   Opus Call Option.doc   Opus L.P. Agreement.doc   Opus SPVLP Advisory Agreement....   Opus Subscription Agreement.do...   Swap Confirm.doc
Swap Sched.doc   USI Advisory Agreement.doc   RFC822 message headers.txt

The key changes made to finalize the documents are:

-the 7% relates to the following, Swap-6.45%, GP Option-.25%, Quadra fee-.30%. The reason for breaking out the .30% was to make the numbers work as to allocating Cayman profits between the option and the swap. Also it makes sense that the Investor is paying Quadra directly in light of the investment advice given to the Investor.
-the GP/LP split is 15/85, again to make the numbers work with respect to the call relative to the option. Value is skewed toward the call, which is good in that it gives more economic substance to the call in which attribution is based.
-the profit allocations are 95/5 and 5/95 again to make the respective allocations work,
-the exercise price for the call is .51%
-the language as to the floating payment within the swap is extremely confusing but is necessary to capture all potential eventualities.

Randy

____________________ Forward Header ____________________
Subject: Documents
Author: Norm Bontje <NormB@qcm.com> at INTERNET
Date: 9/28/98 8:46 AM

Randy, attached please find operative documents. Investment description to follow.

<<Opus Call Option.doc>> <<Opus L.P. Agreement.doc>> <<Opus SPVLP Advisory Agreement.doc>> <<Opus Subscription Agreement.doc>> <<Swap Confirm.doc>> <<Swap Sched.doc>> <<USI Advisory Agreement.doc>>

Permanent Subcommittee on Investigations
EXHIBIT #94jj

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---------------------------- Forwarded with Changes --------------------------
From: Norm Bontje <NormB@qcm.com> at INTERNET
Date: 9/28/98 8:46AM
To: Randall S Bickham at KPMG_Silicon_Valley2
*cc: Jeff Greenstein <jeffg@qcm.com> at Internet
Subject: Documents
-------------------------------------------------------------------------------
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250 Shares of Common Stock
of
«SPVINC_Name»
an exempted company formed under the laws of
the Cayman Islands, B.W.I.

October ___,1998

CALL OPTION

This certifies that for value received from «US_Investor» (the "Buyer") in the amount of $«Call_Option_Premium»the Buyer of this option contract and the option to purchase shares hereunder (the "Option") may call upon, «SPVLP_Name» the party required to perform the obligations of this Option (the "Writer"), to either, at the sole discretion of the Buyer, i) sell to the Buyer 50 percent of the issued and outstanding shares of the Common Stock (the "Shares") of «SPVINC_Name» (the "Corporation") owned by the Writer at the price per share, of U.S.$«Call_Option_Strike» (the "Strike Price"), or (ii) to pay to the Buyer a cash settlement price (the "Cash Settlement Price") of 50% (Fifty per cent) of the adjusted Net Asset Value of the Corporation (as defined in Section 7 below). The Strike Price is subject to adjustment in accordance with the provisions of Section 6 below.

1. *Exercise.* The Buyer may exercise its rights under this Option beginning 60 (SIXTY) days after the date first stated above.

2. *Expiration.* The Option expires on January 31, 1999 5:00 p.m. Pacific Daylight Time (the "Expiration Date").

3. *Presentment.* In order to exercise this Option, the Buyer must deliver to the Writer, before the Expiration Date, the following:

(i) This Option,

(ii) An Election to Call in the form appended hereto, duly signed by the Buyer (or a duly authorized representative thereof),

(iii) Payment of the Strike Price, in accordance with the requirements stated herein.

Upon presentation of this Option to the Writer, together with the duly executed Election to Call and payment of the Strike Price, the Writer agrees to accept notice of the Buyer's exercise of the Option, by stamping or signing where indicated on the Election to Call, and such acknowledgment will constitute a contract and will be controlling with respect to the acceptance and delivery of all certificates representing ownership of the Shares and settlement of the sale of the Shares contemplated herein. This Option cannot be exercised orally.

4. *Payment.* The Buyer will pay the Strike Price to the Writer by wire transfer to the account specified by the Writer, at the same time that the Buyer delivers this Option and the Election to Call.

5. *Commitment.* The Writer agrees to carry out and perform all of its obligations under this Option, in accordance with the provisions hereof.

6. *Adjustments.* Before the expiration of this Option:

(a) The Strike Price will be reduced by the value of any cash dividend on the day that the stock issued by the Corporation of the class specified on the face of this Option (the "Underlying Security") goes ex-dividend;

(b) If the Buyer exercises all or any portion of the Option after any stock dividend, stock split, reverse stock split, recapitalization, combination or exchange of shares, merger or consolidation of the Corporation, acquisition of property or stock by the Corporation, reorganization or other similar change or transaction by the Corporation affecting the class of shares of the Corporation's capital stock of which the Shares are a part, this Option will become an option for the equivalent number and class of new shares the Buyer would have had on the date of exercise had the new shares been purchased for the same Strike Price.

(c) Stock dividends or the equivalent due-bills will be attached to the Underlying Security when and if this Option is exercised, and the total Strike Price will not be reduced.

7. *Definition of Net Asset Value.*

"Net Asset Value" means: 50% (Fifty per cent) of the Corporation's fair market value as of the close of business on the day the Buyer presents the option to the Writer for cash settlement, taking into account all of the assets of the Corporation, less the liabilities of the Corporation, less the strike price per share of U.S.$«Call_Option_Strike» multiplied by 50% of the issued and outstanding shares of the Corporation. The Net Asset Value of the Corporation will be calculated by the Queensgate Bank & Trust Company, Ltd as administrator of the Corporation. For purposes of the Net Asset Value Computation, the assets of the Corporation will be deemed to include:

(i) all cash on hand, on loan or on deposit, or on call including any interest accrued thereon;

(ii) all bills, demand notes, promissory notes and accounts receivable;

(iii) all bonds, time notes, shares, stock, commodities, metals, debentures, debenture stock, subscription rights, warrants, options, financial futures, and investments and securities owned or contracted for by the Corporation,

(iv) all shares, stock and cash dividends and cash distributions to be received by the Corporation and not yet received by it but declared payable to shareholders of record on a date before the day as of which the assets are being valued;

(v) all interest accrued on any interest bearing securities owned by or credited to the Corporation;

(vi) all other securities of the Corporation; and

(vii) all other assets, including assets which are intangible in nature or represent prepaid expenses.

In determining the *fair market value* of the assets of the Corporation, the following guidelines will be used:

(a) The value of any cash on hand or on deposit, bills, demand notes and accounts receivable, cash distributions or dividends declared to holders of record on a date on or before the calculation of the Net Asset Value but not yet received, and interest accrued and not yet received, will be deemed to be the full amount thereof, unless the Directors of the Corporation (the "Directors") have determined that any such deposit, bill, demand note or account receivable, distribution or dividend, or interest accrued is not worth the full amount thereof, in which event the value thereof will be such value as the Directors determine to be the fair value thereof;

(b) The value of any security listed or dealt in on a regular listed or OTC exchange will be determined by taking the last sale price (or, lacking any sales, a price not higher than the closing asked price and not lower than the closing bid price therefor as the Directors may from time to time determine) on the latest available quotation;

(c) If a security is listed or dealt in on more than one stock exchange, the Directors will determine the stock exchange whose quotations will be used in the determination of the value of such security;

(d) If no price quotations, as provided above, are available for a security, the value thereof will be determined in such manner as the Directors will from time to time determine;

(e) Short-term investments will be valued at cost plus accrued interest and plus or minus any unamortized discount or premium;

(f) Assets which are quoted in a foreign currency will be valued by translating the quoted value into dollars at the exchange rate quoted by Bloomberg, L.P. prevailing at the close of business on the day the Net Asset Value is calculated;

(g) Any assets not described in (a) through (f) above will be valued at the amount at which such asset could be converted to cash within 30 (THIRTY) days.

The *liabilities* of the Corporation will be deemed to include:

(i) all bills and notes payable and accounts payable;

(ii) all administrative expenses payable or accrued, or both;

(iii) all contractual obligations for the payment of money or property; and

(iv) all other liabilities of the Corporation of any kind, including loans from shareholders but excluding liabilities represented by the share capital or share premium paid on the Ordinary Shares.

8. *Assignment.* This option contract and the Option it provides inure to the benefit of and is binding upon the successors and assigns of the Buyer. This option contract and the Option may not be assigned by the Buyer.

9. *Amendment: No oral modification or Waiver.* No provisions of this option contract may be changed or waived without a writing signed by the parties.

10. *Severability.* If any of the provisions hereof are held to be invalid, void or unenforceable, the remaining provisions will remain in effect and will not be affected, impaired or invalidated.

11. *Merger of Agreements.* This option contract is intended to express the entire agreement between the parties concerning the subject matter hereof, and it supersedes all other earlier and contemporaneous agreements and expressions between them.

12. *Headings.* The section headings appear only for convenience and may not be used to affect the construction of this option contract.

13. *Governing Law.* This option contract is to be governed by and construed in accordance with the laws of the Cayman Islands, without reference to the conflicts of laws principles thereof.

14. *Professional Advisement.* The Buyer represents that it has consulted its

professional advisers on and informed itself as to matters referred to in this document and in the Company's Memorandum and Articles of Association, including: (a) the legal requirements within the country of its nationality, residence or domicile that may apply to the acquisition of the Option and the Shares; (b) any foreign exchange restrictions or exchange control requirements which it might encounter on acquisition or disposal of the Option; (c) the income tax and any other tax consequences which might be relevant to the acquisition, holding or disposal of the Option; and (d) the significant risks involved in the investment program to be followed by the Corporation, which could entail the risk of losing all investment principal.

IN MAKING A DECISION TO INVEST IN THIS OPTION, THE BUYER MUST RELY ON ITS OWN EXAMINATION OF THE ENTITY CREATING THE SECURITIES AND THE TERMS OF THE SECURITIES, INCLUDING THE MERITS AND RISKS INVOLVED. THE OPTION OFFERED HEREBY HAS NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY OF THE UNITED STATES OF AMERICA, AND ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE. THE OPTION OFFERED HEREIN HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), NOR HAS THE CORPORATION BEEN REGISTERED AS AN INVESTMENT COMPANY UNDER THE UNITED STATES INVESTMENT COMPANY ACT OF 1940 (AS AMENDED).

THIS OPTION IS SUITABLE ONLY FOR SOPHISTICATED INVESTORS WHO DO NOT REQUIRE IMMEDIATE LIQUIDITY FOR THEIR INVESTMENT, FOR WHOM AN INVESTMENT IN THE CORPORATION DOES NOT CONSTITUTE A COMPLETE INVESTMENT PROGRAM, AND WHO FULLY UNDERSTAND AND ARE WILLING TO ASSUME THE RISKS INVOLVED IN THE INVESTMENT PROGRAM OF THE CORPORATION, WHICH PROGRAM MAY RESULT IN A COMPLETE LOSS OF THEIR INVESTMENT.

NO TRANSFER OF ALL OR A PORTION OF THE OPTION OR UNDERLYING SECURITIES SHALL BE MADE AT ANY TIME UNLESS THE CORPORATION SHALL HAVE BEEN SUPPLIED WITH EVIDENCE REASONABLY SATISFACTORY TO IT THAT SUCH TRANSFER IS NOT IN VIOLATION OF THE ACT, SUBJECT TO THE SATISFACTION OF THE AFORESAID CONDITION AND UPON SURRENDER OF THIS OPTION OR CERTIFICATES FOR ANY UNDERLYING SECURITIES AT THE OFFICE OF THE CORPORATION, THE CORPORATION WILL DELIVER A NEW OPTION OR NEW CERTIFICATE OR CERTIFICATES FOR UNDERLYING SECURITIES TO AND IN THE NAME OF THE ASSIGNEE OR ASSIGNEES NAMED THEREIN. THE RIGHTS TO THE SHARES WHICH THE BUYER MAY OBTAIN UPON THE EXERCISE OF THIS OPTION ARE SUBJECT TO ANY LIMITATIONS IMPOSED BY THE ARTICLES OF ASSOCIATION OF THE CORPORATION.

NO PERSON, FIRM OR CORPORATION, OTHER THAN THE BOARD OF DIRECTORS OR THE ADMINISTRATOR OF THE CORPORATION, HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR MAKE ANY REPRESENTATION

OTHER THAN TO DELIVER THE CORPORATION'S MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION. IF MADE BY OTHER THAN SUCH AUTHORIZED PERSONS, ANY SUCH REPRESENTATION SHOULD NOT BE RELIED UPON.

THIS OPTION MAY NOT BE OFFERED DIRECTLY OR INDIRECTLY TO A MEMBER OF THE PUBLIC IN THE CAYMAN ISLANDS.

[continues on next page]

IN WITNESS WHEREOF, the Writer has caused this Option to be executed as of the date first written above.

Writer: «SPVLP_Name»

By_______________________
Name:
Title:

Buyer: «US_Investor»

By_______________________
Name:
Title:

To: «SPVLP_Name»

ELECTION TO CALL

The undersigned hereby irrevocably elects to exercise the right to purchase represented by the within Option for, and to purchase thereunder, 250 (TWO HUNDRED FIFTY) shares of «SPVINC_Name», an exempted company formed under the laws of the Cayman Islands, provided for therein, and requests that the certificate(s) for such shares be tendered to it together with all other deliveries required to effect the transfer under the Option.

Dated:
«US_Investor»

By:
Name:
Title:

To: «SPVLP_Name»

ELECTION FOR CASH SETTLEMENT

The undersigned hereby irrevocably relinquishes its right to purchase represented by the within Option for, and to purchase thereunder, 250 (TWO HUNDRED FIFTY) shares of «SPVINC_Name», an exempted company formed under the laws of the Cayman Islands, provided for therein, in consideration for the payment of the Cash Settlement Price in full by the Writer to the undersigned.

Dated:
«US_Investor»

By:
Name:
Title:

AMENDED AND RESTATED
LIMITED PARTNERSHIP AGREEMENT OF
«SPVLP_Name»

AGREEMENT, made «SPVLPAgreement_date», by and among «SPVINC_Name», an exempted company organized and existing under the laws of the Cayman Islands, «NRA», a company organized and existing under the laws of the Isle of Mann.

W I T N E S S E T H:

WHEREAS, the parties hereto have joined together in a limited partnership for the purposes set forth in Section 5 hereof; and

WHEREAS, the parties desire to set forth the terms and conditions of their partnership agreement referred to above.

NOW, THEREFORE, in consideration of the foregoing, of the mutual promises of the parties hereto, and of other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto, intending legally to be bound, hereby agree as follows:

1. Formation.

The parties hereby form a limited partnership pursuant to the Exempted Limited Partnership Law (1997 Revision) of the Cayman Islands (the "Law").

2. Name.

The name of the partnership is «SPVLP_Name».

3. Definitions.

3.1 Agreement: means this Agreement of Limited Partnership, as amended, modified or supplemented from time to time.

3.2 Capital Account: means, as to any Partner on any given date, the cash contributed by the Partner to the capital of the Partnership, properly adjusted to reflect (a) such Partner's distributive share of Profits and Losses of the Partnership and (b) distributions by the Partnership to such Partner.

3.3 Capital Contribution: means the amount of cash contributed to the capital of the Partnership.

3.4 Capital Receipts: means the proceeds from financing or refinancing of any loans secured by mortgages or deeds of trust on Partnership property, partial or total condemnation of Partnership property, casualty insurance, sale or other disposition of all or any part of the Partnership property, or other extraordinary receipts or proceeds.

3.5 Cash Flow: means the gross cash receipts generated by the operation of the business of the Partnership from all sources, less operating expenses paid, payments made to discharge Partnership debts, amounts set aside as reserves, and capital expenditures.

3.6 General Partner: means «SPVINC_Name», an exempted company of the Cayman Islands having its registered office at «SPVINC_Address_1»,«SPVINC_Address_2».

3.7 Limited Partner: means «NRA», an Isle of Mann company, whose principal business address is «NRA_Address_1», «NRA_Address_2» together with any successors or assigns, in the manner permitted herein.

3.8 Partner: means either the General Partner or the Limited Partner, and Partners: means the General Partner and the Limited Partner together.

3.9 Partnership: means «SPVLP_Name», a Cayman Islands exempted limited partnership formed under the Law in accordance with the terms of this Agreement, with its principal place of business as hereinafter set forth.

3.10 Partnership Interest: as to any Partner, means a Partner's Capital Account, Percentage of Partnership Interest, the right of such Partner to distributions under Section 13 hereof, and any other rights such Partner has in the Partnership; any such Partnership Interest shall be governed by Article 8 of the Uniform Commercial Code, as in effect in the State of New York, U.S.A.

3.11 Percentage of Partnership Interest: as to any Partner, means the percentage in the Partnership shown opposite the name of such Partner in Section 9.1 hereof.

3.12 Profit or Loss: means profit or loss determined by the certified public accountant employed at the close of the taxable year of the Partnership to prepare the partnership information return for Federal income tax purposes.

3.13 Substituted Limited Partner: means that person or party admitted to the Partnership as a Limited Partner, in accordance with the provisions of Section 14 hereof.

4. Registered Office.

The registered office of the Partnership is located at:

Myers & Alberga
PO Box 472 GT
One Regis Place
Fort Street, Grand Cayman
Cayman Islands, B.W.I

or at such other location in the Cayman Islands as the General Partner may from time to time hereafter determine.

5. Purpose.

The purpose of the Partnership is:

to engage in hedge and/or option transactions and all matters ancillary thereto or related thereto, incurring indebtedness in connection therewith, and the pledging or charging of the assets of the Partnership in connection with any of the foregoing, and to issue guarantees, hold, improve, maintain, operate, lease, sell and undertake financing arrangements and invest in securities as the General Partner on behalf of the Partnership may select, and to engage in any and all lawful general business activities related or incidental thereto, and to engage in any other lawful activities as the General Partner on behalf of the Partnership may from time to time determine appropriate in connection with the foregoing.

6. Term.

The term of the Partnership commenced on «SPVLPAgreement_date» and will continue until March 31, 2028, or, if the sooner, the dissolution of the Partnership and its business is completed and wound up following a cause of dissolution, as provided in Section 16.1 hereof.

7. Capital Contributions. Within fifteen (15) business days of the date hereof:

7.1 Capital Contribution of General Partner. The General Partner agrees and covenants to make a contribution of «General_PartnerContribution» to the capital of the Partnership.

7.2 Capital Contributions of the Limited Partner. The Limited Partner agrees and covenants to make an initial contribution of «LimitedPartner_Contribution» to be contributed by the Limited Partner.

7.3 Time for Payment. The contributions to the capital of the Partnership shall be made as required in Sections 7.1 and 7.2 above.

7.4 Additional Capital Contributions. The Limited Partner is not required to contribute to the capital of the Partnership any amount beyond that sum required under Section 7.2 hereof, nor call for any increase in the capital of the Partnership for any purpose. If the General Partner deems that the Partnership needs additional Capital Contributions and gives written notice of a call for such additional Capital Contributions to the Limited Partner, but the Limited Partner does not wish to participate therein, then the Limited Partner will notify the General Partner thereof within twenty (20) business days of the date of the General Partner's notice. If the Limited Partner does not give such notice, the Limited Partner will be deemed to have agreed to such additional Capital Contribution. Upon the payment of such additional Capital Contribution, the Partners agree to amend this Agreement in writing to reflect the same. If the Limited Partner so agrees, or is deemed to have so agreed, further Capital Contributions to the Partnership will be made in proportion to the Percentage of Partnership Interests in effect immediately before such call. Payment of such further Capital Contributions will be made as and when called for in writing by the General Partner. Any Limited Partner who does not agree to such additional Capital Contribution will be deemed to have consented to a proportionate dilution of its Percentage of Partnership Interest.

7.5 Interest. The Limited Partner has no right to receive interest on its Capital Contribution or its Capital Account.

7.6 Return of Capital Contributions. Except as specifically provided in this Agreement, the Limited Partner has no right to withdraw or reduce its Capital Contribution to the capital of the Partnership.

7.7 Form of Certificates for Partnership Interest. A Partner is entitled to have a certificate signed in the name of the Partnership by the General Partner, certifying the Partnership Interest owned thereby. The signature(s) on the certificate may be facsimile. Any such certificate will state conspicuously on its face, to the extent applicable, that the Partnership Interest represented thereby is subject to restrictions limiting transfer.

7.8 Transfer of Partnership Interest. Before any transfer of a Partnership interest is entered upon the books of the Partnership, or before any new certificate is issued therefor, the old certificate properly endorsed shall be surrendered and canceled, unless the certificate has been lost or destroyed.

7.9 Lost, Stolen or Destroyed Certificates. The Partnership will issue a new Partnership interest certificate in the place of any certificate previously issued by it that is alleged to have been lost, stolen, or destroyed; however, before issuing such new certificate the General Partner may require the owner of the certificate (or the owner's legal representative) to give a bond or other adequate security sufficient to indemnify the Partnership against any claim that may be made against it (including but not limited to any expense or liability) on account of the alleged loss, theft or destruction of any such certificate or the issuance of such new certificate.

8. Liability of Limited Partner.

The liability of the Limited Partner for the losses, debts, expenses, obligations or liabilities of the Partnership or encumbrances against the Partnership property is limited, subject to the Law, to the aggregate amount of the Limited Partner's Capital Contribution as set forth in Section 7.2 hereof. Without limiting the generality of the preceding sentence, the liability of the Limited Partner may not be so limited, however: (i) if the Limited Partner takes part in the conduct of the business of the Partnership; or (ii) with respect to any return on contributions received by a Limited Partner within a six month period from the insolvency of the Partnership, in which event the Limited Partner may be liable to return such payments reserved together with interest thereon, all in accordance with Section 14 of the Law.

9. Allocation of Profits and Losses.

9.1 Percentages. The Profits of the Partnership will be shared, and the Losses of the Partnership will be borne by the Partners in proportion to their respective Percentages of Partnership Interest, as set forth below:

9.1.1 General Business Operations. With respect to the general business operations of the Partnership, profits and losses will be allocated as follows:

General Partner	5%
Limited Partner	95%

9.1.2 Special Allocation. Gains and losses from the disposition of investments in UBS AG common stock not subject to a call option will be allocated as follows:

General Partner	95%
Limited Partner	5%

9.2 Changes in Percentages. The Percentages in Section 9.1 will be deemed proportionately changed in the case of any increase of Partnership capital by fewer than all Partners or in amounts not corresponding to their Percentages, in either case under Section 7.4 hereof.

9.3 Allocations. All Partnership items of income, gain, loss, deduction, credit or allowance for any taxable year or other period will be allocated among the Partners in proportion to the Percentage of Partnership Interest set forth in Section 9.1 above.

10. Legal Title to Partnership Property.

Legal title to all Partnership property will be held in the name of «SPVLP_Name» or in such other manner as the General Partner determines to be in the best interests of the Partnership.

11. Management.

11.1 Power and Authority of General Partner. The General Partner has complete authority and responsibility for the management of the Partnership business and affairs. Except as otherwise provided in this Agreement, the General Partner has all the rights and powers of a general partner as provided under the Law and other applicable laws of the Cayman Islands, and any action taken by the General Partner will constitute the act of the Partnership. Without limiting the generality of the above, the General Partner, by any duly elected officer, has the right, power and authority, in furtherance of the purpose of the purpose of the Partnership as set forth in Section 5 hereof, to do the following:

(a) Incur all reasonable expenditures;

(b) Employ and dismiss from employment any and all employees, agents, independent contractors, attorneys and accountants;

(c) Purchase and otherwise acquire property of all kinds, real and personal, in accordance with Section 10 hereof;

(d) Enter into investment advisory agreements with such investment advisors(s) as it deems appropriate;

(e) Sell or exchange, or grant an option for the sale or exchange of, all or any portion of the real and personal property of the Partnership, subject to the limitations of Section 12.2 of this Agreement;

(f) Lease all or any portion of any property for any purpose and without limit as to the term of condition thereof;

(g) Borrow money and as security therefor to mortgage and grant security interests in or otherwise encumber all or any part of any property, or to assume mortgages in like manner;

(h) Place record title to any property in its name or in the name of a nominee or a trustee;

(i) To adjust, compromise, settle or refer to arbitration any claim against or in favor of the Partnership or any nominee thereof, and to institute, prosecute and/or defend any legal proceeding relating to the business or property of the Partnership; and

(j) Execute, prepare, file, record or otherwise deal with any documents, whether of a private or governmental nature, relating to the business or property of the Partnership.

11.2 Duties of General Partner.

The General Partner is not required to devote full time to the affairs of the Partnership, but shall devote to the management of the Partnership so much of its time as it, in its sole discretion, deems reasonably necessary to efficient operation.

11.3 Management and Other Services.

The General Partner may manage the Partnership property or may contract with any person, firm or corporation for the performance of any and all services (including, without limitation, management, accounting, investment advisory and legal services) that may at any time be necessary, proper, convenient or advisable to carry on the business of the Partnership or to hold, manage, supervise or otherwise deal with the Partnership property.

11.4 Reimbursement of Expenses.

The Partnership will fully reimburse the General Partner for the expenses the General Partner incurs in connection with the management and supervision of the Partnership business, if the General Partner presents the Partnership with such invoices and receipts as are necessary to substantiate such expenses.

12. Authority of Limited Partner.

12.1 No Authority. The Limited Partner has no right to participate in the management or conduct of the Partnership business nor has it any power or authority to act for or on behalf of the Partnership.

12.2 Approval of Limited Partner.

Despite the provisions of Section 12.1, it is understood and agreed that the Limited Partner may approve the following:

(a) Amendment of this Agreement of Limited Partnership;

(b) Voting as a limited partner on the sale or disposition of all or substantially all of the property of the Partnership;

(c) Voting as a limited partner on the dissolution and termination of the Partnership other than under the terms of this Agreement;

(d) Voting as a limited partner on the removal of the General Partner and election of a successor general partner.

12.3 Compensation; Drawing Account.

Unless the General Partner specifically employs the services of the Limited Partner, the Limited Partner will not receive any salary or other compensation for services from the Partnership, nor will the Limited Partner have a drawing account in the Partnership.

13. Distribution of Cash Flow and Capital Receipts.

13.1 Distribution of Cash Flow. The Cash Flow of the Partnership may, in the discretion of the General Partner, be distributed among the Partners in proportion to their respective Percentages of Partnership Interest in accordance with the provisions of Sections 9.1.1 and 9.1.2, above, to the extent that funds are available.

13.2 Distribution of Capital Receipts. Capital Receipts will be allocated among the Partners in proportion to their respective Percentages of Partnership Interest in accordance with the provisions of Sections 9.1.1 and 9.1.2, above.

14. Assignment of Interests.

14.1 General Partner. The General Partner has no right to assign its Partnership Interest, or any part thereof.

14.2 Limited Partner. Provided that the prior written consent thereto of the General Partner shall have been obtained, which consent may be withheld in its sole and absolute discretion, the Limited Partner may assign its Partnership Interest, or any part thereof, to a person who is not a Partner in the Partnership and may confer upon such assignee all the attributes of its interest in the organization and the assignee may become a Substituted Limited Partner, but only if the following conditions are also complied with:

(a) The assigning Limited Partner so provides in the instrument of assignment;

(b) The assignee agrees in writing to be bound by the provisions of this

Agreement;

(c) The instrument of assignment is in form and substance reasonable;

(d) The assignor and assignee execute such other instruments as the General Partner may reasonably require to effectuate such substitution, including an assumption by the assignee of the liabilities of the assignor, without relieving the assignor from liability to the Partnership, if any;

(e) The assignee pays, or obligates itself to pay, as the General Partner may determine, all reasonable expenses connected with such substitution; and

(f) The assigning Limited Partner surrenders its certificate or certificates evidencing ownership of its entire Partnership Interest, duly endorsed in blank for transfer thereof, or delivers to the General Partner an affidavit of loss, theft or destruction with respect to such certificate or certificates and complies with the requirements of Section 7.9 of this Agreement.

In no event may a minor or incompetent person become a Substituted Limited Partner.

15. Death, Legal Incompetency, Liquidation, Dissolution or Insolvency of a Limited Partner.

The death or legal incompetency of a Limited Partner that is a natural person, or the liquidation, dissolution or insolvency of a Limited Partner that is an entity, will not dissolve the Partnership. In such event, the personal representative of the deceased or incompetent Limited Partner, or a duly authorized officer of the liquidating, dissolving or insolvent Limited Partner, will have, for purposes of settling the estate of the deceased Limited Partner or management and administration of the affairs of the incompetent Limited Partner or liquidating, dissolving or insolvent Limited Partner, all of the rights of the Limited Partner, including the same right the deceased, incompetent, liquidating, dissolving, or insolvent Limited Partner would have had under this Agreement to assign its Partnership Interest and to constitute the assignee a Substituted Limited Partner.

16. Dissolution; Continuation; Liquidation; and Termination.

16.1 Cause of Dissolution. The Partnership will be dissolved upon the agreement in writing of the General Partner and the Limited Partner to dissolve the Partnership.

16.2 Continuation of Partnership. The Partnership will dissolve upon the withdrawal, liquidation, dissolution, death, adjudication of bankruptcy or adjudication of incompetency of the General Partner, or upon the sale by the General Partner of all of its Partnership Interest, except that if within 90 days of such date of dissolution, there are at least 2 Limited Partners and they unanimously elect one or more General Partners, the business of the Partnership is not hereby required to be wound up. Upon such withdrawal, liquidation, dissolution, death, adjudication or sale, if there are at least 2 Limited Partners, one may be the successor General Partner of the Partnership.

16.3 Liquidation. If the Limited Partner(s) does not agree to continue the Partnership, the General Partner will wind up the Partnership, liquidate the Partnership's assets and distribute the proceeds thereof in the following order:

(a) The debts and liabilities of the Partnership will be paid or otherwise adequately provided for; and

(b) The remaining proceeds will be distributed among the Partners in proportion to their respective Percentages of Partnership Interest.

16.4 Termination. The Partnership will be terminated upon completion of the dissolution, liquidation and distribution of the liquidation proceeds, and any documents of like effect necessary thereto will be executed and delivered or filed with the appropriate persons by the General Partner or Limited Partners, as the case may be.

17. Books of Account; Financial Reports; Tax Returns; Taxable Year; Accounting Method; and Banking.

17.1 Books of Account. The Partnership will maintain, at its principal place of business or at such other place as the General Partner may determine, books of account, which will reflect fully and accurately all Partnership transactions in accordance with generally accepted accounting principles applied on a consistent basis. Each Partner will have access thereto at all reasonable times.

17.2 Financial Report. Not later than ninety (90) days after the close of the taxable year of the Partnership, the General Partner will furnish or cause to be furnished to each Limited Partner a report of the business and operations of the Partnership, prepared by an independent certified public accountant. Said report will contain a copy of the annual financial statement of the Partnership, showing the Partnership's profit or loss for the year and its allocation among the Partners.

17.3 Bank Account. All funds of the Partnership will be deposited in the name of the Partnership in one or more deposit or brokerage accounts or both and will be withdrawn on the authorized signature of an officer of the General Partner or a signatory duly authorized by the General Partner.

18. Power of Attorney.

18.1 To General Partner. By signing this Agreement, the Limited Partner constitutes and appoints the General Partner the attorney-in-fact for the Limited Partner, with power and authority to act in its name and on its behalf in the execution, acknowledgment and filing of documents, including but not limited to the following:

(a) The Statement filed pursuant to Section 9 of the Law or any amendments thereto;

(b) Any other instrument required to be filed by the Partnership by law, or by any governmental agency, or which the General Partner deems it advisable to file; and

(c) Any documents required to effect the continuation of the Partnership, the admission of a Substituted Limited Partner, or the dissolution and termination of the Partnership; provided, however, such continuation, admission or dissolution and termination are in accordance with the specific terms and conditions of this Agreement.

18.2 Specifications of Power. The Power of Attorney hereby granted by the Limited Partner to the General Partner:

(a) may be exercised by the General Partner for the Limited Partner by a facsimile signature of one of the officers of the General Partner; and

(b) will survive the delivery of an assignment by the Limited Partner of the whole or any portion of its Partnership Interest, except that where the assignee thereof becomes a Substituted Limited Partner, the Power of Attorney will survive the delivery of such assignment for the sole purpose of enabling the General Partner to execute, acknowledge and file any instrument necessary to effect such substitution.

19. Exculpation.

No Partner is liable to the Partnership or to any other Partner by reason of its actions in connection with the Partnership, except in the case of actual fraud or dishonest conduct.

20. Ancillary Provisions.

20.1 Meetings of Partnership. Meetings of the Partnership may be called by the General Partner or by written request of a majority of the Limited Partners, stating the purpose or purposes of such meeting. Within ten (10) days after receipt of such a written request by the Limited Partner, the General Partner will provide the Limited Partner with written notice of a meeting to be held, which notice will specify the time and place of such meeting and the purpose or purposes thereof.

20.2 Successors. The terms and conditions of this Agreement are binding upon, and inure to the benefit of the parties and their heirs, executors, administrators, personal and legal representatives, successors and assigns.

20.3 Entire Agreement. This Agreement constitutes the entire agreement among the parties and supersedes all other prior and contemporaneous oral and written agreements and understandings with respect to the subject matter hereof.

20.4 Further Action. The parties each hereby agree to execute and deliver such additional instruments and documents and to take such additional action as may be required from time to time in order to effectuate the provisions and purposes of this Agreement.

20.5 Waivers and Amendments. No waiver, modification or amendment of this Agreement or any provision hereof will be considered valid unless in writing and signed by all of the parties. No such waiver will be deemed a waiver of any other provision or any subsequent breach or default of a similar nature.

20.6 Severability. If any provision of this Agreement is held to be invalid or unenforceable, the remainder of this Agreement will not be affected thereby but will be enforced to the greatest extent permitted by law.

20.7 Counterparts. This Agreement may be executed in one or more counterparts, each of which will be deemed an original, and all of which taken together shall constitute but one and the same instrument.

20.8 Headings. Headings of the sections and subsections of this Agreement are solely for the convenience of the parties, are not a part of this Agreement, and are not to be used for the interpretation or determination of the validity of this Agreement or any provision hereof.

20.9 Notices. Any notice or other communication permitted or required to be given hereunder must be in writing, and will be deemed to have been given when deposited in the United States mail, certified or registered mail (and air mail if overseas), return receipt requested, and with proper postage prepaid, addressed to the parties as follows: To the Partnership: «SPVLP_Name», To the General Partner: «SPVINC_Name», To the Limited Partner: «NRA».

20.10 Governing Law. This Agreement and the rights of the partners will be governed by and construed in accordance with the laws of the Cayman Islands.

[Agreement continues on next page]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as a Deed on this ____ day of ____________, 1998.

GENERAL PARTNER

«SPVINC_Name»

By:
Name:
Title:

By:
Name:
Title:

WITNESS:

By:
Name:

LIMITED PARTNER

«NRA»

By:
Name:

WITNESS:

By:
Name:

QA INVESTMENTS, LLC
INVESTMENT ADVISORY AGREEMENT

This Investment Advisory Agreement is entered into on the ___ day of «Agreement_Month», «Agreement_Year» by and between «SPVLP_Name», a Cayman Islands exempted limited partnership (the "Client"), and QA Investments, LLC, a Delaware limited liability company (the "Investment Advisor").

WHEREAS, the Client wishes to purchase certain securities and may wish to utilize various hedging strategies to minimize differing risks related to these securities and the portfolio as described in the attached Exhibit A; and

WHEREAS, the Client wishes to appoint the Investment Advisor to facilitate the purchase and hedging transactions described above;

NOW, THEREFORE, the parties hereby represent and agree as follows:

1. Appointment of Investment Advisor. The Client hereby appoints the Investment Advisor as the investment manager with respect to the amount of Client Funds set forth in Exhibit A under the heading Account Value (the "Account"). The Investment Advisor may, in its discretion, delegate all or a portion of its responsibilities and duties hereunder to one or more sub-investment advisors. At no time shall the Investment Advisor have actual possession of any property in the Account.

2. Discretionary Authority. The Investment Advisor shall have full power and discretion to open accounts in the Clients name, to transfer funds into such accounts, and in relation to the investment and reinvestment of assets in the Account, without prior consultation with or the approval of the Client, subject to the investment objectives as set forth in Exhibit A. This authority shall include the power to: (a) buy, sell, exchange, convert, borrow, and otherwise trade in any and all publicly and privately traded stocks, bonds, derivative instruments, and other securities as the Investment Advisor may deem advisable and in the best interests of the Client in light of such investment objectives; (b) pledge as collateral or otherwise encumber the assets in the Account to support the trading activities described in (a) above; and (c) place orders for the execution of such securities transactions through such brokers or dealers as the Investment Advisor may select.

3. Procedures with Respect to Securities. All transactions, purchases and sales of securities by the Investment Advisor with respect to the Account shall be consummated by payment to or delivery of the cash or securities or other property due to or from the Client. Instructions which materially change the investment objectives set forth in Exhibit A shall be made to the Investment Advisor in writing (including facsimile transmission) or orally and confirmed in writing (including facsimile transmission) as soon as practicable thereafter. The Investment Advisor shall instruct all brokers executing orders with respect to the Account to forward to the Client or its administrator, Queensgate Bank and Trust Company, Ltd. (the "Administrator"), copies of brokerage confirmations promptly after execution of all such transactions.

4. Fees. The compensation of the Investment Advisor for its services rendered hereunder shall be calculated and paid in accordance with Exhibit B.

5. Dividends and Account Reports. Dividends and other income or distributions on or with respect to any of the assets of the Account shall be credited to the Account and reinvested by the Investment Advisor in accordance with this Agreement. The Investment Advisor in conjunction with the Administrator shall maintain complete records of income and principal of the Account and shall furnish the Client, within ninety days after the last day of each calendar quarter, with quarterly written statements of the Account and valuations of the assets of the Account as of the last day of each quarter, and such other reports as the Client shall reasonably request. The Investment Advisor in conjunction with the Administrator will make available all books and records related to the Account at the request of the Client.

6. Services to Other Clients. The Client understands and agrees that the Investment Advisor and its affiliates perform investment advisory and investment management services for various clients other than the Client. The Client agrees that the Investment Advisor and its respective affiliates may give advice and take action in the performance of its duties with respect to any of its other clients which may differ or be the same as advice given, or the timing or nature of action taken, with respect to the Account. Nothing in this Agreement shall be deemed to impose upon the Investment Advisor any obligation to purchase or sell or to recommend for purchase or sale for the Account any security or other property which the Investment Advisor or its respective affiliates may purchase or sell for its own account or for the account of any other client, if in its sole discretion the Investment Advisor, for any reason, considers it undesirable or impractical to take such action or make such recommendation for the Account.

7. Liability. Neither the Investment Advisor nor any of its officers, directors, employees, or agents shall be liable for any actions performed or omitted, or for any loss, resulting from the exercise of its professional judgment in carrying out its obligation under this Agreement provided that the Investment Advisor shall remain responsible for its gross negligence, willful malfeasance, or violation of applicable law.

The Client shall indemnify the Investment Advisor and its partners, affiliates, employees, and agents (each an "Indemnified Person") against any and all losses, claims, damages or liabilities, joint or several, including, without limitation, reasonable attorney's fees and disbursements, resulting in any way from the performance or non-performance of the Investment Advisor's duties hereunder, except those resulting from gross negligence, willful malfeasance or violation of applicable law in the performance of the Investment Advisor's obligations and duties, and, in the case of criminal proceedings, unless such Indemnified Person had reasonable cause to believe its actions unlawful.

8. Voting. The Investment Advisor shall have the power to vote, either in person or by proxy, tender and take all actions incident to the ownership of all securities in which assets of the Account may be invested from time to time.

9. Duration and Termination. This Agreement shall become effective on the date first set forth above. This Agreement shall continue for a one-year period and

shall thereafter renew for successive one-year periods upon approval of the Client. This Agreement may be terminated by ninety days' written notice by the party requesting such termination.

10. Outside Services. The Investment Advisor has the authority to seek advice, as well as employ services from third parties on behalf of the Investment Advisor or the Client or any beneficial owner of the Client to the extent such advice is in direct relationship to the Client's beneficial interest. Such services are described in Exhibit B.

11. Representations by the Client and the Investment Advisor. The Client and Investment Advisor each represents that the terms hereof do not violate any obligation by which it is bound, whether arising by contract, operation of law, or otherwise. The Client and Investment Advisor each represents that it is duly organized, validly existing and in good standing under the laws of its State or jurisdiction of organization and has full power and authority to execute and deliver this Agreement and carry out its obligations hereunder; the execution and delivery of the Agreement has been duly authorized by all necessary action on its behalf; the execution, delivery and performance of this Agreement does not violate any agreement or arrangement to which it is a party or by which it is bound, or any order or decree to which it is subject; and this Agreement constitutes a valid and binding agreement in accordance with its terms.

12. Confidential Relationship. The parties agree that all information and advice provided by either party to the other or the Administrator hereunder shall be treated as confidential and shall not be disclosed to third parties except as required by law or as necessary in connection with regular portfolio transactions for the Account.

13. Amendment and Assignment. This Agreement may not be amended without the prior written consent of both parties, and may not be assigned by either party without the prior written consent of the other.

14. Waivers. A waiver by either party of a breach of any provision of this Agreement shall not constitute a waiver of any subsequent breach of such provision or of any other provision hereof. Failure of either party to enforce at any time or from time to time any provision of this Agreement shall not be construed as a waiver thereof.

15. Attorneys' Fees. The prevailing party in any action brought by either party hereto to enforce its rights under this Agreement shall be entitled to recover all costs and expenses (including reasonable attorneys' fees) incurred in prosecuting or defending such action.

16. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the Cayman Islands.

17. Compliance. The Client and Investment Advisor shall comply in all material respects with all material laws, regulations and rules applicable to it in its performance of its duties and obligations under this Agreement. In performance of its duties under this Agreement, the Investment Advisor shall at times conform to, and act

in accordance with, any requirements imposed by the provisions of the Client's Memorandum and Articles of Association, as amended from time to time.

18. Aggregation. The Client understands that the Investment Advisor may open "average price" accounts in which purchase and sale orders placed during a trading day on behalf of the Account and other clients or affiliates of the Investment Advisor and its affiliates are combined, and securities bought and sold pursuant to such orders are allocated among such accounts on an average price basis.

The parties hereto have hereunto caused this Agreement to be duly executed the day and year first hereinbefore written.

Investment Advisor
QA Investments, LLC

By: ______________________________

Title: ______________________________
Address: 999 Third Avenue Suite 4150
Seattle, WA 98104

Client
«SPVLP_Name»

By: ______________________________

Title: ______________________________

Address: «SPVLP_Address_1»
«SPVLP_Address_2»

EXHIBIT A
INVESTMENT OBJECTIVES

The Client seeks capital appreciation through an investment strategy involving the common stock and related derivative securities of UBS AG. This investment strategy is based on the fundamental outlook, which may or may not be correct, that UBS AG offers:

- modest appreciation potential over the next twelve months
- such appreciation potential may be gradual; however, there exists a possibility for a sharp rallies in the intervening periods

Based on this fundamental outlook, the Investment Advisor will have discretionary authority, as provided herein, to implement an investment strategy which seeks to offer any or all of the following:

- capital appreciation over a twelve month period
- the potential for substantial capital appreciation over shorter time periods
- mitigation of the risk of loss inherent in the relationship between the Account Value and the Notional Account Value

Account Value: The Account Value shall initially be equal to $«Account_value». The Account Value may change as gains or losses are incurred in the Account, or contributions or withdrawals are made from the Account, by the Client in writing to the Investment Advisor. Any contributions or withdrawals made by the Client shall only occur only on each six month anniversary from the initial date of this Agreement.

Notional Account Value: $«Notional». The investment strategy shall be initiated through the purchase of UBS AG securities with a market value of $«Notional». The Investment Advisor, on behalf of the Client, shall endeavor to secure financing, or leverage through a variety of means including, but not limited to, borrowings, margin, derivative securities, and other investment techniques, in order to cause the Account to implement the investment objectives based on the Notional Account Value. The Notional Account Value will change as gains or losses are incurred by the Account, or as requested by the Client in writing to the Investment Advisor.

Acceptable Hedging Techniques: The Investment Advisor shall use its discretion to hedge the Notional Account Value with regards to the equity market risk associated with the Account's investment position in common stocks and related derivatives; exposure to fluctuation in foreign currencies for which the various securities and derivative instruments may be denominated; and any interest rate risks which might be associated with any leverage or financing.

Hedging of foreign currency and interest rate risk may be accomplished through listed, and non-listed, options, futures, forwards, and any other derivative contracts.

Hedging of the market risk associated must be accomplished only through the following strategies:

1. Writing of in-the-money covered call options. These calls may be written on all or a portion of the portfolio, and may be implemented as deemed appropriate by the Investment Advisor. Any outstanding call options in the portfolio may be adjusted from time to time as market conditions warrant, and the Investment Advisor deems appropriate, in order to comply with the Investment Objectives. These options may be exchange traded or over-the-counter.

2. Purchase long significantly out-of-the-money put options. Acceptable put options can be exchange traded or over-the-counter, and may be purchased to hedge all or a portion of the underlying stock position, and adjusted from time to time as market conditions warrant.

Amendments to this Exhibit: The Client may advise the Investment Advisor to add, or change, the underlying stock(s) described in the first paragraph of this exhibit, provided it gives the Investment Advisor no less than 90 days' prior notice, or the Investment Advisor may recommend to the Client the use of additional stocks provided it notifies the Client no less than 30 days prior to proposed purchase date.

EXHIBIT B
FEES & EXPENSES

On-Going Fixed Investment Advisory Fees:
In consideration of the Investment Advisor's on-going services pursuant to this Agreement, the Client will pay the Investment Advisor a fee equal to 1.75%, on an annualized basis, of the Notional Account Value.

On-going fees shall be calculated and paid within 10 days after each calendar quarter (December 31, March 31, June 30, and September 30) at a rate equal to .4375% per quarter (1.75% annually) of the Notional Account Value existing at the inception of this Agreement. If this Agreement is terminated by the Client before the one year anniversary of this Agreement, and the Investment Advisor has completed its responsibilities under Exhibit B hereof, then the Investment Advisor shall be entitled to any unpaid portion of the 1.75% annual fees for which it has not been compensated. If its responsibilities under Exhibit B hereof have not been completed, a pro-rata portion of the On-going fees shall be due and payable.

Expenses:
In addition to Investment Advisory Fees, the Investment Advisor shall have the authority to incur expenses of the Limited Partnership equal to .50% of the Notional Account Value on an annual basis. These expenses may relate to investment consulting, legal fees, introduction fees, business consulting fees, tax advice, and any other fees deemed appropriate by the Investment Advisor. This .50% amount shall not be reduced by expenses directly related to trading, including but not limited to costs of safekeeping, transport, acquisition, and disposition, such as brokerage and other execution costs, custody fees and margin costs.

SUBSCRIPTION AGREEMENT

«SPVINC_Name» (the "Company")

Gentleman,

The investor named below (the "Investor") hereby irrevocably subscribes for 498 Ordinary Shares of «SPVINC_Name» for the value of the amount indicated below, subject to the provisions of the Memorandum and Articles of Association of the Company. This subscription will only be valid and binding on the Company when accepted by the Company in the Cayman Islands, and cleared funds have been received.

Subscription Information:

Name of Investor: «NRA»

Address: «NRA_Address_1»
«NRA_Address_2»

Telephone Number _________________________

Facsimile Number _________________________

Subscription Amount $«Subscription_Amount»

Subscription &
Payment Date _________________________, «Agreement_Year»

Subscriber Representations

The Investor hereby represents and warrants to the Company that:

(a) it:

- (i) is not a US Person*;
- (ii) is not purchasing the Ordinary Shares on behalf of or for the account of any other; nor with a view to the offer, sale, delivery, directly or indirectly, of the Ordinary Shares in the United States, its territories, possessions and other areas subject to its jurisdiction;
- (iii) is acquiring the Ordinary Shares with its own funds and not with funds that constitute assets of any Investment Company registered under the US Investment Company Act of 1940, as amended (the "Investment Company Act"), or assets of any employee benefit plan, within the meaning of the Employee Retirement Income Security Act of 1974, as amended ("ERISA");
- (iv) is purchasing the Ordinary Shares for investment and not with a view to resale or distribution;
- (v) will not transfer or deliver directly or indirectly any of the Ordinary Shares or any interest therein to a US Person or any person unless such person has duly executed a written agreement containing each of the representations made by the Investor herein in identical form;
- (vi) was not solicited to purchase and did not acquire any of the Ordinary Shares while the Investor was present in the United States;
- (vii) will not redeem any of the Ordinary Shares while any warrant or other equity option issued by the Company has not yet expired, nor when the Investor is present in the United States;
- (viii) will not exercise its rights as shareholder of the Company in any manner contrary to the terms of any warrant or other equity option that the Company may issue and will take all reasonable steps as shareholder to ensure the compliance of the Company with such terms.

(b) it has received, read and understands the Memorandum and Articles of Association of the Company, and the Investment Advisory Agreement entered into by the Company with QA Investments, LLC (the "Investment Advisor"), and has relied solely on these documents in determining to invest in the Ordinary Shares, and it has such knowledge and experience in business and financial matters as to be capable of evaluating the merits and risks of investing in the Ordinary Shares and is able to bear the economic risk of that investment.

(c) the Investor is not a bank, broker or other party purchasing shares for clients.

none of the Investor or any member of its immediate family (including grandparents, parents, spouses, siblings, children and grandchildren) owns either directly or indirectly any interest in the common stock, shares, options, warrants, stock rights, or any other

* A US Person is either (i) a natural person who is a citizen of or resident in the United States; (ii) a partnership or corporation organized or incorporated under the laws of the United States; (iii) a trust of which any trustee is a US Person; (iv) an agency or branch of a foreign entity located in the United States; (v) a non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a US Person; a discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated, or (if an individual) resident in the United States; or (vii) a partnership or corporation if: organized or incorporated under the laws of any foreign jurisdiction; and formed by one or more of the above and/or one or more natural persons resident in the United States principally for the purpose of investing in securities.

derivative security of UBS, AG, and the Investor will not purchase, or otherwise acquire or have an interest in, directly or indirectly, common stock, shares, options, warrants, stock rights, or any other derivative security of UBS AG, for as long as the Investor owns the Ordinary Shares.

Company Representations and Covenants

The Company hereby represents and warrants to the Investor that:

(a) no Ordinary Shares of the Company have been issued to any other investor, except for two subscriber shares issued to the two initial subscribers of the Company to facilitate the incorporation of the Company; and such subscriber's shares will be purchased by the Investor in addition to the shares contemplated by this Agreement;

(b) the authorized share capital of the Company is $«capitalization» comprised of Ordinary Shares, $1.00 par value each.

Governing Law

This Subscription Agreement shall be governed by the laws of the Cayman Islands.

In witness whereof the parties hereto have executed this Agreement this ______day of ____________, «Agreement_Year».

Accepted by: ______________________________

by Queensgate Bank & Trust Company Ltd.
as Administrator for «SPVINC_Name»

Ugland House, South Church Street
Goergetown, Grand Cayman
Cayman Islands, B.W.I.
(809) 949-7888 Telephone
(809) 949-7883 Telefacsimile

Signed for on behalf of «NRA»

____
Signature

____
Title

Address Information:

«NRA_Address_1»
«NRA_Address_2»

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«Swap_Wire_Date»

«NRA»
«NRA_Address1»
«NRAAddress2»

with copy to:

QA Investments, LLC
999 Third Ave., Suite 4150
Seattle, WA 98104

Re: Rate Swap Transaction

Ladies and Gentlemen:

The purpose of this letter agreement (this "Confirmation") is to confirm the terms and conditions of the Swap Transaction entered into between «US_Investor» ("Party A") and us ("Party B") on the Trade Date specified below (the "Transaction"). This constitutes a "Confirmation" as referred to in the Master Agreement specified below.

The definitions and provisions contained in the 1991 ISDA Definitions (the "Definitions") and the 1996 Equity Derivative Definitions (the "Equity Definitions") as published by the International Swaps and Derivatives Association, Inc. ("ISDA") are incorporated into this Confirmation. In the event of any inconsistency between the Definitions, the Equity Definitions and this Confirmation, this Confirmation will govern.

This Confirmation evidences a complete and binding agreement between Party A and Party B as to the terms of the Swap Transaction to which this Confirmation relates. In addition you and we agree to use all reasonable efforts to promptly negotiate, execute and deliver an agreement in the form of the ISDA Master Agreement (the ISDA Form), with such modifications as you and we will in good faith agree. Upon the execution of by you and us of such an agreement, this Confirmation will supplement, form a part of and be subject to that agreement. All provisions contained or incorporated by reference in that agreement upon its execution will govern this Confirmation except as expressly modified below. Until we execute and deliver that agreement, this Confirmation, together with all other documents referring to the ISDA Form (each a "Confirmation"), shall supplement, form a part of, and be subject to an agreement in the form of the ISDA Form as if we had executed an agreement in such form (but without any schedule) on the Trade Date of the first such transaction between us. In the event of any inconsistency between the provisions of that agreement and this Confirmation, this Confirmation will prevail for the purpose of this Transaction.

Each party hereby agrees to make each payment specified in this Confirmation as being payable by it, not later than the due date in place of the account specified below (or as specified in writing to the other party at the address specified below), in freely transferable funds and in the manner customary for payments in the applicable currency.

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Parties to the Transaction:	«US_Investor» Party A «NRA» Party B
Trade Date:	«Swap_Wire_Date»
Effective Date:	«SPVLP_Trade_Date»
Termination Date:	«SPVLP_Settlement_Date»
Fixed Amounts – Party A:	
Notional Amount:	USD «Notional»
Fixed Rate Payer:	Party A
Fixed Rate Payer Payment Dates:	The Trade Date and the 50th day following the Effective Date, subject to adjustment in accordance with the Following Business Day Convention.
Fixed Rate Payments:	(1) On the Trade Date – an amount in USD equal to «Standard_Payment_Amount» of the Notional Amount (First Fixed Rate Payment). (2) On the 50th day following the Effective Date – an amount in USD equal to «Standard_Payment_Amount» (the "Second Fixed Rate Payment").
Prepayment Option:	(1) If Party A, in the exercise of its sole discretion, elects to prepay both Fixed Rate Payments on the Trade Date, then the Second Fixed Rate Payment will be reduced to «Discounted_Payment_Amount».
Floating Amounts - Party B:	
Notional Amount:	The CHF equivalent of USD «Notional» on the Effective Date

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Floating Rate Payer:	Party B
Floating Rate Payer Payment Date:	Ten Exchange Business Days following the Termination Date, subject to adjustment in accordance with the Following Business Day Convention.
Floating Rate Payment:	(1) An amount in Swiss Francs equal to 5.25% of the Notional Amount multiplied by any positive difference (if any) between the price per share of UBS AG on the Start Date ("Starting Price") and the Closing Price on the End Date. The Starting Price shall be CHF «UBS_AGSpotPrice». The Closing Price shall be the closing price per share of UBS AG as published by the Swiss Stock Exchange (the "Exchange").
	(2) An Amount in Swiss Francs equal to an amount as determined in accordance with the formula: «RECAP_Payment_per_day» * Notional Amount * (a+b+c+d) where "a" means the total number of Exchange Business Days during the period from and including Date 1 to and including Date 2 on which the Closing Price is greater than 105% of the Starting Price. "b" means the total number of Exchange Business Days during the period from and including Date 3 to and including Date 4 on which the Closing Price is greater than 110% of the Starting Price. "c" means the total number of Exchange Business Days during the period from and including Date 5 to and including Date 6 on which the Closing Price is greater than 115% of the Starting Price. "d" means the total number of Exchange

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	Business Days during the period from and including Date 7 to and including Date 8 on which the Closing Price is greater than 120% of the Starting Price. If at any time between the Starting Date and the Ending Date the Closing Price is less than or equal to 95% of the Starting Price no further payments under (2) shall be payable provided however that all amounts calculated as payable prior to such event shall remain payable and be multiplied by 102.5%.
	(3) An Amount in USD of «AutoMergeField»«AutoMergeField»_______ __times the Notional Amount if the Closing Price on the Ending Date exceeds Starting Price, otherwise 1.55% of the Notional Amount.
	(4). An Amount in Swiss Francs equal to: If the Closing Price on the Ending Date is greater than or equal to 96% and less than 97% of the Starting Price .10% of the Notional Amount; if the Closing Price on the Ending Date is greater than or equal to 97% and less than 98% of the Starting Price .20% of the Notional Amount; if the Closing Price on the Ending Date is greater than or equal to 98% and less than 99% of the Starting Price .30% of the Notional Amount; if the Closing Price on the Ending Date is greater than or equal to 99% and less than 100% of the Starting Price .40% of the Notional Amount; and if the Closing Price on the Ending Date is greater than or equal to 100% of the Starting Price, .50% of the Notional Amount; plus, If at any time between the Starting Date and the Ending Date the Closing Price is less than or equal to 95% of the Starting Price; If the Closing Price on the Ending Date is greater than or equal to 91% and less than 92%

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	of the Starting Price .10% of the Notional Amount; if the Closing Price on the Ending Date is greater than or equal to 92% and less than 93% of the Starting Price .20% of the Notional Amount; if the Closing Price on the Ending Date is greater than or equal to 93% and less than 94% of the Starting Price .30% of the Notional Amount; if the Closing Price on the Ending Date is greater than or equal to 94% and less than 95% of the Starting Price .40% of the Notional Amount; and if the Closing Price on the Ending Date is greater than or equal to 95% of the Starting Price, .50% of the Notional Amount;
Starting Date:	«SPVLP_Trade_Date»
Ending Date:	«SPVLP_Settlement_Date»
Business Days:	Switzerland
Exchange Business Days:	Days the Swiss Stock Exchange is open for trading.

Account Details:

Account Details for Party A:

«US_Investor»
Bank Name:
Bank ABA:
Account No.:
Reference:
Attention:

Account Details for Party B:

Account No.
Reference:
Attention:

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Offices:

The Office of Party A for the Swap Transaction is:

«US_Investor»
«US_Investor_Address1»
«USInvestorAddress2»

The Office of Party B for the Swap Transaction is the address specified on the first page of this Confirmation:

«NRA»
«NRA_Address1»
«NRAAddress2»

Calculation Agent:

The Calculation Agent is QA Investments, LLC, unless specified in this Confirmation in relation to the relevant transaction.

Please confirm that the foregoing correctly sets forth the terms of our agreement by having an authorized officer (if applicable) sign and return a copy of this document to the address set forth below:

«US_Investor»
«US_Investor_Address1»
«USInvestorAddress2»

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Upon receipt of your confirmation, we will then forward two copies of this Confirmation to you for signature.

Yours sincerely,

«US_Investor»

By:
Name:
Title:

Confirmed as of the Date First Written:

«NRA»

By:
Name:
Title:

SCHEDULE
TO THE ISDA MASTER AGREEMENT
Dated as of «Swap_Wire_Date»

Between «US_Investor» ("Party A") and «NRA» ("Party B"). (Except where otherwise indicated herein, capitalized terms used herein shall have the respective meanings set forth in paragraph (j) of Part 4 of this Schedule.)

Part 1. Termination Provisions.

(a) **"Specified Entity"** means:

in relation to Party A for the purpose of:

Section 5(a)(v): Inapplicable

Section 5(a)(vi): Inapplicable

Section 5(a)(vii): Any partner, at the time of reference thereto, in Party A

Section 5(b)(ii): Inapplicable

And in relation to Party B for the purpose of:

Section 5(a)(v): Inapplicable

Section 5(a)(vi): Inapplicable

Section 5(a)(vii): Any member, at the time of reference thereto, in Party B

Section 5(b)(ii): Inapplicable

(b) **"Specified Transaction"** will have the meaning specified in Section 14 of this Agreement, except that (i) clause (a) of Section 14 is amended by adding in the eighth line thereof, after the words "currency option", the words ", any transaction that is a 'swap agreement,' 'commodity contract,' 'securities contract,' or 'forward contract' under the Bankruptcy Code";

(c) The **"Cross Default"** provisions of Section 5(a)(vi) will not apply to Party A, but will apply to Party B.

"Threshold Amount" is not applicable to Party A and means, with respect to Party B, $100,000.

(d) The **"Credit Event Upon Merger"** provisions of Section 5(b)(ii) will not apply to Party A or to Party B.

(e) The **"Bankruptcy"** provisions of Section 5(a)(vii) are amended as follows: (i) clause (4) thereof is amended by inserting a semicolon after the word "liquidation" in the seventh line of Section 5(a)(vii) and deleting the balance of clause (4); and (ii) clause (7) thereof is amended by inserting a semicolon after the word "assets" in the seventeenth line of the Section 5(a)(vii) (before giving effect to the foregoing amendment) and deleting the balance of clause (7).

(f) The **"Automatic Early Termination"** provisions of Section 6(a) will apply to Party A and to Party B.

(g) **Payments on Early Termination.** For the purpose of Section 6(e) of this Agreement:

(i) Loss will apply; and

(ii) the Second Method will apply.

(h) **Additional Termination Events.** In addition to the Termination Events specified in Section 5(b), the occurrence of any of the following:

(i) any Operative Document of Party A (A) is terminated or ceases to be in full force and effect or (B) is amended or modified and such amendment or modification could have a material adverse effect on the rights of Party B under this Agreement, or any Transaction;

(ii) any Operative Document of Party B (A) is terminated or ceases to be in full force and effect or (B) is amended or modified and such amendment or modification could have a material adverse effect on the rights of Party A under this Agreement, any Transaction.

For the purpose of the foregoing Termination Events, with respect to the Termination Events specified in clauses (i) above, Party B shall be deemed to be the Affected Party and Party A shall not be an Affected Party; and with respect to the Termination Event specified in clause (ii) above, Party A shall be deemed to be the Affected Party and Party B shall not be an Affected Party.

Part 3. **Miscellaneous.**

(a) **Addresses for Notices.** For the purpose of Section 10(a) of this Agreement:

Address for notices or communications to Party A:

«US_Investor»
«US_Investor_Address1»
«USInvestorAddress2»

Address for notices or communications to Party B:

«NRA»
«NRA_Address1»
«NRAAddress2»

With a copy to:

QA Investments, LLC
999 Third Ave, Suite 4150
Seattle, WA 98104

(b) **Calculation Agent.** The Calculation Agent is QA Investments, LLC, unless otherwise specified in Confirmation in relation to the relevant Transaction.

(c) **Governing law.** This Agreement shall be governed by, and construed and enforced in accordance with, the laws of the State of New York (without reference to its choice of law doctrine).

(d) **Jurisdiction.** Section 13(b) is hereby amended by (i) deleting the word "non-" in the second line of subparagraph (i) of Section 13(b) and (ii) deleting the final paragraph of Section 13(b).

(e) **Netting of Payments.** Subparagraph (ii) of Section 2(c) of this Agreement will apply to all Transactions.

(f) **"Affiliate"** will have the meaning specified in Section 14 of this Agreement.

Part 4. **Other Provisions.**

(a) **Single Agreement.** Section 1(c) of this Agreement is hereby amended by adding in the second line thereof after the word "Agreement".

(b) **Condition Precedent.** The condition precedent in Section 2(a)(iii)(1) of this Agreement does not apply to a payment or delivery owing by a party if, at the time of reference thereto, the other party shall have satisfied in full all its payment and delivery obligations under Section 2(a)(i) of this Agreement and shall have no future payment or delivery obligations, whether absolute or contingent, under Section 2(a)(i).

(c) **Change of Account.** Section 2(b) of this Agreement is hereby amended by adding in the first line thereof after the word "delivery" the words "another account in the same legal and tax jurisdiction as the original account".

(d) **Accuracy of Specified Information.** Section 3(d) of this Agreement is hereby amended by adding in the third line thereof after the word "respect" and before the period the words "or, in the case of financial statements, a fair presentation of the financial information purported to be shown with respect to the relevant person",

(e) **Representations.** Section 3 of this Agreement is hereby further amended by adding the following Sections 3(h), (i), (j) (k) and (l) at the end thereof:

> (e) **Capacity.** Party A and Party B each represents to the other (which representations will be deemed to be repeated by such Party on each date on which a Transaction is entered into) that (i) it is entering into this Agreement and each Transaction as principal (and not as agent or in any other capacity, fiduciary or otherwise) and (ii) the persons executing this Agreement on its behalf have been authorized to do so.
>
> (f) **No Reliance.** Party A and Party B each represents to the other on and as of the date hereof and on each date on which a Transaction is entered into between them that, in connection with the negotiation of, the entering into, and the confirming of the execution of this Agreement to which it is a party, each Transaction, and any other documentation relating to this Agreement to which it is a party or that it is required by this Agreement to deliver that:
>
> > (i) It is not relying (for purposes of making any investment decision or otherwise) upon any advice, counsel or representations (whether written or oral) of any other party to this Agreement, such Transaction or such other documentation other than the representations expressly set forth in this Agreement, and any Confirmation;
> >
> > (ii) It has consulted with its own legal, regulatory, tax, business, investment, financial and accounting advisors to the extent it has deemed necessary, and it has made its own investment, hedging and trading decisions (including decisions regarding the suitability of any Transaction) based upon its own judgment and upon such advice from such advisors as it has deemed necessary and not upon any view expressed by any other party to this Agreement, any such Transaction or such

other documentation;

(iii) It directly (or through its partners or members, as applicable) is a sophisticated and informed person that has a full understanding of all the terms, conditions and risks (economic and otherwise) of this Agreement, such transaction and such other documentation and is capable of assuming and willing to assume (financially and otherwise) those risks;

(iv) Each other party to this Agreement, such Transaction and such other documentation (1) is not acting as a fiduciary or financial, investment or commodity trading advisor for it; (2) has not given to it (directly or indirectly through any other person) any advice, counsel, assurance, guaranty or representation whatsoever as to the expected or projected success, profitability, return, savings, performance, result, effect, consequence, benefits or merits (either legal, regulatory, tax, business, investment, financial, accounting or otherwise) of this Agreement, such Transaction or such other documentation; and (3) has not committed to unwind any Transaction; and

(v) It is aware that each other party to this Agreement, such Transaction and such other documentation, or the Affiliates of any such party, may from time to time (1) take positions in instruments that are identical or economically related to a Transaction or (2) have commercial relationships with the issuer of an instrument underlying a Transaction.

(g) **Swap Exemption.** Party A and Party B each represents to the other on and as of the date hereof and on each date on which a Transaction is entered into between them that, in connection with the negotiation of, the entering into, and the confirming of the execution of this Agreement, each Transaction, and any other documentation relating to this Agreement to which it is a party or that it is required by this Agreement to deliver that:

(i) This Agreement and each Transaction is intended to constitute a "swap agreement" within the meaning of Commodity Futures Trading Commission ("CFTC") Regulation Section 35.1(b)(1), Section 101(53)(B) of the Bankruptcy Code and the CFTC Policy Statement Concerning Swap Transactions, 54 Fed. Reg. 30694 (July 21, 1989);

(ii) It is an "eligible swap participant" within the meaning of CFTC Regulation Section 35.1(b)(2);

(iii) Neither this Agreement nor any Transaction is one of a fungible class of agreements that are standardized as to their material economic terms, within the meaning of CFTC Regulation Section 35.2(b); and

(iv) The creditworthiness of the other party was or will be a material consideration in entering into or determining the terms of this Agreement and each Transaction, including pricing, cost or credit enhancement terms of the Agreement or Transaction, within the meaning of CFTC Regulation Section 35.2(c).

(h) **ERISA.** Party A and Party B each represents to the other on and as of the date hereof and on each date on which a Transaction is entered into between them that, with respect to each source of funds to be used by it to enter into Transactions (each such source being referred to herein as a "Source"), the Source is not the assets of any "plan" (as such term is defined in Section 4975 of the Code) subject to Section 4975 of the Code or any "employee benefit plan" (as such term is defined in Section 3(3) of ERISA) subject to title I of ERISA, or otherwise any "plan assets" within the meaning of United States Department of Labor Regulation Section 2510.3-101, 29CFR § 2510-3-101.:

(i) **Securities Act Representations.** Party A and Party B each represents to the other on and as of the date hereof and on each date on which a Transaction is entered into between them that, in connection with the negotiation of, the entering into, and the confirming of the execution of this Agreement, to which it is a party, each Transaction, and any other documentation relating to this Agreement to which it is a party or that it is required by this Agreement to deliver that:

(i) it is an "accredited investor" as defined in Rule 501 under the U.S. Securities Act of 1933 (the "Securities Act"); and

(ii) it acknowledges that certain Transactions under this Agreement may be deemed to involve the purchase or sale of "securities" as defined in the Securities Act; and it understands that any such securities will not be registered under the Securities Act and may not be reoffered, resold or otherwise transferred except (x) pursuant to an effective registration statement under the Securities Act or pursuant to an exemption from the registration requirements of the Securities Act, and (y) in accordance with any applicable securities laws of any state of the United States.

(f) **Additional Agreements.** Section 4 is hereby amended by adding the following subsections (d), (e) and (f) at the end thereof:

(d) **Actions Affecting Representations.** Party A and Party B each agrees not to take any action during the term of this Agreement or any transaction hereunder that renders or could render any of the representations and warranties in this Agreement untrue, incorrect, or incomplete in any material respect, and if any event or condition occurs that renders or could render any such representation untrue, incorrect, or incomplete in any material respect, such Party will immediately give written notice thereof to the other Party.

(e) **Notice of Certain Events.** Party A and Party B each agrees that, promptly upon becoming aware of the same, it will give the other Party at the address specified in Part 3(a) hereof, written notice of (a) any proposed action, change, or modification to any Operative Document or any action that causes or could cause a Termination Event or Event of Default, or any event or circumstance that might reasonably be expected to directly or indirectly lead to a Termination Event or Event of Default, (B) any potential Event of Default, Event of Default or Termination Event, or event or condition that, with the giving of notice or the passage of time or both, could constitute a Termination Event with respect to the Party giving notice, (C) any pending or threatened litigation, action, claim, proceeding, or investigation which could materially adversely affect the ability of the Party giving notice to perform its obligations under this Agreement, or any Transaction, and (D) any other facts or developments which could adversely affect the status of the party giving notice with respect to this Agreement, or any Transaction.

(f) **Permitted Activities.** Party B agrees that, until the termination of this Agreement, Party B will be bound by the provisions set forth in this Section 4(f).

(i) Party B will not (x) wind up, liquidate or dissolve any of its affairs or enter into any transaction of merger or consolidation or otherwise convey, sell, lease or otherwise dispose of all or any substantial part of its property or assets.

(g) **Fully-Paid Transactions.** Notwithstanding the terms of Sections 5 and 6 of this Agreement, if at any time one of the parties to this Agreement ("X") shall have satisfied in full all of its payment and delivery obligations under Section 2(a)(i) of this Agreement and shall have no future payment or delivery obligations, whether absolute or contingent, under such Section, then unless the other party ("Y") is required pursuant to appropriate proceedings to return to X or otherwise returns to X upon demand of X any portion of any payment or delivery theretofore made by or on behalf of X to Y, (i) the occurrence of an event described in Section 5(a) of this Agreement with respect to X or any Specified Entity of X shall not constitute an Event of Default or a Potential Event of Default with respect to X as the Defaulting Party and (ii) Y shall be entitled to designate an Early Termination Date pursuant to Section 6 of this Agreement only as a result of (i) a Termination Event set forth in either Section 5(b)(i) or 5(b)(ii) of this Agreement with respect to Y as the Affected Party or (ii) an Additional Termination Event set forth in Part 1(h) of this Schedule.

(h) **Set-Off.** Section 6 of this Agreement is hereby amended by adding the following Sections 6(f) and (g) at the end thereof:

> (f) **Conditions to Certain Payments.** Notwithstanding the provisions of Sections 6(e)(i)(3) and (4) and 6(e)(ii)(1), as applicable, if in connection with an Early Termination Date resulting from an Event of Default, (x) the amount calculated therein is a positive number, the Defaulting Party or Affected Party shall pay such amount to the Non-defaulting Party or non-Affected Party, and (y) the amount calculated therein is a negative number, the Non-defaulting Party or Non-affected Party shall have no obligation to pay any amount thereunder to the Defaulting Party or Affected Party unless and until the Non-defaulting Party or Non-affected Party shall have received confirmation satisfactory to it in its sole discretion (which may include an unqualified opinion of its counsel) that (i) no further payments or deliveries under Section 2(a)(i) or 2(e) in respect of Terminated Transactions will be required to be made in accordance with Section 6(c)(ii), (ii) all other obligations due and payable by the Defaulting Party or Affected Party under each such Terminated Transaction have been fully and finally performed, (iii) all other obligations of any kind whatsoever (whether pursuant to Specified Indebtedness or otherwise and whether matured, unmatured, absolute, contingent, or otherwise) of the Defaulting Party or Affected Party to make any payments or deliveries to the Non-defaulting or Non-affected Party which are due and payable have been fully and finally performed and (iv) each Specified Transaction between the Defaulting Party or Affected party and the Non-defaulting Party or Non-affected Party shall have been terminated pursuant to its specified termination date or through the exercise by a party of a right to terminate, at which time there shall arise an obligation of the Non-defaulting Party to pay to the Defaulting Party an amount equal to the absolute value of such negative number less any and all amounts which the Defaulting Party may be obligated to pay under Section 9.
>
> (g) **Right to Terminate Specified Transaction.** Notwithstanding any provision to the contrary in this Agreement or in any Specified Transaction entered into between the Defaulting Party or Affected Party (on the one hand) and the Non-defaulting Party or Non-affected Party (on the other hand), the Non-defaulting Party or Non-affected Party will have the right, but not the obligation, at its option and in its sole discretion, to designate an Early Termination Date in respect of Terminated Transactions resulting from the occurrence of an Event of Default, or as a result of the early termination, liquidation, acceleration, or maturity date for any other Specified Transaction between the Defaulting Party or Affected Party and the Non-defaulting or Non-affected Party. Such designation with respect

to any such other Specified Transaction will be made by notice to the Defaulting party or Affected Party. The amount owed to or by the Non-defaulting Party or Non-affected Party in respect of the early termination of any such other Specified Transaction will be determined by such party, to the extent practicable, in substantially the same manner as contemplated in this Agreement, such amount will be deemed due and payable as of the Early Termination Date in respect of the Terminated Transactions. Any Specified Transaction, as to which early termination is not so designated as provided herein will remain in full force and effect without regard to the provisions of this Section 6(g).

(i) **Confirmations.** Each party shall respond promptly to a Confirmation sent by the other party as provided herein, indicating whether the Confirmation contains any error and, if so, how the error should be corrected so that the Confirmation correctly reflects the parties' agreement with respect to the Transaction referred to in the Confirmation. A party's failure to respond promptly to a Confirmation sent to it as provided in Section 10 of this Agreement that has become effective as provided therein shall, absent manifest error, constitute its acknowledgment that the Confirmation correctly reflects the parties' agreement on the terms of the Transaction referred to therein. The requirement of Section 8(e)(ii) and elsewhere in this Agreement that the parties exchange Confirmations shall for all purposes be deemed satisfied by a Confirmation sent and an acknowledgment deemed given as provided herein.

Notwithstanding anything contained in this Agreement to the contrary, if the parties enter into any Specified Transaction with each other, such specified Transaction shall be subject to, governed by and construed in accordance with the terms of this Agreement unless the Confirmation relating thereto shall specifically state to the contrary. Each such Specified Transaction shall be a Transaction for purposes of this Agreement.

Where a Transaction is confirmed by means of exchange of electronic messages on an electronic massaging system or other document or other confirming evidence exchanged between the parties confirming such transaction, such messages, document or evidence will constitute a Confirmation for the purposes of this Agreement even where not so specified therein.

(j) **Waiver of Right to Trial by Jury.** Each of the parties hereby irrevocably waives any and all right to a trial by jury with respect to any legal proceeding arising out of or relating to this Agreement or any Transaction.

(k) **Definitions.**

(i) Reference is made to the 1991 ISDA Definitions (the "1991 Definitions") as published by the International Swaps and Derivatives Association, Inc., which are hereby incorporated by reference. Unless otherwise specified in a Confirmation, any terms used and not otherwise defined herein that are contained in the 1991 Definitions shall have the meanings set forth in such Definitions (without regard to any amendments thereto subsequent to the date hereof). For these purposes, all references in the 1991 Definitions to a "Swap Transaction" shall be deemed to include Transactions under this Agreement. In the event of any inconsistency between the provisions of this Agreement and the 1991 Definitions, the provisions of this Agreement shall prevail. Any definitions included or incorporated by reference in a Confirmation shall prevail over the provisions of this Agreement and the 1991 Definitions.

(ii) "Bankruptcy Code" means the United State Bankruptcy Code, Title 11 of the United States Code, as from time to time in effect (or any successor law).

(iii) "ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

(iv) "Operative Documents" means the memorandum and articles of association, partnership agreement, or other similar documents, instruments or other constituent documents of Party A or Party B, as applicable, and the power of attorney or trading authorization of Party A or Party B, as applicable.

(l) **Severability.** If any term, provision, covenant, or condition of this Agreement, or the application thereof to any party or circumstance, is held to be unenforceable,invalid, or illegal (in whole or in part) for any reason, the remaining terms, provisions, covenants, and conditions hereof will continue in full force and effect as if this Agreement had been executed with the unenforceable, invalid, or illegal portion eliminated, and such unenforceability, invalidity, or illegality will not otherwise affect the enforceability, validity, or legality of the remaining terms, provisions, covenants, and conditions hereof, so long as this Agreement as so modified continues to express, without material change, the original intentions of the parties as to the subject matter hereof and the deletion of such portion of this Agreement will not substantially impair the respective benefits or expectations of the parties hereto.

«US_Investor»	«NRA»
By:__________________	By:__________________
Name:	Name:
Title:	Title:

QA INVESTMENTS, LLC
INVESTMENT ADVISORY AGREEMENT

This Investment Advisory Agreement is entered into on this _____ day of _________, 199___, by and between «US_Investor» (the "Client"), and QA Investments, LLC, a Delaware limited liability company (the "Investment Advisor").

WHEREAS, the Client wishes to obtain exposure to certain securities and may wish to utilize various hedging strategies to minimize differing risks related to these securities as described in the attached Exhibit A; and

WHEREAS, the Client wishes to appoint the Investment Advisor to facilitate the purchase and hedging transactions described in Exhibit A in their designated brokerage accounts which is initially contemplated to be established at Kelcop Financial, Inc. in New York; or if in relation to over-the-counter contracts no brokerage accounts would be utilized.

NOW, THEREFORE, the parties hereby represent and agree as follows:

1. Appointment of Investment Advisor. The Client hereby appoints the Investment Advisor as investment manager with respect to such portion of the funds of the Client as may be designated by the Client from time to time (the "Accounts"). At no time shall the Investment Advisor have actual possession of any property in the Accounts.

The scope of the forgoing appointment shall not in any circumstance be deemed to include the provision by the Investment Advisor to the Client of any federal, state or local tax advice and the Client hereby confirms they are not relying upon the Investment Advisor to provide such advice with respect to any transaction or investment undertaken pursuant to this agreement.

2. Discretionary Authority. The Investment Advisor shall have full power and discretion in the investment and reinvestment of assets of the Accounts, without prior consultation or approval, subject to the investment objectives as set forth in Exhibit A. This authority shall include the power to: (a) buy, sell, exchange, convert, and otherwise trade in any and all publicly and privately traded stocks, bonds, derivative instruments, and other securities as the Investment Advisor may deem advisable and in the best interests of the Client in light of such investment objectives; and (b) place orders for the execution of such securities transactions through such brokers or dealers as the Investment Advisor may select. In selecting a broker or dealer the Investment Advisor will comply with its fiduciary duty to obtain the best net price and the best execution and with the provisions of Section 28(e) of the Securities Exchange Act of 1934, which will take into account such relevant factors as (a) price, (b) the broker's or dealer's facilities, reliability, and financial responsibility, (c) the ability of the broker or dealer to effect securities transactions, particularly with regard to such aspects as timing, order size, and execution of orders, and (d) the research and brokerage services provided by

such broker or dealer to the Investment Advisor, notwithstanding that the Accounts may not be the direct or exclusive beneficiary of such services.

3. Procedures with Respect to Securities. All transactions, purchases and sales of securities by the Investment Advisor with respect to the Accounts shall be consummated by payment to or delivery of the cash or securities or other property due to or from the Client. Instructions which materially change the investment objectives set forth in Exhibit A shall be made to the Investment Advisor in writing (including facsimile transmission) or orally and confirmed in writing (including facsimile transmission) as soon as practicable thereafter. The Investment Advisor shall instruct all brokers executing orders with respect to the Accounts to forward to the Client copies of brokerage confirmations promptly after execution of all such transactions.

4. Fees. The compensation of the Investment Advisor for its services rendered hereunder shall be calculated and paid in accordance with Exhibit B.

All expenses of any sort or kind related to the Accounts including, but not limited to, any costs of safekeeping, transport, acquisition and disposition, such as brokerage and other execution costs, custody fees and margin costs, shall be paid by the Client.

5. Dividends and Accounts Reports. Dividends and other income or distributions on or with respect to any of the assets of the Accounts shall be credited to the Accounts and reinvested by the Investment Advisor in accordance with this Agreement. As confirmations of transactions in the Accounts will be sent directly from the brokers executing orders, the Investment Advisor shall not provide any report of the Accounts.

6. Services to Other Clients. The Client understands and agrees that the Investment Advisor and its affiliates perform investment advisory and investment management services for various clients other than the Client. The Client agrees that the Investment Advisor and its respective affiliates may give advice and take action in the performance of its duties with respect to any of its other clients which may differ or be the same as advice given, or the timing or nature of action taken, with respect to the Accounts. Nothing in this Agreement shall be deemed to impose upon the Investment Advisor any obligation to purchase or sell or to recommend for purchase or sale for the Accounts any security or other property which the Investment Advisor or its respective affiliates may purchase or sell for its own accounts or for the accounts of any other clients, if in its sole discretion the Investment Advisor, for any reason, considers it undesirable or impractical to take such action or make such recommendation for the Accounts.

7. Conflits of Interest. THE CLIENT HEREBY ACKNOWLEDGES THAT THE INVESTMENT ADVISOR OR ITS AFFILIATES MAY HOLD POSITIONS IN SECURITIES CONTEMPLATED IN EXHIBIT A. THE INVESTMENT ADVISOR OR ITS AFFILIATES MAY BENEFIT FROM ANY POSITIVE MARKET IMPACT GENERATED BY THE CLIENT'S TRANSACTIONS (IF ANY).

THE INVESTMENT ADVISOR OR AN AFFILIATE MAY PROVIDE INVESTMENT ADVICE AND OTHER SERVICES DIRECTLY OR INDIRECTLY TO THE COUNTERPARTY OF THE EQUITY SWAP DESCRIBED IN EXHIBIT A. BY EXECUTING THIS AGREEMENT THE CLIENT CONSENTS TO THIS RELATIONSHIP.

THE INVESTMENT ADVISOR OR AN AFFILIATE MAY HOLD A BENEFICIAL INTEREST IN KELCOP FINANCIAL,INC.

THE INVESTMENT ADVISOR AND ITS AFFILIATES MAY HAVE EXISTING OR FUTURE BUSINESS RELATIONSHIPS WITH UBS AG (INCLUDING BUT NOT LIMITED TO LENDING, DEPOSITORY, RISK MANAGEMENT, ADVISORY, DISTRIBUTION AND BANKING RELATIONSHIPS) AND WILL PURSUE ACTIONS AND TAKE STEPS THAT THEY DEEM OR IT DEEMS NECESSARY OR APPROPRIATE TO PROTECT THEIR OR ITS INTERESTS ARISING THEREFROM WITHOUT REGARD TO THE CONSEQUENCES FOR THE CLIENT.

8. Liability. Neither the Investment Advisor nor any of its officers, directors, employees, or agents shall be liable for any actions performed or omitted, or for any loss, resulting from the exercise of its professional judgment in carrying out its obligation under this Agreement provided that the Investment Advisor shall remain responsible for its gross negligence, willful malfeasance, or violation of applicable law.

The Client shall indemnify the Investment Advisor and its partners, affiliates, employees, and agents (each an "Indemnified Person") against any and all losses, claims, damages or liabilities, joint or several, including, without limitation, reasonable attorney's fees and disbursements, resulting in any way from the performance or non-performance of the Investment Advisor's duties hereunder, except those resulting from gross negligence, willful malfeasance or violation of applicable law in the performance of the Investment Advisor's obligations and duties, and, in the case of criminal proceedings, unless such Indemnified Person had reasonable cause to believe its actions unlawful.

9. Voting. The Investment Advisor shall have the power to vote, either in person or by proxy, tender and take all actions incident to the ownership of all securities in which assets of the Accounts may be invested from time to time.

10. Termination. This Agreement shall be for a period of one year, but may be terminated by either the Client or the Investment Advisor by giving the other party written notice of at least 90 days. The Investment Advisor shall notify the Client of any material change in its ownership. Upon such notification, the Client may terminate this Agreement immediately with written notice to the Investment Advisor.

11. Representations by the Client and the Investment Advisor. The Client and Investment Advisor each represents that the terms hereof do not violate any obligation by which it is bound, whether arising by contract, operation of law, or otherwise. The Client (if applicable) and Investment Advisor each represents that it is

duly organized, validly existing and in good standing under the laws of its State of organization and has full power and authority to execute and deliver this Agreement and carry out its obligations hereunder, the execution and delivery of the Agreement has been duly authorized by all necessary action on its behalf; the execution, delivery, and performance of this Agreement does not violate any agreement or arrangement to which it is a party or by which it is bound, or any order or decree to which it is subject; and this Agreement constitutes the valid and binding agreement.

12. Confidential Relationship. The parties agree that all information and advice provided by either party to the other or the Client shall be treated as confidential and shall not be disclosed to third parties except as required by law or as necessary in connection with regular portfolio transactions for the Accounts.

13. Amendment and Assignment. This Agreement may not be amended without the prior written consent of the parties, and may not be assigned without the prior written consent of the other party.

14. Waivers. A waiver by any party of a breach of any provision of this Agreement shall not constitute a waiver of any subsequent breach of such provision or of any other provision hereof. Failure of a party to enforce at any time or from time to time any provision of this Agreement shall not be construed as a waiver thereof.

15. Attorneys' Fees. The prevailing party in any action brought by either party hereto to enforce its rights under this Agreement shall be entitled to recover all costs and expenses (including reasonable attorneys' fees) incurred in prosecuting or defending such action.

16. Governing Law. This Agreement shall be construed in accordance with the laws of the State of Delaware (without regard to principles of conflicts of law) to the extent not preempted by applicable Federal law.

17. Compliance. The Client and Investment Advisor shall comply in all material respects with all material laws, regulations, and rules applicable to it in its performance of its duties and obligations under this Agreement including, without limitation, (i) the federal securities laws and all regulations and interpretations of the Securities and Exchange Commission, (ii) the U.S. Commodity Exchange Act, and all regulations and interpretations of the Commodity Futures Trading Commission and the National Futures Association, (iii) all applicable rules of any relevant U.S. and non-U.S. commodity exchanges, (iv) any applicable money laundering laws or regulations, and (v) all applicable tax laws and regulations.

18. Aggregation. The Client understands that the Investment Advisor may open "average price" accounts in which purchase and sale orders placed during a trading day on behalf of the Accounts and other clients or affiliates of the Investment Advisor and its affiliates are combined, and securities bought and sold pursuant to such orders are allocated among such accounts on an average price basis.

the parties hereto have hereunto caused this Agreement to be duly executed the day and year first hereinbefore written.

Investment Advisor
QA Investments, LLC

By: ______________________

Title: ______________________
Address: 999 Third Avenue Suite 4150
Seattle, WA 98104

Client

By: ______________________

EXHIBIT A
INVESTMENT OBJECTIVE

The Client in seeking capital appreciation, wishes to acquire approximately $_________ of the common stock of UBS AG. The may from time to time instruct the Investment Advisor in writing to increase or decrease its position either directly or indirectly through the purchase and sale of put and call options to the common stock. Any such options or similar derivative financial instruments may be traded on a regulated securities exchange or privately negotiated in the over-the-counter markets.

In addition, the client wishes to enter into a privately negotiated ISDA Master Agreement with a counterparty that is willing to provide a leveraged structured transaction, the underlying reference of which is UBS AG (the "Swap")to enhance the return on the aforementioned common stock. The Investment Advisor shall assist the Client with matters relating to the initial structuring, execution and subsequent valuation of the Swap.

The client wishes to obtain further exposure to UBS AG through the purchase of a privately negotiated call option, the profitability of which is dependent on the stock price movement of UBS AG. The Investment Advisor shall assist the Client with matters relating to the initial structuring, execution and subsequent valuation of the call option.

EXHIBIT B
FEES

In connection with the investment objectives (as set forth in Exhibit A) the Investment Advisor shall be compensated in the amount of $______________. Such amount shall be paid within 30 days of the execution of this agreement. As the Investment Advisor has performed a large portion of its services in development and analysis efforts prior to the execution of this Agreement, any termination of this Agreement by the Client shall NOT result in a pro-rata refund of the aforementioned fees.

If the Investment Advisor receives further instructions from the Client which materially change the investment objectives, the Client and the Investment Advisor shall mutually agree on a written compensation schedule, which may or may not include flat rate fees, asset based fees, or performance based fees.

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  (IMA Internet Exchange 3.01 Enterprise) id 000459AD; Mon, 28 Sep 98 12:04:50
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for <rbickham@kpmg.com>; Mon, 28 Sep 1998 11:59:54 -0400 (EDT)
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From: Norm Bontje <NormB@qcm.com>
To: "'Randy Bickham'" <rbickham@kpmg.com>
Cc: Jeff Greenstein <jeffg@qcm.com>
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new

From: Stalnaker, Carolyn A
Sent: Monday, September 28, 1998 1:03 PM
To: Baumann, Dale R; Carbo, Deke G; Eischeid, Jeffrey A; Henderson, Tracie K; Jordan, Robert M; Liston, Shannon L; Pedersen, Robert A; Slattery, Daniel M; Watson, Mark T; Wissel, Kyle; Zaudtke, David P; Ziegelheim, Carol; Harvey L. Armstrong at KPMG_Silicon_Valley; Randall S Bickham at KPMG_Silicon_Valley2; Bloom, Richard J; Fergus, Terrence P; Gardner, John H; Hasting, Carl D; Nuckolls, John M; Paule, Robin M; Ritchie, Gregg W; Rivkin, David; Speiss, Timothy P; Stalnaker, Carolyn A; Tendler, Neil J; Watkins, B M; Zysik, Jeffrey C
Subject: Quadra Checklist

Forward.txt kpmgck.doc

From Randy Bickham.

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---------------------------- Forwarded with Changes ---------------------------
From: Randall S Bickham at KPMG_Silicon_Valley2
Priority: Urgent
Date: 9/28/98 2:26PM
To: Carolyn A. Stalnaker at KPMG_Warner_Center
Subject: Quadra Checklist
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INVESTMENT COUNTERPARTY DETAILS

PROJECTED NOTIONAL VALUE ________________

US PERSON/ENTITY SWAP COUNTERPARTY ________________

AUTHORIZED SIGNATORY ________________

ADDRESS ________________

ADDRESS ________________

ADDRESS ________________

PHONE ________________

FACSIMLE ________________

WIRE INSTRUCTIONS ________________

FEDERAL TAX ID/SSN ________________

US PERSON STOCK PURCHASOR ________________

AUTHORIZED SIGNATORY ________________

ADDRESS ________________

ADDRESS ________________

ADDRESS ________________

PHONE ________________

FACSIMLE ________________

WIRE INSTRUCTIONS ________________

FEDERAL TAX ID/SSN ________________

PROFESSIONAL REFERENCE LETTER* TO:

MYERS & ALBERGA
One Regis Place, Fort Street
Grand Cayman, Cayman Islands
Facsimile (345) 949-8171

QA INVESTMENTS, LLC
999 Third Avenue Suite 4150
Seattle, WA 98104
Facsimile (206) 442-9291

*Please describe relationship and source of client funds

BANK REFERENCE AND COPY OF PASSPORT/DRIVERS LICENSE TO

QA INVESTMENTS, LLC
999 Third Avenue Suite 4150
Seattle, WA 98104
Facsimile (206) 442-9291

INCLUDE:

a) Collateral material related to US investor (newspaper/magazine/public documents if available)
b) Evidence of signatory authority (portion of Trust deed, LLC agreement, etc)
c) Does long position purchasor need separate brokerage account established?

WILL RECEIVE:

a) Brokerage (Kelcop) account opening forms (if needed)
b) Investment advisory agreement from QA Investments, LLC
c) Wire instructions for swap/option counterparty
d) Draft swap agreement from counterparty
e) Option contract from counterparty
f) Investment analysis prepared by QA Investments, LLC
g) QA Investments, LLC Form ADV

new

From: Henderson, Tracie K
Sent: Monday, September 28, 1998 10:58 AM
To: Eischeid, Jeffrey A
Subject: FW: Documents

fyi

-----Original Message-----
From: Randall S Bickham at KPMG_Silicon_Valley2
Sent: Monday, September 28, 1998 9:45 AM
To: Henderson, Tracie K
Subject: Documents

Tracie

Quadra checklist

______________________________ Forward Header ______________________________
Subject: Documents
Author: Norm Bontje <NormB@qcm.com> at Internet
Date: 9/28/98 8:48 AM

One more <<kpmgchecklist.doc>>

Forward.txt kpmgchecklist.doc RFC822 message headers.txt

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---------------------------- Forwarded with Changes ---------------------------
From: Norm Bontje <NormB@qcm.com> at Internet
Date: 9/28/98 8:48AM
To: Randall S Bickham at KPMG_Silicon_Valley2
Subject: Documents
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INVESTMENT COUNTERPARTY DETAILS

PROJECTED NOTIONAL VALUE	______________
US PERSON/ENTITY SWAP COUNTERPARTY	______________
AUTHORIZED SIGNATORY	______________
ADDRESS	______________
ADDRESS	______________
ADDRESS	______________
PHONE	______________
FACSIMLE	______________
WIRE INSTRUCTIONS	______________
	______________
	______________
	______________
FEDERAL TAX ID/SSN	______________
US PERSON STOCK PURCHASOR	______________
AUTHORIZED SIGNATORY	______________
ADDRESS	______________
ADDRESS	______________
ADDRESS	______________
PHONE	______________
FACSIMLE	______________
WIRE INSTRUCTIONS	______________
	______________
	______________
	______________
FEDERAL TAX ID/SSN	______________

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Facsimile (345) 949-8171

QA INVESTMENTS, LLC
999 Third Avenue Suite 4150
Seattle, WA 98104
Facsimile (206) 442-9291

*Please describe relationship and source of client funds

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Seattle, WA 98104
Facsimile (206) 442-9291

INCLUDE:

a) Collateral material related to US investor (newspaper/magazine/public documents if available)
b) Evidence of signatory authority (portion of Trust deed, LLC agreement, etc)
c) Does long position purchasor need separate brokerage account established?

WILL RECEIVE:

a) Brokerage (Kelcop) account opening forms (if needed)
b) Investment advisory agreement from QA Investments, LLC
c) Wire instructions for swap/option counterparty
d) Draft swap agreement from counterparty
e) Option contract from counterparty
f) Investment analysis prepared by QA Investments, LLC
g) QA Investments, LLC Form ADV

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for <rbickham@kpmg.com>; Mon, 28 Sep 1998 11:56:24 -0400 (EDT)
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(EDT)
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      id <STJ9DMR6>; Mon, 28 Sep 1998 08:48:34 -0700
Message-ID: <90E0009FCE8AD11186C50060976CE313118667@QUADRADELL>
From: Norm Bontje <NormB@qcm.com>
To: "'Randy Bickham'" <rbickham@kpmg.com>
Subject: Documents
Date: Mon, 28 Sep 1998 08:48:33 -0700
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X-Mailer: Internet Mail Service (5.0.1460.8)
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new

From: Stalnaker, Carolyn A
Sent: Thursday, September 10, 1998 1:47 PM
To: Baumann, Dale R; Eischeid, Jeffrey A; Henderson, Tracie K; Pedersen, Robert A; Watson, Mark T; Wissel, Kyle; Ziegelheim, Carol; Harvey L Armstrong at KPMG_Silicon_Valley; Randall S Bickham at KPMG_Silicon_Valley2; Bloom, Richard J; Carbo, Deke G; Fergus, Terrence P; Gardner, John H; Hasting, Carl D; Jordan, Robert M; Shannon L Liston at KPMG_New_Orleans; Nuckolls, John M; Paule, Robin M; Ritchie, Gregg W; Rivkin, David ; Slattery, Daniel M; Speiss, Timothy P; Stalnaker, Carolyn A; Tendler, Neil J; Watkins, B M; Zaudtke, David P; Zysik, Jeffrey C
Subject: REPS

Importance: High

Forward.txt reps.doc

This version should work.

Carolyn

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---------------------------- Forwarded with Changes ---------------------------
From: Randall S Bickham at KPMG_Silicon_Valley2
Priority: Urgent
Date: 9/10/98 4:04PM
To: Carolyn A. Stalnaker at KPMG_Warner_Center
Subject: REPS
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In connection with the investment transactions undertaken, Investor has represented to KPMG Peat Marwick LLP ("KPMG") the following:

- There was no legally binding agreement, written or otherwise, that compelled any of the parties to complete these transactions in the way described.
- Investor independently reviewed the economics underlying the investment strategy and believed it had a reasonable opportunity to earn a reasonable pre-tax profit from each of the transactions described, in excess of all associated fees and costs and not including any tax benefits that may occur.
- Prior to entering the current investment strategy, Investor owned no other shares of Foreign Bank stock.
- Based upon its review of publicly available financial information and to the best of Investor's knowledge, Foreign Bank is highly profitable on a worldwide basis.
- Foreign LP, Investor, Limited Partner, General Partner, Investment Advisor and Foreign Bank each acted independently and at arm's length with respect to the transactions undertaken.
- There were no written agency agreements (apart from a standard investment advisory agreement) consummated with respect to the transactions and none of the parties involved held itself out to a third party as an agent of any of the others with respect to these transactions.
- Investor did not have the ability to control, directly or indirectly, the actions of Foreign LP.
- Investor has provided us with all facts and circumstances that it knows, or has reason to know, are pertinent to this opinion letter and believes that all assumptions or representations on which this opinion relies are reasonable.

new

From:	Stalnaker, Carolyn A
Sent:	Wednesday, September 09, 1998 2:22 PM
To:	Baumann, Dale R; Eischeid, Jeffrey A; Henderson, Tracie K; Pedersen, Robert A; Watson, Mark T; Wissel, Kyle; Ziegelheim, Carol; Harvey L Armstrong at KPMG_Silicon_Valley; Randall S Bickham at KPMG_Silicon_Valley2; Bloom, Richard J; Carbo, Deke G; Fergus, Terrence P; Gardner, John H; Hasting, Carl D; Jordan, Robert M; Shannon L Liston at KPMG_New_Orleans; Nuckolls, John M; Paule, Robin M; Ritchie, Gregg W; Rivkin, David ; Slattery, Daniel M; Speiss, Timothy P; Stalnaker, Carolyn A; Tendler, Neil J; Watkins, B M; Zaudtke, David P; Zysik, Jeffrey C
Subject:	Presidio Checklist & Timeline; Reps.
Importance:	High

Forward.txt timeline.xls checklist.xls reps.doc

From Randy Bickham.

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Attached is a checklist of information required by Presidio and the accompanying timeline to execute the Cayman trades. Also attached is the reps from our opinion letter.

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---------------------------- Forwarded with Changes ---------------------------
From: Randall S Bickham at KPMG_Silicon_Valley2
Priority: Urgent
Date: 9/9/98 5:05PM
To: Carolyn A. Stalnaker at KPMG_Warner_Center
Subject: Presidio Checklist & Timeline; Reps.
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OPIS Timeline
Action Items and Timeline for Investment Transactions

Definitions

Deutsche Bank Securities, Inc. "DBS"

Action Item	**Responsibility**	**Estimated Date**
Provide Kerry Moskalik with information for DBS accounts (see the attached schedule)	KPMG/Investor	Day 1
Prepare DBS account opening documents and fax to Investor	Presidio Advisors	Day 1
Fax the professional reference to Rick Stockton at DBS Fax to (212) 469-8304	KPMG	Day 2
Fax & FedEx the following information to Rick Stockton at DBS: Executed account opening documents Copy of passport or drivers license for each signer Bank reference for each individual/entity Entity Formation Documents	KPMG/Investor	Day 2
Investor DBS accounts are opened	DBS	Day 4
Wire transfer instructions are prepared and sent to Investor	Presidio Advisors	Day 4
Investor wires funds for long position, swap & call option	Investor	Day 5
Investor purchases Deutsche Bank shares	DBS	Day 6
L.P. draws down DB loan and purchases DB shares -	DBS	Day 8
L.P. purchases/sells DB options	DBS	Day 8
Send the following documents for signature by Investor (by FedEx): Pledge Agmt. Account Control Document ISDA Master Agreement Swap Confirmation Swap Schedule Call Option Investment Advisory Agreement	Presidio Advisors	Day 11
Investor wires funds for purchase of OTC call options	Investor	Approx. 35 days after LP trades
L.P. disposes of DB shares	DBS	46 days after LP trades
Investor purchase OTC call options	DBS	Same day as LP redemption

Proprietary Material
Confidentiality Requested

Information to be faxed to Kerry Moskalik at Presidio Advisors - Fax (415) 284-7284

The following information is necessary for each entity/individual involved in the transaction:

1 *Name:* ______________________________

2 *Address:* ______________________________
____

3 *FEIN or SS #:* ____________________

4 *Authorized Signer for the entity:*
Name: ____________________
Title: ____________________
SSN: ____________________

5 *Authorized Signer's Phone* ____________ *Fax* ____________

Documents to be faxed (and send hard copy by Federal Express) to Rick Stockton at Deutsche Bank - Fax (212) 469-8304

1 Executed account opening documents (these are prepared by Presidio after we receive the above info.)

2 Copy of Passport or Driver's License for each authorized signer

3 Bank Reference for each individual and entity

4 Professional Reference (KPMG can provide this reference)

5 Entity Formation Documents:
 (1) LLC - Certificate of Formation & Operating Agreement
 (2) Trust - Trust Agreement
 (3) Corporation - Certificate of Incorporation & Articles of Incorporation

Deutsche Bank Address:

Rick Stockton
Deutsche Bank Private Banking
31 West 52nd Street
New York, NY 10019
Phone: (212) 469-7295

If you have any questions, please call Kerry Moskalik at (415) 284-7282

In connection with the investment transactions undertaken, Investor has represented to KPMG Peat Marwick LLP ("KPMG") the following:

- There was no legally binding agreement, written or otherwise, that compelled any of the parties to complete these transactions in the way described.
- Investor independently reviewed the economics underlying the investment strategy and believed it had a reasonable opportunity to earn a reasonable pre-tax profit from each of the transactions described, in excess of all associated fees and costs and not including any tax benefits that may occur.
- Prior to entering the current investment strategy, Investor owned no other shares of Foreign Bank stock.
- Based upon its review of publicly available financial information and to the best of Investor's knowledge, Foreign Bank is highly profitable on a worldwide basis.
- Foreign LP, Investor, Limited Partner, General Partner, Investment Advisor and Foreign Bank each acted independently and at arm's length with respect to the transactions undertaken.
- There were no written agency agreements (apart from a standard investment advisory agreement) consummated with respect to the transactions and none of the parties involved held itself out to a third party as an agent of any of the others with respect to these transactions.
- Investor did not have the ability to control, directly or indirectly, the actions of Foreign LP.
- Investor has provided us with all facts and circumstances that it knows, or has reason to know, are pertinent to this opinion letter and believes that all assumptions or representations on which this opinion relies are reasonable.

new

From: Napier, Angie
Sent: Friday, December 18, 1998 11:39 AM
To: Bickham, Randall S
Cc: Eischeid, Jeffrey A
Subject: John Larson called about 1091 wash sale rules

Importance: High

Randy,

John Larson called me regarding an issue that came up about the wash sale rules. Deke Carbo called John Larson regarding whether the wash sale rules are a problem if you sale the OTC call options and the investor's long position within 30 days of each other.

In my opinion it does not appear to be a problem to sell these within 30 days of each other. Under the wash sale rules, 1091 is violated if you sell stock/securities and then acquire substantially similar stock or securities within the 61 day period. It seems that as long as you wait 30 days after buying the OTC calls (which is 30 days after the redemption date) that you can sell both the OTC call and the investor's long without violating 1091.

What are your thoughts? John said he left you a voice mail regarding this issue as well.

Also, how have you been counting this 30 day window? On the later Quadra tranche, redemption day is 11/30. Can investors sell on 12/30 or 12/31?

Thanks for your help,
Angie

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=17627
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=17627
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: OPIS Revenue
Sent: 1998-12-23 13:44:56.615
Date: 1998-12-23 13:44:58.448
X-Folder: Revenue Reports

Deke:

Please accept my thanks and congratulations as well - keep up the good work.

John

-----Original Message-----
From: Ammerman, Douglas K
Sent: Tuesday, December 22, 1998 1:00 PM
To: Carbo, Deke G
Cc: Lanning, John T; Goldberg, William J; Eischeid, Jeffrey A; Beakley, William D; Perez, Robert L
Subject: RE: OPIS Revenue

Deke,

I wanted to drop a brief note and compliment you on your outstanding efforts over the last few months in adding six additional OPIS transactions.

I look forward to seeing you in Florida. Keep up the great effort.

Doug Ammerman
KPMG LLP
Orange County Office
(714) 850-4455

-----Original Message-----
From: Carbo, Deke G
Sent: Sunday, December 20, 1998 1:19 PM
To: Ammerman, Douglas K; Eischeid, Jeffrey A
Cc: Goldberg, William J
Subject: OPIS Revenue
Importance: High

I estimate we will recognize additional gross revenue (over what we have recognized to date) from the six OPIS transactions I am involved in of $2.0 million. In arriving at this number, I eliminated $350,000 from the schedule you sent because it includes gross revenue from San Antonio which was reversed by manual adjustment on the period six area P&L. Thus, your schedule includes gross revenue not yet included in our area finacials.

I estimate cash collections of approximately $1.3 million in the next two to four weeks.

I estimate additional cash collections of $950,000 in the next four to eight weeks.

Deke

	A	B	C	D	E	F	G	H	I	J	K	L	M
1	OPIS Revenue Recognition Worksheet												
2	February 15, 1999					YTD	Unrecognized						
3					Expected	Period 8	OPIS	Period 8					
4					OPIS Fees	Gross Revenue	Gross Revenue	Accrual	Period 9	Period 10	Period 11	Period 12	Period 13
5													
6	Fall '98 Deals				$2,749,530	$2,528,967	$220,563						
7	Winter '98 Deals												
8	Spring '99 Deals												
9	MidAtlantic				$2,749,530	$2,528,967	$220,563	$0	$0	$0	$0	$0	$0
10	Fall '98 Deals				$1,611,300	$552,160	$1,059,140	$925,000					
11	Winter '98 Deals												
12	Spring '99 Deals (50%)				$458,220	$0	$458,220						
13	MidWest				$2,069,520	$552,160	$1,517,360	$925,000	$0	$0	$0	$0	$0
14	Fall '98 Deals				$351,250	$73,564	$277,686						
15	Winter '98 Deals												
16	Spring '99 Deals												
17	NorthEast				$351,250	$73,564	$277,686	$0	$0	$0	$0	$0	$0
18	Fall '98 Deals				$7,265,278	$4,634,523	$2,630,755						
19	Winter '98 Deals												
20	Spring '99 Deals (50%)				$1,133,120	$0	$1,133,120						
21	SouthEast				$8,398,398	$4,634,523	$3,763,875	$0	$0	$0	$0	$0	$0
22	Fall '98 Deals				$2,392,708	$932,782	$1,459,926						
23	Winter '98 Deals				$212,200	$145,748	$66,452						
24	Spring '99 Deals (50%)				$311,500	$19,355	$292,145						
25	SouthWest				$2,916,408	$1,097,885	$1,818,523	$0	$0	$0	$0	$0	$0
26	Fall '98 Deals				$4,795,000	$2,239,451	$2,555,549						
27	Winter '98 Deals												
28	Spring '99 Deals												
29	West				$4,795,000	$2,239,451	$2,555,549	$0	$0	$0	$0	$0	$0
30													
31				Total	$21,280,106	$11,126,550	$10,153,556	$925,000	$0	$0	$0	$0	$0

KPMG 0026252

Permanent Subcommittee on Investigations

EXHIBIT #94mm

Proprietary Material
Confidentiality Requested

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=20092
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20092
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: PAT Update
Sent: 1999-02-19 16:27:11.746
Date: 1999-02-19 16:27:11.918
X-Folder: Ins. Product

Kevin,

Just an update - UBS is currently working on the structure of the insurance policy. They will then send it to a NY law firm that Quadra is working with for the legal opinion on the insurance. Once the Law firm looks at the policy and agrees that it is a good insurance policy, they will send us a copy of their analysis so that we can start looking at the insurance issues and incorporating it into our analysis. Quadra thinks it will still be a week or two before we will get anything back from the law firm. I will let you know as soon as we get any info so we can get started on the process again as soon as we get info on the insurance structure.

Dale

Culley, Nancy K

From: Jeffrey_C._Zysk@meomexc07 (Jeffrey C Zysk) [Jeffrey_C_Zysk@meomexc07]
Posted At: Wednesday, March 24, 1999 7 51 PM
Conversation: OPIS Update
Posted To: PFP CaTS

Subject: Re: OPIS Update

Gregg W. Ritchie writes:
>Thank you for your participation in today's call. I will post a
>message to this conference on Monday outlining our discussion and
>giving you the feedback on my conference call with Deutche Bank/DPP
>Assurance/Presidio.

>Jeff Z., please post Larry DeLap's message regarding contingent fees to
>this conference so everyone has access to it.

Subject: OPIS
Author: Larry DeLap at KPMG_Silicon_Valley2 Date: 7/7/98 7:07 AM

Further to yesterday's telephone call:

1. OPIS has NOT been approved for marketing. No commitments should have been made to clients to deliver the product. Gregg Ritchie has repeatedly assured me that no such commitments have been made.

2. As currently contemplated, OPIS, if approved, would be delivered pursuant to what amounts to a contingent fee arrangement. Accordingly, audit clients and persons in positions of significant influence over audit clients should not be targets for the product.

3. The technical aspects of OPIS were approved by the tax advantaged transactions review board on the basis that it would be marketed to INDIVIDUALS. All the material we reviewed contemplated investment by individuals, as we understood Gregg Ritchie to represent that was the target population. If the intention is to market to corporations, we need to consider appropriate "business purpose" conditions. The "reasonable expectation of a reasonable profit" standard applied in evaluating OPIS from an individual investor standpoint is not necessarily sufficient for a corporate investor.

4. The standard for a corporation avoiding a substantial understatement penalty is much higher than the standard for an individual. Under Reg. section 1.6664-4(e)(3), a substantial understatement penalty may be imposed on a corporate participant in a tax shelter (which OPIS clearly is), even if the corporation reasonably believed it was more likely than not its treatment of the shelter was the proper treatment, if:

a. The corporation's participation in the tax shelter lacked SIGNIFICANT business purpose.

b. The corporation claimed tax benefits that are unreasonable in comparison to its investment in the tax shelter, OR

c. The corporation agreed with the organizer or promoter of the tax shelter that the taxpayer would protect the confidentiality of the tax aspects of the structure of the tax shelter.

If the IRS successfully disallowed the deductions to a corporate participant in an OPIS, it is likely it also could sustain the substantial understatement penalty. As such a corporate investor would then be much worse off that if it had not done the transaction. I think it is imprudent to market the product (even it had been approved and even if the contingent fee issue could be overcome) to an audit client, particularly a public audit client. (For reasons we can discuss privately if you wish, I do not have the same concern for tax products that can be shown to meet the business purpose test, such as Joel Resnick's "economic liability" transaction and the affirmative use of section 357(c) in connection with acquisition of business assets).

From: Kimberly M. Devine
Sent: Tuesday, March 30, 1999 3:21 PM
To: 'tanapler@kpmg.com'
Subject: Investment Advisor Letter Requested Changes

Angie:

Let me know if this works.

Regards,
Kim

-----Original Message-----
From: Norm Bontje
Sent: Tuesday, March 30, 1999 9:14 AM
To: Kimberly M. Devine
Subject: see if the following will work for kpmg.

The following are representations which will be relied upon, in part, by KPMG, LLP in connection with their issuance of an opinion regarding the direct and indirect investment strategy utilizing UBS AG common stock, undertaken by the [ ] pursuant to a direct and indirect advisory relationship with QA Investments, LLC ("QA").

In connection with the aforementioned investment strategy, QA represents to KPMG, LLP the following:

- To the best of its knowledge and belief, there was no legally binding agreement, written or otherwise, that compelled the parties known to QA which were involved in the implementation of the investment objectives detailed in the related investment advisory agreements to which QA was a party, to complete the investment strategy transactions involving UBS AG.
- To the best of its knowledge and belief, the margin terms afforded [ ] through its indirect investment, could not have been made through a direct investment in UBS AG common stock in a traditional United States domiciled securities account. Further, the indirect investment afforded [ ] exposure to a structured derivative on UBS AG common. We do not believe this structured derivative was made available and utilized by anyone other than QA clients.
- Based upon our review of publicly available financial information, UBS AG reported after-tax profits of CHF3,030 million for the year ended December 31, 1998.

QLS00460:

Permanent Subcommittee on Investigations
EXHIBIT #94pp

From: Warley, Carol G [cwarley@kpmg.com]
Sent: Wednesday, October 06, 1999 12:08 AM
To: Kim Devine (E-mail)
Subject: FW: Opis99.ppt

Opis99.ppt

Kim, attached is a draft of the presentation for tomorrow. I will review it again first thing in the a.m. to see if anything should change. Please provide me with your comments asap. thanks

```
> -----Original Message-----
> From:     Warley, Carol G
> Sent:     Tuesday, October 05, 1999 7:59 PM
> To: Warley, Carol G
> Subject:  Opis99.ppt
>
>  <<Opis99.ppt>>
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Permanent Subcommittee on Investigations
EXHIBIT #94qq

OPIS

Offshore Portfolio Investment Strategy

KPMG

PFPSubj\Opis99\PPT\Opis99.PPT

OPIS

- Interested In aggressive planning strategies
- Has capital gain of at least $20 million in 1999
- Nondisclosure and confidentiality agreement - protects client and KPMG
- KPMG Fees 1.25 percent of gain
- Tax presentation and Quadra investment presentation

KPMG

PFPSubj\Opis99\PPT\Opis99.PPT 1

QLS004567

OPIS

- Investment program is not subject to the tax shelter reporting requirements
- Tax opinions from KPMG and Brown & Wood
- Client representation letter required
- Engagement letter required

OPIS

Key Points

- Profit Motive/Business Purpose - Reasonable Expectation of Earning Reasonable Profit.
- Stock Redemption Treated as a Dividend to the Cayman Investment Company
- Basis Shift - Cayman Investment Company's tax basis shifts to Investor and generates capital loss.

OPIS

Investor Sentiment:

- Attracted to short-term trading opportunity in foreign bank stock.

Investment Strategy:

- Take short-term highly leveraged bullish position in foreign bank securities.

OPIS

Investment Components:

- Direct:
  - Long position in foreign bank shares
  - Out of the money call option on foreign bank shares
- Indirect (through Cayman Investment Company):
  - Leveraged long position in foreign bank shares
    - → European - style put and calls collar portion of long position
  - Derivatives

OPIS

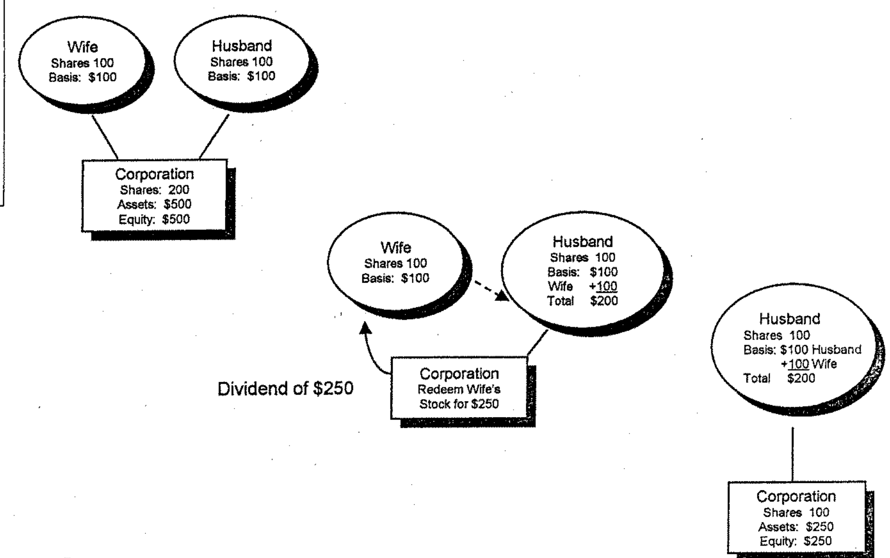
- Optimal investment returns when there is a significant increase in the average foreign bank stock price during the 43 day trading period with a high price point on day 43.

OPIS

Income Tax Consequences (U.S. Investor)

- Short-term gain/loss measured by difference between amount realized on investment strategy and cost of investment.
- Capital loss equal to gross amount of Cayman Investment Company's leveraged long position in foreign bank stock.

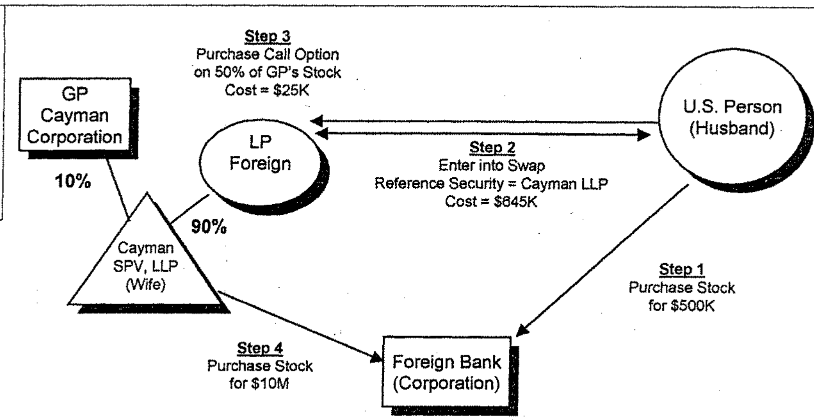
Husband, Wife & Corporation



KPMG

PFPSubj\Opis99\PPT\Opis99.PPT 6

Day 1

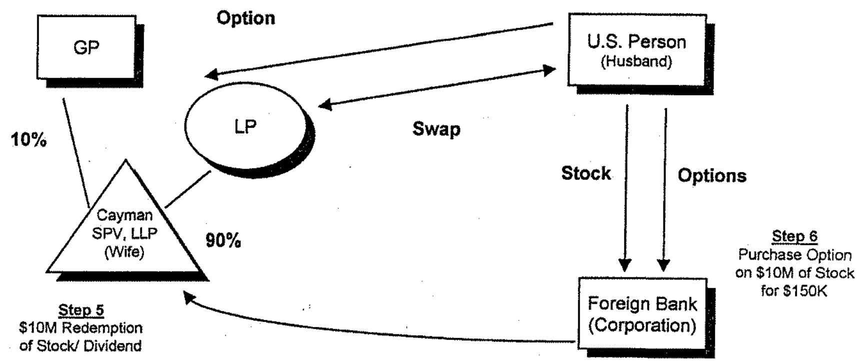


GOAL - $10M Capital Loss

Step 1. U.S. Person purchases Foreign Bank shares for $500K (cost 5% of $10M)
Step 2. U.S. Person enters into Swap with LP (Reference Security = Cayman, LLP) for $645K (cost 6.45% of $10M)
Step 3. U.S. Person purchases call option on 50% of GP's stock for 25K (.25% of $10M)
Step 4. SPV purchases $10M of shares (leveraged) in Foreign Bank and Cashless Collar Transaction Entered Into

KPMG

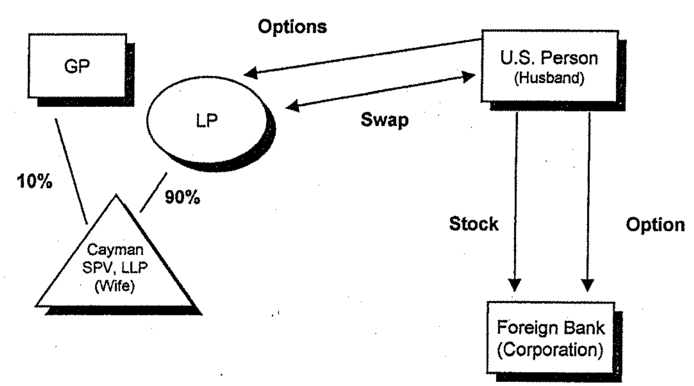
Day 43



Step 5. Foreign Bank redeems shares held by SPV for $10M (assumes no market fluctuation)
Step 6. Simultaneous with Step 5, U.S. Person purchases out of the money call option to acquire $10M of shares in Foreign Bank for $150K (cost 1.5% of $10M)

KPMG

After Day 73



Step 7. U.S. Person settles Swap transaction and puts option to acquire GP Stock and triggers gain/loss depending on success of Cayman investment strategy.

Step 8. U.S. Person sells Foreign Bank Shares and Options as target prices are reached and triggers capital loss.

Summary Comparison -- Net Tax Benefit of the Offshore Portfolio Investment Strategy

Description	Outright Sale	Sale with the Strategy
Gross Sale Proceeds of Property	$10,000,000	$10,000,000
Less: Cost Basis of Property Sold	0	0
Net Capital Gain	$10,000,000	$10,000,000
Less: Capital Gains Tax Cost	$<2,000,000>	$ 0
Strategy Transaction Cost (Net of Tax)	0	< 560,000>
Net Proceeds from Sale of Property	$8,000,000	$9,440,000
Dollar Increase by Using the Strategy		$ 1,440,000

Assumptions:
*The effective capital gains tax rate is 20 percent, which is based on the effective Federal and State capital gain tax rates.
*The transaction cost for implementing the Strategy is approximately 7 % of the capital gain exposure.

KPMG

Offshore Portfolio Investment Strategy Summary of Cash Requirements and Cost of Transaction

Notional Principal Amount = $10 Million

Description	Dollar Amount	Percentage
Initial Cash Requirements:		
Direct Investment in Foreign Bank Shares	$500,000	5.00%
Purchase Swap 6.45 & Quadra fees .3	675,000	6.75%
Purchase Call Option - GP	25,000	0.25%
Total Initial Cash Requirement	$1,200,000	12.00%
Other Cash Requirements:		
Call Option - Foreign Bank Shares	$ 150,000	1.50%
Total Economic Exposure	$1,350,000	13.50%
Less: Return of --		
Direct Investment in Foreign Bank Shares (Assumes no market fluctuation)	($500,000)	-5.00%
Call Option Cost - Foreign Bank Shares (Assumes option breaks-even)	($150,000)	-1.50%
Total Pre-Tax Cash Cost of Transaction	$ 700,000	7.00%

KPMG

OPIS

Economic Exposure

- Indirect investment in leveraged foreign bank trading strategy is unsuccessful. Estimated exposure is 7%. Dependent on market conditions.
- Long position in foreign bank stock will fluctuate with the market (including currency).
- Out of the money call option in foreign bank stock will fluctuate with the market (including currency) and with time.

OPIS

Economic Exposure (cont'd)

- IRS substantial understatement penalty
  - Reasonable reliance on special tax counsel and KPMG tax opinions.
- Interest on any taxes paid pursuant to IRS controversy (current interest is 8% non-deductible). This amount should be reduced by yield on investment of funds.
- Legal fees and costs associated with IRS defense

OPIS

Tax Risk Considerations

- Reasonable expectation of pre-tax profit/business purpose/economic substance doctorines
- Judicial doctorines - step transaction and substance over form
- Challenge by IRS of positions stated in Summary of Opinion
- Law changes

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: OTC calls
Sent: 1999-11-30 14:19:01.641
Date: 1999-11-30 14:19:01.766
X-Folder: OPIS

Kim,

It is my understanding that the investors must hold their options for 5 days. So they will not be able to sell until Monday, 12/6/99.

Angie

-----Original Message-----
From: Kimberly M. Devine [SMTP:kimd@qcm.com]
Sent: Monday, November 29, 1999 7:35 PM
To: 'Napier, Angie'
Subject: RE: OTC calls

Angie:

Just want to clarify: Can they sell ON the fifth holding day. Example: bought options on Friday, November 26th. Is the first day they can sell 12/3 or 12/6?

Kim

-----Original Message-----
From: Napier, Angie [mailto:tanapier@kpmg.com]
Sent: Friday, November 12, 1999 7:30 AM
To: Kim Devine (E-mail)
Subject: OTC calls

Kim,

I spoke to Jeff and the holding periods have not changed. Investors must hold their OTC call options for at least 5 days.

Angie

Watson, Mark T

From: Brockway, David H
Sent: Friday, January 21, 2000 12:28 PM
To: Bailine, Richard W; Watson, Mark T
Cc: Springer, Mark A
Subject: RE: OPIS

I understand the step-down issue in general; I want us to look at it real closely to make sure that there is no persuasive argument that the transaction would no be hit by the regs. We obviously need to confirm also whether the proposed regs were out prior to the sale of OPIS last year.

David H. Brockway
Partner-in-Charge
Washington National Tax
dbrockway@kpmg.com

Please make a note of my new phone & fax numbers (effective 10/25/99):
Ph: 202-533-3036
Fax: 202-533-8542

-----Original Message-----
From: Bailine, Richard W
Sent: Friday, January 21, 2000 7:18 AM
To: Brockway, David H; Watson, Mark T
Cc: Springer, Mark A
Subject: OPIS

Folks--just so we are all on the same page, please be aware that I just left David a voicemail telling him that in my view, OPIS is NOT a viable strategy anymore. I had been very concerned about OPIS strictly from an economic substance point-of-view and would have preferred to see OPIS not sold by our Firm simply because of this.However, the death knell for OPIS is the final "Fast-pay Stock" regulations issued a couple of weeks ago and effective for tax years ending after 2/27/97 (I think we should take a look to see if prior OPIS deals are subject to these retroactive regs!).

Under these regs stock is "fast-pay stock" if it is structured so that dividends (as defined in section 316) paid by the corporation with respect to the stock, are economically a return of the investment, not merely a return on the investment.

The OPIS transaction will be structured so that the Foreign Limited Partnership invests in Foreign Bank stock and then receives a return of its entire investment by means of a dividend (the redemption of its shares being taxed as a dividend by reason of the attribution rules). These regs contain a specific statement that they can apply (i) in situations where there is nominally only one class of stock outstanding (i.e. a portion of the one class can be recharacterized as "fast-pay") and (ii) apply to dividends which are redemptions taxed under section 302(d) (which is the case with OPIS).

Two issues arise by reason of the application of the fast-pay stock rules.

1. The Foreign Limited Partnership is NOT treated as a shareholder in the Foreign Bank such that all distributions to the Foreign Limited Partnership are treated as distributions to the "benefited stock". While it is not precisely clear under these regs I believe there is authority for IRS to maintain that the "benefited stock" is solely those shares of Foreign Bank owned by the Investor (i.e. the party in OPIS trying to get the capital gain). Thus, the full redemption amount received by the Foreign Limited Partnership is recharectorized as a dividend to the Investor giving him the ordinary income.

2. The regs require the paying corporation, i.e. the Foreign Bank, to withhold tax on the dividend and penalties can be invoked for failure to do so. Thus, if OPIS envisions using a Foreign Bank with US operations (Deutchabank, Summitomo etc) there may be a very real issue of getting the "buy-in" of such bank as it will be governed by these same fast-pay stock regs.

Please call to discuss if you have any questions but given the above, especially in concert with existing concerns over economic substance, I do not see how KPMG can go forward with OPIS.

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #94ss

KPMG 0036869

new

From: Balline, Richard W
Sent: Wednesday, March 15, 2000 10:53 AM
To: Eischeid, Jeffrey A; McGrath, Kevin J
Cc: Brockway, David H; Smith, Richard H (WNT); Madden, David P
Subject: OPIS and Fast Pay Regs

Guys--I have just read your memo dated March 2, addressing three potential arguments as to way the new final Fast Pay Stock Regs "more likely than not" (MLTN) do not apply to OPIS. This memo is well written, well thought out and quite creative. Unfortunately, I do not think it will enable the Firm to market future OPIS transactions.

The memo makes three arguments to support the conclusion that it is MLTN that the Fast Pay Stock Regs do not apply to OPIS : (i) the presumption of what is Fast Pay Stock as expressed in the final regs does not apply, (ii) the OPIS transaction does not result in a redemption that has the "same economic and tax effect" as a Fast Pay Stock Arrangement, and, (iii) the regs exceed the scope of authority granted to IRS by section 7701.

Let me say at the outset, I believe argument (i) is absolutely correct but it alone does not solve our problem. Stock can certainly be Fast Pay Stock even if these presumptions are failed. See, for instance, Ex #3 of the final regs.

Also, I believe there is a very strong chance that argument (iii) is also correct. Certainly, one clear reason for this is that these final regs surely do seem to implicate the Public shareholders of Foreign Bank; innocent people who not only play no role in the purported Fast Pay Stock Arrangement, but people who are wholly ignorant of such arrangement. However, no tax advisor can approach a client with a business solution that lies in the face of a published final regulation unless that client is simply looking to take on the Treasury/IRS and do battle the court system, potentially even to the Supreme Court (keep in mind here that there is no "right" to have the Supreme Court hear your case, you must petition them and they must agree--this operates to your benefit if you have won in the Appellate Courts as the Treasury/IRS also have no "right" to have the Supremes hear their appeal).

The focal point of the subject memo is argument (ii); to wit, does the common stock of Foreign Bank held by Foreign Partnership produce the same economic and tax effect as Fast Pay Stock and if so what does this mean. The memo does a very nice job of dispelling this issue but I am afraid the rationale used ignores the true facts and, more importantly, Ex #3 of the final regs.

The notion of "same economic and tax effect" seems to merely require two things; (A) economically there must be a dividend that is a return of investment, and, (B) taxwise, there must be a tax neutral party who receives that dividend. OPIS has both elements of this test. Please see Ex #3 of these regs where it is plainly stated that if Corp has outstanding one class of stock held 50% by A and 50% by Tax Exempt and there is an agreement to redeem the Tax Exempt in a transaction that is taxed as a dividend, then the economic and tax results of Fast Pay Stock *ARE* present making the stock held by Tax Exempt Fast Pay Stock. This example concludes, on really no more facts than expressed above, that the "economic and tax effect" of Fast Pay Stock are present. Thus, all the argument presented in the subject memo must be weighted against this simple fact. The conclusion is as stated, dividend (which is return of investment) to tax neutral party is all that is required to invoke these regs.

Having so concluded, Ex #3 now tells us, the only element missing is that because Corp is neither a RIC nor a REIT, the Commissioner must determine that a principle purpose of the Fast Pay Stock Arrangement is the avoidance of any Federal income tax. Clearly, in OPIS the avoidance of any Federal income tax is also present, a basis increase to the benefited shareholders results in greater loss/less gain upon disposition of shares.

The point of this is to simply say the following. The memo is great and I applaud the effort and thought that went into creating it. However, it appears that the better view is that the express terms of these final regs are at odds with the central argument needed to sustain OPIS as a viable business solution on a go forward basis. We are still evaluating the matter and we look forward with interest to reviewing the thoughts of Brown and Wood on this topic. Thanks again for a well done and creative argument. Obviously, you will be kept informed of our progress.

kpmg

To Jeff Eischeid

Date August 31, 2000

From Joe DePew
Sheldon Kay

Ref PFPMEMO.doc

Over the past several months the Tax Controversy Services group ("TCS"), working with the Atlanta PFP group, conducted a thorough file review of over fifty OPIS investros from 1998 located in the Atlanta office. These files contained numerous items including, but not limited to: Engagement Letter; Representation Letters; Final Opinion Letter; Correspondence; Investment Advisory Agreement; ISDA Master Agreement; Swap Schedule; Swap Confirmation; Call Option; Election for Cash Settlement ;Pledge and Security Agreement; Account Control Agreement; Long Position Confirmations (Bought/Sold); LP Share Option Put/Call; LP Position Confirmations (Bought/Sold); Limited Partnership Agreement; Individual over-the-counter Call Options (Bought/Sold); DBK price table; Basis Calculations; Membership Certificate; Register of Members of LLC; Form 8832; Brown & Wood, LLP Opinion Letter; Trust Amendment; Subscriber Representation; Deposit Agreement; Limited partnership agreement; and Structure Documents.

In an effort to completely review the OPIS files the TCS group reviewed samples of the 1998 files that kept by both Quadra Investment Advisors, LLC and Presidio Investment Advisors. The review of the KPMG, Quadra and Presidio files resulted in the TCS Group identifying a number of items that will be useful should an IRS or state exam be initiated.

Some of the helpful items included:

- Letters confirming the Swap.
- Letters confirming the Election for Cash Settlement was received.

- Letters from the investment advisor to the investor informing investor of sale confirmations for Long positions.

- Sale confirmations from the investment advisor to the investor for over-the-counter Call Options.

- Dean Witter investment summary of why investment in UBS bank stock was a good investment based upon the market conditions present at the time of investment..

- Investment updates from investment advisor to investor related to the value of the investment with advice as to best course of action.

The correspondence section of the files reviewed differed significantly. Some of the files contained over twenty items of correspondence, while others contained as few as one item. The Atlanta office files where the most comprehensive, including all correspondence and administrative items. It is assumed that local offices have kept their own correspondence files for these transactions and these files may have items that are not in the Atlanta office files that may be helpful if needed in the future.

The review is intended to identify information relevant to establishing the economic substance of the transaction. The review helps the firm identify what issues may arise and what evidence will be available. As well as the preservation of all documents related to the transactions.

The TCS group is available to review these files. The cost of this review will be based upon time spent and will normally be between $2,000 and $5,000 per file. For further questions related to this memo, the file review or to set up a review of your local office files please contact one of the following individuals:

Jeff Eischeid	404-222-3180
Sheldon Kay	404-614-8620
Joe DePew	404-614-8757
Angie Napier	404-614-8602

	A	B	C	D
1	Foreign Leveraged Investment Program			
2	Preliminary Issue and Hazard Summary			
3				
4		Issue	Hazards	Whose favor
5				
6		Primary		
7		Stock ownership (FC did not in substance own the UBS stock)	75/25	taxpayer
8				
9		Zenz	80/20	taxpayer
10				
11		Secondary		
12		Step Transaction	80/20	taxpayer
13				
14		Basis Adjustment is not a "proper adjustment" under 1.302-2	80/20	taxpayer
15				
16		Stock Loss not "bona fide" loss under section 165	50/50	even
17				
18		Stock loss disallowed under section 269	100/0	taxpayer
19				
20		Taxpayer not sufficiently "at risk" under section 465	50/50	even
21				
22		Section 482 requires reallocation of basis to FC	75/25	taxpayer
23				
24		The transaction as a whole lacks economic substance	70/30	taxpayer

KPMG 0026813

Proprietary Material
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Permanent Subcommittee on Investigations
EXHIBIT #94vv

	A	B	C
1	**Foreign Leveraged Investment Program**		
2	**Issue and Hazard Summary**		
3			
4	**Issue**	**IRS Position**	**Taxpayer Position**
5	1. Stock ownership (FC did not in substance own the UBS stock)	Because FC never took delivery of the UBS stock, it merely entered into a forward contract that contained a simultaneous purchase and sale, and therefore, it never owned the UBS stock for sections 302 and 318 to apply	The underlying facts and existing documentation make it clear that this was a purchase and sale of stock and not a forward contract. The existing documents, the amount paid for the stock (including the deposit), the existence under law of voting and other shareholder rights, the intent of the parties and other factors make it clear that the benefits and burdens of ownership of the UBS stock clearly passed to FC. The retention of possession of the stock by UBS as collateral is neither unusual nor indicative that the stock was not owned by FC.
6			
7	2. Step Transaction	Even if FC acquired the UBS stock, the substance over form and step transaction principles apply to disregard FC's acquisition and disposition of the UBS stock.	FC actually owned and sold the UBS stock and had a profit or loss on the transaction. Thus there was substance to its ownership and its transaction in the stock. The step transaction doctrine cannot be applied to ignore the steps in a real transaction between real antities which have real consequences.
8			
9	3. Application of the *Zenz* step transaction analysis	Under *Zenz* and the step transaction doctrine the sale by the investor of his or her UBS stock and the redemption of FC's stock are considered together so that the redemption of the FC stock was a complete termination of interest resulting in capital gain and not dividend income. Hence there was no basis to shift.	The *Zenz* step transaction doctrine, as it has been interpreted by the Service, steps together a taxpayer's sale of a portion of his stock and the redemption of the rest of the same taxpayer's stock to find a complete termination of his interest. In the situations we are discussing, the investor sold some or all of his UBS stock to third parties. UBS did not redeem the investor's stock. UBS redeemed FC's stock. Neither *Zenz* nor the related step transaction doctrine are applicable under these circumstances.
10	4. Basis Adjustment is not a "proper adjustment" under 1.302-2	The basis transfer is not a "proper adjustment" under Treas. Reg. § 1.302-2.	Treas. Reg. § 1.302-2 by its terms defines the adjustment as proper. The redemption of FC's UBS stock results in a proper adjustment under the regulation because the redemption was a dividend to FC since the shares owned actually and constructively by the investor were attributed to FC through the attribution rules of section 318. FC's basis in its UBS stock would disappear if the basis did not shift to the investor and this is precisely the result the regulation is designed to prevent. This is demonstrated in Example 2 of the regulation. The Service does not fare well when arguing against its own regulations. *See Woods Investment Company*.
11			
12	5. Stock loss is not "bona fide" loss under section 165	The taxpayer's loss was not a "bona fide" loss under section 165 such that the resulting loss should be disallowed.	There is a closed and completed transaction. The taxpayer entered into the transaction for the possibility of earning a profit, which possibility was real and substantial, and for the tax advantage. The digital RECAP option feature provided real opportunity for profit. For example, during the period July 1, 1997 through December 31, 1997, depending upon when the stock was purchased, the facts show that the taxpayers would have had 18 hits where the price of the stock exceeded the contractual strike price which would have generated a significant profit. The transaction as a whole has economic substance, and the mechanical application of sections 318 and 302 require the basis shift and the resulting loss on the disposition of any of the investors UBS stock.
13			
14			

Proprietary Material
Confidentiality Requested

	A	B	C
4	Issue	IRS Position	Taxpayer Position
5			
15	6. Stock loss disallowed under section 269	The taxpayer acquired control of FC with a principal purpose of avoiding or evading Federal income tax with the result that the purported stock loss is disallowed under section 269.	Because the attribution rules under section 318 are not applicable in applying section 269 (*Brick Milling Co. v. Commissioner*), the taxpayer never acquired a 50 percent interest in FC, a prerequisite for the application of section 269. The taxpayers merely owned warrants entitling them to purchase shares of FC and warrants are not treated as stock. Consequently, the taxpayers did not acquire control of FC within the meaning of 269 and that section cannot apply to disallow the loss.
16	7. Taxpayer not sufficiently "at risk" under section 465	The taxpayer is not at risk for the full amount of the claimed loss under section 465 so the loss must be disallowed.	The taxpayer's position is supported by the Treasury's own proposed regulations. The dividend resulting from the redemption of the bank stock served to increase FC's amount at risk under Treas. Prop. Reg. § 1.465-22(c)(1). By reason of the redemption, FC disposed of its entire interest in bank. Under Treas. Reg. § 1.302-2, FC's basis in its redeemed bank stock was properly transferred to the taxpayer. Under Treas. Prop. Reg. § 1.465-68, FC's at risk amount, as increased by the dividend resulting from the redemption, also shifts to the taxpayer. Contrary to the Service's position, Treas. Prop. Reg. section never requires a transfer of property from FC to the taxpayer. Instead, the transfer of basis is the requisite transfer. Thus the Service would be forced to argue against its own proposed regulation to sustain its contention.
17			
18	8./8a. Section 482	Whether the investor's basis or loss can be reallocated to FC under section 482. Whether FC's dividend can be allocated to the investor under section 482.	The taxpayer's and FC's purchases of bank stock and options represented passive investment activities, not the two trades or businesses required by section 482. Furthermore, the taxpayer and FC were not commonly controlled.
19	9. The transaction as a whole lacks economic substance and business purpose	The taxpayer had no other motive for entering into this transaction other than tax savings evidenced by the fact that the taxpayer had no chance to earn a profit. This transaction was a series of pre-arranged steps engineered for sole purpose of tax avoidance. Therefore, the transaction as a whole lacks economic substance and should be ignored for tax purposes.	The taxpayers had substantial opportunity to earn profits on the transaction in excess of all associated fees and costs, and without regard to tax benefits. Some taxpayers had a history of engaging in similar high risk transactions through Quadra in which they earned substantial profits. A number of investors actually had profits (some very substantial) over and above their transaction costs. It would be difficult to say that a transaction lacks economic substance and business purpose when profits were anticipated and in a number of instances actually occurred. The transaction also was conducted at arms-length and met the literal requirements of the applicable Internal Revenue Code provisions.

Forma

Dear Jerry:

This letter responds to the two questions you e-mailed to me on July 29, 2002 about the transaction we are working on. I am glad to see you have come so far along in such a short period of time, and our Coalition is happy to respond to these or any other questions that you might have. Each of your questions is restated here and is followed by our response.

I. The Foreign Corporation's Ownership of the Foreign Bank Stock

In your first bullet point in your fax to me dated July 24, 2002, you provide that the Government argues that the foreign corporation entered into a forward contract that contained a simultaneous purchase and sale and, therefore, never owned the foreign bank stock. You argue that the underlying facts and existing documentation make it clear that there was a purchase and sale of stock and not a forward contract. I do not have an administrative case file. Could you provide the underlying facts and existing documentation to show that there was a purchase and sale of the foreign bank stock by the foreign corporation?

In the typical foreign leveraged investment ("FLIP") transaction, Foreign Corporation agreed to buy and Foreign Bank agreed to sell a specified number of Foreign Bank's shares for an agreed price. The purchase was closed ("the Closing Date"), with payment, a cash settlement, to take place in the future (typically 50 days after the Closing Date). The price charged for the shares was the price of the stock on the closing date, and there would be an interest charge for the delayed payment. Often the interest charge was rolled into the price of the shares. (I'm not sure that 1) this is accurate or 2) helpful) Pursuant to an agreement executed contemporaneously with the purchase, Foreign Corporation deposited approximately 10% of the cost of the shares with Foreign Bank to secure its payment, and the stock was left with Foreign Bank as further collateral. A sample document issued by Foreign Bank to Foreign Corporation confirming Foreign Corporation's purchase of Foreign Bank stock and a sample Foreign Corporation bank statement showing funds being deposited with Foreign Bank are attached.

Foreign Bank purchased from Foreign Corporation a call on the Foreign Bank shares that were acquired by Foreign Corporation. The call options contained the digital return that resulted in a number of Investors earning an overall profit (discussed below) through their warrant interests in various Foreign Corporations. To limit its risk, Foreign Corporation purchased a put from Foreign Bank. The presence of a put and call arrangement is not unusual, and courts have recognized that taxpayers may still own property despite their efforts to reduce their risk with respect to such property. *See, e.g., IES Industries, Inc. v. United States*, 253 F.3d 350 (8th Cir. 2001); *Highland Farms, Inc. v. Commissioner*, 106 T.C. 237 (1996). What would be highly unusual would be such a put and call arrangement for shares that were not purchased, but were to be purchased in the future (a forward contract).

Thus there was an agreement for the purchase and sale of the Foreign Bank's shares and an actual purchase and sale of those shares. There was no executory agreement to transfer shares in the future as there would have been had this been a forward contract. The Foreign

Corporation intended to make a present purchase of the shares and the relevant documentation evidences that there was such a purchase.

II. Investor Profits

On page 6 of your letter to Jim Lanning dated March 14, 2002, you state that taxpayers could make an overall profit on the investments at issue ...... Is what you describe as an "overall profit," the total profit including the basis shifting loss plus any gains or losses from the digital RECAP option feature or the gains and losses from the digital RECAP option feature excluding any basis shifting loss?

The FLIP transaction provided investors with the opportunity for substantial pre-tax profits. Investors could profit on their direct holdings in Foreign Bank stock, their options to acquire Foreign Bank stock, and/or their warrants to acquire stock in Foreign Corporation.

By "profit," we mean a cash-on-cash profit. That is, if we state that an investor made a profit on a particular leg of the transaction, we mean that the cash return to the investor on that leg of the transaction exceeded the cash cost, including associated transactional expenses, of that leg of the transaction. Many investors profited on one or more legs of the transaction. An investor's failure to profit on a particular leg was due solely to the timing of the investment in relation to market swings in the price of Foreign Bank stock. We are not taking any "tax savings" into account when we refer to a profit.

By "overall profit," we mean that the total cash return to the investor on all legs of the transaction exceeded all of the costs of the transaction. An overall profit, as we use that term, would not necessarily require the investor to profit on the warrant, as an investor could obtain enough profit on the other two legs of the transaction to offset a smaller cash loss on the warrant. However, in the actual transaction we used to illustrate the transaction in the March 14, 2002 letter to Jim Lanning, the investor did profit on the warrant due to substantial gains on the digital RECAP option feature. The profit shown in that letter, as well as the overall profit of other investors represented by the Coalition, excludes any "basis shifting loss."

	A	B	C	D
1	Foreign Leveraged Investment Program			
2	Issue and Hazard Summary			
3				
4		Issue	Hazards	Whose favor
5				
6		Primary		
7		Stock ownership (FC did not in substance own the UBS stock)	75/25	taxpayer
8				
9		Exercise and redemption	80/20	taxpayer
10				
11		Secondary		
12		Basis Adjustment is not a "proper adjustment" under 1.302-2	80/20	taxpayer
13				
14		Stock Loss not "bona fide" loss under section 165	65/35	government
15				
16		Stock loss disallowed under section 269	100/0	taxpayer
17				
18		Taxpayer not sufficiently "at risk" under section 465	65/35	government
19				
20		Section 482 requires reallocation of basis to FC	75/25	taxpayer
21				
22		The transaction as a whole lacks economic substance	60/40	taxpayer

Proprietary Material
Confidentiality Requested

KPMG 0029751

Permanent Subcommittee on Investigations
EXHIBIT #94ww

	A	B	C
1	Foreign Leveraged Investment Program		
2	Issue and Hazard Summary		
3			
4	Issue	IRS Position	Taxpayer Position
5			
6	Stock ownership (FC did not in substance own the UBS stock)	Because FC never took delivery of the UBS stock, it merely entered into a forward contract that contained a simultaneous purchase and sale, and therefore, it never owned the UBS stock such that sections 302 and 318 cannot apply	The Service's characterization of this transaction as a forward contract is not relevant and not controlling. The underlying facts and existing documentation are determinative. Based upon the relevant documents, amount paid for the stock (including deposit), the existence of voting and other shareholder rights according to statute, the intent of the parties, and other factors, the benefits and burdens of ownership of the UBS stock clearly passed to FC.
7			
8	Exercise and Redemption	Because FC never owned the UBS stock, there was no redemption within the meaning of section 317, and thus, sections 302 and 318 do not apply.	As discussed above, FC had the benefits and burdens of ownership such that it clearly owned the subject UBS stock. The documents indicate that the required option exercises took place, and that UBS redeemed its shares from FC. The application of sections 302 and 318 is purely mechanical, and applying those statutes results in dividend treatment of the distribution by UBS in redemption of its shares. None of the 4 tests under section 302(b) are met, therefore the redemption must be treated as a dividend under section 301 and 316. Based upon the U.S. v Davis case, business purpose is irrelevant.
9			
10	Basis Adjustment is not a "proper adjustment" under 1.302-2	The basis transfer is not a "proper adjustment" under Treas. Reg. section 1.302-2.	The application of Treas. Reg. section 1.302-2 is purely mechanical. The distribution results in a proper adjustment under section 1.302-2 because the shares were owned by the taxpayer through the attribution rules under section 318. The application of said regulation requires the resulting basis shift in this case as demonstrated in Example 2 of the regulation.
11			
12	Stock loss is not "bona fide" loss under section 165	The taxpayer's loss was not a "bona fide" loss under section 165 such that the resulting loss should be disallowed.	There is a closed and completed transaction. The taxpayer entered into the transaction for the possibility of earning a profit, which possibility was real and substantial, and for the tax advantage. The digital RECAP option feature provided real opportunity for profit. For example, during the period July 1, 1997 through December 31, 1997, depending upon when the stock was purchased, the facts show that the taxpayers would have had 18 hits where the price of the stock exceeded the contractual strike price which generated an earned premium resulting in a significant profit. The transaction as a whole has economic substance, and the mechanical application of sections 318 and 302 require the basis shift and the resulting loss on the disposition of UBS stock.

	A	B	C
4	Issue	IRS Position	Taxpayer Position
13			
	Stock loss disallowed under section 269	The taxpayer acquired control of FC with a principal purpose of avoiding or evading Federal income tax with the result that the purported stock loss is disallowed under section 269.	Because the attribution rules under section 318 are not applicable in applying section 269 (Brick Milling Co. v. Commissioner), the taxpayer never acquired a 50 percent interest in FC, such that section 269 cannot serve as a basis for disallowing the taxpayer's claimed capital loss. The taxpayers merely owned warrants entitling them to purchase shares of FC. Again, because section 318 does not apply, those warrants are not treated as stock. Consequently, the taxpayers did not acquire control of FC within the meaning of 269 such that section 269 cannot apply to disallow the loss.
14			
15			
	Section 482	Basis in UBS stock must be reallocated to FC	Section 482 only addresses direct and indirect ownership and does not mention constructive ownership. As a result, section 482 is not applicable to the case at hand.
16			
17			
	Taxpayer not sufficiently "at risk" under section 465	The taxpayer is not at risk for the full amount of the claimed loss under section 465 such that the loss must be disallowed.	The legislative history of section 465, and the regulations thereunder, do not suggest any Congressional intent that section 465 should somehow override the application of sections 318 and 302 (and the regulations thereunder) such that the basis shift under Treas. Reg. section 1.302-2 must be respected and is not limited by the amount the taxpayer personally contributed to the investment. Example 2 of regulation section 1.302-2(c) shows the inequity that would result if section 465 were applied to deny realized losses incurred upon a redemption under those facts. Therefore, in this transaction, application of regulation section 1.302-2 is not limited by the amount of the taxpayers' contribution to the transaction/activity.
18			
19			

	A	B	C
4	Issue The transaction as a whole lacks economic substance	IRS Position The taxpayer had no other motive for entering into this transaction other than tax savings evidenced by the fact that the taxpayer had no chance to earn a profit. This transaction was a series of pre-arranged steps engineered for sole purpose of tax avoidance. Therefore, the transaction as a whole lacks economic substance such that it should be ignored for tax purposes.	Taxpayer Position The taxpayer had substantial opportunity to earn a profit on the transaction and entered into it for that purpose along with tax savings. The taxpayers reviewed the economics underlying the transaction and believed in good faith that they could earn substantial profits, in excess of all associated fees and costs, and without regard to tax benefits. Some taxpayers had a history of engaging a similar high risk transactions through Quadra in which they earned substantial profits. The specific economics associated with the RECAP option embedded in the call options provided a viable opportunity to recoup or exceed the taxpayers' investment fees. For example, during the period July 1, 1997 through December 31, 1997, depending upon when the stock was purchased, the taxpayers would have had 18 hits resulting in substantial profits. The transaction was conducted at arms-length and met the literal requirements of the applicable Internal Revenue Code provisions.
20			

	A	B	C	D
1	Foreign Leveraged Investment Program			
2	Issue and Hazard Summary			
3				
4		Issue	Hazards	Whose favor
5				
6		Primary		
7		Stock ownership (FC did not in substance own the UBS stock)	75/25	taxpayer
8				
9		Exercise and redemption	80/20	taxpayer
10				
11		Secondary		
12		Basis Adjustment is not a "proper adjustment" under 1.302-2	80/20	taxpayer
13				
14		Stock Loss not "bona fide" loss under section 165	65/35	government
15				
16		Stock loss disallowed under section 269	100/0	taxpayer
17				
18		Taxpayer not sufficiently "at risk" under section 465	65/35	government
19				
20		Section 482 requires reallocation of basis to FC	75/25	taxpayer
21				
22		The transaction as a whole lacks economic substance	60/40	taxpayer

Proprietary Material
Confidentiality Requested

KPMG 0026484

	A	B	C
1	Foreign Leveraged Investment Program		
2	Issue and Hazard Summary		
3			
4	Issue	IRS Position	Taxpayer Position
5			
6	Stock ownership (FC did not in substance own the UBS stock)	Because FC never took delivery of the UBS stock, it merely entered into a forward contract that contained a simultaneous purchase and sale, and therefore, it never owned the UBS stock such that sections 302 and 318 cannot apply	The Service's characterization of this transaction as a forward contract is not relevant and not controlling. The underlying facts and existing documentation are determinative. Based upon the relevant documents, amount paid for the stock (including deposit), the existence of voting and other shareholder rights according to statute, the intent of the parties, and other factors, the benefits and burdens of ownership of the UBS stock clearly passed to FC.
7			
8	Exercise and Redemption	Because FC never owned the UBS stock, there was no redemption within the meaning of section 317, and thus, sections 302 and 318 do not apply.	As discussed above, FC had the benefits and burdens of ownership such that it clearly owned the subject UBS stock. The documents indicate that the required option exercises took place, and that UBS redeemed its shares from FC. The application of sections 302 and 318 is purely mechanical, and applying those statutes results in dividend treatment of the distribution by UBS in redemption of its shares. None of the 4 tests under section 302(b) are met, therefore the redemption must be treated as a dividend under section 301 and 316. Based upon the U.S. v Davis case, business purpose is irrelevant.
9			
10	Basis Adjustment is not a "proper adjustment" under 1.302-2	The basis transfer is not a "proper adjustment" under Treas. Reg. section 1.302-2.	The application of Treas. Reg. section 1.302-2 is purely mechanical. The distribution results in a proper adjustment under section 1.302-2 because the shares were owned by the taxpayer through the attribution rules under section 318. The application of said regulation requires the resulting basis shift in this case as demonstrated in Example 2 of the regulation.
11			

Proprietary Material
Confidentiality Requested

	A	B	C
4	Issue	IRS Position	Taxpayer Position
	Stock loss is not "bona fide" loss under section 165	The taxpayer's loss was not a "bona fide" loss under section 165 such that the resulting loss should be disallowed.	There is a closed and completed transaction. The taxpayer entered into the transaction for the possibility of earning a profit, which possibility was real and substantial, and for the potential tax advantage associated with the investments. The digital RECAP option feature provided real opportunity for profit. For example, during the period July 1, 1997 through December 31, 1997, depending upon when the stock was purchased, the facts show that the taxpayers would have had 18 hits where the price of the stock exceeded the contractual strike price which generated an earned premium resulting in a significant profit. There are several additional periods in both 1998 and 1999 in which the RECAP option feature would have resulted in profits in excess of all fees. The transaction as a whole has economic substance, and the mechanical application of sections 318 and 302 require the basis shift and the resulting loss on the disposition of UBS stock.
12			
13	Stock loss disallowed under section 269	The taxpayer acquired control of FC with a principal purpose of avoiding or evading Federal income tax with the result that the purported stock loss is disallowed under section 269.	Because the attribution rules under section 318 are not applicable in applying section 269 (Brick Milling Co. v. Commissioner), the taxpayer never acquired a 50 percent interest in FC, such that section 269 cannot serve as a basis for disallowing the taxpayer's claimed capital loss. The taxpayers merely owned warrants entitling them to purchase shares of FC. Again, because section 318 is not applicable, those warrants are not treated as stock. Consequently, the taxpayers did not acquire control of FC within the meaning of 269 such that section 269 cannot apply to disallow the loss.
14			
15	Section 482	Basis in UBS stock must be reallocated to FC	Section 482 only addresses direct and indirect ownership and does not mention constructive ownership. As a result, section 482 is not applicable to the case at hand.
16			
17			

Proprietary Material
Confidentiality Requested

KPMG 0026486

	A	B	C
4	Issue	IRS Position	Taxpayer Position
	Taxpayer not sufficiently "at risk" under section 465	The taxpayer is not at risk for the full amount of the claimed loss under section 465 such that the loss must be disallowed.	The legislative history of section 465, and the regulations thereunder, do not suggest any Congressional intent that section 465 should somehow override the application of sections 318 and 302 (and the regulations thereunder) such that the basis shift under Treas. Reg. section 1.302-2 must be respected and is not limited by the amount the taxpayer personally contributed to the investment. Example 2 of regulation section 1.302-2(c) shows the inequity that would result if section 465 were applied to deny realized losses incurred upon a redemption under those facts. Therefore, in this transaction, application of regulation section 1.302-2 is not limited by the amount of the taxpayers' contribution to the transaction/activity.
18			
19			
	The transaction as a whole lacks economic substance	The taxpayer had no other motive for entering into this transaction other than tax savings evidenced by the fact that the taxpayer had no chance to earn a profit. This transaction was a series of pre-arranged steps engineered for sole purpose of tax avoidance. Therefore, the transaction as a whole lacks economic substance such that it should be ignored for tax purposes.	The taxpayer had substantial opportunity to earn a profit on the transaction and entered into it for that purpose along with potential tax savings. The taxpayers reviewed the economics underlying the transaction and believed in good faith that they could earn substantial profits, in excess of all associated fees and costs, and without regard to tax benefits. Some taxpayers had a history of engaging a similar high risk transactions through Quadra in which they earned substantial profits. The specific economics associated with the RECAP option embedded in the call options provided a viable opportunity to recoup or exceed the taxpayers' investment fees. For example, during the period July 1, 1997 through December 31, 1997, depending upon when the stock was purchased, the taxpayers would have had 18 hits resulting in substantial profits. The transaction was conducted at arms-length and met the literal requirements of the applicable Internal Revenue Code provisions.
20			

Proprietary Material
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Quadra Advisors, LLC

RECAP Option Description

<u>*For Internal Use Only*</u>

The following examples and hypothetical return analysis are subject to a number of market conditions and should not be construed as a forecast of future investment returns or available option prices. Also, such examples include various commissions, financing charges, investment advisory fees and other costs which may or may not be applicable to potential investors. Furthermore, any stock and option prices used herein may vary substantially from those included and may therefore invalidate all, or a portion, of the rationale for any potential investment strategy. This document is for informational purposes only and does not constitute an offer to sell or a solicitation of an offer to buy any securities. Quadra does not represent as to the accuracy of these forecasts.

Proprietary Material
Confidentiality Requested

KPMG 0010386

Permanent Subcommittee on Investigations
EXHIBIT #94xx

Rationale for Investment

Many investors, including major investment brokerage firms and professional investment advisors, believe that there is an opportunity to profit from certain stock and option strategies involving Union Bank of Switzerland ("UBS"). These opportunities are based on the potential appreciation of UBS's stock price. The positive outlook for the stock price can be based on numerous fundamental or technical factors, including:

- The diversification of UBS's core business beyond traditional banking into more lucrative areas such as asset management, risk management, securities sales and trading.
- This diversification coupled with aggressive efforts to consolidate less profitable business operations in domestic Swiss banking. Such efforts resulted in a fourth quarter 1996 charge of CHF 3 billion to write-off bad loans and make certain reorganization changes.
- As UBS expands to become a global financial services firm, it should be able to utilize its financial strength, credit rating, and franchise value to gain an edge over other financial institutions.
- The favorable valuation of UBS's share price relative to those of other global financial institutions

The Offshore Investment Portfolio

The investment portfolio of the offshore fund will be designed to generate substantial profits if the stock gradually appreciates over the trading period selected. The core position will likely involve purchasing a highly leveraged position in UBS bearer shares. This highly leveraged position is possible because the investment portfolio will be outside the jurisdiction of U.S. regulatory rules concerning the financing of securities. Due to the substantial leverage utilized, the portfolio will immediately hedge its risk by purchasing out-of-the-money put options to limit the downside exposure. In addition to the put purchase, the portfolio will most likely sell a covered call option on the UBS stock position. A basic covered call writing strategy would typically be used by investors who anticipate modest appreciation in the underlying stock during the term of the option. Similarly, the application of this strategy in the portfolio will be specifically designed to maximize profit based on the fundamental view that gradual appreciation in the stock price will occur.

Opportunity for additional profits in the portfolio will be created by embedding a digital option premium feature ("RECAP") in the call option. With this feature in place, the premium received from selling the covered call will be increased if the stock moves beyond pre-defined levels during the options life. Specifically, the amount of any additional premium will increase by a fixed amount for each day and paid to the option seller at expiration. The pre-defined levels are established to correspond to an investors fundamental forecast of gradual appreciation in the underlying stock price.

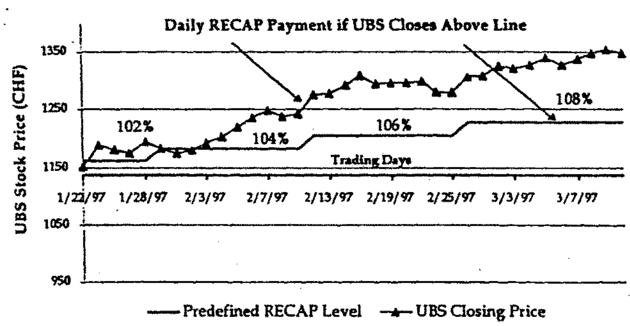
ACTUAL TRADE EXAMPLE USING RECAP FEATURE

Week 1	102% of purchase price
Week 2 & 3	104% of purchase price
Week 4 & 5	106% of purchase price
Week 6 & 7	108% of purchase price

The payoff pattern of this RECAP structure differs dramatically from a standard call option in that each day has a limited discrete payoff pattern, whereas with a standard call option the payoff pattern is based on the stock price at the expiration of the option.

The RECAP feature was constructed to meet the objectives of minimizing the cost and maximizing the upside potential should a gradual appreciation scenario unfold. To accomplish these objectives, the RECAP structure will have a knock-out feature whereby any remaining portion of the RECAP term will disappear if at any time the stock price closes at or below 95% of the original purchase price. Should this knock-out occur, the portfolio will retain any premium payments earned prior to the knock-out.

The following example illustrates the RECAP structure for a transaction entered on January 21, 1997 on behalf of Muirfield International Inc., Kayak Partners, Inc., Hampshire Capital, Inc., and Palmetto Capital, Inc.



Potential Trading Days: 36 *Days RECAP Achieved: 33* *Percentage: 91%*

	Actual Deal Costs*	Current Fee Schedule*
Warrant Cost	7.0%	6.50%**
Realized Profits	9.29%	13.86%
Total Net Profits	2.29%	7.36%
Actual Return 50 days	32.7%	113%
Annualized Return	667%	23,038%

*Expressed as % of Notional Amount
** Does not include .50bp initial structuring fee

Hypothetical Trade Analysis

Each portfolio will have the flexibility to modify the RECAP structure and the resultant costs and payoff patterns based on the stock price levels, implied volatilities, knock-out levels and the fees paid various parties. The table below illustrates the potential returns available from a highly leveraged covered call option/put purchase option strategy which includes the RECAP structure discussed below. Given the RECAP's daily payoff, the best way to analyze its impact on the portfolio's profitability is to base the calculation of potential profits on the number of days the stock closes over the pre-defined RECAP levels (expressed as a percentage). For example, a certain return could be earned if the stock closed above the pre-defined RECAP levels on 80% of the 35 potential trading days (35*.80 or 28 days).

Trade analysis is based on the following assumptions:

Trade Date	15-Jun-97	Base Warrant Price	6.50%
Number of Trading Days	35	Value Added Fee	STD
Original Stock Price	1675	Recap Knock-Out	95%

Comparative Return Analysis for Varying Fees/Costs

PREDEFINED RECAP LEVELS

Week 1	102.5% of purchase price
Week 2 & 3	105% of purchase price
Week 4 & 5	107.5% of purchase price
Week 6 & 7	110% of purchase price

% RECAP	CURRENT	
Hit	Actual	Annual
0%	-97%	-100%
20%	-60%	-100%
40%	-24%	-86%
50%	6%	-33%
60%	13%	138%
70%	31%	603%
80%	49%	1701%
90%	68%	4041%
100%	86%	8630%

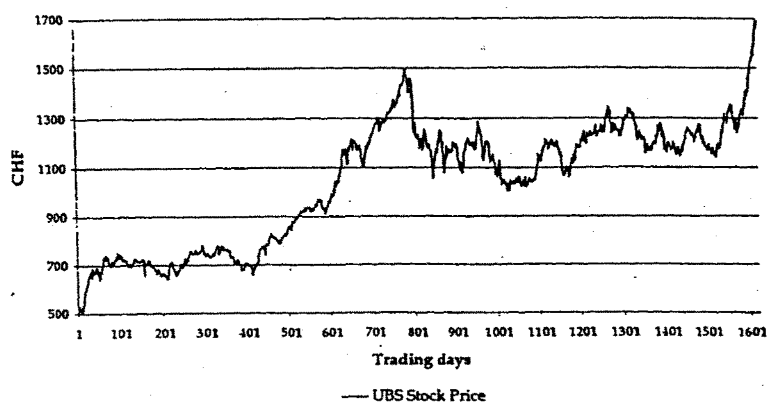
The above returns approximate the total gains that would be earned by the portfolio including any profits or losses associated with:

- RECAP option payoffs
- Short covered call premium
- Long put premium
- Interest
- Stock price movement

Actual investment returns will fluctuate based on changes in market conditions, including but not limited to, changes in stock prices, option implied volatilities, interest rates, and number of trading days.

Historical Analysis

While historical analysis alone should not be used for predictive purposes, such analysis may provide insight regarding historical stock price volatility and the ability to achieve the target levels of a particular RECAP structure. *The graph below depicts the share price of UBS bearer shares for the 1,620 trading days during the period 1/3/91 through 6/13/97.*



Using the current trade, during the previous six year period a total of 157 trades would have been profitable with an average actual return of 39% (over 50 days) and an annualized return of 963%.

Absent any market timing or subjective views for the period January 1991 through May 1997, a RECAP option structure similar to the one described herein would have hit 56% or more of its pre-defined levels 9.93% of the time.

Long RECAP

	Bin	*Frequency*	*Occurrence Ratio*
	0-10%	1161	
	11-20%	111	
	21-30%	52	
	31-40%	54	
	41-56%	46	
Profit Level	57-60%	21	
	61-70%	36	
	71-80%	46	
	81-90%	29	
	More	25	
		1581	9.93%

The above hypothetical analysis assumes an investor is indifferent to market timing as it relates to the share price of UBS. This assumption is unrealistic especially given the inherent long bias of a covered call strategy with an embedded RECAP structure. Typically, an investor would only initiate such a position when they believed an upward directional move in the stock price is likely. For long-term investment objectives the impact of short-term market timing is not significant in the decision process. However, because of the short-term nature of the RECAP exposure, a correct market timing assumption is critical to earning favorable investment returns.

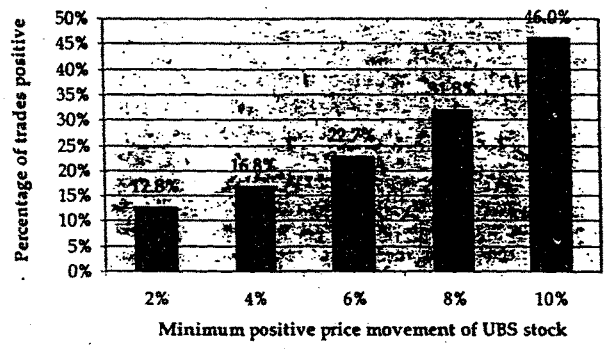
In order to asses the profit potential of the Recap portfolio the following analysis examine how a historical portfolio would have performed if an investor were marginally correct regarding their short-term market assumptions.

In the first case we assume an investor was correct in predicting the direction of the underlying shares during the same historical period. As shown below, if the stock was higher at the end of the trading period, then an investor would have profited with RECAP structure 15.8% of the time. Additionally, the returns earned by an investor during these profitable periods would have been substantial. Specifically, of the trades that were profitable 84% of such trades would have generated annualized net returns in excess of 100%.

Long RECAP

	Bin	*Frequency*	*Occurrence Ratio*
	0-10%	599	
	11-20%	84	
	21-30%	42	
	31-40%	47	
	41-56%	44	
Profit Level →	57-60%	20	
	61-70%	36	
	71-80%	46	
	81-90%	29	
	More	25	
		972	15.8%

In the second case we are limiting our analysis to those trades that had a minimum positive price movement at any point during the course of the trade. In other words, the first bar shows the percentage of profitable trades when we restrict our analysis to those trades with at least a 2% upward price movement at any time during the trade period. The second bar shows the percentage of profitable trades when we restrict our analysis to those trades with at least a 4% upward price movement, and so on. This analysis differs from the above in that we are looking at price movement during the course of the trade rather than looking at the ending price appreciation. This analysis illustrates that from a historical perspective if an investor's fundamental assumption for modest stock appreciation is correct over the short term than they have a reasonable probability of a profitable transaction. Moreover, the probability increases if the investor's assumption actually materializes.



UBS
Union Bank of Switzerland

AEF6/ 073

Delayed Settlement Stock Transactions via Zurich

Jeff,

With regard to your enquiry regarding the rationale behind our delayed stock settlements via Zurich, please find below a brief explanation. In the case of the transactions we have undertaken for your clients we have extended the delayed settlement period. This is perfectly permissable under Swiss law and in most cases is characterised as an "OTC stock transaction".

Stock Exchange Rules Governing Delayed Settlement

Transactions with delayed settlement are not offered by the Swiss Exchange. In general, all transactions done at the Exchange have to be settled by Trading Day (T)+3. Nevertheless, UBS routinely offers to its customers delayed settlement transactions with a settlement period of (T)+7. If a client wants to buy or sell securities with a delyed settlement UBS arranges for the transaction at the exchange on a (T)+3 basis, however credits or debits the client on (T)+7. UBS obviously charges a margin for this service.

As delayed settlement is not a transaction which is offered by the stock exchange trading system, (T)+7 transactions are not governed by stock exchange rules. Nevertheless, UBS applies also on delayed settlement tranactions, except for the settlement period, the terms and conditions which are included in the stock exchange rules.

Trading of Swiss Securities OTC

Over the counter trading of stock is allowed for :

- securities not listed on the Swiss exchange
- for listed securities if the size of the transaction reaches a certain limit (CHF 200,000 nominal value).

In the event that OTC trading is allowed, Stock Exchange Rules do not apply.

I hope that this is of value. If you have any further questions please do not hesitate to contact me.

Regards

Dr. Chris Donegan
Vice President

Permanent Subcommittee on Investigations
EXHIBIT #94yy

UBS000008

KPMG Peat Marwick LLP

FOREIGN STOCK REDEMPTION OPINION

Larry DeLap

6/12/98

COMPARATIVE REVIEW
FLIP INVESTMENT STRUCTURES

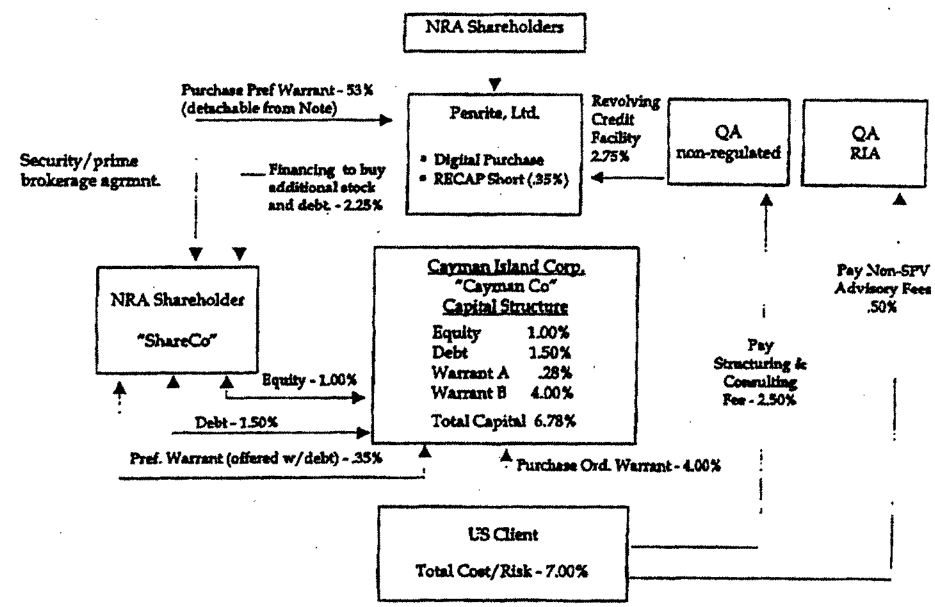
Structure utilized by KPMG - 1997	*Structure utilized by Quadra - 1998*
• Single warrant held by US taxpayer.	• Two warrants. One held by foreign person, one held by US taxpayer.
• No debt issued by SPV.	• SPV issues debt to foreign person.
• Foreign person contributes lesser of 1% of notional or $250,000.	• Foreign person contributes 1% of notional, not limited.
• Exercise strike price of warrant set at a future variable price.	• Exercise strike price of warrant predetermined.
• Put strike price of warrant equates to majority of initial equity of the SPV.	• Put strike price equates only to profits of SPV.
• Foreign person's return fixed at inception.	• Foreign person's return dependent on company profitability.
• US taxpayer participates in all SPV profits.	• US taxpayer participates pro-rata in SPV profits.
• Warrant cost 7.0% of notional investment.	• Warrant cost 4.0% of notional
• No advisory fee.	• Advisory fee of 3.0%

Proprietary Material
Confidentiality Requested

KPMG 0010226

KPMG 0010227

Cayman Island Financing Structure

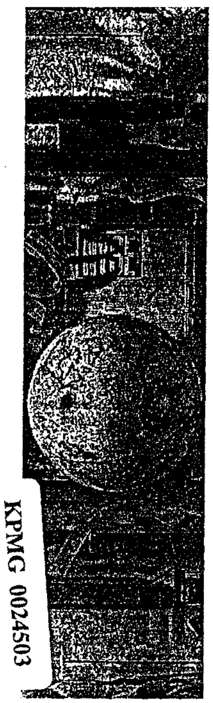


6/12/98

Proprietary Material
Confidentiality Requested

Innovative Income Tax Strategies
Capital Transactions Strategies

Jeffrey A. Eischeid
KPMG Personal Financial Planning

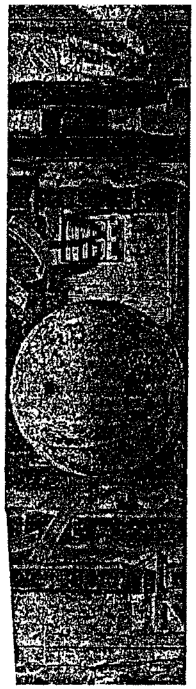


What is “CaTS”? (Capital Transactions Strategies)

- Integrated solutions for individual sellers of appreciated property.
- Creates portfolio of innovative tax strategies
- Links tax “risk” of individual strategies with potential “return”
- Includes income and transfer tax strategies as appropriate for the seller

KPMG 0024503

KPMG Corporate Finance



CaTS (cont.)

- ➤ Dovetails with investment portfolio architecture following sale
- ➤ Provides innovative KPMG and external strategies (reviewed by KPMG professionals)

KPMG
Corporate Finance

Client Profile

- ndividual sellers of appreciated property (can include family business, narketable securities, real estate, etc.)
- ppetite for strategic income tax planning
- ppetite for estate and gift tax planning
- eed for strategic portfolio advice

KPMG
Corporate Finance

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on Investigations

KPMG 0024506

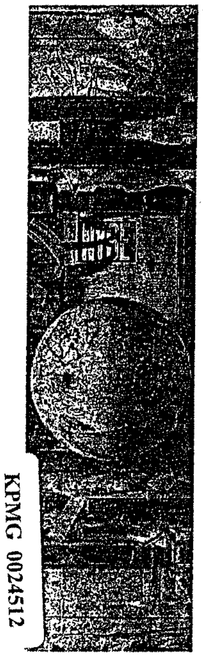
KPMG 0024507

KPMG 0024508

KPMG 0024509

KPMG 0024510

KPMG 0024511



OPIS

Offshore Portfolio Investment Strategy

KPMG 0024512

KPMG
Corporate Finance

Proprietary Material
Confidentiality Requested

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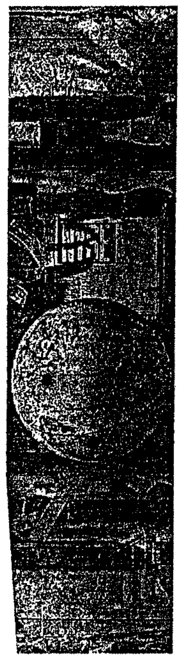


OPIS

Investor Sentiment:

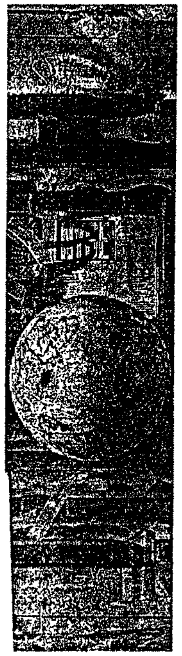
- *Attracted to short-term trading opportunity in foreign bank stock.*

Investment Strategy:

- *Take short-term highly leveraged bullish position in foreign bank securities.*

KPMG 0024513

KPMG
Corporate Finance

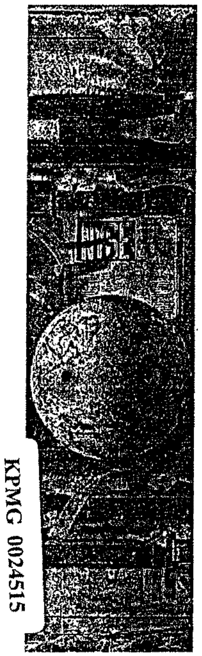


OPIS

Investment Components:

- *Direct:*
  - *Long position in foreign bank shares*
  - *Out of the money call option on foreign bank shares*
- *Indirect (through Cayman Investment Company):*
  - *Leveraged long position in foreign bank shares*
    - *European - style put and calls collar portion of long position*
  - *Asian Derivative*

KPMG 0024514



OPIS

- *Optimal investment returns when there is a significant increase in the average foreign bank stock price during the 49 day trading period with a high price point on day 49.*

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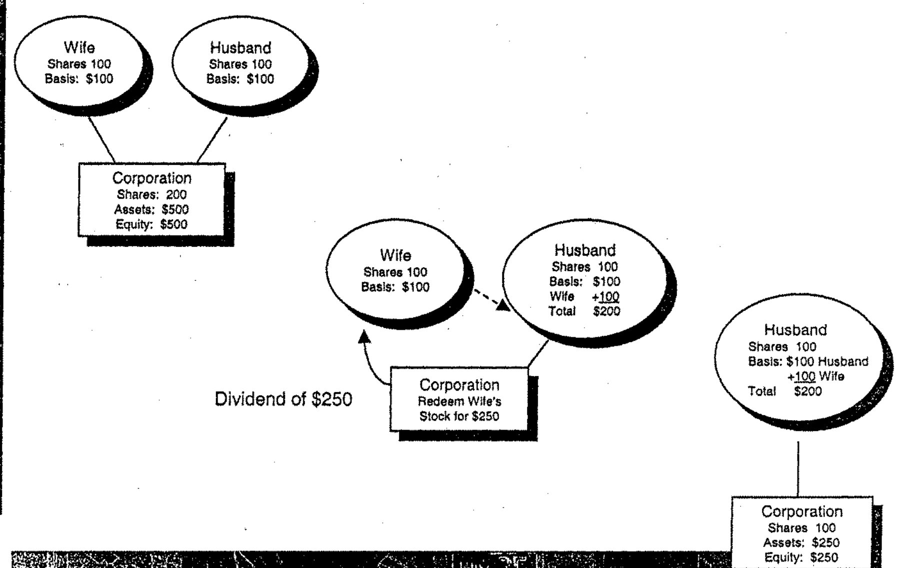
OPIS

Income Tax Consequences (U.S. Investor)

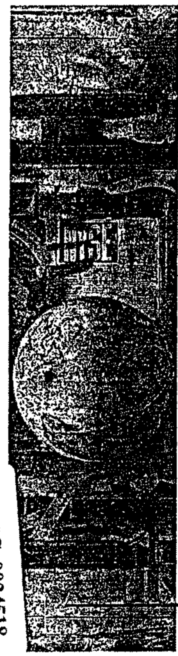
- *Short-term gain/loss measured by difference between amount realized on investment strategy and cost of investment.*
- *Capital loss equal to gross amount of Cayman Investment Company's leveraged long position in foreign bank stock.*

KPMG 0024516

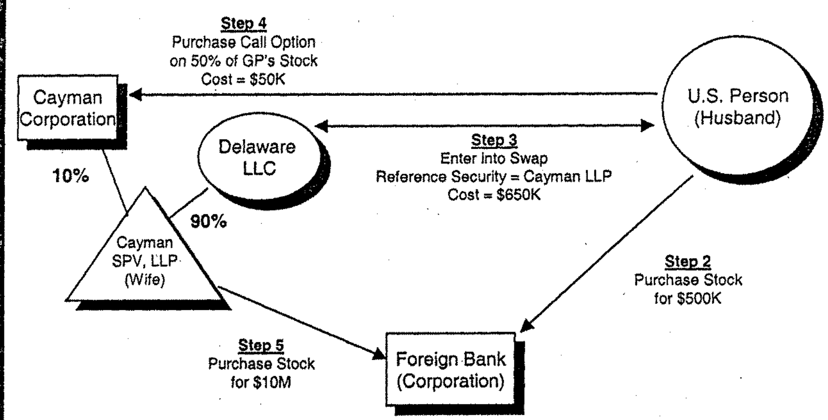
Husband, Wife & Corporation



KPMG Corporate Finance



Day 1



GOAL - $10M Capital Loss

Step 1. U.S. Person purchases Foreign Bank shares for $500K (cost 5% of $10M)
[redacted]
Step 4. SPV purchases $10M of shares in Foreign Bank

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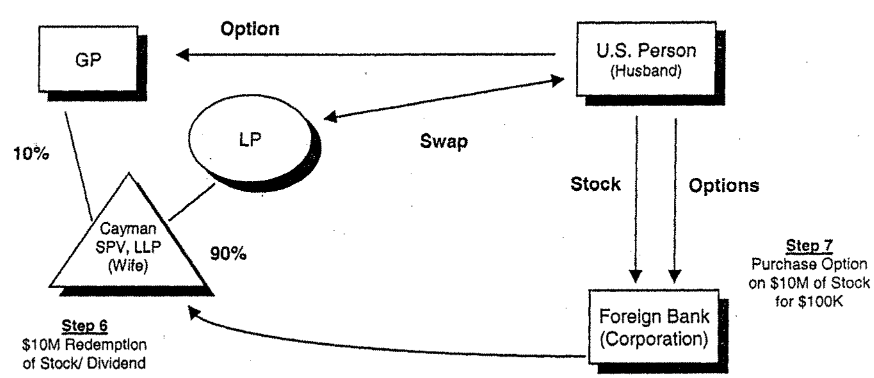
Proprietary Material
Confidentiality Requested

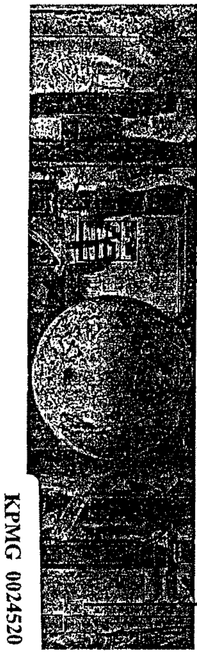
KPMG 0024518

Day 49

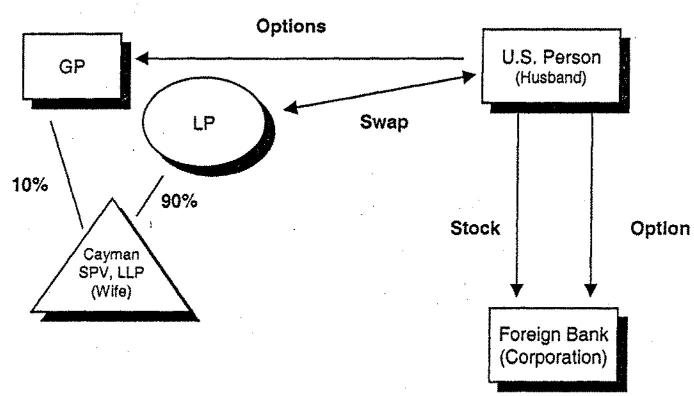


Step 6. Foreign Bank redeems shares held by SPV for $10M (assumes no market fluctuation)
Step 7. Simultaneous with Step 6, U.S. Person purchases out of the money call option to acquire $10M of shares in Foreign Bank for $100K (cost 1% of $10M)

KPMG
Corporate Finance



After Day 49

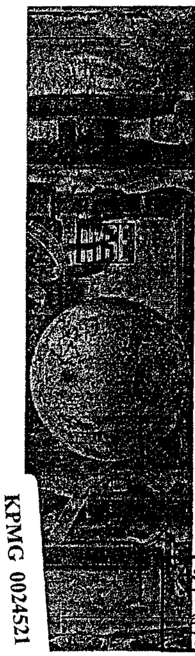


Step 8. **U.S. Person settles Swap transaction and puts option to acquire GP Stock and triggers gain/loss depending on success of Cayman Investment strategy.**

Step 9. **U.S. Person sells Foreign Bank Shares and Options as target prices are reached and** [redacted]

KPMG

Corporate Finance



Summary Comparison -- Net Tax Benefit of the Offshore Portfolio Investment Strategy

Description	Outright Sale	Sale with the Strategy
Gross Sale Proceeds of Property	$10,000,000	$10,000,000
Less: Cost Basis of Property Sold	0	0
Net Capital Gain	$10,000,000	$10,000,000
Less: Capital Gains Tax Cost	$<2,000,000>	$ 0
Strategy Transaction Cost (Net of Tax)	0	< 560,000>
Net Proceeds from Sale of Property	$8,000,000	$9,440,000
Dollar Increase by Using the Strategy		$ 1,440,000

ssumptions:
he effective capital gains tax rate is 20 percent, which is based on the effective Federal and State apital gain tax rates.
he transaction cost for implementing the Strategy is 7 percent of the net capital gain exposure.

KPMG 0024521

Offshore Portfolio Investment Strategy Summary of Cash Requirements and Cost of Transaction

Notional Principal Amount = $10 Million

Description	Dollar Amount	Percentage
Initial Cash Requirements:		
Direct Investment in Foreign Bank Shares	$500,000	5.00%
Purchase Swap	650,000	6.50%
Purchase Call Option - GP	50,000	0.50%
Total Initial Cash Requirement	$1,200,000	12.00%
Other Cash Requirements:		
Call Option - Foreign Bank Shares	$ 100,000	1.00%
Total Economic Exposure	$1,300,000	13.00%
Less: Return of --		
Direct Investment in Foreign Bank Shares (Assumes no market fluctuation)	($500,000)	-5.00%
Call Option Cost - Foreign Bank Shares (Assumes option breaks-even)	($ 100,000)	-1.00%
Total Pre-Tax Cash Cost of Transaction	$ 700,000	7.00%

KPMG 0024522

KPMG
Corporate Finance

OPIS

Key Points

- Profit Motive/Business Purpose - Reasonable Expectation of Earning Reasonable Profit.
- Basis Shift - Cayman Investment Company's tax basis shifts to Investor and generates capital loss.

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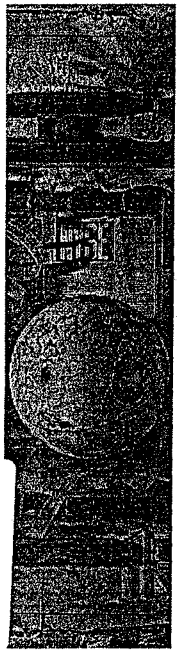


OPIS

Economic Exposure

- Indirect investment in leveraged foreign bank trading strategy is unsuccessful. Maximum exposure is 7%.
- Long position in foreign bank stock will fluctuate with the market (including currency).
- Out of the money call option in foreign bank stock will fluctuate with the market (including currency) and with time.

KPMG Corporate Finance

OPIS

Economic Exposure (cont'd)

- IRS substantial understatement penalty (20%)
  - Reasonable reliance on special tax counsel and KPMG tax opinions.
- Interest on any taxes paid pursuant to IRS controversy.

KPMG 0024525

Capital Transactions Strategies ("CaTS")

Jeffrey A. Eischeid
Partner

KPMG The Global Leader

Proprietary Material
Confidentiality Requested

CATs1105.PPT

Permanent Subcommittee on Investigations
EXHIBIT #94bbb

KPMG 0024487

What is "CaTS"?

- *Integrated solutions for individual sellers of appreciated property.*
- *Creates portfolio of innovative tax strategies.*
- *Links tax "risk" of individual strategies with potential "return".*
- *Includes income and transfer tax strategies as appropriate for the seller.*

CaTS (cont.)

- Dovetails with investment portfolio architecture following sale.
- Provides innovative KPMG and external strategies (reviewed by KPMG professionals).

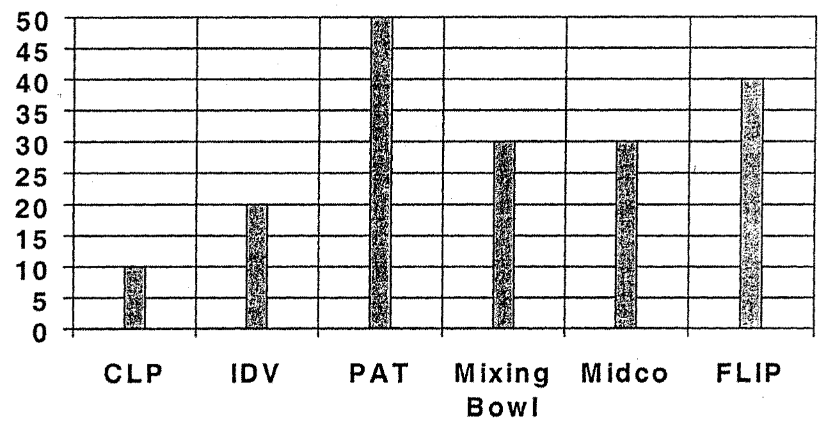
Client Profile

- ***individual*** *sellers of appreciated property (can include family business, marketable securities, real estate, etc.).*
- *appetite for strategic income tax planning.*
- *appetite for estate and gift tax planning.*
- *need for strategic portfolio advice.*

Sample Strategies

- *Private Annuity Trust ("PAT")*
- *Foreign Leveraged Investment Program ("FLIP")*
- *Investment Diversification Vehicle ("IDV")*
- *Charitable Legacy Plan ("CLP")*
- *"Mixing Bowl"*
- *"Midco"*

Risk Spectrum



KPMG The Global Leader

Proprietary Material
Confidentiality Requested

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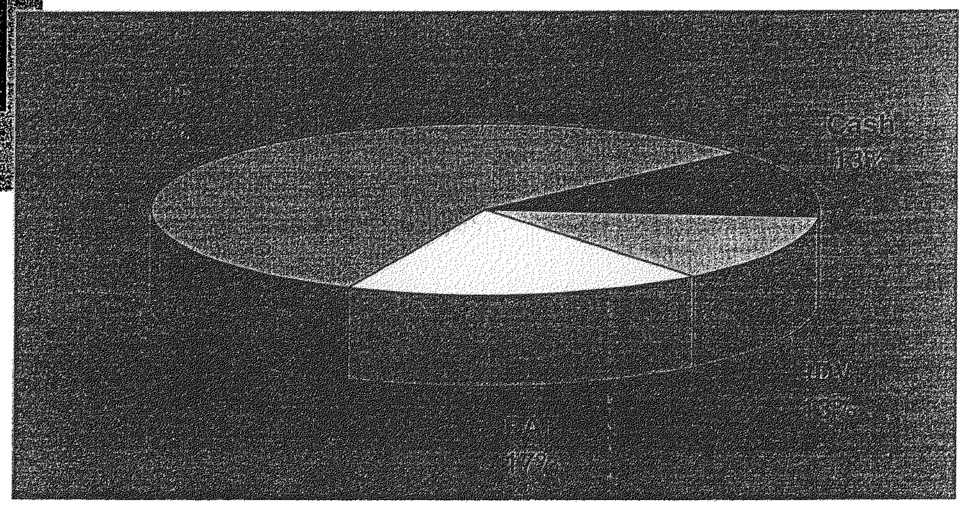
KPMG 0024492

Strategic Tax Planning Portfolio



Proprietary Material
Confidentiality Requested

The Global Leader

CATs1105.PPT

KPMG 0024493

Foreign Leveraged Investment Program

KPMG The Global Leader

Proprietary Material
Confidentiality Requested

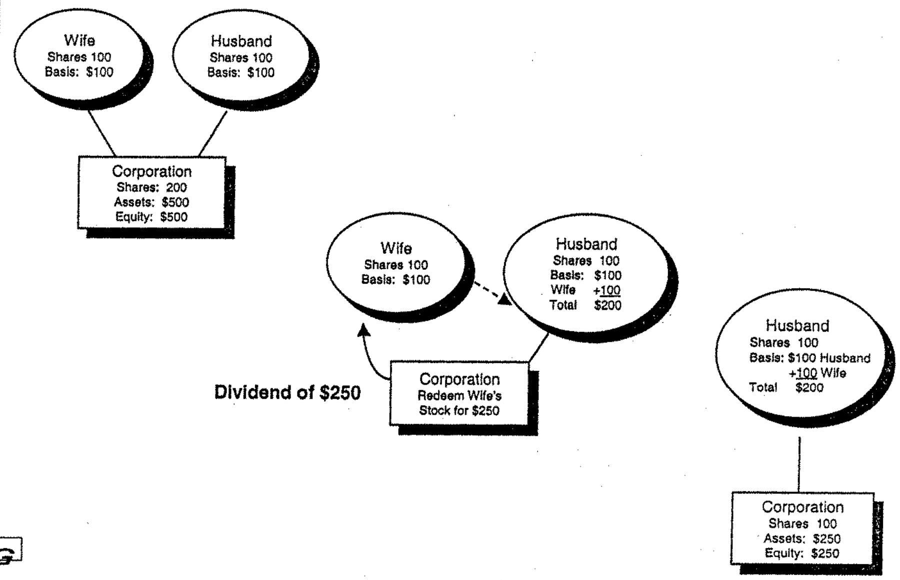
CATs1105.PPT

Summary Comparison -- Net Tax Benefit of the Foreign Leveraged Investment Strategy

Description	Outright Sale	Sale with the Strategy
Gross Sale Proceeds of Property	$10,000,000	$10,000,000
Less: Cost Basis of Property Sold	0	0
Net Capital Gain	$10,000,000	$10,000,000
Less: Capital Gains Tax Cost	$<2,450,000>	
Strategy Transaction Cost (Net of Tax)	0	$ 0 <528,500>
Net Proceeds from Sale of Property	$ 7,550,000	$ 9,471,500
Dollar Increase by Using the Strategy		$1,921,500
Percentage Increase by Using the Strategy		25.45%

Assumptions:
*The effective capital gains tax rate is 24.5 percent, which is based on Federal and State capital gain tax rates of 20 percent and 6 percent, respectively.
*The transaction cost for implementing the Strategy is 7 percent of the net capital gain exposure.

Husband, Wife & Corporation



KPMG The Global Leader

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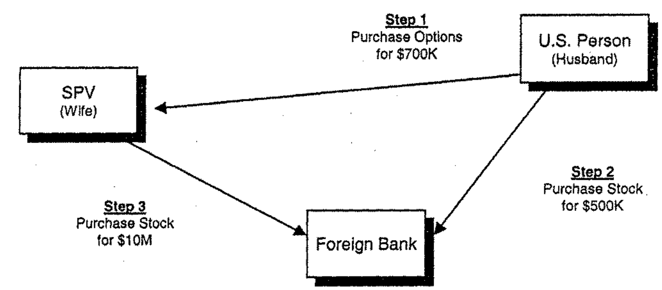
Proprietary Material
Confidentiality Requested

Day 1



GOAL - $10M Capital Loss

Step 1. U.S. Person purchases options for 90% of SPV for $700K (Cost 7.0% of $10M)
Step 2. U.S. Person purchases Foreign Bank shares for $500K (cost 5% of $10M)
Step 3. SPV purchases $10M shares of Foreign Bank

KPMG The Global Leader

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Proprietary Material
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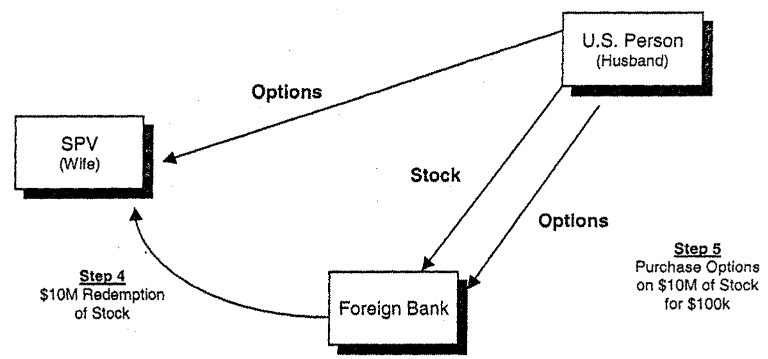
Day 46



Step 4. Foreign Bank redeems shares held by SPV for $10M (assumes no market fluctuation)
Step 5. Simultaneous with Step 4, U.S. Person purchases out of the money call options to acquire $10M shares of Foreign Bank for $100K (cost 1% of $10M)

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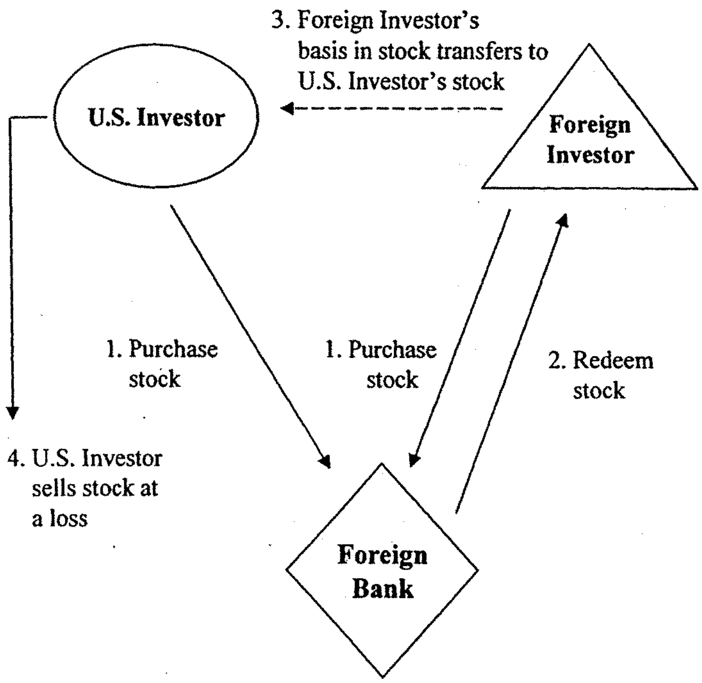
on Investigations

KPMG 0024499

KPMG 0024500

KPMG 0024501

Offshore Portfolio Investment Strategy

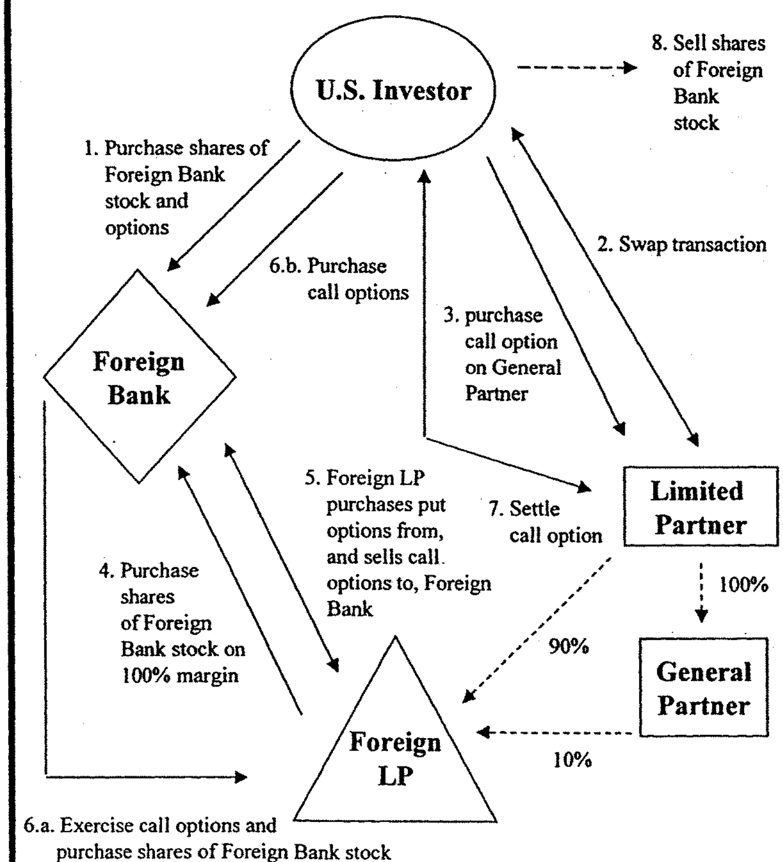


Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #94ccc

KPMG 0009454

Offshore Portfolio Investment Strategy



Offshore Portfolio Investment Strategy

- Description of OPIS:
  - A highly leveraged investment strategy whereby a U.S. investor invests directly and indirectly in the stock of a foreign bank.
  - The investment strategy requires participation by five parties -- a U.S. Investor (USI), a foreign limited partnership (FLP) owned by a foreign individual (FI) and a foreign corporation (FC), and a foreign bank (FB) -- and involves the following steps:
    - Investor purchases shares of stock in FB.
    - Investor enters into a swap transaction with a FI whereby Investor pays FI an up-front fee and FI agrees to pay Investor an amount equal to 90% of any distributions on FI's FLP interest and 90% of the appreciation thereon during swap term.
    - Investor purchases a call option from FI to acquire 90% of FI's interest in FC.
    - FLP purchases shares of FB on 100% margin.
    - FLP purchases put options from FB on 100% of its FB stock.
    - FLP sells call options to FB on 90% of its FB stock.
    - FB exercises its call options and purchases FB shares from FLP.
    - Investor purchases call options from FB equal to the number of shares FB redeems from FLP.
    - Investor sells call options back to FLP or lets them expire.
    - Investor sells shares of FB stock.

Offshore Portfolio Investment Strategy (cont.)

- Benefits of OPIS:
  - Enables U.S. investor to maximize leverage in stock of a foreign bank and thereby potentially increase investment return.
  - Maximizes U.S. investor's basis in foreign bank stock and thereby minimizes gain, or maximizes loss, on the disposition of such stock.

PRIVATE

Dear

Enclosed is a copy of our engagement letter for the Quadra transaction. As it says, we will provide you with a tax opinion as to the tax consequences of your participation in the Strategy. Brown & Wood will also provide you with a legal opinion as to the tax consequences. The funds to pay both our fee and their fee will come from settlement of the swap transaction.

I look forward to working on this transaction with you.

Very truly yours,

KPMG LLP

Partner

Permanent Subcommittee on Investigations
EXHIBIT #94ddd

PRIVATE & CONFIDENTIAL

Dear

The purpose of this letter is to define the role of KPMG LLP ("KPMG") in the proposed participation of ____________________ ("Client") in an investment strategy (the "Strategy") and to confirm our understanding of the terms of our engagement to assist you as a tax advisor in connection with your participation in the Strategy. The background for your participation in the Strategy and the role of KPMG is as follows.

Background

KPMG understands that Client intends to engage Quadra Custom Strategies LLC (Quadra), a registered investment advisor, to provide Client with investment advisory services and trading strategies designed to permit Client to acquire both directly, and indirectly, a position in the shares of a foreign financial institution to be selected by Client from alternative investee financial institutions offered by Quadra.

KPMG understands that Quadra will facilitate the purchase of shares and options in a foreign financial institution. The purchase of the foreign financial institution shares and options will involve full economic risk to Client in the stock market movement (up or down) of the foreign financial institution securities. Client may realize either profits or losses based upon the movement of the foreign financial institution shares. No one has provided Client with any assurances or guarantees that they will make money in any of these transactions. Client is at all times subject to market risks for both reward and loss. We recommend that Client seek independent advice concerning the investment aspects of the proposed transactions. Client acknowledges that he understands that he must have a reasonable expectation of achieving a reasonable profit from the Strategy (separate and apart from any tax benefits realized) and that Client has received such investment advice concerning the Strategy (from Quadra and/or other qualified investment advisors).

Client intends to enter into a total return swap agreement with respect to an offshore investment company in connection with the Strategy.

KPMG's Role as Tax Advisor

Pursuant to this engagement, KPMG will provide only the following services with respect to your participation in the Investment Program:

- Meet with you to discuss the U.S. federal income tax implications associated with participating in the Investment Program.
- Provide Client with an opinion letter that addresses the U.S. federal income tax consequences associated with participation in the Investment Program based upon your unique facts and circumstances.

The conclusions in our opinion letter will be based on the facts, representations and assumptions that you and Quadra submit to us and we will not independently gather, verify, audit or investigate the accuracy or completeness of this information. Inaccuracy or incompleteness of the information provided to us could have a material effect on our conclusions. In rendering our advice, we will consider the applicable provisions of the Internal Revenue Code of 1986, as amended, the regulations thereunder, and judicial and administrative interpretations thereof, all as in effect as of the date of the opinion letter. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect the nature or validity of our advice. Unless you specifically engage us to do so in writing, we will not update our advice for subsequent changes or modifications to the law and regulations, or to the judicial and administrative interpretations thereof.

Client acknowledges that any tax opinion issued by KPMG would not guarantee tax results, but would provide that with respect to the tax consequences described in the opinion, there is a greater than 50 percent likelihood (i.e., it is "more likely than not") that those consequences will be upheld if challenged by the Internal Revenue Service. Client further acknowledges that the Investment Program is aggressive in nature and that the Internal Revenue Service might challenge the intended results of the Investment Program and could prevail under any of various tax authorities. Client also acknowledges receipt of a memorandum that discusses certain penalties that might be asserted by the Internal Revenue Service should it challenge any tax deductions or tax losses that might be claimed by Client with respect to participation in the Investment Program.

Client recognizes that KPMG is not a registered broker-dealer and will not be providing services to Client as a broker-dealer or investment advisor. In the course of this engagement, all services provided by KPMG will be strictly as a tax advisor to Client and KPMG will not undertake any activity that would require registration as a broker-dealer or investment advisor under the federal securities laws.

Federal Confidential Communications Privilege

A confidentiality privilege under Internal Revenue Code Section 7525 may pertain to certain communications between KPMG personnel and Client regarding federal tax advice provided pursuant to this engagement. By retaining KPMG, you agree that KPMG is instructed to claim the privilege on your behalf, with respect to any applicable communications, up and until such time as you may waive any such privilege in writing. As disclosure of any such confidential communications to the Internal Revenue Service or other third party may cause any confidentiality privilege to be waived, you should notify us if the Internal Revenue Service or other third party requests information about any tax advice or tax advice documents provided by us.

Client understands that KPMG makes no representation, warranty or promise, and offers no opinion with respect to the applicability of such confidentiality privilege to any communication and agrees to hold KPMG harmless should the privilege be determined not to apply to any or all communications. Client agrees to indemnify KPMG for any attorneys' fees and other costs and expenses incurred by KPMG in defending the confidential communications privilege on Client's behalf.

Professional Fees

Our fees for this engagement will be based on the complexity of the issues and the value of the services provided, rather than directly on the time required of the individuals who will be performing the services. Client agrees to pay KPMG a fixed fee of ______________for the services described above. Client agrees, by accepting the terms of this letter, to pay all invoices to KPMG within 30 days of receipt.

The amount of our fee is not dependent on the amount of Client's investment in the Investment Program, the investment results of the Investment Program, the tax opinion expressed, or on the amount of any tax savings projected or achieved by Client. You agree that all written or oral advice provided by KPMG to Client, including but not limited to the tax opinion, will be for Client's information and use only and will not be provided to any third party without the express advance written permission of KPMG.

Limitation on Liability and Indemnification

By signing this engagement letter, Client agrees to indemnify KPMG and its affiliates, partners, principals, and personnel (collectively, the " Indemnified Parties") from and against any and all losses, claims, damages, and liabilities, including reasonable attorney's fees and other expenses or costs of litigation (collectively, "Damages"), arising out of or relating to this engagement letter and KPMG's services hereunder (including claims by third parties), except to the extent caused by the gross negligence or intentional misconduct of KPMG.

In the event any Indemnified Party is requested pursuant to subpoena or other legal process to produce documents relating to this engagement in judicial or administrative proceedings to which such Indemnified Party is not a party, Client shall reimburse the Indemnified Party at standard billing rates for the Indemnified Party's professional time and expenses, including reasonable attorney's fees, incurred in responding to such requests.

KPMG shall have no liability to Client, under any circumstances, for any special, incidental or consequential damages, including without limitation loss of profits, even if KPMG has been advised of the possibility of such damages.

KPMG's maximum aggregate liability to Client, whether a claim be in contract, tort, or otherwise, for all claims arising out of or relating to this engagement letter or any services rendered under this letter, shall be limited to fifty thousand dollars ($50,000).

Client will not directly or indirectly refer to KPMG or any of its affiliates in any printed, audiovisual, on-line or other advertising or promotional material prepared or distributed by or for you without KPMG's specific advance review and prior written approval. The provisions of this paragraph shall survive the expiration of this Agreement.

All of the provisions of this Section, entitled Limitation on Liability and Indemnification, shall survive indefinitely any termination or expiration of this Agreement.

In the event that any term or provision of this Agreement shall be held to be invalid, void, or unenforceable, then the remainder of this Agreement shall not be affected, impaired or invalidated, and each such term and provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

This Agreement is to be construed in accordance with the laws of the state of New York.

Please sign the enclosed copy of this letter to confirm your agreement with all of the terms expressed in this engagement letter and return it to us within ten days. If you have any questions, please call me.

Very truly yours,

KPMG LLP

Enclosure

ACCEPTED:

____________________________ ________________
Signature Date

Memorandum

To: Larry DeLap

CC: Jeffrey A. Eischeid; Randy Bickham

From: Tracie Henderson

Date: 5/7/2003

Re: Domesticated OPIS

Larry:

A domesticated version of OPIS has been proposed, which takes into account, and avoids the effect of, the proposed legislation amending Section 1059 and imposing a tax on "tax indifferent" parties. Following is a brief description of the domesticated version, with an analysis of the effect of the proposed legislation.

Structure

An S corporation wholly owned by its ESOP will participate in the OPIS transaction. The S corporation will make the same investment in Foreign Bank that the foreign limited partnership makes in the current OPIS structure, and the US investor and the S corporation will be treated as the related parties for purposes of Sections 302 and 318. Upon the redemption of the S corporation's position in Foreign Bank, its basis will shift to the US investor. In short, the S corporation will assume the foreign limited partnership's role in the OPIS transaction.

The proposed legislation would negatively affect the OPIS transaction, as currently structured, in two ways. First, Section 1059 would be amended so that there would be no basis shift upon the redemption of Foreign LP's stock in Foreign Bank. Second, the proposed legislation would impose a tax on certain "tax indifferent" parties, where an item of income is passed to such tax indifferent party. The legislation would impose a tax on such items of income, and make all participants in the transaction jointly and severally liable for the tax. The domesticated version of OPIS using an S corporation and an ESOP would avoid the impact of the proposed legislation, as described below.

Section 1059

Section 1059 currently requires a corporate shareholder holding stock to reduce the basis of the stock by the nontaxed portion of any extraordinary dividend it receives with respect to such stock. The nontaxed portion of the dividend effectively equals the amount of the dividend that is offset by the dividends received deduction. A dividend resulting from a non pro rata redemption or a liquidation is an extraordinary dividend, as is a dividend resulting from a redemption that is treated as a dividend due to options being treated as the equivalent of stock ownership.

The proposed legislation would amend Section 1059 to provide that the amount of the nontaxable portion of an extraordinary dividend also includes the amount of the dividend that is not subject to U.S. tax. The proposed legislation would contain rules to determine the amount of the dividend not subject to U.S. tax where a treaty reduces the tax otherwise payable on the dividend, and will provide similar rules for foreign entities that are not corporations.

From the explanation of the proposed legislation, the meaning of "not subject to U.S. tax" is not entirely clear; for example, ESOP income is not *currently* subject to U.S. tax. However, it is clear that the legislation is aimed at basis attribution from foreign shareholders, and not domestic shareholders. The explanation of the reasons for the change states: "Similar transactions involving dividends to *domestic* shareholders were addressed by amendments to section 1059 in the Taxpayer Relief Act of 1997." Furthermore, the title of the proposal, "Prevent Capital Gains Avoidance Through Basis Shift Transactions Involving Foreign Shareholders," indicates its scope will be limited to basis shifts using foreign shareholders. Thus, the legislation, as enacted, likely will not affect basis shifting transactions among domestic shareholders, including the proposed version of the "domesticated" OPIS.

Tax-Indifferent Parties

The proposed legislation attempts to close corporate tax shelters which involve a timing mismatch or separation of income or gains from losses or deductions that is exploited through the use of tax indifferent parties. The legislation would provide that any income allocable to a tax indifferent party with respect to a corporate tax shelter is taxable to such party. The tax on the income allocable to the tax indifferent party would be determined without regard to any statutory, regulatory, or treaty exclusion or exception. All other participants of the corporate tax shelter (i.e., any participant other than the tax indifferent party in question) would be jointly and severally liable for the tax.

A tax indifferent party would be defined as a foreign person, a Native American tribal organization, a tax-exempt organization, and domestic corporations with expiring loss or credit carryforwards. Thus, the ESOP, as a tax-exempt organization, may be classified as a tax indifferent party (however, as described below, a provision in the proposed legislation may treat an ESOP of an S corporation as a taxable organization). However, the tax on tax indifferent parties only applies if the income is allocable to such party with respect to a "corporate tax shelter." The term "corporate tax shelter" would be defined as "any entity, plan, or arrangement (to be determined based on all facts and circumstances) in which a direct or indirect corporate participant attempts to obtain a tax benefit in a tax avoidance transaction." A tax benefit would be defined to include a reduction, exclusion, avoidance, or deferral of tax, or an increase in a refund, but would not include a tax benefit clearly contemplated by the applicable provision (taking into account the Congressional purpose for such provision and the interaction of such provision with other provisions of the Code). In the domesticated version of OPIS (as well as the prior version), no direct or indirect corporate participant obtains a tax benefit; rather, the beneficiaries of the basis shift are individuals. Accordingly, the tax on tax indifferent parties should not apply to the OPIS transaction.

Modification of ESOP rules

The proposed legislation would modify the treatment of S corporation's ESOP's. This proposal may offer additional support for the position that the tax indifferent party rule described above is inapplicable to the domesticated version of OPIS. The proposal would reinstate the pre-1997 rule, which provided that income of an S corporation that flowed through to its ESOP (or gain on the sale of S corporation shares by the ESOP) was treated as unrelated business income and subject to tax at the ESOP level. The proposal would be effective for taxable years beginning on or after the date of first committee action.

Since an S corporation's ESOP will be subject to taxation on the S corporation's income, it is arguable that the ESOP of an S corporation is no longer a tax exempt organization, and thus not enumerated in the list of "tax indifferent parties" above. As stated above, the tax indifferent party rule should not apply to an *individual* who obtains a tax benefit; the proposed modification of the ESOP rules provide an additional argument that the tax indifferent party rules are inapplicable, if, for example, the enacted legislation goes further than the proposal, and includes individual as well as corporate tax shelters within its reach.

ESOP structure

Representations have been obtained from Moore & Van Allen, PLLC, and will be reviewed by Gary Cvach, that the ESOP structure is valid. The validity of the ESOP will thus not be an issue in the opinion letter.

NM2- [illegible] 001

From: Chris Donegan <don>
Date: Mon, 21 Jul 97 16:57:36 +0100
To: ramy
Subject: Quadra : UBS Trades - background
cc: wolfgang, ruwan, ronny@gednyc

Ramy,

FYI,

Ronny (and Stainbrook) are 100% on top of the risk issues associated with this business (and we have recently have a large number of conversations about how to manage this and reduce it).

However, thus far Wolfgang and I have not had an explicit conversation with you re: the overall structure and purpose of the trade. This e-mail addresses this (for your benefit).

<u>Basic Premise : Creating Capital Losses For a US Person</u>

- **A US person is taxed on the basis of beneficial ownership of assets.**
- **Under certain circumstances, the basis of ownership is maintained for tax purposes but not economically.**

A simple example of this is where a US person holds a bond and swaps away the coupons.

Under this scenario the bond (as a taxable asset) falls in value (i.e. value minus coupons) and a capital loss is allowed. However the US Person still benefits ecomically from the swap and so the losses are not real but only tax relevant.

The "UBS Trade" uses provisions in the US Tax Code to create a synthetic tax loss via a trading strategy in UBS shares.

<u>Legal / Tax Risk to UBS</u> : minimal as UBS has no direct role. Investor nakes his decision based on *"should do"* legal opinion and his own counsel. Clients are high quality (Ron Perlmann, Carl Icon, Ezra Zilke, etc.) and smart. UBS makes no recommendation or solicitation. UBS New York Private banking is now referring clients to Quadra based on our last trip.

<u>Legal Opinions</u> : Brown and Wood, KPMG (Staddon has revewied), Skadden Arps (Perlmanns guys have hired them and they have not finalised yet but are positive).

<u>P&L : 2.5 - 3%</u>

<u>Business To Date : Approx $20m P&L</u>

Wolfgang and I will be happy to provide further explanation if you require after reading the below.

<u>Trade Mechanics</u>

A US person ("Investor") buys a call warrant in an offshore company ("SPV") which entitles the holder to 80% of the company's assets. This creates a shared tax base between the SPV and Investor.

The SPV invests in UBS stock (via a stock purchase with delayed settlement). The Investor is therefore deemed

1) Users 5/Don/Mailboxes/Outgoing.mbox/Re: Provinzial : 10yr swap on a basket of SE Asian single [illegible]

to have beneficial ownership of the UBS stock.

The SPV also invests in a call/put arrangement with UBS on the UBS stock. The reason for this is to hedge the SPV's economic exposure to the shares whilst creating a good chance for the SPV to make money. (This is the most complex component of the trade from a risk perspective.)

Exercise of the put option between UBS and the SPV is treated for US tax purposes as a *redemption* of stock. The redemption proceeds are deemed to be a dividend from UBS. This dividend is taxable as income. (actually there are no net proceeds as the SPV borrowed cash to buy the shares, so the only real financial transaction here is financing).

Similtaneous with the redemption; the US person buys a call option on UBS stock. The call option is for a number of shares equal to the number of shares redeemed. This has the effect of creating the impression that the number of shares owned (or attributed to) the investor remains constant throughout the trade.

At maturity the investor sells their call option and realises a loss this net loss is offsetable against capital gains.

Numerical Example (tax calculation)

Theoretical Cost of shares to SPV - $100
SPV Redemption dividend - $100 (taxable income)
Value of shares on sale/termination of call option - zero
Capital Loss Arising - $100

Other Details

The customer posts collateral to cover the marginal credit risk on the synthetic forward. This is because the put/call is struck out of the money and carries market risk. This is essential for the tax treatment to succeed.

The customer however is "guaranteed" not to lose on this risk position in a seperate arrangement with Quadra - who have put their fee up as part of the collateral. To ensure that Quadra can deliver on their guarantee Quadra, as a seperate trade, have entered into a put/call transaction to cover the market risk their customers have on the UBS share price. This obviously costs them, but is better than taking the risk on losing their fee.

Don

13 NOV 2003 15:29 FROM UBS TO 900121226954?? P.02/03

009

AEF 14/

SBC Warburg Dillon Read

Swiss Bank Corporation
1 Finsbury Avenue
London EC2M 2PP
Tel: 44 171 567 8000
Fax: 44 171 458 4237

FAX COVER SHEET
Equity Risk Management Product Group

DATE:	16 June 1998
FAX TO:	Karen Lancaster / Kit Thompson
FAX NO:	74076
FROM:	Chris Donegan / John Staddon
PAGES:	

Account Opening Forms

Please see attached numerous New Customer Account Forms (seven in all) which we have completed to the fullest applicable extent. Bob Scanlon is aware of and has approved the forthcoming transactions which will be traded with each of these entities and a short description of their role is given in the note attached to each form. Please note that our section head, Wolfgang Stolz, is out of the office until Thursday and so we have been unable to get his signature. We will of course provide you with this as soon as Wolfgang we are able to get him to sign. He is however fully aware of the transactions - as Bob Scanlon will testify.

Regards

John Staddon

Chris Donegan / John Staddon

Received Nov-13-03 08:57am From-+44 20 7568 8234 To-02 Cahill Gordon & R Page 002

Permanent Subcommittee on Investigations
EXHIBIT #94ggg

13 NOV 2003 15:29 FROM UBS

26 JUL '98 13:06 FROM SBC W D R CRM TO 5566d505

** TOTAL PAGE.08 **

AEF 14 / 07

Explanatory Note:

This entity is a Cayman Islands company that has been specifically and exclusively set up for the purpose of a series of transactions that feature in a structure (referred to as "Redemption Trade") for which non-vanilla approval was given by Bob Scanlon on 1 June 1998. Its role is limited to buying SBC shares for delayed settlement, purchasing puts on SBC shares and selling calls on SBC shares. The maximum call exposure is fully cash collateralised. No further transactions will be entered into by the company.

The company is administered by Queensgate Bank & Trust Company in the Cayman Islands. The directors of the company are employees of Queensgate.

The company has appointed QA Investments, LLC as its investment adviser. QA Investments is a member of the Quadra Group and is an SEC registered investment adviser and CFTC registered Commodity Pool Operator. The Quadra Group has worked closely with UBS for over five years and has been the subject of numerous due diligence exercises, most recently by UBS Credit (Patrick Hoban). John Hogan (NY SBC Credit) has commenced a similar exercise.

All investment decisions of the company will be taken by QA Investments LLC and the company may not undertake any additional investment activity without its involvement. QA Investments LLC covenants with SBC not to permit the company to engage in any activity other than expressly contemplated by the Redemption Trade.

For further information contact Chris Donegan (81927), John Staddon (81947) or Sundar Palavapam (86779)

** TOTAL PAGE.03 **

Received Nov-13-03 08:57am From-+44 20 7568 8234 To-02 Cahill Gordon & R Page 003

Unknown

From: Liston, Shannon L
Sent: Wednesday, February 10, 1999 1:32 PM
To: Zysik, Jeffrey C
Cc: Ammerman, Douglas K; Bickham, Randall S; Watson, Mark T; Eischeid, Jeffrey A
Subject: RE: BLIPS

Jeff, attached is a powerpoint illustration and summary. It has been reviewed by Randy and should give you the info you need. Since Jeff E. is traveling today, he has not gotten to take a look at it, but we can incorporate his comments promptly. Feel free to call with questions or comments. I saved the powerpoint in both ppt97 and ppt 4.0.

Thanks.

BLIPS Summary rsb.doc   BLIPS Picture ppt97.ppt   BLIPS Picture ppt4.ppt

-----Original Message-----
From: Zysik, Jeffrey C
Sent: Wednesday, February 10, 1999 6:33 AM
To: Eischeid, Jeffrey A; Watson, Mark T
Cc: Ammerman, Douglas K; Bickham, Randall S; Liston, Shannon L
Subject: RE: BLIPS

Jeff,

Has the team created a power point presentation illustrating BLIPS? Also, do you have a summary (a 1 - 5 pager) that walks you through (1) the economics/business case of/for the deal and (2) highlights the code secs/judicial doctrines applicable to BLIPS. DPP has stated that these two tools will vastly improve their turn around time. In addition, the functional areas within WNT find it much easier to review a proforma opinion letter if they have these documents in addition to a proforma opinion letter because it cuts down on time otherwise spent simply figuring out what is happening in the transaction - something often very difficult figure when what you are working from is an opinion letter only.

Thanks,

Jeff

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Tuesday, February 09, 1999 5:11 PM
To: Watson, Mark T; Zysik, Jeffrey C
Cc: Ammerman, Douglas K; Bickham, Randall S; Liston, Shannon L
Subject: BLIPS
Importance: High

At long last, here is the draft more-likely-than-not opinion on "BLIPS". As you know, we hope to market it soon as a replacement for OPIS. Fortunately, it appears the product is relatively unscathed by the current Budget proposals.

I'd suggest we try to put together a conference call to review the basic structure, perceived technical issues, layout of the opinion, etc. It should make the review process a lot easier. When are you guys available (Mark & Jeff)? Let me know and I'll set it up. Thanks for all your help!!

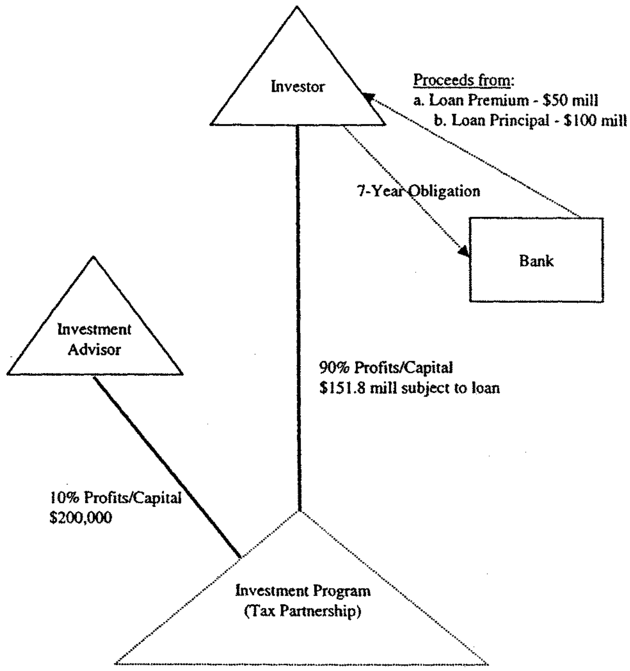
Jeff

<< File: blips dpp 2.9.doc >>

Permanent Subcommittee on Investigations
EXHIBIT #95a

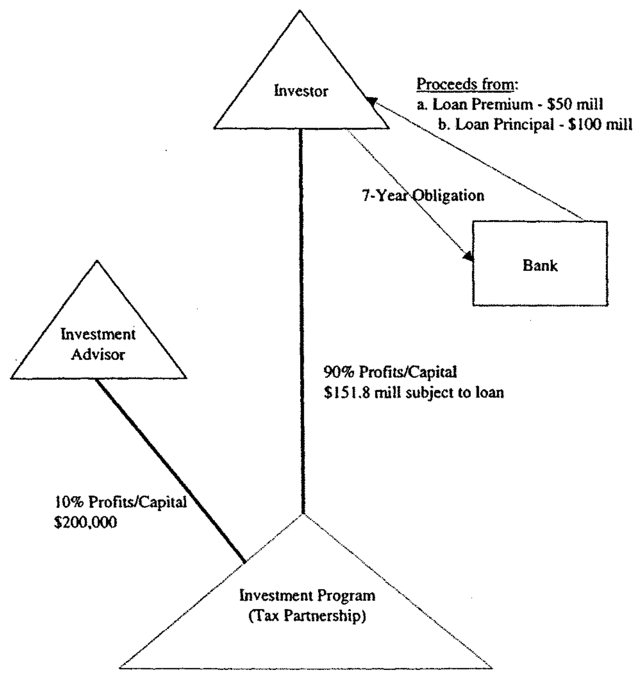
P.S. I'll send you separately an investment package (assembled by Presidio and Sentinel) as well as a letter from Brown & Wood confirming their concurrence with the more-likely-than-not conclusions in our draft opinion.

BLIPS



•Partnership terminated at end of Stage 1 of Investment Program
•Bank repaid and Partnership assets distributed

BLIPS



- Partnership terminated at end of Stage 1 of Investment Program
- Bank repaid and Partnership assets distributed

BLIPS

Overview

BLIPS refers to an Investment Program designed and managed by Investment Advisor that is entered into by Investor, a single member LLC. The objective of the Investment Program is to generate significant investment returns through participation in short-term and long-term profit opportunities arising in emerging markets currencies. The underlying investments will be made in foreign currencies and foreign currency-based options and derivative contracts.

The Investment Program is structured through a Partnership in which Investor is a 90% limited partner and Investment Advisor is a 10% general partner. The primary source of Investor's funding of its participation in Investment Program is through cash from a nonrecourse loan. Investor has opted to pay an above market rate of interest on the borrowing and, as a consequence, a loan premium is created for financial accounting and OID purposes.

The Investment Program is executed in three distinct phases. Each successive phase allows for greater investment return potential with corresponding levels of incremental financial risk. Participation in successive phases is at Investor's option. Should Investor opt not to proceed to the next phase, the Partnership Agreement allows either party to buy-out the other partner's interest at fair market value or, alternatively, for liquidation of Partnership.

Proposed Transaction and Assumed Facts for Purposes of the Review

- Investor is a single-member Delaware LLC formed by Individual.
- Investor borrows $100 million from Bank on a nonrecourse basis. The loan is structured as a 7-year note with interest payable quarterly at an annual rate of 15.85 percent, and the principal due at the end of the note term. Because the stated interest rate of the debt exceeds market rates, Investor will receive a $50 million loan premium in addition to the $100 million loan proceeds.
- Investor enters into a fixed-for-floating interest rate swap for a term of approximately seven years.
- Investor contributes $151.8 million cash subject to the $100 million loan to Partnership in exchange for a 90 percent limited partnership interest. Investment Advisor contributes cash for a 10 percent general partnership interest.
- At the end of Stage I of Investment Program, Investor opts not to proceed to Stage II. The partners elect to terminate Partnership. Partnership repays its $100 million debt

and makes liquidating distributions of the Partnership assets. Investment Advisor receives cash, and Investor receives cash and financial instruments.

- Investor subsequently sells the financial instruments.

Anticipated Tax Consequences

- Investor will recognize no gain or loss on receipt of the loan proceeds and loan premium.
- Investor will recognize no gain or loss on its cash contribution subject to the loan to Partnership.
- The $50 million loan premium will not constitute a Code Section 752 liability.
- Upon termination of Partnership and repayment of loan, Investor's adjusted basis in its Partnership interest will equal $51.8 million, plus or minus its allocable share of Partnership income or loss.
- Investor's basis in the financial instruments received upon termination of Partnership will equal $51.8 million, plus or minus its allocable share of Partnership income or loss, less the actual cash received by Investor.
- Investor will recognize no gain on the liquidating distribution because Investor's adjusted basis in its Partnership interest exceeds the cash distributed.
- Investor's "at risk" amount for Code Section 465 purposes will also be $51.8 million, plus or minus its allocable share of Partnership income.
- The Code Section 469 passive loss rules will not apply.
- The anti-abuse rules under Code Sections 163, 1271 through 1275, and 701-777 will not apply to the proposed transaction.

Summary

The Code Section 752 provisions do not require application of the OID rules. Consequently for Code Section 752 purposes, Investor will be deemed to contribute cash of $151.8 to Partnership subject to a $100 million loan. The resulting $51.8 in outside basis upon repayment of the loan provides a permanent tax deferral to Investor that is recognized when Investor sells the enhanced-basis financial instruments received as a Partnership liquidating distribution. Thus, Investor's outside basis in the partnership interest from the loan premium is maintained when Partnership is terminated early.

The base assumption is that Partnership will elect capital treatment under the Code Section 988 regulations for the foreign currency contracts entered into. As a second base alternative, Partnership will not elect capital treatment and, as a result, the subsequent disposition of the financial instruments by Investor will result in ordinary income or loss treatment.

Applicable Code Sections and Judicial Doctrines

- Subchapter K
- Original Issue Discount: Code Sections 1271-1275
- At-risk rules: Code Section 465
- Passive activity losses: Code Section 469
- Accuracy related penalties: Code Section 6662
- Anti-abuse rules under Treas. Reg. Section 1.1275-2(g) and 1.701-2
- Business Purpose/Economic Substance Doctrine
- Foreign currency transactions: Code Sections 985-988

Sequential

From: Smith, Richard H [rhsmith@KPMG.COM]
Sent: Monday, February 15, 1999 11:38 PM
To: Larkins, Richard G; Rosenthal, Steven M; Madden, Lisa A.; DeLap, Larry; Elgin, Evelyn; Watson, Mark T; Springer, Mark A; Zysik, Jeffrey C; Eischeid, Jeffrey A; Sams, James K; Bickham, Randall S; Liston, Shannon L
Subject: RE:

Based on the summaries, DB (or an affiliate) holds all assets of the partnership as collateral for the note, and DB clears all the trades (I think I even remember that DB must approve of the trading activity that occurs). It does not make sense if the PS assets (i.e., cash and currency positions) are unemcumbered.

With regard to the swap, I noticed that the summaries and the opinion were not consistent in this regard. In the summaries, the PS entered the swap. In the opinion, the Investor entered into the swap. If the Investor enters the swap, PS needs to assume all rights and obligatins to make it work economically.

> -----Original Message-----
> From: Larkins, Richard G
> Sent: Monday, February 15, 1999 7:43 PM
> To: Smith, Richard H; Rosenthal, Steven M; Kelloway, Lisa A; DeLap,
> Larry; Elgin, Evelyn; Watson, Mark T; Springer, Mark A; Zysik, Jeffrey C;
> Eischeid, Jeffrey A; Sams, James K; Bickham, Randall S; Liston, Shannon L
> Subject:
>
> All:
>
> Steve Rosenthal and I spoke on Sunday about several of the issues on which
> we are being asked to opine with respect to the BLIPS transaction. In
> connection with our initial consideration of these issues, a couple of
> questions arose. First, when the Partnership assumes the Investor's
> obligations under the nonrecourse debt, what happens to the collateral
> securing the debt? Is the collateral also transferred to the Partnership?
> If not, once the Partnership assumes the Investor's obligations under the
> nonrecourse debt, what property is securing the obligation? The concern
> is whether a significant modification is triggered under Reg. sec.
> 1.1001-3(e)(4)(iv)(B), which provides that a significant modification may
> occur if the collateral is substantially altered unless such collateral is
> fungible (e.g., Treasury securities). If there is a significant
> modification, the issue price of the modified debt would likely be $100
> million rather than $150 million. If the debt becomes recourse in nature
> upon the assumption by the Partnership, this too may be a significant
> modification. See Reg. sec. 1.1001-3(e)(5)(ii).
>
> Second, according to the facts, the Investor entered into an interest rate
> swap with DB on January 2, 1999. What happened to the Investor's rights
> and obligations under this swap when the Investor's obligations under the
> debt, which the swap was entered into to hedge, were assumed by the
> Partnership? Were the Investor's rights and obligations under the
> interest rate swap assumed by the Partnership also?
>
> Steve and I will pass along more questions as they arise throughout the
> course of our review.
>
> Richard

Permanent Subcommittee on Investigations
EXHIBIT #95b

Robinson, Karen

From: DeLap, Larry
Sent: Tuesday, February 16, 1999 6:56 PM
To: Robinson, Karen
Subject: FW: BLIPS

Fax to RLD

-----Original Message-----
From: Smith, Richard H
Sent: Monday, February 15, 1999 1:35 PM
To: Zysik, Jeffrey C; Elgin, Evelyn; Sams, James K; DeLap, Larry; Kelloway, Lisa A; Springer, Mark A; Watson, Mark T; Larkins, Richard G; Rosenthal, Steven M
Subject: RE: BLIPS

I have a number of technical issues concerning the transaction but let me focus us on just one at this point. Assuming that there is no section 752 liability associated with the $50M of cash that represents bond premium, when the Partnership prepays the loan and pays a $50 million prepayment penalty, is the prepayment penalty a section 705(a)(2)(B) item (i.e., a nondeductible, noncapitalizable expense of the partnership) that reduces the basis in the partnership interest by $50 million. If so and assuming that the rest of the analysis is on the money, the tax benefits outlined do not exist because the Investor's basis in the partnership interest is [1.8 million rather than 51.8M]. (As an aside, the opinion at page 12 and 13 refers to a liability coming into existence under 752(a) and an interest deduction under 163 as the liability for the bond premium matures -- if this same analysis applies for the prepayment to the bank, I want to know whether section 752(b) should apply when the liability is reduced as a result of the prepayment. If it does, again no $50M basis in the partnership interest exists for Investor.

Richard

-----Original Message-----
From: Zysik, Jeffrey C
Sent: Monday, February 15, 1999 10:42 AM
To: Evelyn Elgin; James Sams; Larry DeLap; Lisa Kelloway; Mark Springer; Mark Watson; Richard Larkins; Richard Smith; Steven Rosenthal
Subject: FW: BLIPS

FYI.

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Monday, February 15, 1999 10:27 AM
To: Zysik, Jeffrey C; DeLap, Larry; Elgin, Evelyn
Cc: Springer, Mark A; Watson, Mark T; Becker, Charles J; Bickham, Randall S
Subject: RE: BLIPS

See below for specific comments. Attached is Shannon Liston's PowerPoint summary-diagram of the strategy.

Jeff

<< File: BLIPS Picture ppt4.ppt >>

-----Original Message-----
From: Zysik, Jeffrey C
Sent: Thursday, February 11, 1999 7:03 PM
To: DeLap, Larry; Elgin, Evelyn
Cc: Springer, Mark A; Eischeid, Jeffrey A; Watson, Mark T; Becker, Charles J; Bickham, Randall S
Subject: RE: BLIPS

Larry,

I can't since I have had no involvement with the technical aspects or structuring of the transaction. However, by this message I am requesting that Jeff Eischeid/Randy Bickham answer your requests/questions, below.

Thanks,

Jeff

-----Original Message-----
From: DeLap, Larry
Sent: Thursday, February 11, 1999 6:44 PM
To: Zysik, Jeffrey C; Elgin, Evelyn
Cc: Springer, Mark A; Eischeid, Jeffrey A; Watson, Mark T; Becker, Charles J
Subject: RE: BLIPS

Jeff -

Can you prepare a summary or chart of the transactions. Apparently, the investor ends up with a lot higher basis in the distributed financial instruments than their value, but the flow of cash is not immediately clear to me.

In the second bullet of the overview memorandum, the investors "borrows" $100 million, but actually receives $150 million in cash, which gets invested in the partnership, with the partnership assuming the liability.

In the fifth bullet, the partnership repays the $100 million loan to the bank.

As the $50 million "premium" contemplated a seven year term, but the loan has been paid off within a few months, it would appear the bank has been screwed out of about $50 million, but I can't believe that will happen. Where does the extra $50 million go in between the second and fifth bullets. When the $100 million loan is paid-off early, the partnership will be required to pay a prepayment penalty that will make the bank whole. The prepayment penalty, conceptually, should be approximately equal to the unamortized balance of the loan premium.

The opinion letter contains an "overview of investment strategy" that appears to be *our* view. I think we should say something like "[Investment Advisor has provided the following overview of the investment strategy". Agree.

We may need an alliance form for Sentinel Advisors. That can take a while to complete and get approved. We should discuss. The language in the opinion is unclear. It is my understanding that Presidio has subcontracted a portion of the investment advisory function (the foreign currency trading strategy) with Sentinel. If that makes Sentinel an "alliance partner" with KPMG, I'll complete the paperwork and the related background checks.

The opinion letter refers to transactions with Deutsche Bank. If the transactions will always involve Deutsche Bank, we could have an independence issue. Has a financial institution and an investment bank that are not attest clients been lined up as potential participants that the investor could choose rather then Deutsche Bank or Deutsche Morgan Grenfell? (That is, will the investor be able to freely choose participants who are not attest clients of KPMG?) It is NOT contemplated that Deutsche Bank will be involved in all of the transactions. The investor will be able to freely choose a bank. I understand that RaboBank has been lined up as a potential participant.

It appears that GAAP is an important part of the overall plan. If so, the transaction will need to be reviewed by DPP-Assurance from an accounting standpoint, which could take a while. I'm not sure that GAAP is particularly important here. We do indicate that APB 21 defines and prescribes the treatment of loan discounts and premiums. It seems to be a useful analogy to the income tax treatment. I don't believe assurance clients will be adopting the strategy so it seems that the financial reporting aspects of the strategy will not be critical.

Larry

-----Original Message-----
From: Zysik, Jeffrey C
Sent: Thursday, February 11, 1999 6:02 PM
To: DeLap, Larry; Elgin, Evelyn
Cc: Springer, Mark A
Subject: BLIPS

Proprietary Material
Confidentiality Requested

KPMG 0008985

Eve and Larry,

2

Following are documents relating to a message you are both about to receive. While I realize neither of you volunteered, you both seem like the logical choice (you will understand when you see the attachment to my subsequent message). Please let me know if you delegate to someone else. Eve, I will drop hard copies of these materials at your office later tonight.

Thanks,

Jeff

<< File: blips dpp 2.9.doc >> << File: BLIPS Summary rsb.doc >> << File: BLIPS Picture ppt4.ppt >>

Unknown

From: Presidio Advisors [jlarson@presidioadv.com]
Sent: Thursday, February 18, 1999 9:33 AM
To: 'eischeid@kpmg.com'
Cc: 'rbickham@kpmg.com'
Subject: FW: Response to BLIPS questions

-----Original Message-----
From: Presidio Advisors [SMTP:jlarson@presidioadv.com]
. Thursday, February 18, 1999 9:01 AM
.o: 'rbickham@presidioadv.com'
Cc: 'amakov@msn.com'; 'rruble@brownwoodlaw.com'
Subject: Response to BLIPS questions

Randy-
I have responses to the questions posed by Richard Larkins and Richard Smith:

1. I confirm that the Investor's loan collateral is transferred to the Partnership. This collateral is all pledged by the Partnership to the lender. The cash transferred to the Partnership by the General Partner/Investment Advisor is also pledged to the lender.
2. Our current plan calls for the Investor LLC to draw down the fixed rate loan, hold the proceeds for at least 7 days, and then contribute the proceeds plus additional funds to the Partnership.
3. The fixed to floating swap will be entered into by the Partnership (not the Investor) at the time that the Partnership assumes the loan.

I will be travelling to New York later this morning, returning to SF Tuesday night. I will not have a lap top so if you need to reach me, leave a message or send a fax to the NY Palace.

Best Regards,

Permanent Subcommittee on Investigations
EXHIBIT #95d

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=4747
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=4747
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS meeting 2/19 - Notes
Sent: 1999-02-22 15:39:15.056
Date: 1999-02-22 15:39:16.507
X-Folder: BLIPS

I think another important issue people discussed at the meeting was whether we could issue an opinion based on a representation that we had doubts about. In particular, as I understand it, one of the representations (the ACM rep) is likely to be true only if the investor participates in more than the first phase of the investment program. This rep says:

"Investor independently reviewed the economics underlying the Investment Program and believed there was a reasonable opportunity to earn a reasonable pre-tax profit from each of the transactions described herein, in excess of all associated fees and costs and not including any tax benefits that may occur."

Although the opinion (under Description of Investment Transaction) says "[t]he original intent of the parties was to participate in all three investment stages of the Investment Program," there doesn't seem to be much in support of this original intent.

Eve

-----Original Message-----
From: Zysik, Jeffrey C
Sent: Saturday, February 20, 1999 1:15 PM
To: Evelyn Elgin; James Sams; Jeffrey Eischeid; Larry DeLap; Mark Springer; Mark Watson; Philip Wiesner; Randall Bickham; Richard Larkins; Richard Smith; Steven Rosenthal
Cc: Ammerman, Douglas K; Lanning, John T
Subject: BLIPS meeting 2/19 - Notes

Attached please find a summary of the BLIPS meeting held 2/19. The meeting summary sets forth critical issues that must be addressed before a final determination is possible that a viable product exists. As discussed in the summary, the key issue that must be resolved concerns sec. 705.

Please remember to mark your calanders for the next BLIPS meeting scheduled for 4:00 pm on Tuesday, 2/23 in the large conference room located on the 7th floor. A call in number will be distributed on Monday for those who cannot participate in person.

<< File: 02_19SUM.DOC >>

BLIPS Meeting
03/05/99
Agenda Appendix

Jeff,

This is to confirm our discussion yesterday afternoon.

With regard to the following issues, we believe that we can conclude in a manner that makes the BLIPs product technically viable on a "more-likely-than-not" basis:

- section 752
- section 705(a)(2)(B)
- section 465
- business purpose / economic substance / various anti-abuse rules

I have discussed these positions with Phil Wiesner. I have not had the opportunity to circle back with Jim Sams or Steve Rosenthal, but these conclusions take into account analyses they had set forth earlier. I will close this loop over the weekend.

To best position our clients, we believe that the transaction should be restructured slightly. We believe that the opinion letter should be redrafted to add, expand, and/or delete certain analyses. We also believe that we must craft the representations in a more focused manner.

We look forward to meeting with Randy Bickham next week to get the process underway of getting a completed opinion letter drafted.

Thanks,

Richard H. Smith

Permanent Subcommittee on Investigations
EXHIBIT #95f

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=5136
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=5136
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS Update
Sent: 1999-03-15 23:05:07.142
Date: 1999-03-15 23:05:08.756
X-Folder: BLIPS

This is a short status update on BLIPS. Please read the following message in its entirety, as it may impact the development team's decision to press forward:

At this time, it appears that each functional group within WNT has responded with the facts and circumstances necessary for a more-likely-than-not sign-off, and that Randy Bickham has been working with each group to resolve any open issues and redraft the opinion letter as necessary based upon each group's comments. It is also appears that Randy has been working with Phil Wiesner to restructure the transaction so that meets the economic substance and sham transaction concerns of WNT.

However, it has come to the TIC's attention that even if the transaction is restructure sufficiently to meet each functional area's concerns and the opinion letter is redrafted to incorporate the changes to the structure, DPP has determined unequivocally that BLIPS must be registered as a sec. 6111(c) tax shelter. As a result, the development team should consider if the strategy would be commercially viable before expending additional resources with respect to restructuring the transaction.

If you have any questions, please do not hesitate to contact me at (202)739-8659.

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=20483
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20483
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS business purpose for premium bond
Sent: 1999-03-23 20:25:00.906
Date: 1999-03-23 20:25:22.353
X-Folder: BLIPS

Phil:

Assume you have seen Steve's message. We are still working on the registration issue (hope for resolution today) and the ordinary vs. capital loss issue (again, hope for resolution today or tomorrow). As you have lead responsibility for the overall economic substance/ACM analysis, have you received everything you need to complete that analysis? Do you want another meeting of the core development team to discuss/conclude? Thanks,

Mark
202-467-3807

-----Original Message-----
From: Rosenthal, Steven M
Sent: Tuesday, March 23, 1999 3:00 PM
To: Springer, Mark A
Subject: FW: BLIPS business purpose for premium bond

-----Original Message-----
From: Rosenthal, Steven M
Sent: Monday, March 22, 1999 3:49 PM
To: Smith, Richard H
Cc: Eischeid, Jeffrey A; Zysik, Jeffrey C
Subject: BLIPS business purpose for premium bond

Richard,

Just to fill you in on my earlier conversation with Jeff Eischeid and two employees of Presidio Advisors (John Larsen and Amir Makoff). We discussed the non-tax business reasons for an Investor to borrow at an above-market coupon rate to fund its investment in the BLIPS partnership (the "Partnership"). In short, Presidio believes that an Investor would prefer a borrowing with above-market coupons (i.e., a "premium borrowing") in order to help the Partnership, which ultimately will assume the borrowing obligation.

The non-tax business reasons for the Partnership preferring a premium borrowing are more involved. Basically, the Partnership prefers the cash flow payments on a premium borrowing to the cash flow payments of a borrowing with market-rate coupons. That is because the cash flow on a premium borrowing is higher at the start of the borrowing and lower later on. Presidio argues that the Partnership's high-to-low cash flow payments will mitigate the Partnership's risk from increasing its foreign currency exposure as the investment phases progress. I can understand this business rationale, although I am not sure that this effect is very significant. (Of course, the Partnership could replicate the high-to-low cash flow of a premium borrowing by a borrowing with market-rate coupons with principal repayments scheduled early in the loan).

In addition, I am not sure that this rationale will fit the final structure. I was told last week that the Partnership now is changing its investment strategy to invest 100% of its proceeds at the start, rather than phasing-in the level of its investments. There are apparently other reasons for a premium borrowing, because Jeff sent me a list of companies that had done so. I do not know why these other premium borrowings were made, unless there were, perhaps, special regulatory or rating-agency benefits. I asked for any articles that might explain why premium borrowings are made, but I have not yet received any.

Steve

Steve

Unknown

From: DeLap, Larry [ldelap@KPMG.COM]
Sent: Wednesday, April 14, 1999 7:33 PM
To: Zysik, Jeffrey C
Cc: Eischeid, Jeffrey A; Bickham, Randall S; Lanning, John T; Lippman, Michael H; Ammerman, Douglas K; Watson, Mark T; Springer, Mark A; Wiesner, Philip J; Smith, Richard H; Elgin, Evelyn
Subject: RE: BLIPS

BLP_ENG.DOC (40 KB)

<<BLIPS DPP RSB.DOC>> <<BLP_ENG.DOC>> <<BLIPS.PPT>>

Jeff -

Note that I have substituted engagement letter forwarded by Randy Bickham for the letter that was attached to your message.

1. The essential question is whether the investor is entitled to claim a deductible loss upon the disposition of the foreign currency received in the liquidating distribution. However, neither the "Summary of Opinion" nor the "Conclusion" opines on this issue. I'm not sure I understand the utility of an opinion that does not address the essential issue.

1a. The body of the opinion letter does include a section on "Foreign Currency Implications". The "Ordinary Version" thereof [it is not immediately clear why there is a "capital version" and an "ordinary version"] does state that it is MLTN that "taxable loss recognized upon subsequent disposition of nonfunctional currency assets will be characterized as ordinary loss". However, it does not explicitly state that it is MLTN the loss will be deductible. Moreover, the fourth paragraph of the letter states, "Our opinion is limited to the conclusions expressed below in the sections titled "Summary of Opinion" and "Conclusion". Accordingly, such statement in the "Ordinary Version" of "Foreign Currency Implications" is not part of our opinion in any event.

1b. PowerPoint slides state "Gain/Loss recognized by Investor is ordinary" and "Gain or loss on sale of assets by Investor may be either ordinary or capital", which would lead one to believe that we have concluded there is a deductible loss. But our opinion should be consistent with our slides (or vice versa).

2. The bank makes the loan to the investor for the purpose of investing in the partnership, with the knowledge that the proceeds and the liability will be immediately transferred to the partnership, and with the knowledge or expectation that the partnership will immediately thereafter into an interest rate swap with an affiliate of the bank. It seems to me that a threshold issue is "who is the borrower". I would think the IRS would advance the argument that the borrower is the partnership, and the investor's cash contribution to the partnership was $1.8 million, not $151.8 million. If that argument were successfully pursued, the rest of the analysis in the opinion letter would be academic. Why is the "who is the borrower" issue not addressed?

3. Please send me a copy of the "attached investment analysis" and "Analysis of Financing Alternatives" referenced in the opinion letter.

4. I believe we should not be making our own investment analysis and conclusions as part of the opinion letter. The "Overview of Investment Strategy" and "The Investment Structure" sections contain a number of declarative statements that one could interpret as representing our views. I think those sections should be rewritten to make it clear that those statements are those of Investment Advisor.

5. The last paragraph under "The Investment Structure" states, "The original intent of the parties was to participate in all three investment stages of the Investment Program". It seems to me that this a critical element of the entire analysis and should not be blithely

Permanent Subcommittee on Investigations
EXHIBIT #95i

assumed as a "fact". If it is true, I think it should be one of the investor's representations. However, I would caution that if there were, say, 50 separate investors and all 50 bailed out at the completion of Stage I, such a representation would not seem credible.

6. There are several parenthetical references to Deutsche Bank. Will other banks be participating as lenders under similar terms? In either case, we need to get clearance from DPP-Assurance that Deutsche Bank's participation does not constitute an alliance or joint venture that would impact our independence with Deutsche Bank (which is a KPMG audit client). However, if only Deutsche Bank is participating as lender, I think we know what DPP-Assurance's reaction is likely to be.

7. With respect to the investor's second representation (no legally binding agreement), don't we need to look at the loan agreement to verify this is correct?

8. I don't think we should be giving the final opinion in the "Summary of Opinion" and "Conclusions" (namely, that "Investor has a business purpose and a profit motive"). That is a subjective determination that is in the mind of the investor. He can represent it to us, but I don't think we should be opining on it.

9. Who, in the Assurance department, wrote or reviewed the financial accounting discussions under "Debt Instruments - The General Rules"?

10. There are a lot of absolute statements sprinkled throughout the opinion letter (e.g., "the amount of the debt is [$100 million]". I think we need a general statement (see Eve Elgin for wording) that nothing in the letter is to be construed as implying a higher level of assurance than "more likely than not".

11. I question a statement in the last paragraph under "The Amount of the 'Liability' for Code Section 752 Purposes" that a position by the IRS that the amount of the liability is $150 million "would be inconsistent with the economics of the transaction". It is my understanding that any prepayment of the loan requires payment of a prepayment penalty, and that the amount of the prepayment penalty at any particular point in time would translate to an overall effective borrowing cost equal to 7% per annum on a $150 million base. Nowhere in the letter does there appear to be any mention of a prepayment penalty, other than peripherally in footnote 4. I would think that such a provision needs to be disclosed before one can talk about the "economics of the transaction".

12. In my view, footnote 34 is nonsensical. An obligation to repay proceeds of a borrowing, whether as principal or as "prepayment penalty", is not analogous to the receipt of payments under a long-term contract where there is no obligation to repay.

13. Footnote 4 and the penultimate paragraph under "Investor's Capital Contribution - The General Rules" refer to certain covenants in the loan agreement. Don't we need a representation from the investor that he was in compliance with those covenants prior to the transfer of the liability to the partnership?

14. I'm puzzled by the wording of the paragraph referenced in item 13:

With respect to a change in security, Treas. Reg. Section 1.1001-3(e)(4)(iv)(B) provides that a modification that releases, substitutes, adds or otherwise alters a substantial amount of collateral for, a guarantee on, or other form of credit enhancement for a nonrecourse debt instrument is a significant modification. The covenants contained in the loan agreement .... stipulate a collateral pool ... and provides [sic] the lender with the right to periodically review the collateral pool .... The loan covenants were not altered or amended upon the assumption of the loan by Partnership. Accordingly, there was no alteration made to the debt instrument that would constitute a ... change in security.... [Emphasis added.]

However, it seems to me that does not address the question of whether there was "a substitution of collateral" that would constitute a "significant modification". I see nothing in the letter that addresses the question of whether the investor provided collateral at all during the period he was the obligor, much less whether that collateral was "fungible or otherwise of a type where the particular units pledged are unimportant" with respect to the collateral provided by the partnership after the transfer.

15. In the third paragraph under "Activities Subject to the Code Section 465 Rules", the statement is made that "Investor invests directly in marketable securities and other financial instruments on its own account". But how do we know that? I see no such statement in the "facts" or the "representations".

16. Is the last sentence under "The Amount "At Risk" meant to indicate that any loss resulting from disposition of the foreign currency contracts is deductible only to the extent of the investor's income and gains from other investment activities?

17. According to the fourth paragraph under "Application of Anti-abuse Rules under Treas. Reg. Section 1.701-2", "the acquisition of the partnership interest is profit motivated; and, consequently as subsequently discussed, be [sic] respected as being bona fide and as having a business purpose". Even if it were established that the acquisition of the partnership interest (as opposed to participation in the investment program) were profit motivated, I don't understand how (and I see nothing in the subsequent discussion to establish how) one must necessarily conclude that therefore:

* The partnership is bona fide and each partnership transaction or series of related transactions is entered into for a substantial business purpose.
* The form of each partnership transaction must be respected under substance over form principles, and
* The tax consequences under the partnership provisions to each partner of partnership operations and of transactions between the partner and the partnership reflect the partner's economic agreement and clearly reflect the partner's income.

In the words of a Wendy's commercial from a long time ago, "Where's the beef". In my view, we need a lot more meat in this section to support the conclusion that the anti-abuse provisions of the partnership regulations are more likely than not to be inapplicable.

18. In the discussion of the Third Circuit decision in ACM under "Application of the Business Purpose/Economic Substance Doctrine", I'm a bit mystified as to the reason the emphasized sentences have been emphasized. It seems to me that the test of "objectively affecting the taxpayer's net economic position" is not met here.

19. I don't think it is correct to say "The most recent court case to address the business purpose doctrine is ACM Partnership". Leema Enterprises, T.C. Memo 1999-18 was decided subsequent to ACM. It's likely that other business purpose/economic substance cases has been decided after October 1998.

20. The statement that "ACM stands for the simple proposition that a transaction with no reasonable potential for pre-tax profit cannot be salvaged because the taxpayer also has unrelated profit-generating activity" is subject to voracious debate. I think it is preferable, if the statement is made at all, to preface it with "we believe that" or "it is our view that".

21. The first bullet in the paragraph that begins, "In summary, the case law applying the business purpose/economic substance doctrine consistently require the following requisites" is missing a few words ("the investor must be a reasonable potential").

22. The paragraph immediately following that referenced in item 21 makes declarative statements about the investment program. I think those statements should be avoided. (See item 4).

23. The paragraph just referenced includes the sentence, "Unlike the corporation disregarded in Gregory v. Helvering, Partnership was not a transitory entity that was formed, received contributed assets, and was liquidated within six days...." Do we really believe that a corporation in existence for six days is transitory, but a partnership in existence for sixty days is not? Also, it's not clear to me that the statement in the same paragraph that the "transactions entered into do not entail ... offsetting transactions with the same counterparty involving circular flows of funds with no net change in the taxpayer's economic position" is necessarily substantively accurate.

I'm starting to get concerned that my computer will soon lock up and I will lose everything written to this point. Accordingly, I am transmitting this message now, and will continue on another message.

Larry

> -----Original Message-----
> From: Zysik, Jeffrey C
> Sent: Wednesday, April 14, 1999 1:08 PM
> To: DeLap, Larry
> Cc: Eischeid, Jeffrey A; Bickham, Randall S; Lanning, John T; Lippman,
> Michael H; Ammerman, Douglas K; Watson, Mark T; Springer, Mark A;
> Wiesner, Philip J; Smith, Richard H; Elgin, Evelyn
> Subject: BLIPS
> Importance: High
>
> Larry,
>
> Please find attached the revised BLIPS opinion letter, the BLIPS power
> point presentation, and the BLIPS engagement letter for your review.
> Please note that the opinion letter has been revised to take into
> account the comments of each member of the BLIPS review team here at
> Washington National Tax.
>
> << File: BLIPS DPP RSB.DOC >> << File: BLP_ENG.DOC >> << File:
> BLIPS.PPT >>
>
> It is our understanding that you previously received a memo with
> respect to the sec. 6111(c) registration issue. If this is not the
> case, please let me know ASAP.
>
> We anxiously await your comments.
>
> Jeff

new

From: DeLap, Larry
Sent: Thursday, April 15, 1999 4:21 PM
To: Stein, Jeff
Cc: Lanning, John T
Subject: FW: BLIPS

Jeff -

I have received a response from Randy Bickham on the identified issues. He understands each of the issues and is working with Jeff Eischeid (or, with respect to certain issues, Washington National Tax) to make appropriate revisions.

My biggest concern (aside from the tax shelter registration issue) is in accepting a representation that the investor will participate in the full seven years of the investment program if all indications are that the intention is to bail out after 60 days. I plan to discuss this concern with John on Tuesday.

Larry

-----Original Message-----
From: DeLap, Larry
Sent: Thursday, April 15, 1999 9:53 AM
To: Stein, Jeff
Cc: Lanning, John T
Subject: RE: BLIPS

Jeff -

I really can't comment on what you may have been led to believe, but do believe strongly that my role must be more than a rubber stamp. I will be glad to work with Randy Bickham relative to resolving the issues, but some of the matters need to be addressed by the Washington National Tax partners involved in putting the document together.

Larry

-----Original Message-----
From: Stein, Jeff
Sent: Thursday, April 15, 1999 9:17 AM
To: DeLap, Larry
Cc: Lanning, John T
Subject: RE: BLIPS

Larry - It goes without saying that your analysis and the issues you raise are penetrating. I will tell you I'm a little surprised at the number of what appear to be open items given that John and I were led to believe througout this process that everyone that needed to be involved, was involved, so that once this thing got to you it would almost be a perfunctory review and approval. This looks to me like at least 2 more weeks of work before we see clear sailing although I could be overstating the case slightly. Can you walk Bickham or whoever is driving this from the PFP side through all of your points and given them the guidance they need to resolve them as quickly as possible.

Thanks

-----Original Message-----
From: DeLap, Larry
Sent: Wednesday, April 14, 1999 8:29 PM
To: Stein, Jeff
Subject: FW: BLIPS

fyi

-----Original Message-----
From: DeLap, Larry
Sent: Wednesday, April 14, 1999 8:15 PM
To: Zysik, Jeffrey C
Cc: Eischeid, Jeffrey A; Bickham, Randall S; Lanning, John T; Lippman, Michael H; Ammerman, Douglas K; Watson, Mark T; Springer, Mark A; Wiesner, Philip J; Smith, Richard H; Elgin, Evelyn

Subject: RE: BLIPS

Jeff -

This is a continuation of my preceding message.

24. The discussion of "Foreign Currency Implications" needs to be better tied into the rest of the letter (and the conclusion included in the summary of opinion). Also, there should be only one "version" and only one font.

25. I think we are remiss, in the section 6662 discussion, in citing cases where the court held it was reasonable for the taxpayer to rely on a professional tax advisor without also citing *Lincir*, T.C. Memo 1999-98. In *Lincir*, the court held that it was *not* reasonable for the taxpayer to rely on the advice of an accountant, where the accountant had an economic interest in promoting the investments that were the subject of the IRS disallowances. Obviously, as with any court case, we can distinguish the facts in *Lincir* from the instant situation. Nonetheless, I think we should mention the possibility a court would view our opinion as tainted, given our economic interest in promoting an investment in BLIPS.

26. I think we should add a tax risk disclosure statement to the engagement letter similar to that in the "Property Distribution Planning" engagement letter:

> Client acknowledges that the Investment Program is aggressive in nature and has a high degree of tax risk. It is entirely
> possible that the Internal Revenue Service might challenge the intended results of the Investment Program and could
> prevail under any of various theories and authorities at their disposal.

27. I think the second paragraph under "Background" in the engagement letter needs to be rewritten. Currently, it is written as though investor would invest directly in the foreign currency contracts, which is contrary to the bona fide partnership argument.

28. Please confirm that the intention is to market BLIPS only to individuals (or S corporations or partnerships that only have individuals as partners).

29. I still have a concern about the section 6111(c) issue. As I have not seen the referenced memorandum thereon, I cannot comment on whether it allays my concerns.

Larry

-----Original Message-----
From: Zysik, Jeffrey C
Sent: Wednesday, April 14, 1999 1:08 PM
To: DeLap, Larry
Cc: Eischeid, Jeffrey A; Bickham, Randall S; Lanning, John T; Lippman, Michael H; Ammerman, Douglas K; Watson, Mark T; Springer, Mark A; Wiesner, Philip J; Smith, Richard H; Elgin, Evelyn
Subject: BLIPS
Importance: High

Larry,

Please find attached the revised BLIPS opinion letter, the BLIPS power point presentation, and the BLIPS engagement letter for your review. Please note that the opinion letter has been revised to take into account the comments of each member of the BLIPS review team here at Washington National Tax.

<< File: BLIPS DPP RSB.DOC >> << File: BLP_ENG.DOC >> << File: BLIPS.PPT >>

It is our understanding that you previously received a memo with respect to the sec. 6111(c) registration issue. If this is not the case, please let me know ASAP.

We anxiously await your comments.

Jeff

Proprietary Material
Confidentiality Requested

Unknown

From: John Larson [jlarson@presidioadv.com]
Sent: Tuesday, April 20, 1999 6:52 PM
To: rbickham@kpmg.com
Cc: eischeid@kpmg.com; tkhenderson@kpmg.com; amakov@presidioadv.com
Subject: Loan premium

BLIPS0308.doc   3 type of loan comparison.xls

Randy-

We have attached a memo and spreadsheet that address the loan premium rationale. In this discussion we also refer to the proposed use of the fixed to floating swap.

JL

[redacted]

rate	NPV	% change
	$ 150.00	
3%	$ 187.38	25%
5%	$ 167.36	12%
7%	$ 150.00	0%
9%	$ 134.90	-10%
11%	$ 121.73	-19%
13%	$ 110.20	-27%

<u>7 year bullet loan</u>

annual interest rate	7%
annual coupon	7%
par value	150

year	1	2	3	4	5	6	7
cash flows	$ 10.50	$ 10.50	$ 10.50	$ 10.50	$ 10.50	$ 10.50	$ 160.50
PV	$ 9.81	$ 9.17	$ 8.57	$ 8.01	$ 7.49	$ 7.00	$ 99.95
NPV	$ 150.00						

[redacted]

rate	NPV	% change
3%	$ 182.72	22%
5%	$ 165.26	10%
7%	$ 150.00	0%
9%	$ 136.63	-9%
11%	$ 124.87	-17%
13%	$ 114.50	-24%

<u>7 year premium loan</u>

annual interest rate	7%
annual coupon	**16.278%**
Par value	100

year	1	2	3	4	5	6	7
cash flows	$ 16.28	$ 16.28	$ 16.28	$ 16.28	$ 16.28	$ 16.28	$ 116.28
PV	$ 15.21	$ 14.22	$ 13.29	$ 12.42	$ 11.61	$ 10.85	$ 72.41
NPV	$ 150.00						

[redacted]

rate	NPV	% change
	$ 150.00	
3%	$ 173.41	16%
5%	$ 161.05	7%
7%	$ 150.00	0%
9%	$ 140.08	-7%
11%	$ 131.15	-13%
13%	$ 123.09	-18%

<u>7 year amortizing loan (mortgage)</u>

annual rate	7%
annual coupon	7%
Loan amount	150

year	1	2	3	4	5	6	7
cash flows	$27.83	$27.83	$27.83	$27.83	$27.83	$27.83	$27.83
PV	$ 26.01	$ 24.31	$ 22.72	$ 21.23	$ 19.84	$ 18.55	$ 17.33
NPV	$ 150.00						

Proprietary Material
Confidentiality Requested

KPMG 0006041
KPMG 0006042
KPMG 0006043
KPMG 0006044

BLIPS – Loan Premium Rationale

The BLIPS transaction investment advisor, Presidio Advisors LLC ("Presidio") intends to recommend funding the BLIPS transactions with above market rate coupon, fixed term, seven-year debt (resulting in a loan premium). There are several reasons for this recommendation:

1. The three phase BLIPS investment plan calls for *increasing* levels of investment risk over the seven years of the program. Presidio, therefore, believes it is prudent to have a *higher level* of financing risk early in the program, with that risk declining as a portion of the borrowing (the loan premium amount) is amortized over the term of the loan. In effect, Presidio is proposing an integrated plan that seeks complementary levels of investment risk and financing risks at all times during the seven year life of a BLIPS program. By having a premium loan, it is possible to match the investment risks with the financing risks. As the investments become riskier, the financing becomes less risky.
2. Over the seven-year term of the proposed loan, the borrower is exposed to several risks resulting from potential changes in interest rates. As illustrated on the attached schedule, the net present value of the loan will change dramatically with changes in interest rates. While some of these risks (the "duration" risk – see discussion below) can be hedged by entering into a seven year fixed to floating rate swap, borrower will still have residual interest rate risk (the "convexity" effect - described below) that it proposes to manage through the use of the loan premium. Thus, the fixed to floating rate swap hedges the interest duration risk but it does not hedge the convexity risk. Other means are required to hedge or manage this second order convexity risk.

Discussion

Note - To demonstrate how the use of a loan premium debt structure helps Presidio manage certain risks, we prepared a schedule (attached) that contrasts three different ways that a seven year, 7% fixed rate, loan of $150 could be structured. Option 1 is for $150 interest only for seven years with all principal due at maturity. (Identical to a Treasury bond.) Option 2 is $100 interest only for seven years and $50 of loan premium fully amortizing over seven years. Option 3 is $150 fully amortizing over 7 years (a mortgage). In these three examples, it is assumed that the current 7-year yield is 7%. In other words, a 7-year bond with a 7% coupon would be a par bond.

As described in the BLIPS investment summary, the three-phase plan calls for increasing levels of investment risk in the foreign currency trades as the plan progresses. We want to have higher debt service payments and a greater loan balance early in the program when investment risks are relatively low. We want a significant reduction in the loan balance later in the program when the investment risks are significantly higher. While fully amortizing mortgage type loan could achieve this goal, the price would be unacceptably high debt service payments that could hamper Presidios ability to enter fully into the proposed foreign currency strategy. Borrowing at above market rates and amortizing the loan premium over the life of the loan (Option 2) facilitates a balance between decreasing levels of financing risk and management of periodic debt service payments.

Fixed rate borrowers are always subject to interest rate risk. As illustrated on the attached schedule, changes in the net PV of the borrower's liability can be substantial when rates decline. This risk can be partially hedged by having the borrower enter into a 7 year fixed to floating rate swap. However, even where a borrower hedges the primary interest rate risk with a swap, an additional more subtle risk remains. That risk is called "convexity."

Two concepts, noted above, are relevant to determining a bond's value. These concepts are "duration" and "convexity". In order to assess and manage the interest risk inherent in the BLIPS transactions, Presidio has to understand, quantify, and hedge these risks.

Duration - Duration (or more precisely "modified" duration) is a measure of the price sensitivity of a bond to interest rate movements. In other words, it can be used to measure the sensitivity of a bond's price (i.e., the present value of its cash flows) to interest rate movements. Duration does a good job of estimating actual bond price changes resulting from small changes in yield. Thus, within certain limited ranges, a change in bond yield will result in predictable changes to the bond's price. As noted above, a swap from fixed to floating does an effective job of hedging (offsetting) interest rate duration risk.

Convexity – Convexity is the measure of how much a bond's price/yield curve deviates from a straight line. Because of the convex shape of a price/yield curve, for a given change in yield up or down, *the gain in price for a drop in yield will always be greater than the fall in price due to an equal rise in yields.* This is a positive attribute for the holder of a bond (the lender) and negative attribute for the borrower.

The negative convexity is relatively minor with small interest rate changes but is significant with larger rate changes. From the borrowers point of view it is prudent to hedge or manage the negative convexity risk. One way to achieve this is to structure a loan premium note with higher up front payments. Option 2 – the loan premium note is an effective way to decrease convexity.

It is important to note that all option-free fixed rate instruments have positive convexity. Positive convexity is valuable in a world where interest rates dynamically change. In our case, since we are the borrowers of a fixed rate note, we suffer from negative convexity. By entering into a premium loan, we are minimizing the effects of the negative convexity. Furthermore, combining the loan with a fixed to floating rate swap, we can achieve an overall positive convexity for the partnership's investment portfolio. In other words, by combining the premium loan and the swap, the partnership can make money regardless if interest rates go up or down. Hence, positive convexity.

Rosenthal, Steven M

From: Rosenthal, Steven M
Sent: Friday, March 26, 1999 12:08 PM
To: DeLap, Larry
Subject: FW: BLIPS business purpose for premium bond

FYI

-----Original Message-----
From: Rosenthal, Steven M
Sent: Monday, March 22, 1999 3:49 PM
To: Smith, Richard H
Cc: Eischeid, Jeffrey A; Zysik, Jeffrey C
Subject: BLIPS business purpose for premium bond

Richard,

Just to fill you in on my earlier conversation with Jeff Eischeid and two employees of Presidio Advisors (John Larsen and Amir Makoff). We discussed the non-tax business reasons for an Investor to borrow at an above-market coupon rate to fund its investment in the BLIPS partnership (the "Partnership"). In short, Presidio believes that an Investor would prefer a borrowing with above-market coupons (i.e., a "premium borrowing") in order to help the Partnership, which ultimately will assume the borrowing obligation.

The non-tax business reasons for the Partnership preferring a premium borrowing are more involved. Basically, the Partnership prefers the *cash flow* payments on a premium borrowing to the *cash flow* payments of a borrowing with market-rate coupons. That is because the cash flow on a premium borrowing is higher at the start of the borrowing and lower later on. Presidio argues that the Partnership's high-to-low cash flow payments will mitigate the Partnership's risk from increasing its foreign currency exposure as the investment phases progress. I can understand this business rationale, although I am not sure that this effect is very significant. (Of course, the Partnership could replicate the high-to-low cash flow of a premium borrowing by a borrowing with market-rate coupons with principal repayments scheduled early in the loan).

In addition, I am not sure that this rationale will fit the final structure. I was told last week that the Partnership now is changing its investment strategy to invest 100% of its proceeds at the start, rather than phasing-in the level of its investments. There are apparently other reasons for a premium borrowing, because Jeff sent me a list of companies that had done so. I do not know why these other premium borrowings were made, unless there were, perhaps, special regulatory or rating-agency benefits. I asked for any articles that might explain why premium borrowings are made, but I have not yet received any.

Steve

Permanent Subcommittee on Investigations
EXHIBIT #951

Rosenthal, Steven M

From: Rosenthal, Steven M
Sent: Tuesday, April 06, 1999 3:55 PM
To: DeLap, Larry
Cc: Springer, Mark A
Subject: RE: BLIPS

Larry,

I would not characterize my assessment of the economic substance of the "premium borrowing" in the BLIPS transaction as "positive." I had one conversation with representatives of the Presidio investment firm, and did not find their economic arguments compelling. There is a "cash-flow" difference between borrowing at a premium rate and borrowing at a market coupon rate, although, in my judgement, the difference is small (the "cash-flow" from payments under a premium borrowing arguably offsets the increasing risks from the graduated investment strategy). Also, these advantages, however small, disappear if the investment strategy is changed to require full investment from the start (which is what I now understood the transaction to require).

I summarized my understanding of the economic arguments for the premium borrowing in a short E-mail to Richard Smith (which I will forward to you). I have not been asked to evaluate the business purpose of issuing a premium bond, the economic substance of the BLIPS investment program, or the overall business purpose/economic substance of the BLIPS transaction.

Steve

-----Original Message-----
From: DeLap, Larry
Sent: Friday, April 02, 1999 1:53 PM
To: Rosenthal, Steven M
Subject: FW: BLIPS

Steve -

Is the reference to "Steve's positive assessment" accurate?

Larry

-----Original Message-----
From: Ammerman, Douglas K
Sent: Friday, April 02, 1999 12:57 PM
To: Lanning, John T
Cc: Stein, Jeff; Lippman, Michael H; DeLap, Larry; Brian Rivotto; Carolyn Branan; David Zaudtke; Dennis Ito; Glen Wright; James Duty; Jeffrey Eischeid; Mark Watson; Neil Tendler; Neil Wolfson; Robert Pedersen; Robert Perez; Tracie Henderson; William Goldberg
Subject: BLIPS

John,

I wanted to provide you with a quick update on the status of the BLIPS approval process and what we can expect over the next few days. This summary is based upon multiple conference calls throughout the last two weeks with Jeff Eischeid, Randy Bickham, Mark Watson and others. Additionally, I have spoken directly with John Raedel and have exchanged messages with John Guinan and Phil Wiesner.

Registration Issue. Larry DeLap, based upon a technical analysis by Eve Elgin, concluded that the product fell within the purview of Internal Revenue Code Section 6111(c) and must be registered as a tax shelter. Eve's conclusion was that there was no reasonable basis for not registering the product. In response to DPP's position, Randy Bickham prepared the attached memorandum to Mark Ely dated March 24, 1999, that concluded that there was a reasonable basis for not registering based upon satisfying the "tax shelter ratio" test contained in Code Section 6111. Based upon the logic contained in the memorandum and his own independent assessment, Mark agreed that there was a reasonable basis for not registering the product as a tax shelter. He is drafting a memorandum to DPP setting forth his logic for concluding that there is a reasonable basis for not registering the BLIPS product.

Technical Issues. The only remaining technical issues are the applicability of Internal Revenue Code Section 988 to the "ordinary" version of the product and Phil Wiener's final sign-off on whether the BLIPS product meets the requisite business purpose threshold.

Jim Sams could not initially get to a MLTN position with respect to the application of Code Section 988 because of the anti-abuse provision contained in the regulations under Code Section 988. The anti-abuse provision incorporates a "substance over form" analysis that allows the Commissioner to recharacterize the timing, source and character of transactions. Jeff Eischeid and Randy Bickham prepared that attached memorandum dated March 31, 1999, which concludes that on a "more-likely than-not basis" that an application Code Section 988(a) allows for ordinary income or loss treatment and the anti-abuse provision contained in

Permanent Subcommittee on Investigations
EXHIBIT #95m

SMR 0012

Treasury Regulation Section 1.988-2(f) does not apply. John Raedel has asked Jim to reconsider his initial conclusion based upon Jeff's and Randy's analysis.

<< File: BLIPS 6111 Issue.doc >> << File: 988rsb.doc >> << File: blips dpp rsb.doc >>
With respect to business purpose, Phil Wiesner enlisted Steve Rosenthal's assistance in assessing the economics of the BLIPS investment program. There have been extensive discussions between Presidio and Steve orchestrated by Jeff Eischeid to address Steve's outstanding issues. Steve's positive assessment has been conveyed to Phil. In addition, Phil has been provided with approximately 20 examples of actual transactions which effectively replicate the economics of the BLIPS financing structure by using above-market interest rate debt offerings.

Next Step. On Monday, John Raedel, Richard Smith and Phil Wiesner will meet to review Jim Sams' concerns and to form a conclusion as to the applicability of Code Section 988. Phil will then conclude as to business purpose and WNT's overall conclusion that the BLIPS product meets the "more-likely-than-not" standard. The product will then go to Larry DeLap and DPP Assurance to obtain requisite approvals. I am fully confident that Larry will give us his immediate response.

I may need to solicit your assistance to insure that we receive an expeditious review from DPP Assurance.

I realize that you are quite swamped with the Canadian situation but, if you have any other questions, please give me a call.

Thanks,

Doug Ammerman
KPMG LLP
Orange County Office
(714) 850-4455

Unknown

From:	DeLap, Larry
Sent:	Thursday, April 29, 1999 2:06 PM
To:	Bickham, Randall S
Cc:	Ammerman, Douglas K; Eischeid, Jeffrey A; Rosenthal, Steven M; Smith, Richard H (WNT); Sams, James K; Springer, Mark A; Watson, Mark T; Wiesner, Philip J; Elgin, Evelyn
Subject:	FW: BLIPS
Importance:	High

Randy -

See attached comments.

Steve Rosenthal, Richard Smith, Jim Sams, Phil Wiesner, Mark Watson (and any other WNT people I've overlooked) need to go over this "final" draft and affirm they are in technical agreement therewith.

I would like to request Eve Elgin to go through the draft and pick up in language inconsistencies or missing data that I may have overlooked.

Where is the separate "penalty discussion" that is to be provided to the investor?

I must say that I am trepidatious about the degree of reliance being placed on the terms of a loan agreement and a partnership agreement that no one has seen. Before the first BLIPS engagement letter is issued, I think it is essential the relevant WNT personnel (including Mark Watson) receive, review, and approve the intended language of the documents to be used.

Larry

-----Original Message-----

From:	Bickham, Randall S
Sent:	Thursday, April 29, 1999 1:31 PM
To:	DeLap, Larry
Cc:	Ammerman, Douglas K; Eischeid, Jeffrey A; Rosenthal, Steven M; Smith, Richard H (WNT); Spinger, Mark A; Watson, Mark T; Wiesner, Philip J
Subject:	BLIPS
Importance:	High

Larry -

Attached is the revised BLIPS opinion letter incorporating your comments and thoughts. The most recent changes have been highlighted. The revised engagement letter wil'be sent under separate cover.

Randy

KPMG 0040176

Proprietary Material
Confidentiality Requested —

Permanent Subcommittee on Investigations
EXHIBIT #95n

Unknown

From:	Ammerman, Douglas K
Sent:	Wednesday, April 28, 1999 11:24 AM
To:	Brent Lipschultz; Carl Hasting; Carol Warley; Dale Baumann; David Rivkin; David Zaudtke; Deke Carbo; Jeffrey Eischeid; Jeffrey Zysik; Katherine Pace; Mark Watson; Randall Bickham; Richard Bloom; Robert Jordan; Robert Pedersen; Timothy Speiss; Tracie Henderson
Subject:	BLIPS Product
Importance:	High

Yesterday, Jeff Eischeid, Randy Bickham and I participated in a conference call with Larry DeLap and representatives of WNT to discuss various aspects of the BLIPS product. While we are still in the process of responding to Larry's questions, I am hopeful that we will secure Larry's approval this week.

In anticipation of such approval, I have asked Mark Watson and Jeff Eischeid to assemble a BLIPS task force to meet Friday, April 30 through Saturday afternoon, May 1 to discuss the technical mechanics of this program. Following that meeting, I would like for area participants to contact their respective area PFP leader on Monday, May 3 to discuss the BLIPS product in detail and to initiate an action plan on selling this product. I should emphasize again that this product has **not yet been approved**. It is entirely possible that we will not be able to offer this product to clients. Nevertheless, in an effort to promptly respond to a positive response from Larry, I want to insure that we decisively and expeditiously take advantage of marketplace opportunities.

The task force members that are being asked to attend include:

Dale Baumann
Randy Bickham
Richard Bloom
Deke Carbo
Carl Hasting
Tracie Henderson
Bob Jordan
Brent Lipschultz
Katherine Pace
Bob Pedersen
David Rivkin
Tim Speiss
Carol Warley
David Zaudtke
Jeff Zysik

The meeting particulars are noted below:

Date & Time:	Friday, April 30, 1999 beginning @ 12:15 p.m. Saturday, May 1, 1999 ending @ approximately 4:00 p.m.
Place:	Hyatt Regency DFW Airport International Parkway Dallas, TX 75261 Phone: (972) 453-1234 Fax: (972) 456-8668
Room:	East Tower Boardroom
Meals:	Lunch both days and dinner Friday night will be served.

To make travel arrangements, please contact Travel Services at 1-800-457-6493 and indicate you are attending the **meeting no. 4269**. The engagement number for **expenses only** is 001-98392-01.

If for some reason you cannot attend, please contact Jeff Eischeid

Doug Ammerman
KPMG LLP
Orange County Office
(714) 850-4455

1 of
4/30/99
JRB

Blips - Bond Linked issued Premium Structure

- Our fee 1 1/4%
- 50 Transactions (Possibly)
- Waiting on final sign off
- Task force is the only group allowed to be involved (Per Larry)
- Only PFP ⓔ can be set up - no sharing revenue
- Other Partner can get cross selling credit
- George Theofeld (SF Atty) / Presideo / Deutsche Bank
- Brown & Wood will do concurring opinion
- OL or CL (Pres. budget proposal may shut o.d. eliment down

- Play in P-Ship rules under 752
- Premium loan
- Need profit motive - reas. possib. of making reas. profit.

- NDA
- Representation } To client mtg.
- Scripting

Not giving out white-papers or opinion letters.

- Inv. in Foreign currency.

- Presideo has to meet with client

KPMG 0004480

- Equity - 2-3% of total Borrow

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95p

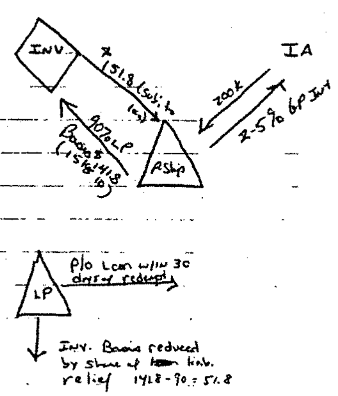
2 of
4/30/99
DRB

- If sell P-Ship interest - will generate CL
- If distrib. foreign currency - get substituted basis
  - OL when sold

Stage I - Low Risk (relative to other stages)

- 30-60 days
- Still have risk of losing all of investment

Non-recourse loan!



KPMG 0004481

3-4

LP Liquid. dist / For. Sec. → Investor

Sells FC asset. Sales proceeds less $51.8 mil

Ord / CL

Buyer

Ord Elim under Clinton Budget § 732.

Loan prem = Approx. LOSS

$\boxed{\text{USP}}$ (74 dual)

$4.2m

100%

100 BP as Loan orig. = 600k

LLC

$100 mil

Prem. $60 mil

Bank (Boston currencies)

x 7%

$4.2 mil Cost

160

+3.6 (4.2 - .6)

163.6

A Pres. Mgr. 5% GP 200k

B Other 5% GP 200k

LP

$164 Total $

100 Loan

• Inv. Adv. Agreement $\boxed{\text{GP}}$ → LP-Ship

$\boxed{\text{U.S. Pers}}$ →

KPMG 0004482

Proprietary Material
Confidentiality Requested

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Amice - Presides

Trading Strategy

Premium Loan

Obj
① Pre-tax profit
② Put full $/164 @ risk
③ Min. potential for loss

Currencies that peg to U.S. dollar (emerging mkts)

· Short local currency
· Long US

Ways to make $/. Core strategy

· Hong Kong $
· Venezuela $

① Looking for a devaluation to occur.

② Perception of devaluation
- if another financial turmoil
(if spreads between foreign interest rates spread).

Suppl. trades -
Swaps/Bonds - trades which would benefit from

KPMG 0004483

Fixed to Floating Swap entered in on day 1
· Loan was fixed rate. 1 BP move in Int rate is $90,000 ...

54

Fixed/Var Swap eliminates risk area in U.S. mkt.

Amt of Risk ↑ w/each stage

Stage 2 ↑ amt of risk - Portfolio is more volatile.
: could do more currency trades

• Banks very comfortable
° If assets/liab reach certain level - Bank could require additional cash or bank could force unwinding provision

• Bank has a veto right over trade. No right to substitute trade

30-60 days until Bank will be ready to execute.

We would like some people to hold longer than 60 days. (Push for end of yr.)

: Can opt out every 30 days.

WT needs to sign off on each of the deals.

KPMG 0004484

64

Blips - Summary of Opinion

① Investor's Receipt of Loan

· Bond Issuance prem is Excess of DI's issue price over its stated redemp. price

Stated Int	15.85	
Prem	8.85	(Reg 1.163-13 Amortize) offset to Int Exp.
Int	7%	Deductible amt inside P-Ship

· Investor is $\boxed{\text{true borrower}}$ since enters into loan in individual capacity, had title/control over cash proceeds and the economic "benefits/burdens" of ownership for 10 days. (Supported by case law in §1366 area) (Bank will restrict what can be done with the proceeds) : could still invest in some types of assets that P-Ship could invest in.

· Investor can control amount of leverage by doing this lending outside the Partnership.

KPMG 0004485

② Capital Contribution

· Contrib of $151.8 subject to loan is N/T under §721

· 3.1274(c) - does not apply unless terms of condition of debt are Signif. modified — is a 1001 modification

· Chg of oblig'n of non-recourse debt is not a Sign. modif.

7 of

③ Section 752

- Loan ↑ basis by $150 mil under Rev. Rule 95-26 (and other Short Sale rulings) §752 Liab. is $100

- The amount of the liability for §752 purposes is $100 million. the OID rules don't apply in §752 context.

- Int and prepayment penalty are not accrued until all events have occurred to fix amt of obligation and economic performance has occurred.

- Prepayment penalty is contingent, not fixed, upon existing interest rates. §461 (LaRue/Long)

Analysis is performed @ time of contribution

④ • Investor ops and and partnership interest is redeemed
- Under 731 nonrecognition treatment because p-ship basis exceed $ distributed. Foreign $ is not money under §731(c).
- Upon liquidation, investors remaining basis of $51.8 million is first reduced by cash distributed and residual amt is allocated to foreign currency and financial instruments distributed.

8 of

(5) §705 - reduce basis of P-Ship int by expenditure which is not properly chargeable to cap acct. (worried about prepayment penalty being a §705 adjustment).

· To side step issue - don't pay off loan until after partner exits partnership. (only matters where we are going for to OL)

(6) At Risk · §465
· positive at risk @ close of TY) - discrete activity.

· activity is not well defined, a sep. p-ship would constitute a discrete activity

· 465 loss is generated at indiv. level, not @ p-ship level - P-Ship is profitable

Marketing

① Who S/B Engagement partner?

· PFP Partner?
· US w/ PFP Cross Selling credit.

② Opinion Letter - copies to who?

· No one!

③ Alternate Distribution Channel
· Banks
· What should finders fee be? 25 BPs
· Can not pay or receive referral fees in CA.
· Deloitte will allow finders fee if allowed in state and person is not significant influence (if audit client, talk to Sandy Spitz).
·

④ NDA
→ Use!

⑤ Toolkit → Outlook - Hot tax product

KPMG 0004488

(6) Deal Size

· At least $20 mil

(7) Not a corporate deal.

(8) We can do it w/ trusts/Partnerships
· Issues on trust enabling language for alternative investments. Fid. Lia. issues are concern.

(9) Could do it in individual name - then they contribute it to C-corp (B:W would need to issue the §351 ~~[illegible]~~ opinion).

(10) Have to do the prospective client paperwork.

(11) Roles / Responsibilities

Unknown

From: Watson, Mark T
Sent: Wednesday, May 05, 1999 6:21 AM
To: Ammerman, Douglas K; Eischeid, Jeffrey A; Bickham, Randall S
Subject: BLIPS

Based on our meeting on April 30 and May 1, I am *not* comfortable with the BLIPS product for the following reasons:

- According to Presidio, the probability of making a profit from this strategy is remote (possible, but remote). Thus, I don't think a client's representation that they thought there was a reasonable opportunity to make a profit is a reasonable representation. If it isn't a reasonable representation, our opinion letter is worthless.
- The bank will control, via a veto power over Presidio, how the "loan" proceeds are invested. Also, it appears that the bank will require this "loan" to be repaid in a relatively short period of time (e.g., 60 days) even though it is structured as a seven-year loan. These factors make it difficult for me to conclude that a bona fide loan was ever made. If a bona-fide loan was not made, the whole transaction falls apart.

Until these issues are resolved satisfactorily, I don't think we should release this product.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-467-2433 (phone)
202-822-8887 (fax)

Unknown

From:	DeLap, Larry
Sent:	Friday, May 07, 1999 4:48 AM
To:	Ammerman, Douglas K; Eischeid, Jeffrey A; Bickham, Randall S
Cc:	John Lanning; Jeff Stein
Subject:	FW: BLIPS

Doug, Jeff, and Randy -

Steve Rosenthal informed me on Tuesday afternoon that he had substantial concern with the "who is the borrower" issuer, and that he would be discussing the matter with Randy on Tuesday or Wednesday. I don't know what the outcome of those discussions were. I imagine Steve would have a concern with the second bullet in Mark Watson's message.

I don't believe a PFP product should be approved when the top PFP technical partner in WNT believes it should not be approved.

I will be back in the U.S. on Saturday and in the Silicon Valley office on Monday morning. Please give me a call on Saturday afternoon or Sunday at home (408-353-3309) or on Monday morning in the office.

Larry

-----Original Message-----

From:	Watson, Mark T
Sent:	Wednesday, May 05, 1999 9:21 AM
To:	Ammerman, Douglas K; Eischeid, Jeffrey A; Bickham, Randall S
Subject:	BLIPS

Based on our meeting on April 30 and May 1, I am *not* comfortable with the BLIPS product for the following reasons:

- According to Presidio, the probability of making a profit from this strategy is remote (possible, but remote). Thus, I don't think a client's representation that they thought there was a reasonable opportunity to make a profit is a reasonable representation. If it isn't a reasonable representation, our opinion letter is worthless.

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Until these issues are resolved satisfactorily, I don't think we should release this product.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-467-2433 (phone)
202-822-8887 (fax)

MEMORANDUM

TO: Jeff Eischeid
CC: Bob Pfaff, John Larson
FROM: Amir Makov
DATE: May 6, 1999
RE: BLIPS Investment Program's Profit Potential.

Participants in the BLIPS Investment Program have a reasonable pre-tax, after fees, profit expectation on their investment capital.

Generally, there are two scenarios under which such profit would be realized. The first scenario would be an actual devaluation of the underlying emerging-market currency. The second scenario would be a shift in the market's perception of the likelihood of such devaluation.

Should a currency devaluation occur in one of the underlying markets during Phase One of the BLIPS Investment Program, profit expectation should be several hundred percent return on investment capital, assuming that the magnitude of such a devaluation would be similar to other currency devaluations that occurred in 1997 through 1999.

Should the market's perception of devaluation risk increase due to economic or political uncertainty, a participant in the BLIPS Investment Program would realize an pre-tax, after fees, profit (although the profit realized under this scenario should be lower than under the first scenario where the actual devaluation occurs).

As we have demonstrated in some of our earlier analysis, and from the above scenarios, our profit expectation is linked to the expectation (or in mathematical terms, probability) of an underlying currency devaluation.

It is my own, unbiased opinion, that Hong Kong and/or Argentina are likely to devalue their currency in the future, given the events ~~that happened~~ in 1997 through 1999 in their neighboring countries. Furthermore, many of the large offshore hedge funds (who pay no taxes on their investments, and therefore, have only a pre tax profit motive) employ very similar investment strategies.

Permanent Subcommittee on Investigations
EXHIBIT #95r

However, when one markets a risky hedge fund type investment program (such as BLIPS), no assurance or guarantees can ever be given to investors. The prudent practice of disclosing the potential for the ~~risk of~~ entire loss of invested capital is very common in hedge fund's Private Placement Memorandums. It is very important to carefully manage our Investor's expectations.

Unknown

From: Springer, Mark A
Sent: Tuesday, May 04, 1999 1:43 PM
To: Eischeid, Jeffrey A
Subject: FW: Bond Linked Issue Premium Structure (BLIPS)

Jeff:

I am really concerned about the series of messages below...as you know, we are not there yet! I had lunch w/ Rosenthal, and he still has concerns which, at Larry's request, he needs to discuss w/ Larry, Randy, Phil, et. al. We also do not have the final DPP signoff. Is there anything we can do to slow the horse down a little until it's all signed off.

Mark
202-467-3807

-----Original Message-----
From: Beakley, William D
Sent: Tuesday, May 04, 1999 3:56 PM
To: Goldberg, William J; Sokolosky, Stephanie
Cc: Springer, Mark A
Subject: RE: Bond Linked Issue Premium Structure (BLIPS)

I just spoke w/J. Stein about this product and he seemed to indicate that it might be awhile b/4 this comes out. What's the timing ?

WDB

-----Original Message-----
From: Goldberg, William J
Sent: Tuesday, May 04, 1999 2:52 PM
To: Beakley, William D; Sokolosky, Stephanie
Subject: FW: Bond Linked Issue Premium Structure (BLIPS)
Importance: High

Please forward to all area tax partners and business development managers. This is the successor product to OPIS and can be used in conjunction with **either capital gains or ordinary income.** Since the number of clients that can utilize this strategy is limited, we must move quickly to be sure this area gets its fair share.

Contact Deke Carbo (New Orleans) at 504-584-1050 or Carol Warley (Houston) 713-319-2180.
Bill Goldberg

KPMG
700 Louisiana St, Ste. 3000
Houston, TX 77002
Telephone: 713-319-2143
Facsimile: 713-319-2040
e-mail: wgoldberg@kpmg.com

-----Original Message-----
From: **Warley, Carol G**
Sent: Tuesday, May 04, 1999 2:46 PM
To: US-HOU Partners; US-HOU Managers
Subject: Bond Linked Issue Premium Structure (BLIPS)
Importance: High

This past Friday and Saturday, Deke Carbo and I participated in a meeting which primarily focused on the status of our new investment strategy for clients with significant capital gain income (BLIPS).

Permanent Subcommittee on Investigations
EXHIBIT #95s

Although this tax product is not yet approved for marketing to clients, BLIPS was far enough along to conduct a meeting of the individuals who will be responsible for marketing.

Some of the key points discussed in the meeting were:

- BLIPS will have a $20 million minimum just like OPIS
- ***DPP has indicated that we will only be able to do 50 BLIPS transactions***
- Providing a copy of a draft opinion letter will no longer be done to assist clients in their due diligence process
- Signed nondislosure agreements will have to be obtained before any meetings can be scheduled
- BLIPS cannot be done for a corporate client (this includes S corporations)

Given the current limitation on number of transactions, it is imperitive we identify, start to talk about and screen candidates now. Therefore, it is imperitive that you talk to Deke or me about BLIPS prospects so we can fine tune our prospect list and immediately attempt to close these prospects once we get the go ahead to market BLIPS.

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=5136
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=5136
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: New Personal Financial Planning Innovative Strategies Product Approved
Sent: 1999-05-21 16:21:07.610
Date: 1999-05-21 16:21:08.184
X-Folder: BLIPS

On Wednesday, May 19 a new investment strategy for individual clients and targets with significant capital gain income (BLIPS) was approved for marketing by the PFP Innovative Strategies group.

Following are a number of the key marketing parameters for BLIPS.

* BLIPS candidates have a $20 million investment minimum
* BLIPS may be presented only if a member of the PFP Innovative Strategies group, or another person designated by Doug Ammerman, PFP PIC, is present
* DPP has indicated that only a limited number of transactions will be allowed
* A copy of a draft opinion letter will not be provided to assist clients in their due diligence process
* Signed nondisclosure agreements must be obtained before any meetings can be scheduled
* BLIPS is not available to corporate clients (including S corporations); however, partnships with only individual members are BLIPS candidates
* Third parities (e.g.,   , etc.) are not to be used as a referral source in connection with marketing BLIPS without express permission of DPP
* BDMs are not to be used for marketing BLIPS

Please note that a number of additional conditions apply to BLIPS marketing and delivery.

Given the limited number of BLIPS transactions that will be allowed , it is imperative that you contact me ASAP if you are aware of a prospect so that we may discuss the applicability of the strategy to your client.

Thank you for your attention to this matter,

Jeff Zysik
(305)913-2719
Director
Personal Financial Planning
PFP Innovative Strategies
South Florida

REDACTED

BLIPS

Bond Linked Issue Premium Structure

KPMG

BLIPS

Investment Product:

- Reasonable Expectation of Earning Reasonable Profit

Investor Sentiment:

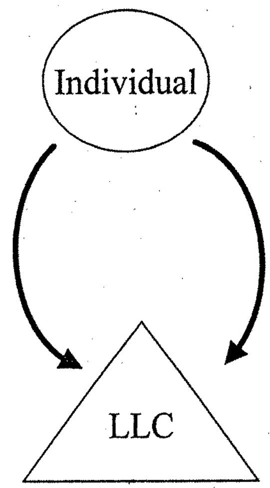
- Attracted to both short-term and long-term trading opportunities in emerging market currencies.

Investment Strategy:

- Multi-stage strategy designed by Presideo Investment Advisors to generate significant investment returns through strategic investments in emerging market currencies.

Day 1

<u>Step 1</u>: Individual forms single member LLC

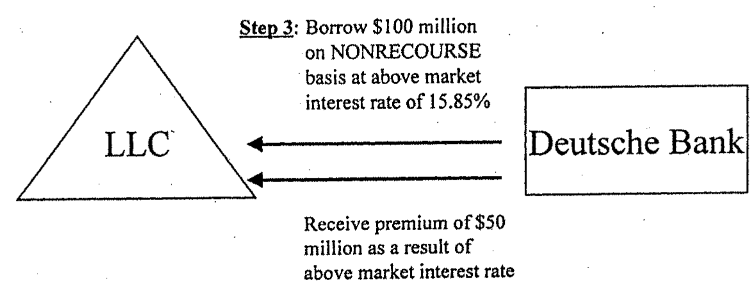


<u>Step 2</u>: Individual contributes cash equal to 7 percent of the loss to generate - $3.6 million

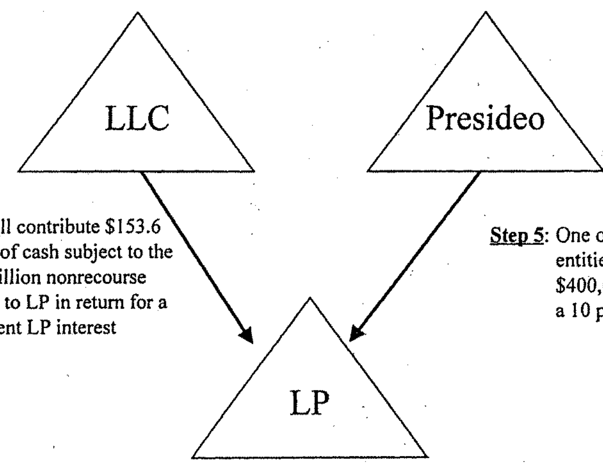
KPMG

KPMG 0000395

Day 1


LLC
Deutsche Bank
Step 3: Borrow $100 million on NONRECOURSE basis at above market interest rate of 15.85%
Receive premium of $50 million as a result of above market interest rate

Day 10



Step 4: LLC will contribute $153.6 million of cash subject to the $100 million nonrecourse liability to LP in return for a 90 percent LP interest

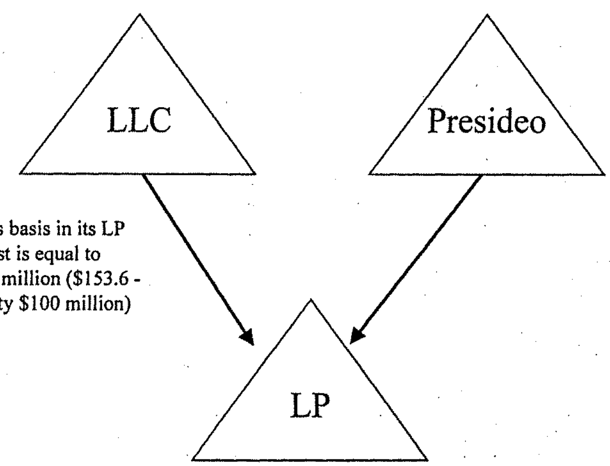
Step 5: One or more Presideo entities will contribute $400,000 to LP in return for a 10 percent GP interest

Proprietary Material
Confidentiality Requested

KPMG

KPMG 0000397

Day 10

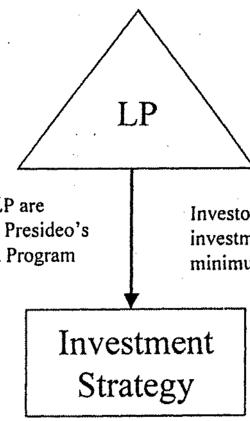


<u>Basis</u>: LLC's basis in its LP interest is equal to \$53.6 million (\$153.6 - liability \$100 million)

KPMG 0000398

Day 10 through End of Investment

Step 6: Assets of LP are invested in Presideo's Investment Program



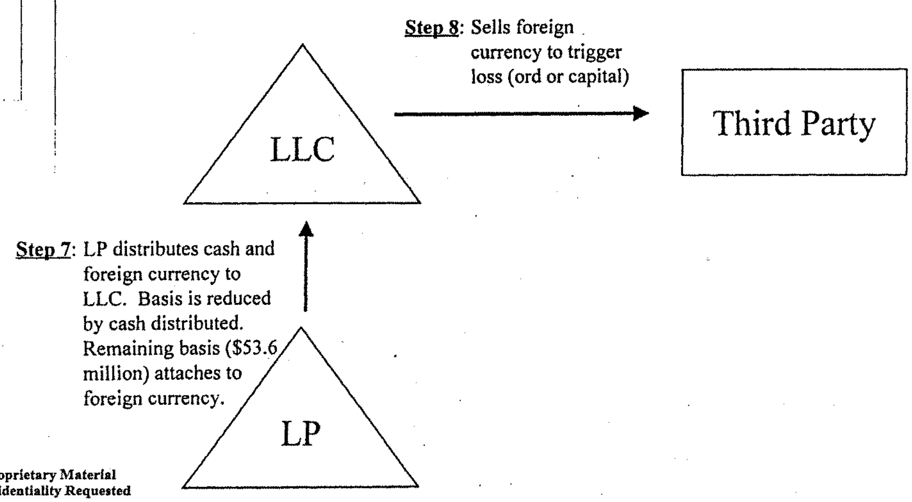
Investor elects when to exit investment strategy - minimum period is 60 days

Proprietary Material
Confidentiality Requested

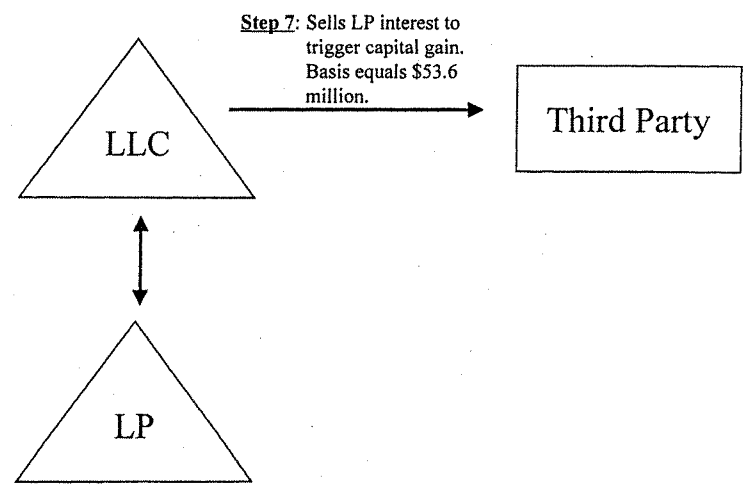
KPMG

KPMG 0000399

Subsequent Events - 1st Alternative



Subsequent Events - 2nd Alternative



KPMG 0000401

BLIPS

Income Tax Consequences (Investor)

- Investor will recognize a pro-rata share of partnership's gains and losses generated from investment strategy.
- Upon liquidation of partnership interest, Investor will recognize no gain or loss unless Investor receives cash exceeding his basis in his partnership interest.
- Investor will recognize gain/loss (either short-term or long-term depending on partnership's holding period) measured by difference between amount realized on subsequent sale of distributed assets and former basis of partnership interest.
- Gain/Loss recognized by Investor is ordinary unless capital treatment is elected by partnership.
- Upon sale of partnership interest, Investor will recognize capital gain or loss equal to the sale proceeds less basis.

BLIPS

Key Points

- Profit Motive/Business Purpose - Reasonable Expectation of Earning Reasonable Profit.
- Basis - Investor's basis in partnership interest transfers to partnership's assets received upon liquidation.
- Gain/Loss recognized by Investor on sale of Foreign Currency is ordinary unless capital treatment is elected by partnership.

BLIPS

Economic Exposure

- Investment in foreign currency transactions is unsuccessful. Maximum exposure is $3.6M.
- IRS substantial understatement penalty (20%)
- Interest on any taxes paid pursuant to IRS controversy (currently 8 percent).

BLIPS

Bond Linked Issue Premium Structure

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Proprietary Material
Confidentiality Requested

KPMG 0007460

Permanent Subcommittee on Investigations
EXHIBIT #95v

BLIPS

Investment Focus:

- Attracted to both short-term and long-term profit opportunities in emerging market currencies.

Investment Strategy:

- Multi-stage strategy designed by Presidio Advisors to generate significant investment returns through strategic investments in emerging market currencies.

Investment Logic → Profit Motive:

- Investment transactions will not be respected for tax purposes unless transactions have economic substance.
- Investor must have a *reasonable expectation* of earning a *reasonable pre-tax profit* from investment.

KPMG

BLIPS

Presidio's Three Stage, Seven Year Investment Program:

- Stage I - Investment cycle is 60 days with investments made in relatively low risk financial instruments. The underlying investment strategy is based upon the premise that devaluation will occur with respect to certain foreign currencies currently pegged to the U.S. dollar.

BLIPS

Presidio's Three Stage, Seven Year Investment Program:

- <u>Stage II</u> - Investment cycle is 120 days with investments made in relatively moderate risk financial instruments. The underlying investment strategy is similar to that of Stage I but a greater percentage of investment capital is used to purchase securities and derivatives with greater levels of associated investment risk.

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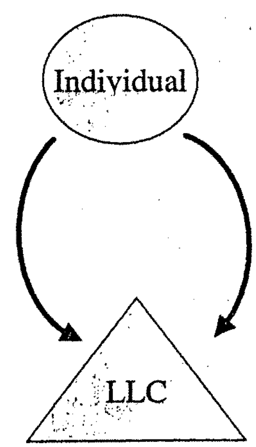
BLIPS

Presidio's Three Stage, Seven Year Investment Program:

- Stage III - Investment cycle is 6.5 years with investments in relatively high risk financial instruments. Investments are made in foreign currency-based securities and derivative contracts, post-devaluation, with the expectation that there will be extraordinary amounts of appreciation in value subsequent to devaluation.

Day 1 -- $20 Million Loan/ $10 Million Loan Premium

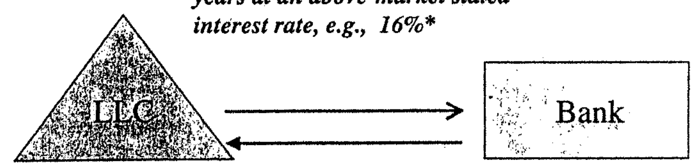
Individual forms single member LLC



Individual contributes cash equal to 7% of Premium - $700,000

Day 1 -- $20 Million Loan/ $10 Million Loan Premium

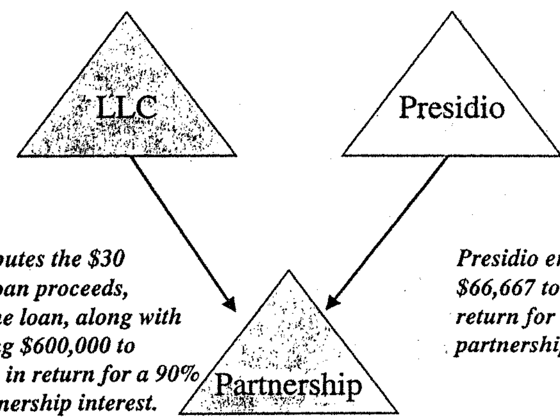
*LLC borrows $20 million on a NONRECOURSE basis for 7 years at an above-market stated interest rate, e.g., 16%**



LLC receives a loan premium of $10 million as a result of the above-market stated 16% interest rate.

**Bank is paid a loan origination fee equal to .5% of the loan ($100,000)*

Day 10 -- Capital Contributions

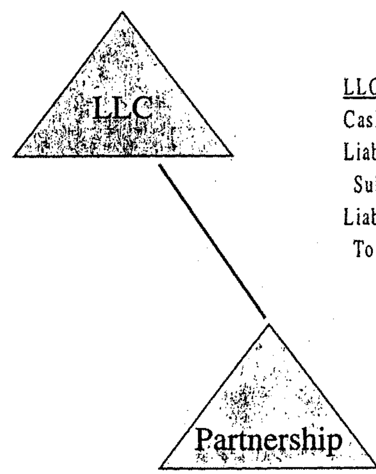


LLC contributes the $30 million of loan proceeds, subject to the loan, along with its remaining $600,000 to Partnership in return for a 90% limited partnership interest.

Presidio entities contribute $66,667 to Partnership in return for 10% general partnership interests.

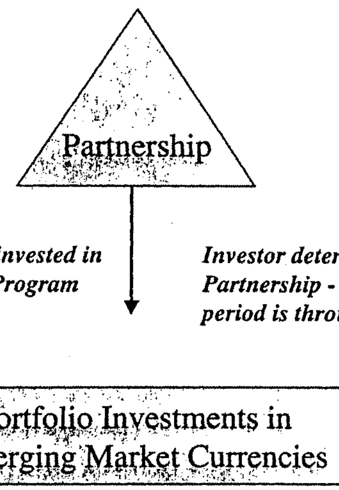
KPMG

Day 10 -- LLC's Tax Basis



LLC's Tax Basis in Partnership	
Cash contribution	$ 30.6
Liability assumed (100%)	(20.0)
Subtotal	10.6
Liability allocated (90%)	18.0
Total Tax Basis	$ 28.6

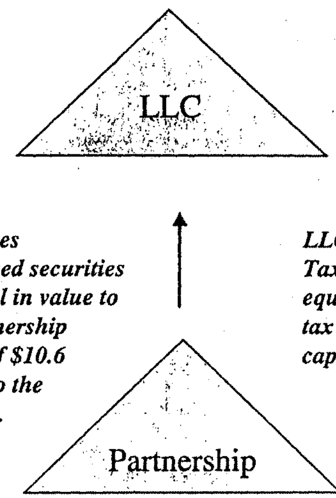
Day 10 through End of Investment Period



Partnership assets are invested in Presidio's Investment Program

Investor determines when to exit Partnership - minimum holding period is through Stage I.

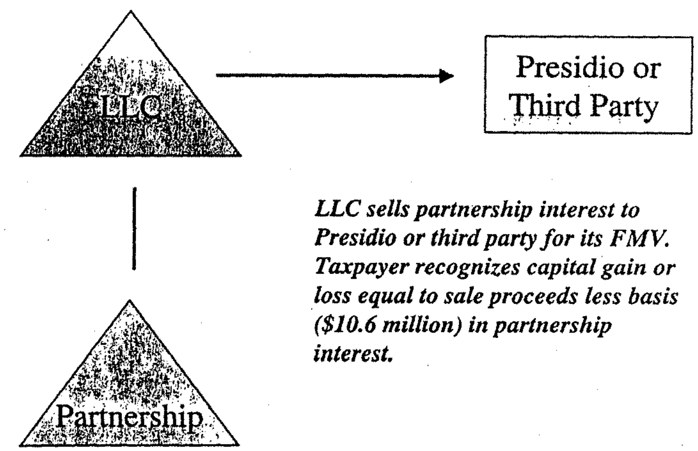
Termination of Investment - Liquidating Distribution



Partnership distributes foreign currency-based securities to LLC that are equal in value to the FMV of the partnership interest. Tax basis of $10.6 million is allocated to the distributed securities.

LLC sells distributed securities. Taxpayer recognizes gain or loss equal to the difference between tax basis and FMV (ordinary or capital).

Termination of Investment - Sale of Partnership Interest



LLC sells partnership interest to Presidio or third party for its FMV. Taxpayer recognizes capital gain or loss equal to sale proceeds less basis ($10.6 million) in partnership interest.

Tax Impact of Investment Program

	Outright Sale	Sale with the Strategy
Gross Sale Proceeds of Property	$10,000,000	$10,000,000
Less: Cost Basis of Property Sold	$0	$0
Net Capital Gain/Ordinary Income	$10,000,000	$10,000,000
Less: Tax*	($2,500,000)	$0
Maximium Transaction Cost**	$0	($525,000)
Net Proceeds from Sale of Property	$7,500,000	$9,475,000
Dollar Increase by Using the Strategy		$1,975,000

Assumptions:
**The effective capital gains tax rate is 25 percent (Federal and State).*
***The maximum downside exposure from participation in the Investment Program is the loss of invested capital, $700,000 (approximately $525,000 net of tax benefit).*

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BLIPS

Income Tax Consequences (Investor)

- Investor will recognize a pro-rata share of Partnership income or loss.
- Redemption of Partnership interest - Investor will recognize gain or loss equal to the amount realized on the subsequent sale of distributed assets less the former basis in the Partnership interest.
  - Gain/Loss is ordinary unless capital treatment is elected by Partnership.
- Sale of Partnership interest - Investor will recognize capital gain or loss equal to the sale proceeds less the basis in the Partnership interest.

BLIPS

Economic Exposures

- Investment in the Investment Program is unsuccessful. Maximum downside exposure is $700,000 (approximately $525,000 net of tax benefit).
- Interest on any taxes paid pursuant to IRS controversy (currently 8 percent).
- IRS 20% substantial understatement penalty.

Unknown

From: Henderson, Tracie K
Sent: Wednesday, June 09, 1999 3:00 PM
To: Bickham, Randall S
Cc: Eischeid, Jeffrey A; Watson, Mark T; Taylor, Theresa S
Subject: FW: Blips attached

I've made changes to address Larry's concerns. I'll have Theresa input the changes and send the new version to you. I haven't followed Larry's recommendations completely, so....

-----Original Message-----
From: DeLap, Larry
Sent: Wednesday, June 09, 1999 3:45 PM
To: Bickham, Randall S
Cc: Eischeid, Jeffrey A; Henderson, Tracie K; Watson, Mark T
Subject: FW: Blips attached

Randy -

Slide 2

Change third bullet to "Investment transactions need to have economic substance in order to be respected for tax purposes".

Slides 2, 3, 4

I think there should be footnote or something to the effect that "The above information has been provided by Presidio Advisers".

Slide 3

Change "devaluation will occur" to "devaluation may occur".

Slide 13

I'd be inclined to eliminate this slide. The assertion that the maximum downside exposure is approximately $525,000 is simply not true.

If you keep the slide, the title of slide should be changed to "Intended [or Expected] Tax Impact of Investment Program", the "Maximum Transaction Cost" line should be eliminated, and the line "Dollar Increase by Using the Strategy" should have a parenthetical of something like "excluding investment gains/losses from the program".

Slide 14

Gives impression that results are a sure thing (liberal use of "will"). I suggest starting out with "It is more likely than not that", then changing "will recognize" in each of the bullets to "recognizes".

Slide 15

Maximum downside exposure is a lot more than $700,000 (legal fees, substantial understatement penalty, etc.) Also, if transaction were successfully attacked for not having a profit motive, the IRS and the court could disallow any tax deduction for out of pocket costs, so the "net of tax benefit" parenthetical should come out.

As the potential tax savings have been quantified on Slide 13 (if that slide is retained), the potential substantial understatement penalty should be quantified on this slide (i.e., 20% of $2.5 million = $500,000).

Legal and other fees in defending strategy in event of IRS challenge should be listed as an economic exposure.

Larry

-----Original Message-----
From: Bickham, Randall S
Sent: Tuesday, June 08, 1999 3:15 PM
To: DeLap, Larry
Cc: Eischeid, Jeffrey A; Henderson, Tracie K; Watson, Mark T
Subject: FW: Blips attached

Larry -
Larry -

We have attempted to better structure our BLIPS marketing presentations by reformatting the slides that were previously submitted for DPP review. Any thoughts or changes before release to our BLIPS marketing group?

Randy

-----Original Message-----
From: **Henderson, Tracie K**
Sent: Friday, June 04, 1999 8:29 AM
To: Bickham, Randall S
Cc: Eischeid, Jeffrey A
Subject: FW: Blips attached

Randy - Great job on the slides. Here are our collective changes.

Theresa S. Taylor
Secretary-Personal Financial Planning
KPMG LLP - Atlanta
404/222-3319
tstaylor@kpmg.com

BLIPS

Bond Linked Issue Premium Structure

KPMG

Proprietary Material
Confidentiality Requested

BLIPS

Investment Focus:

- Attracted to both short-term and long-term profit opportunities in emerging market currencies.

Investment Strategy:

- Multi-stage strategy designed by Presidio Advisors to generate significant investment returns through strategic investments in emerging market currencies.*
- Investment transactions need to have economic substance in order to be respected for tax purposes.

*Information provided by Presidio Advisors.

BLIPS

Investment Stages:

- Stage I - Investment cycle is 60 days with investments made in relatively low risk financial instruments. The underlying investment strategy is based upon the premise that devaluation may occur with respect to certain foreign currencies currently pegged to the U.S. dollar.*

*Information provided by Presidio Advisors.

BLIPS

Investment Stages:

- Stage II - Investment cycle is 120 days with investments made in relatively moderate risk financial instruments. The underlying investment strategy is similar to that of Stage I but a greater percentage of committed investment capital is used to purchase securities and derivatives with similar levels of associated investment risk.*

*Information provided by Presidio Advisors.

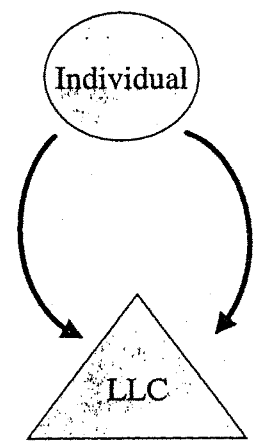
BLIPS

Investment Stages:

- Stage III - Investment cycle is 6.5 years with investments in relatively high risk financial instruments. Investments are made in foreign currency-based securities and derivative contracts, post-devaluation, with the expectation that there will be extraordinary amounts of appreciation in value subsequent to devaluation.

Day 1 -- $20 Million Loan/ $10 Million Loan Premium

Individual forms single member LLC



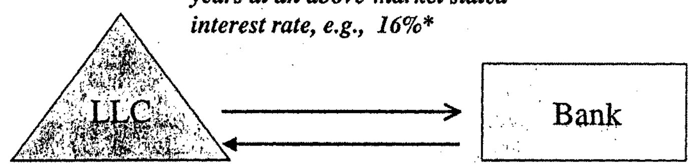
Individual contributes cash equal to 7% of Premium - $700,000

KPMG

Proprietary Material
Confidentiality Requested

Day 1 -- $20 Million Loan/ $10 Million Loan Premium

*LLC borrows $20 million on a NONRECOURSE basis for 7 years at an above-market stated interest rate, e.g., 16%**



LLC receives a loan premium of $10 million as a result of the above-market stated 16% interest rate.

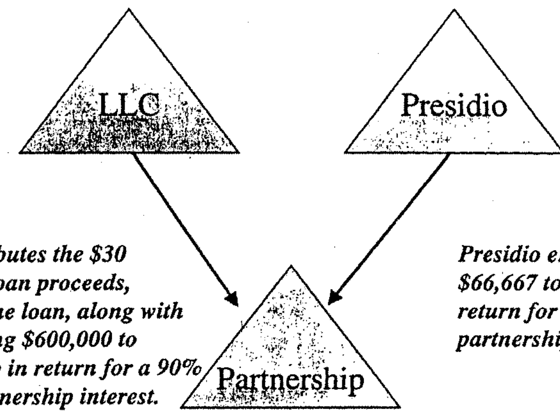
**LLC pays Bank a loan origination fee equal to 1% of the premium ($100,000)*

KPMG

Proprietary Material
Confidentiality Requested

7

Day 10 --
Capital Contributions



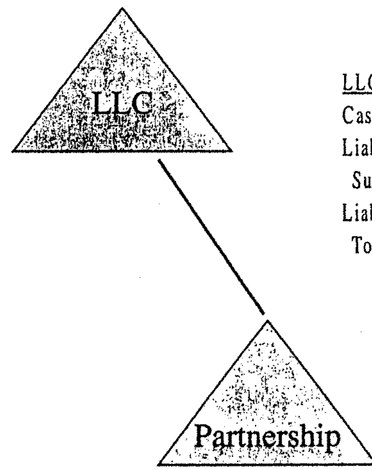
LLC contributes the $30 million of loan proceeds, subject to the loan, along with its remaining $600,000 to Partnership in return for a 90% limited partnership interest.

Presidio entities contribute $66,667 to Partnership in return for 10% general partnership interests.

KPMG

Proprietary Material
Confidentiality Requested

Day 10 --
LLC's Tax Basis

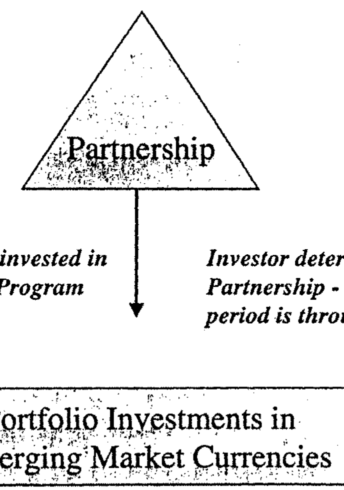


LLC's Tax Basis in Partnership	
Cash contribution	$ 30.6
Liability assumed (100%)	(20.0)
Subtotal	10.6
Liability allocated (90%)	18.0
Total Tax Basis	$ 28.6

KPMG

Proprietary Material
Confidentiality Requested

Day 10 through End of Investment Period

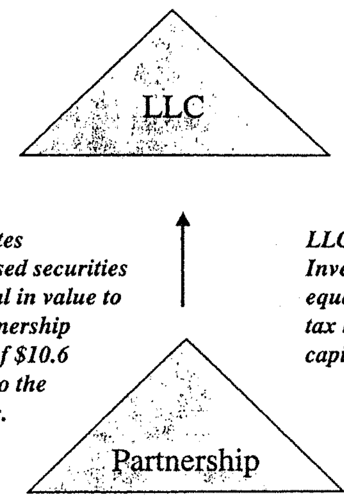


Partnership assets are invested in Presidio's Investment Program

Investor determines when to exit Partnership - minimum holding period is through Stage I.

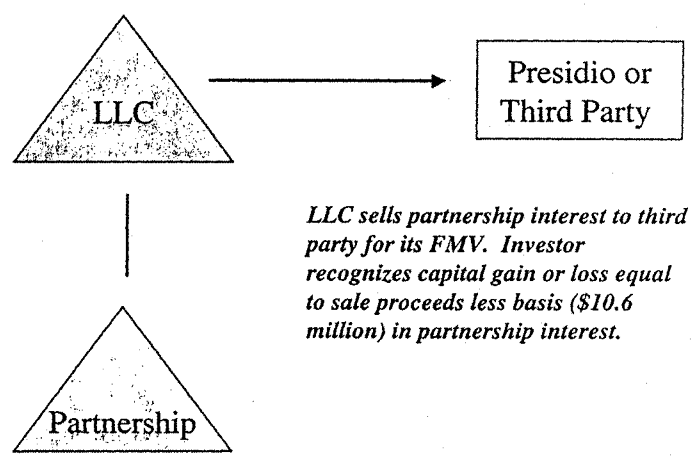
Termination of Investment - Liquidating Distribution

Partnership distributes foreign currency-based securities to LLC that are equal in value to the FMV of the partnership interest. Tax basis of $10.6 million is allocated to the distributed securities.



LLC sells distributed securities. Investor recognizes gain or loss equal to the difference between tax basis and FMV (ordinary or capital).

Termination of Investment - Sale of Partnership Interest



LLC sells partnership interest to third party for its FMV. Investor recognizes capital gain or loss equal to sale proceeds less basis ($10.6 million) in partnership interest.

Expected Tax Impact of Investment Program

	Outright Sale	Sale with the Strategy
Gross Sale Proceeds of Property	$10,000,000	$10,000,000
Less: Cost Basis of Property Sold	$0	$0
Net Capital Gain/Ordinary Income	$10,000,000	$10,000,000
Transaction Costs/Invested Capital	$0	($700,000)
Savings (Cost)	($2,000,000)	$140,000
Net Proceeds from Sale of Property	$8,000,000	$9,440,000
Dollar Increase by Using the Strategy		$1,440,000

Assumptions:
- *The investment strategy is unsuccessful*
- *The effective capital gains tax rate is 20 percent (Federal and State).*
- *The transaction costs/invested capital are deductible.*

KPMG

Proprietary Material
Confidentiality Requested

BLIPS

Income Tax Consequences (Investor)

- More likely than not: Investor recognizes a pro-rata share of Partnership income or loss.
- Redemption of Partnership interest - Investor recognizes gain or loss equal to the amount realized on the subsequent sale of distributed assets less the former basis in the Partnership interest.
  - Gain/Loss is ordinary unless capital treatment is elected by Partnership.
- Sale of Partnership interest - Investor recognizes capital gain or loss equal to the sale proceeds less the basis in the Partnership interest.

BLIPS

Economic Exposure

- Loss of capital ($700,000) if the Investment Program is unsuccessful. (The loss may be deductible, reducing the after tax loss.)
- Interest on any taxes paid pursuant to IRS controversy (currently 8 percent).
- IRS 20% substantial understatement penalty (20% x 2 million = $500,000).
- Legal and other fees in event of IRS challenge.

KPMG

Unknown

From: Henderson, Tracie K
Sent: Wednesday, August 11, 1999 4:30 PM
To: Eischeid, Jeffrey A
Subject: FW: BLIPS Presentation & Opinion Letter

Jeff -

I left the tax issues and procedural issues in the presentation, but changed them somewhat. I took out the calculation of penalties. I could not change "$107 loss" to read "$107 basis," because the basis is $287 (less liab assumed of $180 = $107 loss). So, I just elimated the parenthetical. The numerical example on the side does show the "($107)" labeled as "gain [illegible]oss)" however.

Anyway, I'm happy if you are.

Tracie

-----Original Message-----
From: McGrath, Kevin J
Sent: Wednesday, August 11, 1999 5:35 PM
To: Henderson, Tracie K
Subject: RE: BLIPS Presentation & Opinion Letter

I made two editing changes (a comma and an making an underline appear on the screen). I also deleted the slide 13, because it appears that the next slide says the exact same thing. My updated version is the "2nd Final ..." Everything else looked fine. Is this what you wanted me to do?

Final BLIPS Presentation.ppt   2nd Final BLIPS Presentation.p...

-----Original Message-----
From: Henderson, Tracie K
Sent: Wednesday, August 11, 1999 3:34 PM
To: McGrath, Kevin J
Subject: FW: BLIPS Presentation & Opinion Letter
Importance: High

Can you go through the Power Point and edit? Thanks.

-----Original Message-----
From: Taylor, Theresa S
Sent: Wednesday, August 11, 1999 9:35 AM
To: Henderson, Tracie K
Subject: FW: BLIPS Presentation & Opinion Letter
Importance: High

Let me know.

Theresa S. Taylor
Admin. Asst.-Personal Financial Planning
KPMG LLP - Atlanta
404/222-3319
tstaylor@kpmg.com

-----Original Message-----
From: Bickham, Randall S
Sent: Tuesday, August 10, 1999 7:56 PM
To: Taylor, Theresa S
Cc: Eischeid, Jeffrey A; Henderson, Tracie K
Subject: BLIPS Presentation & Opinion Letter
Importance: High

Proprietary Material
Confidentiality Requested

KPMG 0007752

Permanent Subcommittee on Investigations
EXHIBIT #95w

Theresa,

Attached are the BLIPS Marketing Presentation and latest draft of the opinion that need to be posted to the BLIPS outlook folder. Please coordinate with Tracie any changes that she would like to make to the marketing presentation.

Randy << File: BLIPS DPP FINAL (M).doc >> << File: Final BLIPS Presentation.ppt >>

BLIPS

Bond Linked Issue Premium Structure

Proprietary Material
Confidentiality Requested

KPMG

KPMG 0007754

BLIPS

Investment Focus:

- Attracted to both short-term and long-term profit opportunities in emerging market currencies.

Investment Strategy:

- Multi-stage strategy designed by Presidio Advisors to generate significant investment returns through strategic investments in emerging market currencies.*

**Information provided by Presidio Advisors*

KPMG

BLIPS

Investment Logic→Profit Motive:

- Investment transactions need to have economic substance in order to be respected for tax purposes.
- Investor must have a *reasonable expectation* of earning a *reasonable pre-tax profit* from investment.

BLIPS

Presidio's Three Stage, Seven Year Investment Program:

- Stage I - Investment cycle is 60 days with investments made in relatively low risk financial instruments. The underlying investment strategy is based upon the premise that devaluation may occur with respect to certain foreign currencies currently pegged to the U.S. dollar.*

**Information provided by Presidio Advisors*

BLIPS

Presidio's Three Stage, Seven Year Investment Program:

- <u>Stage II</u> - Investment cycle is 120 days with investments made in relatively moderate risk financial instruments. The underlying investment strategy is similar to that of Stage I but a greater percentage of investment capital is used to purchase securities and derivatives with greater levels of associated investment risk.*

**Information provided by Presidio Advisors*

BLIPS

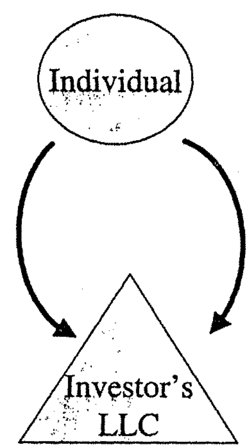
Presidio's Three Stage, Seven Year Investment Program:

- Stage III - Investment cycle is 6.5 years with investments in relatively high risk financial instruments. Investments are made in foreign currency-based securities and derivative contracts, post-devaluation, with the expectation that there will be extraordinary amounts of appreciation in value subsequent to devaluation.

**Information provided by Presidio Advisors*

Day 1 -- $200 Million Loan/ $100 Million Loan Premium

Individual forms single member LLC



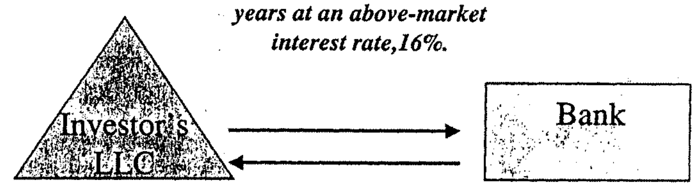
Individual contributes cash equal to 7% of Premium - $7 million

KPMG

7

Day 1 -- $200 Million Loan/ $100 Million Loan Premium

Investor's LLC borrows $200 million on a NONRECOURSE basis for 7 years at an above-market interest rate,16%.

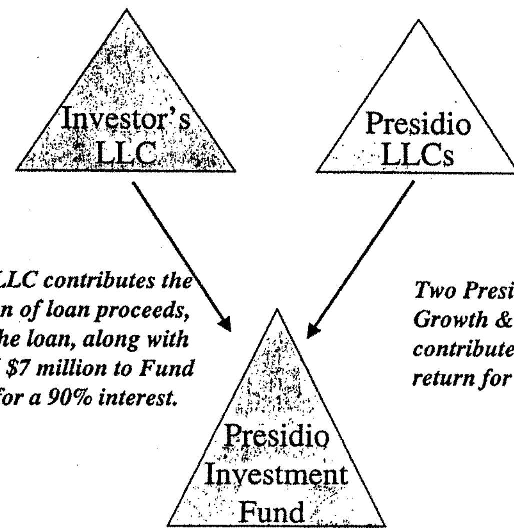


Investor's LLC receives a loan premium of $100 million as a result of the above-market 16% interest rate.

Proprietary Material
Confidentiality Requested

KPMG

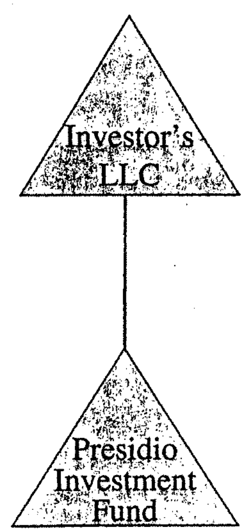
Day 10 --
Capital Contributions



Investor's LLC contributes the $300 million of loan proceeds, subject to the loan, along with the original $7 million to Fund in return for a 90% interest.

Two Presidio LLCs, Presidio Growth & Presidio Resources, contribute $777,778 to Fund in return for a 10% interest.

Day 10 -- Investor's Tax Basis in Fund



Investor's Tax Basis in Fund	
Cash contribution	$ 307
Liability assumed (100%)	(200)
Subtotal	107
Liability allocated (90%)	180
Total Tax Basis	$ 287

10

Proprietary Material
Confidentiality Requested

KPMG 0007763

Day 10 through End of Investment Period

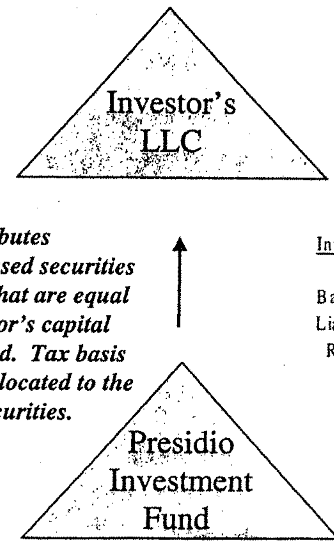
Presidio Investment Fund

Fund's assets are invested in Presidio's Investment Program

Investor determines when to exit Investment Program - minimum holding period is 60 days.

Portfolio Investments in Emerging Market Currencies

Termination of Investment - Liquidating Distribution



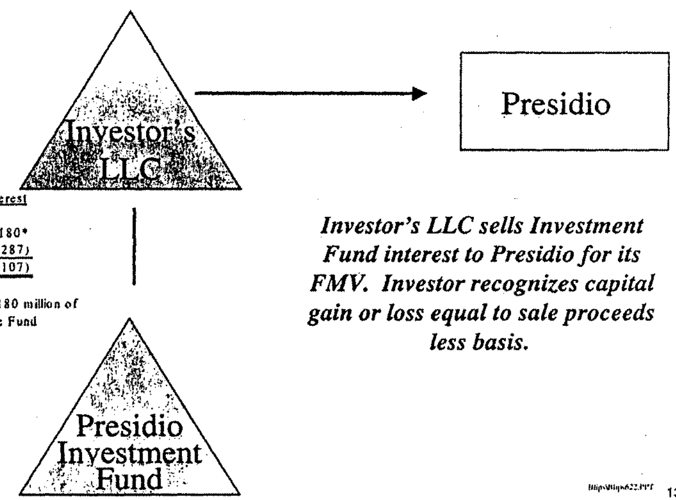
Fund distributes foreign currency-based securities to Investor's LLC that are equal in value to Investor's capital account in the Fund. Tax basis of $107 million is allocated to the distributed securities.

Investor's Tax Basis at Liquidation

Basis in Fund	$287
Liability Relieved	($180)
Remaining Basis	$107

KPMG

Termination of Investment - Sale of Investment Fund Interest



Gain/Loss on Sale of Fund Interest

Amount Realized	180*
Basis in Partnership	($287)
Gain / (Loss)	($107)

* Amount Realized includes $180 million of debt relief, plus the value of the Fund interest, if any

Investor's LLC sells Investment Fund interest to Presidio for its FMV. Investor recognizes capital gain or loss equal to sale proceeds less basis.

Proprietary Material
Confidentiality Requested

KPMG

13

Expected Tax Impact of Investment Program

	Outright Sale	Sale with the Strategy
Gross Sale Proceeds of Property	$100,000,000	$100,000,000
Less: Cost Basis of Property Sold	$0	$0
Net Capital Gain/Ordinary Income	$100,000,000	$100,000,000
Transaction Cost/Invested Capital	$0	($7,000,000)
Tax Savings (Cost)	($25,000,000)	$1,750,000
Net Proceeds from Sale of Property	$75,000,000	$94,750,000
Dollar Increase by Using the Strategy		$19,750,000

Assumptions:

**The effective capital gains tax rate is 25 percent (Federal and State).*
**The investment strategy was unsuccessful.*
**The transaction costs/invested capital are deductible.*

KPMG

BLIPS

Income Tax Consequences to Investor:

(It is more likely than not that)

- Investor recognizes a pro-rata share of Investment Fund income or loss.
- Redemption of Investment Fund Interest - Investor recognizes gain or loss equal to the amount realized on the subsequent sale of distributed assets less the basis in the Fund.
  - Gain/Loss is ordinary unless capital treatment is elected by the Fund.
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BLIPS

Economic Exposures

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- Interest on any taxes paid pursuant to IRS controversy (*Currently 8 percent*).
- IRS 20% substantial understatement penalty.
- Legal and other fees in defending strategy in the event of IRS challenge.

BLIPS

Filing/Procedural Considerations

- Presidio investment presentation
- Client representations letter
- No tax shelter reporting requirements.
- Tax opinions from KPMG and Brown & Wood
- Flow-through reporting

BLIPS

Tax Risk Considerations

- Reasonable expectation of pre-tax profit
- Law changes
- Investor treated as true borrower
- Face amount of the loan is the "liability"
- Deductibility of "at risk" amounts
- Various judicial doctrines

BLIPS

Bond Linked Issue Premium Structure

KPMG

BLIPS

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KPMG

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KPMG

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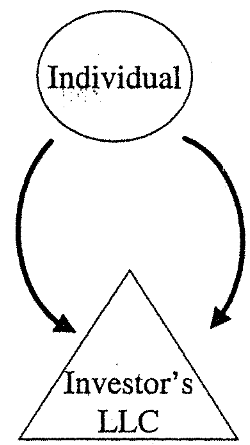

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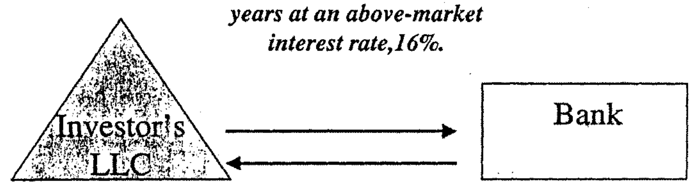

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KPMG

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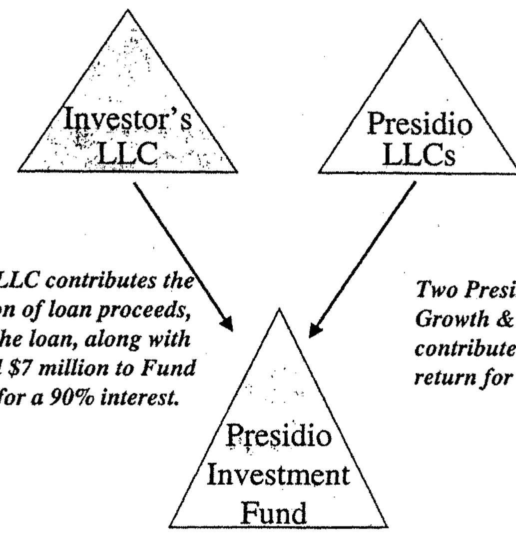

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KPMG

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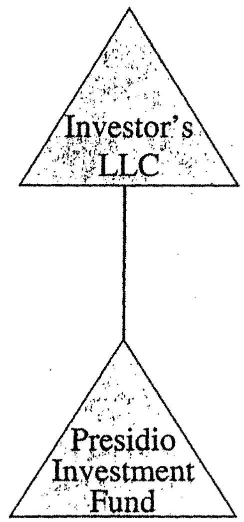

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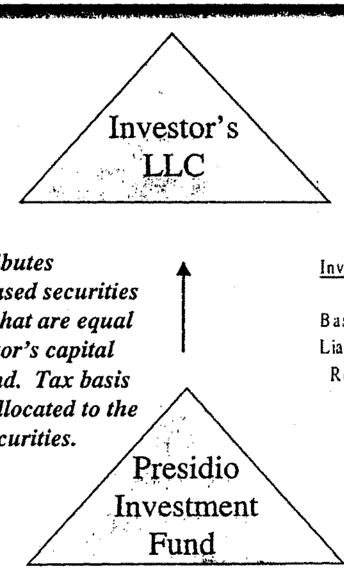

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KPMG

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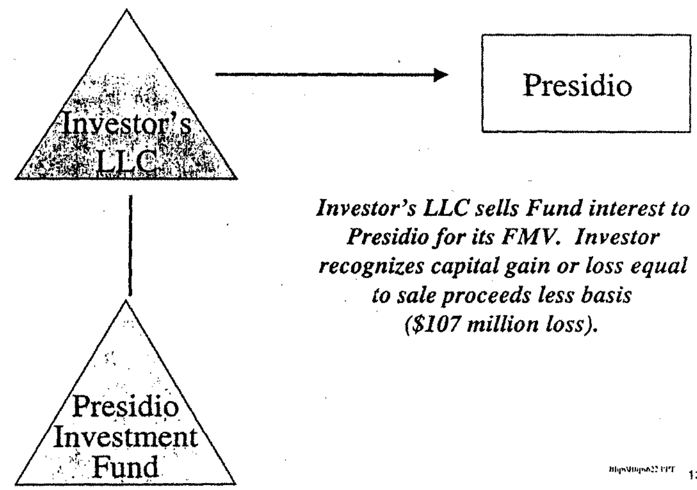
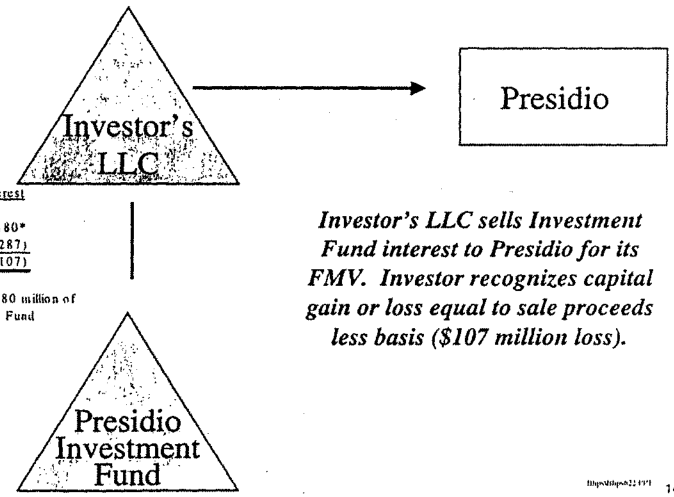


Investor's LLC sells Fund interest to Presidio for its FMV. Investor recognizes capital gain or loss equal to sale proceeds less basis ($107 million loss).

Termination of Investment - Sale of Investment Fund Interest



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KPMG

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KPMG

BLIPS

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KPMG

BLIPS

Economic Exposures

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- Interest on any taxes paid pursuant to IRS controversy (*Currently 8 percent*).
- IRS 20% substantial understatement penalty (20% x $25 million = $5 million).
- Legal and other fees in defending strategy in the event of IRS challenge.

KPMG

BLIPS

Filing/Procedural Considerations

- Investment Program is not subject to the Tax Shelter Reporting Requirements.
- Tax Opinions From KPMG and Brown & Wood
- Client Representations Letter Required
- Flow-Through Reporting
- Presidio Investment Presentation

BLIPS

Tax Risk Considerations

- Reasonable expectation of pre-tax profit/business purpose/economic substance doctrines
- Step transaction doctrine
- Substance over form doctrine
- Investor treated as true borrower & the face amount of the loan is the "liability"
- Deductibility of "at risk" amounts
- Law changes

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=20092
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20092
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS Prospect
Sent: 1999-06-21 18:27:55.126
Date: 1999-06-21 18:27:56.204
X-Folder: Sales Assistance

I met with a client today that has a total of $50 M of gain for 1999. He already did a Quadra/Price Waterhouse UBS deal to cover $15 M of the gain (the amount of the gain he originally thought he was going to have). We wants to offset the other $35M and he likes the BLIPS product. He indicated that we could file his return this year if we wanted to. I told him that we would need to get comfortable on the remaining elements of his return including the structure of the Quadra transaction before we would agree to prepare and file his return. Provided we control the reporting of both transactions or alternatively, if we let the local CPA file with our guidance, does the fact that both transactions will be reported on the same return give either of you any concern? Price will not be the one filing his return, so there should not be any issue with them learning about BLIPS.

Thanks

francesco.piovanetti@db
.com

To: Ivor Dunbar
cc: paul.glover@db.com, william.boyle@db.com
Subject: BLIPS

Sent: 06/29/1999 09:03 PM

Ivor,

Following is a schedule of the current fee structure presented to Global Markets (Nancy Donohue)/Private Banking (John Rolfes) by Presidio:

1) Deutsche Bank 1.25%
2) KPMG 1.25%
3) ICA 0.60%
4) Brown& Wood 0.40% (legal opinion to US Investor)
5) Equity Capital Return 0.15%
6) Admin Costs 0.20%
7) Expected Execution Cost 1.00%
8) Return to Investor 0.50%
Total 5.35%

all fees are based on Loan Premium amount (item b)

For discussion purposes I will use the following assumptions:

a) Loan Amount USD 100 MM
b) Loan Premium USD 60 MM - this is the tax benefit portion of the transaction.
c) Total Advance USD 160 MM

US Investor will wire on day zero 7% of the Loan Premium amount (item b) in this example it will be USD 4.2MM. These funds will be used for collateral and payment of the fees described above, of which DB-Global Markets will collect 1%, out of the 1.25%, of that amount on day zero ("Up-front Loan Origination Fee"). After stage two of the transaction (seven days after the loan funds have been disbursed) DB-Global Markets will collect a .25% ("Custody Fee") for the management of the funds in the margin account, (ie. the funds that will not be "at--risk" in FX positions) this funds should amount to approximately 80% of the Total Advance (item c). In addition, DB-Global Markets will charge 15bps (for 60 days) as an interest rate spread on the Total Advance (item c). That is the current view of Presidio on DB fees.

The following issues should be discussed in your meetings with John Rolfes and, subsequently, Bob Pfaff in London:

- Item 4 should always be a fixed amount. I would assume that Brown & Wood would charge around USD 200,00 - 250,000 for an opinion to any US client. Hence, the USD 240,000, as they have presented to us, seems like a standard fixed cost of the transaction and should not change depending on the tax benefit amount in the transaction (item b). This would imply that as the transaction size increases, there would be more bps left on the table for-grabs.

- Item 5 should be discussed with Presidio, since Nancy or John have not been able to determine what the Equity Capital Return is.

- Item 6 is a fixed cost that should not change with transaction size. It is my opinion that USD 120,000 per client to market and execute a transaction is on the high side.

- Item 7 has been analysed by Nancy Donohue on various "sample trades". She and Presidio concluded that 65bps is the total amount of negative carry of the transactions. Hence, 35bps will be left unused by the trading entity (LLC). It

Permanent Subcommittee on Investigations
EXHIBIT #95y

should be noted that out of the 65bps, 20bps represent the cost of a swaption between DB and the LLC.

- Item 8 should be discussed with Presidio, since Nancy or John have not been able to determine what the Return to Investor is. Is the true cost to the US Investor 6.50% or 7.00%?...

It is in our best interest to understand what the actual fee structure is, and what the actual components of the fee structure are. Currently there is 165bps (7%-5.35%) of money that has not been assigned to any part of the transaction cost scheme. I would assume that amount would be the fees for Presidio. That means that they would be getting 32% more than DB. That percentage could be higher if Presidio keeps most of the fixed costs of the transaction.
Conversely, you could make the argument that 125bps (plus 15bps of margin and 20bps on the swaption) should be a fair market price for the execution of these types of trades in the US.

The only internal issues that we have outstanding now are (i) your conversation with Hugo (Credit) and (ii) your conversation with Arnd (Tax). Hugo should be persuaded to give the responsibility of the credit approval process (on these and other transactions) to his deputies in NY (ie. Harry and Paul M.); this should eliminate the burden of going to GCC. They have credit signing authority up to EUR 400MM. As discussed, I don't foresee any transaction going beyond EUR 200MM. Your conversation with Arnd should be with the understanding that Joe C. has given consent to the transaction after discussions with Shearman & Sterling. The Controlling area approval will be handled by Michael Dougherty (STG-Business Manager, NY).

I am currently identifying all the areas that are relevant to the BLIPS transaction. I want to ensure that all key personnel in the various areas are aware of the actions that need to take place in the entire transaction scheme.

Paul Glover met with Nancy Donohue today and discussed our current standing in the BLIPS transaction. She is going to set up a meeting with Paul Glover and John Larson in NY on Thursday. Also, Paul met with Laurence and will meet with Michelle Cenis tomorrow.

I will try to give you a call tomorrow to discuss these and other matters.

Best regards,

FP

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=21656
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=21656
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: Blips matters
Sent: 1999-07-13 18:40:45.483
Date: 1999-07-13 18:40:46.455
X-Folder: Sales Assistance

Jeff

Thanks for copying me on your note to Mark. It certainly wasn't our intention to put anyone in an awkward position with Larry DeLap. We felt this had already been contemplated by DPP.

In Larry's e-mail dated May 18,1999, he writes to Doug, you, Mark and Phil Wiesner with copies to others. He lists 13 "conditions under which marketing of BLIPS is approved." Number 13 says "If there is an intention to use Business Development Managers in connection with the marketing of BLIPS, the intended script and other aspects of the BDM's participation are to be approved in advance by DPP-Tax."

It's in that spirit that I forwarded you the script.

If we intend to introduce this to non-clients, I'd argue that the BDM's are at least as well equipped to make those calls as any of us. . On the other hand if there has been a decision to not introduce this to anyone that we do not already have a relationship with, I understand. It just restricts our ability in Dallas.

Thanks,
Dan
-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Tuesday, July 13, 1999 7:14 AM
To: Watson, Mark T
Cc: Slattery, Daniel M
Subject: FW: Blips matters

Mark -

The use of BDMs or, worse yet, telemarketers to prospect for BLIPS candidates is clearly outside the spirit of the guidelines we discussed with Larry DeLap. I happen to agree with Larry's stance on this particular issue. Nevertheless, I am willing to revisit it with Larry. Are you pro or con?

Jeff

-----Original Message-----
From: Slattery, Daniel M
Sent: Monday, July 12, 1999 8:22 PM
To: Watson, Mark T; Eischeid, Jeffrey A
Subject: Blips matters

Gents

I'm writing to ask for your help on some Blips marketing matters. In the Dallas office, I have been encouraged to market BLIPS by not relying on our contacts within the office, but rather by conducting research on deals and attempting to meet with people who may be able to benefit from the strategy. Bill Beakly, the area tax PIC believes that most of the partner group is so new to the market, that their network of contacts is not especially developed.

We are developing a list of deals that have been closed or announced. That list will be circulated among partners and managers to see if there are any contacts. Nevertheless, we want to be prepared to call people up directly if the short list comes up a little short.

In that regard, we have prepared a script for a BDM or other professional to use if we do find it necessary to call. I've attached that script. I understand it needs to be approved by DPP or their delegate.

I'd be grateful if you would review our script and forward it to the appropriate people for approval. If we should speak, please call me at 210-2170-1606.

Thanks,
Dan Slattery

<< File: TELEMARKETING SCRIPT-6-21.DOC >>

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=16224
Subject: National Accounts Database
Sent: 1999-07-21 13:10:29.461
Date: 1999-07-21 13:10:29.461
X-Folder: National Accounts

The following is a draft "product pitch" similar to the one you forwarded me last month. Note that this product has received tentative DPP-Tax approval. It is still subject to Washington National Tax review of the underlying documentation to insure the documentation comports with various representations. That review is currently in process and should be completed some time this week or next week. To be conservative, you should probably wait for formal approval before distributing your email to National Account TSPs.

I'd like to talk to you about more specific targeting within the National Accounts list. This effort is going to be somewhat difficult given the breath of application of the BLIPS product.

Finally, I am not sure how to integrate the BLIPS product announcement with the broader PFP issue we discussed on the 14th. Specifically, if the priority of the TSPs is to enhance KPMG's relationships with the "C class", they should introduce their local PFP partner and the broad services that the PFP practice offers, e.g., tax return preparation, estate planning, stock option planning, retirement planning, etc. Innovative Strategies (formerly CaTS) is an integral part of that broad practice and is something like the icing on the cake. If the notion of a broad PFP relationship doesn't sell in a particular situation, we can at least offer key executives an introduction to Innovative Strategies. Innovative Strategies is a portfolio of value-added products that are designed to mitigate an individual's income tax as well as estate and gift tax burdens. BLIPS is just one of the products in the Innovative Strategies portfolio.

Jeff

************************ ACTION REQUIRED ***********************

PRODUCT: BLIPS

CRITERIA: Individuals with:

* significant (> $20 million) capital gain income, e.g., sale of company stock, or
* significant (> $20 million) ordinary income, e.g., exercise of nonqualified options.

VALUE PROPOSITION: Reduce Federal and state tax liabilities by making tax advantaged investments in emerging markets currencies. Aside from trading profits, a key objective is for the tax loss associated with the investment structure to offset/shelter the taxpayer's other, unrelated, economic profits. This is a turnkey investment program that integrates the services of various parties including the investment advisor, legal/drafting, banking, and KPMG tax opinion. The all-in cost of the program, assuming a complete loss of investment principal, is 7% of the targeted tax loss (pre-tax). The tax benefit of the

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investment program, which ranges from 20% to 45% of the targeted tax loss, will depend on the taxpayer's effective tax rates.

FEE: BLIPS is priced on a fixed fee basis which should approximate 1.25% of the tax loss. Note that this fee is included in the 7% described above.

CONTACT:
Jeff Eischeid -Personal Financial Planning - Atlanta- 404/222-3180

-----Original Message-----
From: Comer, Michael S
Sent: Tuesday, July 20, 1999 10:12 AM
To: Eischeid, Jeffrey A
Subject: National Accounts Database

<< File: NA720.xls >>
Jeff,

Attached is the current listing of National Accounts for the PFP analysis. It's not substantially different than the June 2 listing. Let me know if you need any other information.

Michael
212 872 6039

William Boyle
To: mick.wood@db.com@HUB, ivor.dunbar@db.com@HUB, Paul Glover@Bankers_Trust, francesco.piovanetti@db.com@HUB
cc: stuart-db.bray@db.com@HUB
Sent: 07/28/1999 10:04 PM Subject: Risk & Resources Committee Approval - BLIPS

Attached for your review is a discussion paper for presentation to the Risk and Resources Committee. I would like any comments you have regarding the appropriateness of the discussion for presentation to the Committee and any suggested changes which should be made. Due to problems with Lotus Notes, I needed to attched this note to an earlier note and place the attached discussion paper at the bottom of that note. Sorry for any inconvenience this causes..

Memorandum

To: william.boyle@db.com
cc: Francesco Piovanetti
Harry Olsen
Alan Greatbatch
Eric Gallinek
From: mick.wood@db.com @ HUB
Local Date: 07/28/99 08:05:41 AM
Sender's Date: 07/28/99 12:05:41 PM GMT
Subject: **BLIPS**

NOTE: There is a file attached to this note

I left a message on your voicemail.

First a bit of background:

Business such as "BLIPS" may be brought before the RRC by the business itself either a) to have the RRC arbitrate if there are areas of disagreement betwen business units or b) to get high level buy in to a line of business. The latter can be useful if the business wants to ensue it has high level political backing, particularly if it wishes to pursue an appeal to a higher level in one of the "control" functions.

You should be aware that RRC is a "high level/big picture" type review function for GCI business alone. It is not a "new Products Committee" and will expect all business to have the technical issues resolved at that level. It is also not an appeal body for credit issues.

Credit Officers can also refer transactions to RRC if either a) they see the transaction as satisfying the groups technical requirements for credit, but they personally feel the business should not be pursued for other reasons - e.g. poor return, business suitability vis a vis client etc. (i.e its an forum which can arbitrate on business issues) or b) if they feel it is business which is on the borderline, and they are minded to approve, but only aftrer assuring there is appropraite high level support that this is indeed business that GCI wants to do.

The context that I believe Hugo wishes the BLIPS product to go to RRC is therefore:

to get high level buy in to any reputational risks that may attach to this "tax based" business

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to get high level buy in to the nature of the Credit Risks being run

The presentation you make should focus on these aspects - particularly why they are out of the ordinary run of business for DB and why we think the risks acceptable.

I would suggest a note of no more than a page summarising the key issues, plus backing papers as necessary both to explain the deal structure and provide an appropriate analysis of the issues.

It would be useful to involve Credit (Harry Olsen?), Compliance and Tax in the preparation of that note. Nevertheless it need not reflect consensus if their are open issues upon which the RRC is being asked to opine. (such issues should be flagged)

Just as background, I am attaching a copy of a note wriiten following discussion at the RRC of the turkish tax trades. This is not directly comparable, but gives you an idea of the scope that the RRC will want to cover.

Mick

(See attached file: RRC 19 Mar report re Turkish tax transactions (as sent).doc)

- RRC 19 Mar report re Turkish tax transactions (as sent).doc

Rskresr1.doc

Unknown

From:	Nahum Arav [narav@presidioadv.com]
Sent:	Thursday, July 29, 1999 7:38 PM
To:	eischeid@kpmg.com; Rbickham@kpmg.com; amakov@presidioadv.com; bpfaff@presidioadv.com; jlarson@presidioadv.com; kbratton@presidioadv.com; narav@presidioadv.com
Subject:	A historicall analysis of a BLIPS investment case study

case study 7_29 7pm.doc

For your review, please find the attached document which represents historicall analysis of a BLIPS investment case study.
Please contact Amir Makov should you have any questions/comments regaring this analysis.

Nahum Arav

Proprietary Material
Confidentiality Requested

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EXHIBIT #95cc

KPMG 0007669

Case Study - BLIPS Investment Program

This document sets forth the inherent profit potential from participating in the BLIPS Investment Program. The methodology used to demonstrate such potential is to assume that the BLIPS Investment Program was historically in place and that hypothetical trades were entered into during the last quarter of 1997. The analysis reflects the actual fluctuations in the value of traded currencies during that time period.

The investment strategy for the case study included a short position on the Indonesian Rupee. During the time in which the position was open, the Indonesian Rupee significantly devalued resulting in a $22,000,000 profit for the Fund. Relative to the initial capital investment of $4,200,000, this profit represents more than a 450% return on capital during the 90-day period.

Assuming Presidio had executed the BLIPS Investment Program in the last quarter of 1997, Presidio would have recommended selling the Indonesian Rupee short as well as entering short positions in a number of other foreign currencies. During 1997 and thereafter, the following currencies have devalued: Thai Baht, Malaysian Ringett, Russian Ruble and Brazilian Real and others.

Investment and Cash Flow Analysis:

Base Assumptions:

- Investor formed LLC by contributing $4,200,000 in cash.
- LLC obtained a seven-year fixed rate loan with a $100,000,000 face amount and an interest coupon rate of 17%. The loan principal payment of $100,000,000 was due in year seven. As a result of the 17% coupon rate and the seven-year duration of the loan, the investor received a $60,000,000 loan premium. A key point to note is that although the stated coupon on the loan was above market (17%), the fact that LLC received cash proceeds of $160,000,000 and that the value of the loan amortizes over time, the effective cost of capital with respect the loan was approximately 5.5%.
- LLC contributed cash, subject to the loan, to the Investment Fund ("the Fund") for a 90% interest. The total amount of cash contributed to the Fund was $164,360,000, which includes the original equity, loan proceeds, premium and accrued interest.

Assumed Trading Activities:

- The total amount of cash in the Fund was used to purchase Deutsche Marks at an exchange rate of 1.75 per dollar. The total Deutsche Mark holding by the Fund was approximately DM 300,000,000. The Fund invested the Deutsche Marks in European money market securities.
- The Fund entered into the following forward exchange transactions:
  - Sold short $40,000,000 Indonesian Rupee, at the 90 day forward exchange rate of 3590 Rupee per dollar. That is: In 90 days the Fund delivers 143,600,000,000 Rupee and receives $40,000,000.
  - Sold $20,000,000 HK$, at the 90 day forward exchange rate of 7.83 HK$ per dollar. That is: In 90 days the Fund delivers 156,600,000 HK$ and receives $20,000,000.

During the 90-day period the Indonesian currency devaluated by 71% and the exchange rate became 12,500 Rupee per dollar. The numbers for the Indonesian currency reflect the actual values for the 90 days spot and forward exchange rates that occurred in October of 1997 and the spot exchange rate in December of 1997.

Day 90 Cash Flows:

- The total amount of money in the Fund after 90 days equaled approximately $190,000,000.
    - The forward contract on the Indonesian Rupee yielded a net profit of $28,512,000. This is a result of the difference between (1) $11,488,000, the cost of purchasing the Indonesian Rupee to satisfy the forward contract and (2) $40,000,000, the proceeds.
    - The forward contract on the Hong Kong Dollar resulted in a slight loss as the Hong Kong Dollar did not devalue.
    - The Fund exchanged the 300,000,000 Deutsche Marks (plus accrued interest) for USD at the current market exchange rate for a total of $166,975,200.
    - A coupon payment on the $100,000,000 loan was paid to the bank, which equaled (17%/4)*100,000,000 or $4,250,000.

After accounting for the fair market value of the loan, LLC2 was left with a market value position of $33,000,000. Deducting operating expenses and fees the investment plan distributed to the 90% class A member $27,000,000 which consisted of a $4,200,000 return on capital and approximately $22,000,000 profits interest.

Summary:

As demonstrated by our case study, the BLIPS Investment Program has the potential to create extremely high returns on the amount invested. Using historical data from the Indonesian Rupee devaluation in late 1997, we conclude that a net profit of approximately $23,000,000 within 90 days from a $4,200,000 initial investment is not only possible, but in fact would have actually occurred, given our above assumptions. Furthermore, in this case study, only one of the pegged currencies devalued. To the extent that two currencies devalue during the trading period, one could achieve even a higher rate of return.

We also analyzed the results of participating in the Investment Program for a full year period. Assume that on 1/1/1997 the Fund entered into the following forward exchange transactions: Sold short $30,000,000 of Indonesian Rupee at the one year forward exchange rate, a similar forward contract on $30,000,000 of Korean Won and another such contract on $30,000,000 of Thai Baht. The devaluation of these currencies over a one-year period (1/1/97-12/31/97) would have resulted in a $48,000,000 profit. Deducting operating expenses and fees, the Fund could distribute $41,000,000 to LLC. (This consists of $4,200,000 return of capital and approximately $37,000,000 profit, approximately a 900% return on the initial investment.)

A similar investment plan for a recent period, (1/6/98-1/6/99), assuming forward contracts on $40,000,000 of Russian Rubbles and $40,000,000 of Brazilian Real, the LLC would have made a profit of $34,000,000, which is an 800% return on the initial investment.

SHEARMAN & STERLING

July 29, 1999

Memorandum to: Persons on the attached Distribution List

"Blips" Transactions:
Financing Documentation

In connection with the above captioned transaction, enclosed please find a complete set of financing documents to be delivered in connection with the closing of the initial Blips Transaction, marked to show changes, if any, from the last distributed draft:

(i) Credit Agreement;
(ii) Form of Promissory Note (Exhibit A);
(iii) Form of Notice of Borrowing (Exhibit B);
(iv) Form of Pledge and Security Agreement (Exhibit C-1);
(v) Form of Account Control Agreement (Exhibit C-2);
(vi) Form of Borrower's Certificate (Exhibit E);
(vii) Form of Investor Representation Letter (Exhibit F);
(viii) Form of Presidio Advisors Representation Letter (Exhibit G);
(ix) Form of KPMG Representation Letter (Exhibit H);
(x) Presidio Advisors "Program" Representation Letter;
(xi) KPMG LLP "Program" Representation Letter; and
(xii) Form of UCC-1 financing statement.

In addition, please find revised drafts of the following documents to be delivered in connection with the assignment and assumption of the obligations under the Credit Agreement:

(i) Assignment and Assumption Agreement;
(ii) Form of Assignee's Certificate (Exhibit A); and
(iii) Form of Managing Member Representation Letter (Exhibit D).

Also enclosed are revised versions of the Closing Checklist and the BLIPS Working Group List. Please provide any changes to the Working Group List directly to Chris Kimball at 212-848-8764.

The Master Agreement and Schedule (Exhibit D to the Credit Agreement), as well as the revised forms of legal opinions (Exhibit I to the Credit Agreement and Exhibits B and C to the Assignment and Assumption Agreement) will be circulated under separate cover.

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Finally, in order to complete the financing documentation, we will need contact information (i.e., addresses, telephone and fax numbers and names) for the various entities involved in the Blips Structure.

Please feel free to contact me at (212) 848-7876 with any questions or comments.

Robert S. Lasky

Attachments

cc: S&S Working Group

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Distribution List

Deutsche Bank AG
William Boyle
Michelle Cenis
Nancy Donahue
Marcia Lapham
Kamran Naqvi
Francesco Piovanetti
John R. Rolfes

Presidio Advisors
John Larson
Kerry Bratton
Amir Makov
Robert Pfaff

Hale & Dorr LLP
Dimitri Racklin
David Phelan
John Sigel
Robert Burke
Charles McCain

Walter, Conston, Alexander & Green, P.C.
Harvey M. Bagg, Jr
Rudolph S. Houck
Noel Para

Shearman & Sterling
Azam H. Aziz
Cornelius J. Dwyer, Jr.
Michelle Jenab
Alvin D. Knott
Robert S. Lasky
Gerald Rokoff
Julie E. Siegel
T. Robert Zochowski, Jr.

KPMG / Presidio Advisors

Bond Linked Indexed Premium Strategy

Product Overview

Confidential and Proprietary

Overview

- Bond Linked Index Premium Strategy (the "Strategy" or "Strategies") will be marketed as a foreign exchange investment program to High Net Worth Individual Clients of KPMG by Presidio Advisors ("Presidio"). Presidio has structured the Strategy with significant pre-tax profit potential for US investors.
  - KPMG and Brown & Wood will issue "more likely than not" tax opinions to the investors regarding the tax implications of investing in the Strategy.
- Presidio has approached Deutsche Bank ("DB") with the opportunity to participate in the financing of the Strategy and the execution of foreign exchange and interest rate derivative transactions.
  - At no time will DB provide any tax advice to any of the investors involved in the transactions.
  - Representation letters designed to protect DB from any tax and reputational risk will be executed by the participants of the Strategy to further reinforce DB's position.

Deutsche Bank's Role

- Presidio has approached DB to participate in the financing of the Strategy and the execution of foreign exchange and interest rate derivative transactions. *DB will only execute FX and interest rate transactions, and finance the Strategy structure*.
- DB has worked closely with Shearman & Sterling ("S&S") in drafting the credit and derivative documents for use in Strategies in which DB chooses to participate.
  - S&S believes, based upon the facts, that DB is acting in its ordinary role as a lender and market maker of foreign exchange and interest rate transactions.
  - Based upon the facts, S&S will issue a tax opinion which concludes that:

    (i) DB should have no obligation to register the transaction with the IRS as a tax shelter,

    (ii) if DB had an obligation to register the transaction with the IRS and failed to do so, DB should not be imposed with any penalties by the IRS under the "reasonable cause" exception, and

    (iii) if a party to the transaction other than DB is liable for tax, DB will not be liable for any tax, addition to tax, interest or penalties.
- At no time will DB provide any tax, accounting, regulatory, financial, investment, and other advice to any of the investors involved in the transactions.
  - Representation letters designed to protect DB from any tax and reputational risk will be executed by investors to further reinforce DB's position.
  - Representation letters from Presidio will be executed regarding DB's involvement in the transaction.
- DB will not be mentioned by name in any of KPMG/Presidio marketing efforts.
  - Representation letters from KPMG and Presidio will be executed regarding the prohibition against the use of DB's name in any marketing materials.

Deutsche Bank's Role

- DB is not legally obligated to execute any of the Strategy transactions presented to us by Presidio.
  - DB will evaluate each transaction independently in determining whether it will participate in the Strategy.
  - Stringent collateral requirements are in place under the credit agreement and other related documents.

Deutsche Bank Fees

- 0 - 6 months: DB will earn an amount at least equal to 125bps on the premium (i.e. the amount advanced in excess of the face amount of the loan) if the transaction matures anytime within the first six months of the structure.
    - The return may be paid as a custody fee in the first quarter equal to 25bps of the premium amount, and the fixed coupon on the loan will earn a margin of 120bps annually.
- 6 months - 7 years: DB will earn a margin of 75bps annually of the amount advanced (i.e. the face amount of loan, plus premium) during the period after the first six months.
- In addition, DB will charge a custody fee of 25bps for the first quarter that the loan is outstanding, with the option to re-price the custody fee at a different level thereafter.
- FX and Swaps desk will charge the current market spread on any instruments sold to the LLC.
- Due to stringent collateral requirements, the loan will be treated as a zero risk weighted asset by DB-Treasury.

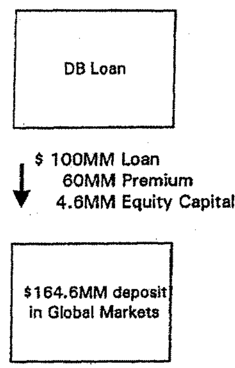
Marketing

- Presidio, the investment manager, has structured a seven-year foreign exchange investment program with significant pre-tax profit potential for US investors.
  - By utilizing leverage, along with foreign exchange strategies, investors in the Strategies may achieve high rates of return on their investments.
  - The Strategies will be marketed as a three stage/seven-year investment program.
  - The stages are differentiated by the amount of risk that the fund will take in each stage.
  - The US investors may choose to exit the program prior to year seven in lieu of providing additional capital to meet increased collateral requirements.
- Presidio will market the Strategies to the High Net Worth Individual Clients of KPMG.
  - Presidio and KMPG currently have a formal exclusive joint-venture arrangement to market the product *only* to KPMG's client base.
  - This arrangement provides Presidio with sophisticated clientele to participate in the Strategies.
  - KPMG and Brown & Wood (a major New York law firm) will issue "more likely than not" tax opinions to the investors regarding the tax consequences of investing in the Strategy.
- DB's name will not be used in any of KMPG/Presidio's marketing materials presented to investors.
- Other major banks are expected to participate in funding and executing the Strategies.

Proposed Transaction Structure - Margin Account

For presentation purposes we will use the following sample trade:

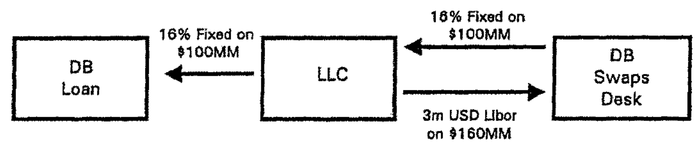
A newly created LLC will receive a seven year loan from DB-STG. The loan will carry a high coupon rate (e.g. 16%) and will be delivered to the LLC in the form of a par amount ($100MM) and a premium amount ($60MM). The loan will be collateralized with a cash contribution of approximately 7.7% ($4.6MM) of the premium amount.



Deposit loan and premium proceeds into a DB Margin Account where the funds will be held-in-custody.

Proposed Transaction Structure - Loan / Swap

The LLC may enter into an Interest Rate Swap with DB-NY Swaps desk to effectively convert the loan from a fixed rate into a floating rate Libor based obligation:



Loan Details	Swap Details
7yr	7yr
Fixed Rate Approximately 16%	Fixed Rate to Match Exact Loan Coupon
Quarterly Coupon Payments	Floating 3month Libor on $160MM

- DB-STG will enter into a offsetting swap with the DB-NY Swaps desk, creating a Libor based loan.
- If the LLC does not enter into an interest rate swap, then DB-NY Swaps desk may wish to enter into an interest rate swap with an unrelated party.
- The loan and swap will be priced simultaneously on the USD Libor curve.
- For DB-STG, the loan and swap will *always* net off against each other at each point in time to value $160MM, plus Libor accrued interest.
- The swap may have two elements to create a small basis to the loan. This risk will be borne by the LLC:
  - Seven day timing mismatch on the start date
  - Cap on 3m Libor payments, at 9%, for first two years of swap

Proposed Transaction Structure - Potential FX Transactions

1. Sell HKD / Buy USD
2. Sell ARS / Buy USD
3. Sell SAR / Buy USD
4. Sell EGP / Buy USD
5. Sell DKK / Buy EUR

In compliance with the terms of the credit agreement, all trades must be approved by DB for maturity and notional size.

Trades will typically be 2 and 3 month forward trades.

Un-pegged currency forwards will typically be hedged for down-side moves with put option purchases.

Typical Investment Program

$164.6MM in Global Markets Margin account

- Sell HKD / Buy $35MM USD
- Sell ARS / Buy $15MM USD
- Sell SAR / Buy $ 5MM USD

$55MM USD

- In all emerging market trades, the LLC will short the local currency and go long the USD.

Proposed Transaction Structure - Synthetic USD Deposit

- A key part of Presidio's FX investment program will be to hold the loan and equity proceeds in a non-USD currency.

- This will be constructed as a synthetic USD deposit using FX spot and forward trades.

- For example:
  - Day 1: Sell $160MM USD/buy EUR for value Day 1 and buy USD/sell EUR for value Day 60
  - Day 1-60: Earn Eurolibor based deposit rate

Proposed Transaction Structure - Summary

- Expected Swap/Loan/FX/Depo holding period is estimated to be 45-90 days per account.

- Managing the counterparty credit risk entails real time monitoring of LLC Equity Value versus two key risks:

1. Depo/Swap Basis Risk: Interest earned in margin account/synthetic USD depo vs. interest due on interest rate swap
2. FX Market Risk: Expected and actual MTM on fx trade

- Present "trial run" calculations estimate the risks as being equal to:

1. Depo/Swap Basis Risk: 25bps of premium amount
2. FX Market Risk: 25bps of premium amount

- 7.7% of premium amount will be held, in full, by DB until the LLC account is closed and DB has a legal claim on that amount in the credit agreement.
- The 7.7% will cover market risks, transaction costs, and DB fees.

Unknown

From: DeLap, Larry
Sent: Wednesday, August 04, 1999 7:03 AM
To: Watson, Mark T; Bickham, Randall S; Eischeid, Jeffrey A
Cc: Ammerman, Douglas K; Springer, Mark A; Rosenthal, Steven M; Larkins, Richard G
Subject: RE: Revised BLIPS Documents

As I recall, due to concerns that transacting solely with Deutsche Bank could raise an independence issue, the investor was to be given a choice of banks from whom to make the borrowing, one of which would not be a KPMG audit client. We should be looking at the various documents to be prepared by the alternative bank(s) and also request the representations from the alternative bank(s).

Larry

-----Original Message-----
From: Watson, Mark T
Sent: Tuesday, August 03, 1999 8:32 AM
To: Bickham, Randall S; Eischeid, Jeffrey A
Cc: Ammerman, Douglas K; Springer, Mark A; Rosenthal, Steven M; Larkins, Richard G
Subject: Revised BLIPS Documents

Yesterday at approximately 4:00 pm EDT I received the following revised BLIPS documents:

- Credit Agreement
- Note
- Notice of Borrowing
- Investor Representation Letter
- Pledge and Security Agreement
- Account Control Agreement
- Assignment and Assumption Agreement
- ISDA Schedule to the Master Agreement

I anticipate that we will complete our review of *these* revised documents and communicate our comments thereon (if any) to you by the close of business on Wednesday, August 4. In order to complete our review, however, we still need a copy of (1) the revised LLC agreement, (2) Presidio's economic substance analysis, and (3) a written statement from Deutsche Bank indicating that they are willing to make the representations we have asked them to make. Further, based on my brief review of the above-listed documents, I noticed that Deutsche Bank is now requesting that KPMG sign a representation letter. Thus, we also need to review this representation letter.

Once I receive the additional information (i.e., the revised LLC agreement, Presidio's economic substance analysis, a written statement from Deutsche Bank indicating that they are willing to make the representations we have asked them to make, and the KPMG representation letter), I will update you on when we anticipate completing our review of such information.

Finally, DPP-Tax and WNT still need a copy of the final BLIPS opinion letter.

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95ff

KPMG 0007677

Unknown

From: POSTMASTER
Sent: Tuesday, August 10, 1999 12:08 PM
Subject: BLIPS Conference Call

Date: August 10, 1999

To: All PFP Partners and Management Group

From: Doug Ammerman - Orange County

Subject: BLIPS Conference Call

Thank you again for participating in the PFP National Conference Call. Also, I wanted to again congratulate the practice in concluding the best year ever. PFP revenues finalized at $114MM ($14M ahead of plan) with contribution at $60.7MM ($13.MM ahead of plan). As mentioned during our call, our continued success is premised upon effective development and execution of innovative tax strategies.

With respect to BLIPS, we have a very brief window to discuss this strategy with clients. From my perspective, we have roughly two weeks to conduct initial client visits. Furthermore, given the Firm requirement that Innovative Strategy Team members be intimately involved with this product, it is imperative that you identify prospects as soon as possible. If you wait until after Labor Day, it is likely this opportunity will not be available.

As soon as possible, please contact one of the following Innovative Strategies Team members regarding your prospects:

Midatlantic		
Belcher, Gregory	Baltimore	Sr. Manager
Spiess, Timothy	Philadelphia	Partner
Remo, DeeAnn	Richmond	Sr. Manager
Watkins, Mike	Philadelphia	Partner
Midwest		
Jandl, Rusty	Kansas City	Partner
Jordan, Robert	St. Louis	Partner
Pedersen, Robert	Chicago	Partner
Shatzman, Jan	Detroit	Partner
Zaudtke, David	Minneapolis	Partner
Northeast		
Bloom, Richard	Short Hills	Sr. Manager
Desany, Ed	Burlington	Sr. Manager
Lipschultz, Brent	New York	Sr. Manager
Smolin, Jay	Stamford	Partner
Tendler, Neil	New York	Partner
Southeast		
Eischeid, Jeffrey	Atlanta	Partner
Gray, Mike	Raleigh	Partner
Henderson, Tracie	Atlanta	Partner
Pace, Katherine A.	Orlando	Partner
Spitz, William	Greenville	Partner
Zysik, Jeffrey	Miami	Sr. Manager
Southwest		
Carbo, Deke	New Orleans	Partner
Perez, Robert	New Orleans	Partner
Slattery, Daniel	Dallas	Partner
Warley, Carol	Houston	Partner
Weems, Pam	Denver	Sr. Manager
West		
Baumann, Dale	Silicon Valley	Partner
Bickham, Randy	San Francisco	Sr. Manager
Hasting, Carl	Warner Center	Partner
Liston, Shannon	Seattle	Sr. Manager
McCrimlisk, George	Los Angeles	Partner
Nuckolls, Jack	San Francisco	Sr. Manager
Paule, Robin	Warner Center	Sr. Manager
Rivkin, David	San Diego	Partner
Washington National Tax		
Gardner, John	Washington DC	Sr. Manager
Ohle, John	Washington DC	
Pye, Nicholas	Washington DC	Sr. Manager
Ransome, Justin	Washington DC	
Stone, Tracy	Washington DC	
Vail, Daniel	Washington DC	
Watson, Mark	Washington DC	Partner
National Support		
Ziegelheim, Carol		

I would like to again to take this opportunity to remind you of the ground rules regarding this strategy.

1. ***Standard Engagement Letters Are Required.*** To the extent that there are any changes they must be jointly approved by Mark Watson and Jeff Eischeid.

2. ***The Standard BLIPS Structure is Required.*** Any departures must receive the advance approval from Mark and Jeff.

3. Finally, I want to again reiterate that Innovative Strategy Team members ***MUST*** be involved with these transactions.

In short, we have a phenomenal opportunity to add to the incredible success of last year. It is clear that we have a brief window of opportunity.

Thank you in advance for your efforts.

Doug Ammerman
Personal Financial Planning
KPMG LLP
Orange County Office
(714) 850-4455
Fax (714) 850-4410
dammerman@KPMG.com

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=20092
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20092
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS Transaction
Sent: 1999-08-10 21:32:43.337
Date: 1999-08-10 21:32:44.601
X-Folder: Sales Assistance

Jeff/Mark,

We have the following transaction for which we would like to get an engagement letter signed on Monday:

The transaction is to be structured as a standard transaction. The client is interested in generating a $60 million capital loss. His capital gain will be generated from the sale of Microsoft stock which will be reported directly on his Schedule D. Client will identify which assets he will use to fund this investment, transfer them to a separate bank account, and we will have an attorney draft a declaration of separate property with respect to those funds to make sure that the IRS can not argue that we have a deemed partnership between the husband and wife here under California law. It is anticipated that the client will own the single member LLC in his own name and not through a grantor trust.

Please let me know if we are approved to execute this transaction and whether WNT will issue the opinion letter.

Thanks,

Dale

Unknown

From: Henderson, Tracie K
Sent: Wednesday, August 11, 1999 12:34 PM
To: Segel, Karen B
Cc: Eischeid, Jeffrey A; Bickham, Randall S; Springer, Mark A; Taylor, Theresa S
Subject: BLIPS Opinion Letter

Importance: High

.Karen - Please post to the BLIPS outlook folder. Thanks. Tracie

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95ii

KPMG 0039836

July 22, 1999

Investor
[Address]

You have requested our opinion regarding the U.S. federal income tax consequences of certain investment transactions that have been concluded by Investor, a Delaware single-member limited liability company. As more fully described below, Investor, through an investment fund, participated in a series of transactions involving investments in foreign currency-based securities and derivative contracts. The investments were structured through an investment program (the "Investment Fund"), designed by Presidio Growth LLC. Presidio is an independent investment advisor registered under the 1940 Investors Act that specializes in structured financial products and the execution of associated investment and derivative-based trading strategies.

Presidio acted as investment advisor (the "Investment Advisor") with respect to Investor's participation in the Investment Fund. Prior to entry into the Investment Fund, the Investment Advisor provided to Investor the attached investment analysis that sets forth the potential financial returns from participation in the strategy. Investor has represented that, based upon Investor's independent assessment of the Investment Fund investment analysis, Investor believed that there was a reasonable expectation of earning a reasonable pre-tax profit from the investment transactions described that would be in excess of all associated fees and costs, without regard to any tax benefits that might occur.

Our opinion and supporting analysis are based upon the following description of the facts, assumptions and representations associated with the investment transactions undertaken by Investor through its investment in the Investment Fund. In rendering our opinion, we have reviewed the applicable provisions of the Internal Revenue Code of 1986, as amended ("Code"), and the final, temporary, and proposed Treasury Regulations ("Treas. Reg.") promulgated thereunder; relevant decisions of the U.S. federal courts; published Revenue Rulings ("Rev. Rul.") and Revenue Procedures ("Rev. Proc.") of the Internal Revenue Service ("Service") and other materials as we have considered relevant.[1]

Our opinion is limited to the conclusions expressed below in the sections titled "*Summary of Opinion*" and "*Conclusion*". In various sections of the opinion, for ease of understanding and as a stylistic matter, we may use language such as "will" or "should" which could suggest that we reached a conclusion on an issue at a standard different from

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[1] Code Section 6110(j)(3) provides that a written determination, (e.g., a private ruling, determination letter, or technical advice memorandum), may not be used or cited as precedent. However, in Xerox Corp. v. U.S., 656 F.2d 659 (Ct. Cl. 1981), the court noted that although private letter rulings have no precedential value, "they are helpful, in general, in ascertaining the scope of the....doctrine adopted by the Service and in showing that the doctrine has been regularly considered and applied by the Service."

"more likely than not".[2] Such language should not be so construed. Our conclusions on any issue discussed in this opinion letter do not exceed a "more likely than not" standard.

[2] Under a "more likely than not" standard, we are of the opinion that under current U.S. federal income tax law there is a greater than 50 percent likelihood (i.e., it is "more likely than not") that the positions taken will be upheld if challenged by the Internal Revenue Service.

Description of Investment Transactions

A. <u>Overview of Investment Strategy</u>

The following describes the investment program entered into by Investor and the investment structure utilized based upon information provided to us by the Investment Advisor. A more detailed explanation of the underlying investment strategy prepared by the Investment Advisor is contained in the attached Presidio Strategic Investment Fund Confidential Offering Memorandum.

The Investment Advisor has represented the following relative to the investment program entered into by Investor:

> Since inception of floating exchange rates in 1973, all currencies have been subject to wide swings in value. The general consensus by the international financial community is that exchange rate volatility is undesirable because of the adverse impact these swings have on international capital flows. Consequently, many governments influence the level of their currency by intervening in the foreign exchange markets. Emerging market governments are typically more active participants in their respective currency markets because emerging market currency levels are more easily controlled and the benefits to the emerging market nations are more significant. By controlling the level of their currency, emerging market nations entice capital inflows by mitigating the risk of currency devaluation. In addition, by entering into a managed currency regime, the emerging market nation can credibly curb hyperinflation, a problem faced by many emerging market nations due to a combination of rapid growth and imprudent fiscal management common to many of these countries.
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> The objective of the Investment Fund is to generate significant investment returns through strategic investments in emerging market currencies. The general investment logic upon which the investment strategy is premised is that there are both short-term and significant long-term profit opportunities in these foreign currency markets. These profit opportunities are primarily based upon selectively selling ("shorting") overvalued emerging market currencies and selectively buying ("going long") undervalued emerging market currencies. The investment strategy seeks to obtain high risk-adjusted returns for its investors by exploiting opportunities to short currencies that are under unsustainable managed currency regimes and going long currencies previously subject to managed currency regimes that are considered fundamentally undervalued by the Investment Advisor due to political or economic upheaval. In order to mitigate risks, the Investment Fund establishes hedged positions. These positions provide an asymmetrical risk-reward relationship in which outsized returns are generated upon a favorable movement, but bear only minimal losses in the event of an adverse development.

The Investment Fund is executed in three distinct stages over a seven-year period. It is the Investment Advisor's conclusion that a successful implementation of its Investment Fund can be best achieved through utilization of a long-term investment horizon since the extraordinary market events that will maximize inherent profit potential are difficult to time. Over the seven-year time horizon encompassing the Investment Fund, the Investment Advisor expects a significant number of such market events to occur; however, no one can predict with any degree of certainty when such events will occur. In order to ensure that the Investment Advisor will have the financial wherewithal to act and invest when the market affords extraordinary trading opportunities, an investor's required investment capital to participate in the program must be committed upon entry into the Investment Fund. If an investor funds its investment capital through a loan, the Investment Advisor requires investors to arrange at least seven-year financing in order to cover the term of the program.

The three stages are differentiated by the amount of investment risk undertaken at each stage. The entire amount of capital will be invested in foreign currency-based instruments in each stage, but there will be differing degrees of volatility associated with different investments. Participation in successive stages of the Investment Fund affords the investor with the potential for higher levels of expected profitability with increasing levels of associated investment risk. At the end of each stage, the investor has the option of continuing to the next stage or terminating participation in the program.

<u>Stage I –</u> Investment cycle is 60 days with investments in relatively low risk financial instruments. The underlying investment strategy is based upon the premise that devaluation will occur with respect to certain foreign currencies currently pegged to the U.S. dollar (e.g., Hong Kong dollar, Venezuelan bolivar, Argentine peso).

<u>Stage II –</u> Investment cycle is 120 days with investments in moderate risk financial instruments. The underlying investment strategy in Stage II is similar to that of Stage I but utilizes a greater percentage of committed investment capital to purchase securities and derivatives with similar levels of associated investment risk.

<u>Stage III –</u> Investment cycle is approximately 6.5 years with investments in relatively high risk financial instruments. Investments are made in foreign currency-based securities and derivative contracts, post-devaluation, with the expectation that there will be extraordinary amounts of appreciation in value subsequent to devaluation.

B. <u>The Investment Structure</u>

The investment transactions entered into by Investor were structured through a Delaware limited liability company that was treated as a partnership for U.S. federal income tax purposes ("Partnership").[3] On [January 1, 1999] Investor obtained a [$100 million] fixed rate nonrecourse loan[4] from [Deutsche Bank AG] to fund its participation in Partnership.[5] The [$100 million] principal amount of the loan was payable on [December 31, 2005].[6] Interest on the loan was payable quarterly at a rate of [16] percent per annum. The loan proceeds were initially transferred to Investor's personal bank account at [Deutsche Bank] and then immediately transferred to Investor's trading account at [Deutsche Bank Securities, Inc., a subsidiary of Deutsche Bank AG].

The Investment Advisor has represented to us that Investor opted to repay the loan at a [16] percent interest rate in return for a premium payment of [$60 million] in order to lessen the financial risks associated with participation in the Investment Fund. As discussed, the Investment Fund uses a three phase approach with increasing levels of investment risk in each subsequent stage. The Investment Advisor further represented to us that Investor entered into a financing arrangement whereby higher levels of financing risks were incurred early in the program, with such risks declining as a portion of the borrowing (the loan premium amount) is amortized over the term of the loan. According to the Investment Advisor, the structure of Investor's loan results in an integrated investment strategy whereby there are complementary levels of investment risks and financing risks at all times during the term of the Investment Fund. By having the loan premium, it is the view of the Investment Advisor that it is possible to match the investment risks with the financing risks.[7]

On [January 10, 1999], the Investment Advisor and Investor jointly formed a Delaware limited liability company, Presidio Strategic Investment Fund, LLC, to invest in foreign currency contracts and other financial instruments pursuant to the Investment Fund. The

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[3] An limited liability company with multiple members can elect to be classified as a partnership or as an association taxable as a corporation. A domestic multi-member limited liability company will automatically be classified as a partnership pursuant to Treas. Reg. Sec. 301.7701-3(b)(1)(i)).

[4] The loan should be considered a nonrecourse liability for U.S. federal income tax purposes. Treas. Reg. Section 1.752-1(a)(2) defines a nonrecourse liability as one for which no partner (or related person) bears the economic risk of loss. In determining whether a partner bears the economic risk of loss, the primary consideration is whether a partner bears the economic burden of discharging the obligation if the partnership is unable to perform. Accordingly, a loan negotiated with a financial institution where the note specifically states that the lender will look only to the note's collateral for satisfaction of the note and that no person has any personal obligation on the note, as in the instant case, should be treated as a nonrecourse liability.

[5] To participate in the Investment Fund, Investor was required to commit a sufficient level of cash to the program so as to allow the funding of participation in all three stages. The Investment Advisor allowed an investor a choice of funding its participation in the Investment Fund on either a non-leveraged basis or a leveraged basis by contributing cash subject to an outstanding loan to the Investment Fund.

[6] As part of the loan agreement (*See* attached copy), [Deutsche Bank AG] retains the right to periodically review the collateral pool and to require improvements to the collateral pool pursuant to the covenants of the agreement. In the event of early repayment, the loan is subject to a prepayment penalty.

[7] Investment Advisor has represented to us that over the seven year term of the loan, an investor would be exposed to several types of financial risks resulting from potential changes in interest rates. Of particular concern to an investor is residual interest rate risk (the "convexity" effect). According to Investment Advisor, Investor has managed residual interest rate risk through the structuring of a financing package with a loan premium as its integral economic component. *See* the attached discussion of the underlying financial theory in the "Analysis of Financing Alternatives" prepared by the Investment Advisor. In the analysis, the Investment Advisor recommends the use of the loan premium structure to mitigate residual interest rate risk.

Investment Advisor, through two limited liability companies contributed [$400,000] to its capital account for a 1% interest as Managing Member and a 9% percent Class B interest. Investor contributed [$163.6 million] subject to the [$100 million] loan for a 90 percent Class A interest. The transfer of the loan to Partnership was approved by [Deutsche Bank AG]. To mitigate its risk position with respect to interest rates changes during the term of the loan, Partnership entered into a fixed-for-floating rate interest rate swap with [Deutsche Bank Securities, Inc., a subsidiary of Deutsche Bank AG] for a term of approximately [7] years.[8]

The Limited Liability Company Agreement required that capital accounts be maintained pursuant to Code Section 704(b) and the Regulations promulgated thereunder. In general, Partnership net profits and losses were allocated among the Members as follows: 20% to the Managing Member and 80% to all the Members, such 80% being allocated in proportion to the Members' respective capital contribution. Under the Limited Liability Company Agreement, Investor, as a Class A Member, could have withdrawn its entire capital account balance provided, however, that no withdrawal could have been made prior to sixty days after the date of the initial capital contribution of such Class A Member. The Managing Member, at its sole discretion, could have elected not to honor a withdrawal request from a Class A Member if the Managing Member either (i) elected to dissolve the Partnership or (ii) arranged for the purchase of the Class A Member's Interest for an amount equal to the amount that would have been payable to such Class A Member if such withdrawal request were honored by the Managing Member.

Upon the withdrawal of a Class A Member's capital account, the Partnership shall pay to the Class A Member an additional amount equal to the excess, if any, of (i) such Class A Member's guaranteed payment amount over (ii) the amount distributable to such Class A Member. In no event shall the amount of such additional payment exceed the amount of any positive capital account balance of the Managing Member as of the withdrawal date.

C. <u>Subsequent Events and Investment Results</u>

On [date], upon completion of [Stage I] of the Investment Fund, Investor opted to terminate its participation in the Investment Fund. As a result of Investor not opting to participate in [Stage II] of the Investment Fund, Investor elected to have its partnership interest redeemed. On [date] Investor's Partnership interest was liquidated. Investor's liquidating distribution consisted of the following Partnership assets:

- Cash [amount]
- Foreign Currency [amount]

[8] Partnership entered into the fixed-to-floating rate swap to hedge interest duration risk. Duration risk (or more precisely "modified" duration) is a measure of the price sensitivity of a bond to interest rate movements. It is used to measure the sensitivity of a bond's price (i.e., the present value of its cash flows) to interest rate movements. A swap from fixed-to-floating can be used to hedge interest rate duration risk. *See* attached discussion of the underlying financial theory in the "Analysis of Financing Alternatives" prepared by Investment Advisor.

- Financial instrument #1 [FMV]
- Financial instrument #2 [FMV]

Investor was liquidated on [date] and Investor's single member contributed the distributed assets to [his/her] existing investment activity. The foreign currency and financial instruments were sold on [date] for [amount]. Such amount represented a [amount] economic profit [loss] to Investor on Investor's initial investment.

Subsequent to Investor's withdrawal from Partnership, Partnership continued making investments with the remaining partnership assets utilizing the [$100 million] loan for financing. The covenants contained in the loan agreement allowed [Deutsche Bank] to call the [$100 million] loan within a thirty day period in the event of a 50 percent or more decrease in Partnership capital. [Deutsche Bank] called the loan on [date].

Representations

A. <u>Representations Made to KPMG by Investor</u>

In connection with the transactions described above, Investor has represented to KPMG LLP ("KPMG") the following:

- Investor's single member invests directly in marketable securities and other financial instruments on its own account.

- Investor, the Investment Advisor and [Deutsche Bank] each acted independently and at arm's length with respect to the transactions described herein.

- There was no legally binding agreement, written or otherwise, that compelled Investor to complete the transactions in the way described herein. The duration of Investor's participation in the Investment Fund was dependent upon the performance of the program relative to alternative investments.

- There were no written agency agreements (apart from a standard investment advisory agreement) consummated with respect to the transactions undertaken pursuant to the Investment Fund and none of the parties involved held itself out to a third party as an agent of any of the others with respect to these transactions.

- Investor independently reviewed the economics underlying the Investment Fund before entering into the program and believed there was a reasonable opportunity to earn a reasonable pre-tax profit from the transactions described herein (not including any tax benefits that may occur), in excess of all associated fees and costs.

- The [Deutsche Bank AG] loan collateral and covenants were not altered or amended upon assumption of the loan by Partnership.

- Investor was liquidated subsequent to receiving the liquidating distributions from Partnership. The foreign currency and financial instruments received as Partnership liquidating distributions were sold by Investor's single member.

- Investor has provided KPMG with all facts and circumstances that Investor knows, or has reason to know, are pertinent to this opinion letter and believes that all assumptions and representations on which this opinion relies are reasonable.

B. Representations Made to KPMG by the Investment Advisor

In connection with the transactions described above, the Investment Advisor has represented to KPMG the following:

- The Investment Advisor believes there is a reasonable opportunity for Investor to earn a reasonable pre-tax profit, in excess of all associated fees and costs, and without regard to any tax benefits that may occur, by participating in the Investment Fund. Further, the Investment Advisor has communicated this belief to Investor.

- [Deutsche Bank] does not, directly or indirectly, control or participate in the management or operations of Partnership.

- [Deutsche Bank] does not, directly or indirectly, control or direct the investments of Partnership apart from its rights under the security/collateral agreement.

- All transactions undertaken by Partnership were executed on foreign exchanges not designated as "qualified boards of exchange" under Code Section 1256(g)(7).

- None of the transactions undertaken by Partnership constituted a "straddle" as defined under Code Section 1092(c) (without regard to Code Sections 1092(c)(4) and (e)).

- The [Deutsche Bank AG] loan collateral and covenants were not altered or amended upon assumption of the loan by Partnership.

- The descriptions of the Investment Fund and the economics of the financing arrangement used by Investor, as set forth in the Overview of Investment Strategy and The Investment Structure sections of the opinion letter, and in the attachments thereto, are accurate.

C. Representations Made to KPMG by [Deutsche Bank]

- The security/collateral agreement is consistent with industry standards.

- [Deutsche Bank] will record the loan and premium amounts paid to Investor as a [$100 million], seven-year loan and a [$60 million] premium payment for financial accounting and regulatory purposes.

- [Deutsche Bank] has made a seven-year loan to Investor and will not, except as provided in the loan agreement, accelerate any stated principal or interest payment due under the loan agreement.

- There is no plan or intention to require Investor to convey the loan proceeds or assign the loan obligation to Partnership.

Summary of Opinion

Based on and subject to the facts, documentation, representations and assumptions described above and the discussion and analysis of the relevant statutory provisions, judicial doctrines, and other authorities below, we are of the opinion that under current U.S. federal income tax law there is a greater than 50 percent likelihood (i.e., it is "more likely than not") that the following positions will be upheld if challenged by the Internal Revenue Service:

- The [$60 million] loan premium does not constitute a liability of Investor or Partnership for purposes of Code Section 752, but represents an addition to the [$100 million] loan to be amortized under Treas. Reg. Section 1.163-13 against the issuer's interest expense over the life of the loan;
- Investor will recognize no gain or loss upon receipt of the loan proceeds of [$100 million], including the loan premium of [$60 million];
- Investor will be recognized as the true borrower of the loan for U.S. federal income tax purposes;
- Investor will recognize no gain or loss with respect to its capital contribution of [$163.6 million] to Partnership subject to the [$100 million] loan;
- The fixed rate debt instrument and interest rate swap will not be integrated under Treas. Reg. Section 1.1275-6(c)(2);
- Upon liquidation of Investor's Partnership interest, Investor's adjusted basis of [63.6 million, plus or minus its allocable share of Partnership income or loss] in its Partnership interest is first reduced by actual cash received of [amount] and the residual amount is allocated to the foreign currency and financial instruments distributed;
- The difference between the basis allocated to the foreign currency and financial instruments received in liquidating distributions and the proceeds received upon disposition of such foreign currency and financial instruments will be deductible by Investor as an ordinary loss under Code Sections 165(a) and 988(a). ***[In the event Partnership makes a Code Section 988(a)(1)(B) election, or if Investor sells his partnership interest, the loss is a capital loss deductible under Code Section 165(a) subject to Code Section 165(f) which provides that losses from sales or exchanges of capital assets are allowed only to the extent allowed in Code Sections 1211 and 1212.***];
- Investor's Code Section 465 "at risk" amount for its taxable year ending on [December 31, 1999] includes the cash and the adjusted basis of the assets distributed

to Investor as liquidating distributions by Partnership;

- Partnership income meets the definition of portfolio income and such income will be excluded under Code Section 469(e)(1) from the passive activity loss limitation rules;

- Investor's issuance of the debt instrument will not have a substantial effect on the issuer's U.S. *federal income tax liability that could be construed as unreasonable in* light of the purposes of Code Sections 163(e), 1271 through 1275, or 701-777.

Analysis of Investment Transactions

A. Investor's Receipt of Loan Proceeds

1. Debt Instruments – The General Rules

The value of a debt instrument is equal to the present value of its future cash flows, which consist of interest and principal. The rate used to compute the present value of these cash flows is the interest rate that provides an acceptable return on an investment commensurate with the issuer's risk characteristics (the "market rate of interest"). If the market rate of interest differs from the stated interest rate, the present value of the debt instrument will differ from the face value of the debt instrument. The difference between the face value and the present value of the debt instrument is either a discount or premium. For example, if a debt instrument is issued with a premium, the effective interest rate will be lower than the stated interest rate. In the instant case, the calculation is as follows:

Present value of the principal = principal x discount factor at the market rate of interest
- $100 million x .623= $62.3 million

Present value of interest payments = annual payments x discount factor at the market rate of interest
- $16 million x 6.11= $97.7 million

Present value of debt = Present value of principal + Present value of interest payments
- $62.3 million + $97.7 million = $160.0 million

From a financial accounting perspective, a debt instrument must be recorded at its present value to properly measure the associated interest expense for financial statement purposes. The resulting $60 million premium in the above example is not a liability because it does not result in any future net economic loss to the issuer. The lower effective rate of interest merely results because the proceeds from the borrowing exceed the face or maturity amount of the debt. The same logic would apply to a discount. A discount on a debt instrument does not represent prepaid interest and is not an asset for financial accounting purposes. Such amount is not an asset because it does not provide any future economic benefit. A loan discount or premium is not an asset or liability separate from the note giving rise to it, but is reported as a direct deduction from, or addition to, the face amount of the loan for financial accounting purposes. Conceptually, a premium on debt payable is a liability valuation account that has no existence apart from the related debt. For financial accounting purposes, based upon U.S. generally accepted accounting principles, the premium account is referred to as an adjunct account.[9]

[9] Opinions of the Accounting Principles Board No. 21 (New York: AICPA, 1971).

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The "OID rules" were introduced to conform the Code provisions relating to the measurement and timing of interest with the methods developed in the financial marketplace and applied under generally accepted accounting principles. OID stands for original issue discount, and generally refers to the tax accounting methods developed since 1982 for the measurement and timing of interest income and expense arising with respect to debt instruments. The Code and Regulations refer to all forms of indebtedness as "debt instruments." The term "bond" has the same meaning as the term "debt instrument" in Treas. Reg. Section 1.1275-1(d)[10]. Thus, the terms will be used interchangeably for purposes of this opinion.

Under the OID rules, a debt instrument issued with a stated interest rate in excess of prevailing market rates for instruments of the same credit quality and maturity results in receipt of a bond premium to the issuer. Bond premium generally can be viewed as the mirror image of OID. From an income tax perspective, amortization of a premium results in the proper timing of recognizing interest income on the part of the holder and deducting interest expense on the part of the issuer of a debt instrument. Thus, for OID purposes, consistent with the financial accounting rules, the amount of premium is not considered a liability separate from the debt instrument that gave rise to it.

As further discussed herein and consistent with financial accounting rules, the amount of loan premium for tax purposes is calculated by subtracting from the loan's issue price all amounts payable under the debt instrument other than stated interest. In the instant case, Investor borrowed [$100 million]. The [$100 million] loan is due on [December 31, 2005] and bears interest payable quarterly at an annual interest rate of [16] percent. The present value and issue price of the loan is [$160 million]. Subtracting the [$100 million] face amount from the loan's [$160 million] issue price results in a loan premium of [$60 million]. The loan premium is not an additional liability; but is reported for the purpose of properly measuring interest consistent with both the financial accounting rules and the OID provisions. The premium is effectively a valuation account that is an addition to the [$100 million] face amount of the loan giving rise to it.

Bond issuance premium is the excess of a debt instrument's issue price over its stated redemption price at maturity ("SRPM"). Code Section 1273(a)(2) defines SRPM to include all amounts payable under the debt instrument (other than interest based on a fixed rate or an objective interest index, and payable unconditionally at fixed intervals of one year or less during the entire term of the debt instrument).

Under Code Sections 1273(b)(1) - (5) and 1274, the issue price of a debt instrument depends on the circumstances surrounding its issuance. The following general rules apply:

- For publicly offered debt instruments not issued for property, the issue price is the initial offering price at which a substantial amount of the debt was sold.

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[10] Treas. Reg. Section 1.171-1(b)(1).

- For debt instruments issued for property when either the debt or the property is publicly traded, the issue price is the fair market value of the property.

- For debt instruments issued for property when neither the debt nor the property is publicly traded, the issue price under Code Section 1274 is the stated principal amount of the debt, or a lower imputed amount.

- For other debt instruments not issued for property, including those issued in a bank's lending transactions, the issue price under Code Section 1273(b)(2) is the amount paid by the first purchaser.

- For transactions not subject to any of the above rules, the issue price generally will be the SRPM.

For purposes of applying the above rules, the term "property" includes services and the right to use property, but does not include money. In transactions to which Code Section 1273(b)(2) applies, a payment from the borrower to the lender (other than a payment for property or for services provided by the lender such as commitment fees or loan processing costs) reduces the issue price of the debt instrument evidencing the loan. Solely for purposes of determining the tax consequences to the borrower, the issue price is not reduced if the payment is deductible under Code Section 461(g)(2).[11] Thus, the bond issuance premium is [$60 million], measured by the excess of the obligation's issue price under Code Section 1273(b)(2) of [$160 million] over the SRPM of [$100 million]. Any payment of points to obtain the loan will reduce the obligation's issue price.

Under Treas. Reg. Section 1.163-13, the issuer amortizes bond issuance premium by offsetting the qualified stated interest[12] allocable to an accrual period[13] with the bond issuance premium. Thus, the interest deduction otherwise allowable under Code Section 163 is reduced by the amount of bond issuance premium allocable to the period. The interest deduction amount and amortization of bond issuance premium are determined on a constant yield method and accrue ratably within an accrual period. The amount of bond issuance premium allocable to an accrual period is the product of the debt instrument's adjusted issue price[14] at the beginning of each period and its yield to maturity[15] as adjusted to reflect the length of the period. In the instant case, the loan premium will be amortized ratably as an offset to Partnership's interest expense deductions for each accrual period.[16]

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[11] Treas. Reg. Section 1.1273-2(g)(2).
[12] As defined in Treas. Reg. Section 1.1273-1(c).
[13] Treas. Reg. Section 1.446-2(b) determines the accrual period to which qualified stated interest is allocable and the qualified stated interest allocable to an accrual period.
[14] Determined under Treas. Reg. Section 1.1275-1(b).
[15] Determined under Treas. Reg. Section 1.1272-1(b)(1)(i).
[16] With respect to Partnership's assumption of the nonrecourse loan, the terms "issuer" and "obligor" are interchangeable and refer to the issuer of a debt instrument or a successor obligor. Treas. Reg. Section 1.1001-3(f)(5)(i).

Under Treas. Reg. Section 1.61-12(c), prior to amendment by the final regulations, the issuer of a premium debt instrument took the premium into account as a separate item of income over the life of the debt instrument and interest payable was also a separate deductible item. Treas. Reg. Section 1.163-13 clarifies that the issuer determines its interest deduction by offsetting the interest allocable to an accrual period with the bond issuance premium allocable to that period. This change effectively makes the tax accounting rules consistent with the financial accounting rules by recognizing that premium and discounts are merely valuation accounts, not discrete liabilities or assets.

Under Treas. Reg. Section 1.61-12(c)(1), an issuer does not recognize gain or loss upon the issuance of a debt instrument. Accordingly, we are of the opinion that it is more likely than not that Investor will recognize no gain or loss upon receipt of the loan proceeds of [$100 million], including the loan premium of [$60 *million*].

2. <u>Investor as the True Borrower</u>

Investor entered into the [$100 million] loan on [*January 1, 1999*] and Investor then contributed [$163.6 *million*] subject to the [$100 million] loan for a 90 percent interest in Partnership on [January 10, 1999]. Upon the contribution, the loan was assumed by Partnership. In that the loan was entered into by Investor in contemplation of participating in the Investment Fund, the issue arises as to *whether Investor is the true* borrower of the loan proceeds for U.S. federal income tax purposes. The Service could assert that Partnership should be considered the true borrower based upon an application of the "substance over form" doctrine. A corollary issue is whether Investor should be viewed as having "tax ownership" of the [$160 million] in cash *received* from the loan.

The question of who is the true borrower arises as a result of Investor's contribution of the loan proceeds to Partnership and Partnership's subsequent assumption of the loan. Investor contributed the proceeds subject to the loan for the business purpose of leveraging its capital contribution. By leveraging its capital contribution outside the partnership, Investor was able to <u>insure that there was a significant</u>~~guarantee a minimum initial~~ amount of financial leverage <u>within the Partnership</u>. This leveraging effect would be particularly important during the first two stages of the Investment Fund where investment returns are premised upon investments in low and moderate risks positions.

In <u>Bolding v. Commissioner</u>[17], the Tax Court found that the taxpayer, and not his wholly owned S corporation, was the true borrower on a line of credit, the proceeds of which taxpayer loaned to his S corporation. Taxpayer's share of flow-through S corporation losses were denied, however, on the basis that the taxpayer was unable to prove that he loaned the proceeds to his S corporation. As a result, the taxpayer was found not to have substantiated sufficient basis in his S corporation stock to deduct the losses.

[17] <u>Bolding v. Commissioner</u>, 117 F.3d 270 (5th Cir. 1997).

On appeal, the Fifth Circuit agreed with the Tax Court's holding regarding the taxpayer being the true borrower on the line of credit, but found that the Tax Court had erred in concluding the taxpayer could not substantiate his stock basis.

The facts the Court considered in determining taxpayer was the true borrower were as follows:

- The promissory note was signed by the taxpayer, as an individual borrower;
- No documents associated with the line of credit were signed by taxpayer in his capacity as "President" of the S corporation;
- The bank did not include the S corporation's tax identification number on the note (a practice they would have followed if the S corporation had been borrower), but included only the taxpayer's social security number;
- The bank testified it intended taxpayer to be the obligor, and it requested financial information only from taxpayer

Although on appeal, the Fifth Circuit ultimately sustained the taxpayer's position, the taxpayer's failure to rigorously respect the form of his loans to the corporation was used against him. Examples of the taxpayer's disregard of proper form included the deposit of loan proceeds from the bank into the corporation's account, the corporation's payment of principal and interest directly to the bank, and the taxpayer failing to report interest income on the loan.

There is also a line of cases in which the question is whether the true borrower is a corporation that, in form, issued a debt instrument or a shareholder of the corporation which guaranteed the debt. The leading case in this area is Plantation Patterns v. Commissioner.[18] In Plantation Patterns, the court held that the shareholder-guarantor was the true borrower rather than the corporation for purposes of determining which party was entitled to an interest deduction. The court determined that based on the meager capital position of the nominal borrower, the corporation, the lender was in economic substance looking to the shareholder-guarantor for payment. As a result, the court treated the guaranteed debt as an indirect capital contribution to the corporation by the shareholder-guarantor, treating the shareholder-guarantor as, in substance, the true borrower. A key fact in this case was the court's determination that the corporation's assets were wholly inadequate to sustain the debt.

An additional line of cases deal with loans by one party to an intermediary party who relends to another party (a so-called back-to-back loan). The principal case is Northern Indiana Public Service Co. v. Commissioner,[19] where the court held that a finance subsidiary engaged in a back-to-back loan arrangement was not treated as a conduit

[18] Plantation Patterns v. Commissioner, 462 F.2d 712 (5th Cir. 1972).
[19] Northern Indiana Public Service Co. v. Commissioner, 115 F.3d 506 (7th Cir. 1997).

merely because it was thinly capitalized. Most importantly, the court focused on the fact that the finance subsidiary earned a positive spread on its lending activity. The court also emphasized that the intermediary was not merely transitory and that the intermediary exercised dominion and control over interest proceeds. By contrast, in Aiken Industries, Inc. v. Commissioner,[20] the intermediary was a mere conduit because it earned no profit (and, thus, was not respected as the borrower).

The Tax Court looked at the question of true borrower in determining the deductibility of interest expense in Goodstein v. Commissioner[21]. In Goodstein, the court held that the taxpayer's purchase of Treasury notes and a loan to finance the purchase were shams. The facts of the case were that the taxpayer ordered his broker to purchase $10 million in face value of 1-3/8% Treasury notes. The taxpayer then executed a promissory note with a finance company for $9.9 million secured by the Treasury notes. The taxpayer directed the finance company to transfer the funds for the promissory note to his broker. Under the agreement with the finance company, the finance company could sell the Treasury notes.

When the broker purchased the Treasury notes for the taxpayer, the finance company did not have sufficient cash to pay the broker, so the finance company had the broker sell the Treasury notes. The Treasury notes were held by the broker for approximately half an hour. The taxpayer issued checks to the finance company for interest on the note; shortly after the finance company received the checks, the finance company loaned the taxpayer an amount equal to the interest paid. On his tax return, the taxpayer deducted the interest paid with the checks as well as the interest on the Treasury notes the finance company credited to his account.

The court determined that no indebtedness existed between the taxpayer and the finance company. The court found that the transitory possession of the Treasury notes was not sufficient to provide substance to the purchase of the Treasury notes or the loan of the funds to purchase the notes. While the court recognized the transactions did create a legal relationship between the taxpayer and the finance company, the relationship was not one of borrower and lender. The court determined the transaction was an exchange of promises for future performances. Because the promissory note lacked substance as indebtedness, the court denied the taxpayer's interest deductions.

The Tax Court also looked at the issue of true borrower in Estate of Helliwell v. Commissioner[22]. Champion was a limited partnership formed for the stated purpose of film production. Because Champion did not have the experience, staff, or equipment to handle film production, it entered into an agreement with an experienced production company, WFS, to provide certain described services in exchange for a fee. The partners of Champion anticipated receiving tax deductions for the costs of producing films in exchange for providing the financing for such production costs. Basis increases obtained

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[20] Aiken Industries Inc. v. Commissioner, 56 TC 925 (1971).
[21] Goodstein v. Commissioner, 267 F.2d 127 (1st Cir. 1959), *aff'g*. 30 T.C. 1178 (1958).
[22] Estate of Helliwell v. Commissioner, 77 T.C. 964 (1981).

through the use of nonrecourse loans would enhance the limited partners' anticipated tax benefits.

The Tax Court based its determination that WFS, and not Champion, was the true borrower, on the following factors:

- The loans were negotiated by WFS;
- Through agreements executed by the bank, WFS, and Champion, WFS completely guaranteed Champion's obligation for film production;
- WFS was the principal obligor on the loans; and
- Champion did not have sufficient funds to timely repay the loans.

The court concluded that the limited partnership had been used exclusively for financing purposes and that it had purchased a net profits interest in the films. Therefore, the limited partnership was not entitled to any deductions. A review of the factual particulars surrounding the liabilities also disclosed that the partnership was not the true obligor. The obligations were totally collateralized by another party and the partnership throughout the term of the liability had insufficient funds for repayment.

The facts in the instant case can be distinguished from the aforementioned cases due to the existence of a business purpose for Investor's entering into the loan. Investor was able to effectively guarantee a minimum initial amount of financial leverage by borrowing its investment funds prior to its contribution to Partnership. In addition, we believe that the underlying loan agreement and the existence of economic risk and reward with respect to holding the [$160 million] during the [ten] day period between the time of entering into the loan and the contribution of the proceeds to Partnership are key determinants as to whether Investor or Partnership should be considered the true borrower. As to both factors, we believe that Investor should be viewed as the true borrower.

The underlying loan documentation clearly establishes that Investor was the true borrower:

- The loan was entered into by Investor in its individual capacity, not as a representative (or member) of "to be formed" Partnership.
- Investor signed both the loan covenants and the associated financing statements in its individual capacity.
- The cash proceeds were transferred to Investor's bank account, not the account of Partnership.
- The assumption agreement provided that the loan was originally entered into by Investor and assumed by Partnership on [January 10, 1999].

- The assumption agreement did not alter or amend the loan covenants existing when the loan was originally entered into by Investor.

- As a 90 percent member, Investor's economic risk was not significantly altered upon contribution of the loan proceeds to Partnership subject to the loan.

With respect to economic risk and reward, during the [ten] day period before the cash was contributed to Partnership, Investor had "dominion and control" of the cash proceeds in that Investor could decide how to invest the cash, subject to the loan covenants. In addition, Investor had the economic "benefits and burdens" associated with tax ownership of such proceeds. The income derived from investing the proceeds was income to Investor and the interest associated with carrying the loan was an expense to Investor. Accordingly, we are of the opinion that it is more likely than not that Investor will be recognized as the true borrower of the loan.

3. <u>The Amount of the "Liability" for Code Section 752 Purposes</u>

In 1988, Treasury promulgated Proposed and Temporary Regulations under Code Section 752. In 1991, Treasury issued a new set of Final Regulations under Code Section 752 in an attempt to simplify the rules. While the current Regulations under Code Section 752 do not define the term "liability",[23] the 1988 Regulations defined an "obligation" as a "liability" only to the extent that incurring or holding the obligation gave rise to:

- The creation of, or an increase in, the basis of any property owned by the obligor (including cash attributable to borrowings);

- A deduction that is taken into account in computing the taxable income of the obligor; or

- An expenditure that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital.[24]

The Service's rulings defining the term "liability" tend to be consistent with the definition in the 1988 Regulations. In Revenue Ruling 88-77[25], the Service ruled that accrued, unpaid expenses and accounts payable of a cash method partnership are not partnership liabilities. The Service's conclusion was based upon the view that "liabilities" include only those obligations that either create basis (including cash from the borrowings) or give rise to an immediate deduction.

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[23] Although Temporary Regulations issued in 1988 provided a definition, the definition was deleted without specific comment in the Final Regulations as part of Treasury's efforts to simplify the regulations.
[24] Treas. Reg. Section 1.752-1T(g).
[25] Revenue Ruling 88-77, 1988-2 C.B. 128.

In Revenue Ruling 73-301[26], the Service ruled that interim payments received by a partnership for services rendered in connection with a long-term contract reported on the completed contract method do not constitute liabilities for purposes of Code Section 752. Instead, the ruling characterizes such payments as "unrealized receivables" within the meaning of Code Section 751(c). The income or loss from performance of the contract would affect the basis of the partnership interests of the partners, as provided for in Code Section 705(a), when such income or loss is recognized for U.S. federal income tax purposes. Accordingly, no increase is the adjusted basis of the partnership interests of the partners is made as a result of the receipt by the partnership of the advance payments. The ruling emphasized that the partnership had fully earned the payments and was under no obligation to return them or perform additional services to retain them.

The Service's conclusion in Revenue Ruling 73-301 is consistent with the conclusion of the Tax Court in Helmer v. Commissioner[27] where a partnership gave an option on property to a prospective buyer in exchange for consideration. Even though the holding resulted in the partnership receiving money (and increasing the basis of its property) without a correlative increase in the partner's bases, the court held that the option agreement did not create a liability because it created no liability on the part of the partnership to repay the funds paid or to perform any services in the future. Accordingly, the obligation to deliver the property upon exercise of the option did not create a liability.

In Revenue Ruling 95-26[28], the Service ruled that a partnership obligation to return securities sold short creates a partnership liability for purposes of Code Section 752. The reasoning in the ruling is twofold. First, it maintains that a short sale creates an obligation to return the securities borrowed to effect the sale. However, the ruling cites in support of this proposition Deputy v. du Pont[29], a Supreme Court case that expressly held that a short-sale obligation does not create "indebtedness" for purposes of the interest deduction under the 1928 predecessor of Code Section 163 because "although an indebtedness is an obligation, an obligation is not necessarily an indebtedness[.]" Second, the ruling maintains that the cash proceeds of the short sale create a partnership asset, thereby increasing basis and bringing the obligation within the definition of liability based upon the logic of Revenue Ruling 88-77.[30]

Revenue Ruling 95-45[31] applies a similar analysis to characterize the short-sale obligation of a shareholder who contributes its interest in the sales proceeds, in conjunction with a Code Section 351 incorporation of a going business, as a liability for purposes of Code Section 357 (which treats liabilities transferred in incorporations as taxable "boot" to the extent in excess of the basis of the transferred property) and Code Section 358 (which treats transferred liabilities as money received in calculating the basis of the transferor's

[26] Revenue Ruling 73-301, 1973-2 C.B. 215.
[27] Helmer v. Commissioner, T.C. Memo 1975-160.
[28] Revenue Ruling 95-26, 1995-1 C.B. 131.
[29] Deputy v. du Pont, 308 U.S. 488 (1940).
[30] An obligation is a liability to the extent that it creates or increases the basis to the partnership of any partnership asset (including cash attributable to borrowings).
[31] Revenue Ruling 95-45, 1995-1 C.B. 53.

stock). Applying the same reasoning as in Revenue Ruling 95-26, Revenue Ruling 95-45 cites Deputy v. du Pont for the proposition that a short sale creates an obligation to return the borrowed securities. Because that obligation results in an increase in asset basis, the ruling concludes that the obligation constitutes a "liability," even though acknowledging that the sales proceeds are not currently taxable. In contrast, Revenue Ruling 95-8[32], although issued in conjunction with the other two rulings, holds that an exempt organization's income from a short sale does not result in unrelated business taxable income under Code Section 511 from "debt-financed property" under Code Sections 512(b)(4) and 514(a) and (b). Its rationale is that there is no "acquisition indebtedness" within section 514(c) because under Deputy v. du Pont, a short-sale obligation creates an "obligation" but not an "indebtedness."

The 1995 short-sale rulings collectively hold that the requirement to replace or return the securities borrowed to effect a short sale constitutes an "obligation", which in turn constitutes a "liability" for purposes of Code Sections 752, 357, and 358, even though not an "indebtedness" for purposes of Code Section 514. The rulings' rationale seems to be that, because the sales proceeds create basis, they constitute a "liability" even though, as Revenue Ruling 95-45 expressly acknowledges, such proceeds remain untaxed in the recipient's hands until closure of the sale. The Service's view in these rulings is that, at the point the obligation is incurred, the amount of the obligation can be determined "with reasonable accuracy". Accordingly, the "all events" test specified for the accrual of a deduction by Code Section 461(h) and Treas. Reg. Section 1.461-1(a)(2) is satisfied.[33] This capacity to measure the amount of the obligation, in turn, supposedly makes the obligation sufficiently "choate" to permit its characterization as a Code Section 752 liability.

The conclusions reached by the Service in these rulings are subject to question because the rulings confuse the sale, which produces the proceeds, with the securities borrowing. Because it is the sale, not the borrowing, that gives rise to the cash and creates additional basis, there is no liability to which Code Section 752 status can attach.[34] The question of whether an open short sale position is a "liability" for Code Section 752 purposes is the subject of pending litigation in the Tax Court.[35]

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[32] Revenue Ruling 95-8, 1995-1 C.B. 107.
[33] Under the Regulation, the all events test traditionally permitted the accrual of an expense when "all events have occurred which determine the fact of the liability, and the amount of such liability can be determined with reasonable accuracy." *See* Code Section 461(h)(4) (restating traditional test). Since 1984, however, Code Section 461(h) generally has required that the test not be treated as having been satisfied until the occurrence of economic performance, such as the provision of required goods or services. Pub. L. No. 98-369 section 91(a), 98th Cong., 2d Sess. (1984) (adumbrating the "all events" test of Treas. Reg. Section 1.461-1(a)(2)).
[34] *See* Federal Taxation of Partnerships and Partners, McKee, Nelson, and Whitmore, Chapter 7.01, for a further discussion of the inconsistencies contained in these rulings.
[35] FFP Acquisition Partners, L.P. v. Commissioner, Tax Court Docket No. 3943-96 (motion to dismiss pending; awaiting trial), and Fulcrum Financial Partners v. Commissioner, Tax Court Docket No. 3944-96 (motion pending; awaiting trial).

In the instant case, Investor obtained a [$100 million] loan from [Deutsche Bank] that included a premium payment of [$60 million] in addition to the principal amount of [$100 million]. Investor contributed [163.6 million] in cash subject to the loan of [$100 million] to Partnership. Investor's basis in its interest in Partnership is a function of the amount of the cash contributed and the treatment of the loan as a liability under Code Section 752. As discussed, a liability for Code Section 752 purposes generally includes any obligation of the partnership or partner to the extent that incurring or holding it results in the creation of, or an increase in, the basis of any property owned by the obligor (including cash); a deduction taken into account in computing taxable income; or a nondeductible, noncapitalizable expenditure.[36] In the Code Section 752 context, the OID concepts discussed above are not generally applied (except as discussed below in two defined situations). Accordingly, the amount of the debt assumed is [$100 million], the principal amount of the debt contributed to Partnership, because such amount constitutes the amount of the loan assumed based upon the [15.85] percent coupon rate of interest.

The application of the time-value-of money concepts in the Code Section 752 context parallels how the rules are applied in the Code Section 465 context.[37] In Follender v. Commissioner,[38] the Tax Court rejected the Service's position that present value concepts should be imposed on the "at risk" rules under Code Section 465. Based upon the lack of support in the legislative history and the statutory language of Code Section 465, the Tax Court refused to find an "implied limitation of the borrowed amount to present value," observing that "Congress has been explicit in the areas it has chosen to require present value calculations." The court further stated that "the statute does not allow for present value calculation, expressly or implicitly."[39] In the Code Section 752 context, time-value-of money concepts are applied in two defined situations: (1) a special rule for nonrecourse liabilities with interest guaranteed by a partner,[40] and (2) with respect to an unreasonable delay of a partner's obligation to make payments to the partnership.[41] Neither fact pattern applies to the instant case. As to the instant case, there is no requirement in the Statute or Regulations that a taxpayer apply a present value approach in the context where the applicable interest rate with respect to a debt instrument gives rise to a loan premium

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[36] *See* the Revenue Rulings discussed above, as well as Federal Taxation of Partnerships and Partners, McKee, Nelson, and Whitmire, Chapter 7. As previously noted, Code Section 752 and the Treasury Regulations thereunder do not define the term "liability."

[37] *See* S. Rep. No. 938, 94th Cong., 2d Sess. 50 n.8 (1976).

[38] Follender v. Commissioner, 89 T.C. 943 (1987).

[39] Follender v. Commissioner, 89 T.C. 943, 9532 (1987).

[40] Treas. Reg. Section 1.752-2(e) treats a nonrecourse obligation as a recourse obligation if a partner guarantees a substantial portion of the interest that will accrue under the obligation. If the rule applies, the partner that has guaranteed the payment of interest is treated as bearing the economic risk of loss for the partnership liability to the extent of the present value of the guaranteed future interest payments.

[41] Treas. Reg. Section 1.752-2(g) provides that if a *partner's* obligation to make a payment or contribution is unreasonably delayed, the obligation is adjusted to reflect the time value of money of the deferral. The result of failing to satisfy an obligation on a "timely" basis is to effectively cause the obligation to be valued at less than its "face" amount. If an obligation does not bear interest at a rate at least equal to the applicable federal rate at the time of valuation, the value of the obligation is the discounted present value of all payments due from the partner.

amount. Accordingly, the amount of the debt assumed by Partnership is the "face", or principal amount, of [$100 million].

With respect to the interest paid on the loan, all interest paid or accrued within the taxable year on indebtedness is deductible under Code Section 163. A liability (as defined in Treas. Reg. Section 1.446-1(c)(1)(ii)(B)) is incurred, and generally is taken into account for U.S. federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability; the amount of the liability can be determined with reasonable accuracy; and economic performance has occurred with respect to the liability.[42] Treas. Reg. Section 1.461-4(e) provides that economic performance with respect to interest occurs as the interest cost economically accrues in accordance with the principles of the relevant provisions of the Code. This is consistent with the approach taken by the Service in Revenue Ruling 83-84[43] dealing with the continuing viability of the "Rule of 78's" method. In the ruling, the Service stated that "no deduction will be allowed to the extent that the debtor's liability or payment is for interest that does not economically accrue in the current year." Accordingly, interest payable on the loan would constitute a liability to Partnership in the year payable. The accrued interest payable as a Code Section 752 liability will increase Investor's basis in Partnership upon accrual and there will be corresponding decrease in basis under Code Section 705 when the interest is paid.

Based on its reasoning in the short sale rulings that the amount of the Code Section 752 liability is a function of the amount of basis resulting from the short sale, the Service could argue that the amount of the liability for Code Section 752 purposes is [$160 million] because the [$100 million] loan gave rise to [$160 million] in Partnership assets. Such position by the Service would be inconsistent with the logic that a liability is not recognized for Code Section 752 purposes until such time as the all events and economic performance rules are satisfied pursuant to the Code Section 461 Regulations.

In the instant case, the [$60 million] incremental amount that relates to the premium is repayable though interest payments. In the event of early repayment, a prepayment penalty would arise that is determined based upon prevailing economic factors, primarily then existing interest rates. Accordingly, the all events and economic performance rules are not satisfied upon the Investor's contribution of the cash subject to the loan.[44] The prepayment penalty is effectively contingent because the cost of retiring the loan cannot be determined with reasonable accuracy. In LaRue v. Commissioner,[45] the Tax Court held that an obligation is not incurred and taken into account by an accrual basis taxpayer until the year in which all events have occurred to fix the amount of the obligation and economic performance has occurred with respect to the obligation.[46] The Tax Court in

[42] Treas. Reg. Section 1.461-1(a)(2).
[43] Revenue Ruling 83-84, 1983-1 C.B.97.
[44] The all events and economic performance rules are not satisfied during the term of the partnership. The [$100 million] loan remained outstanding after Partnership was terminated.
[45] LaRue v. Commissioner, 90 T.C. 465 (1988).
[46]

LaRue relied on Long v. Commissioner,[47] for its conclusion that contingent liabilities could not be included in a partner's basis until such time as those liabilities are made definite or fixed. Accordingly, we are of the opinion that it is more likely than not that the face amount of the loan, [$100 million], should constitute the amount of "liability" for Code Section 752 purposes.

B. Investor's Capital Contribution to Partnership

1. Entity Classification as a Partnership

Treas. Reg. Section 301.7701-2(b) describes certain entities that are classified as *per se* corporations for U.S. federal income tax purposes. None of the categories of entities defined in the Regulations as *per se* corporations would apply to Partnership. Treas. Reg. Section 301.7701-3 provides that an entity not described in Treas. Reg. Section 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8) is considered an "eligible entity", which may elect to be classified as a corporation or, if it has 2 or more members, a partnership. Treas. Reg. Section 301.7701-3(b)(1) provides that a domestic eligible entity that has two or more members and does not choose to elect to be classified as a corporation will be classified as a partnership for U.S. federal income tax purposes.

Based on the facts set forth, Partnership will constitute a domestic eligible entity. Consequently, because an affirmative election to be treated as a corporation was not made, Partnership will be classified as a partnership for U.S. federal income tax purposes.

2. Investor's Capital Contribution - The General Rules

The Limited Liability Company Agreement provides that the members' respective capital accounts are maintained based upon the capital account maintenance rules of Code Section 704. The Code Section 704(b) Regulations[48] provide that a partner's capital account must be credited with the following:

- The amount of money the partner contributes to the partnership;
- The fair market value of property the partner contributes to the partnership net of any liabilities secured by such property that the partnership is considered to assume or to which the property remains subject to in the partnership's hands.[49]
- Allocations to the partner of partnership income and gain, including income and gain exempt from taxation.

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[47] Long v. Commissioner, 71 T.C. 1 (1978).
[48] See Treas. Reg. Section 1.704-1(b)(2)(iv)(b) for the basic rules associated with maintaining capital accounts.
[49] Unlike the Code Section 721 provisions discussed below which look to the adjusted basis of the property contributed, the Code Section 704 capital account maintenance rules look to the fair market value of the property.

A partner's capital account is decreased by the following:

- The money distributed to the partner by the partnership.

- The fair market value of property distributed to the partner by the partnership net of liabilities that the partner is considered to assume or to which the property remains subject to in the partner's hands.

- Allocations to the partner of partnership expenditures that are not deductible in computing the partnership's taxable income or not properly chargeable to capital account.

- Allocations to the partner of partnership losses and deductions, including financial losses and deductions, but excluding the nondeductible items immediately above.

Code Section 721(a) provides the general rule that no gain or loss is recognized by a partnership or any of its partners as a result of a contribution of "property" in exchange for an interest in the partnership. Money constitutes "property" for purposes of Code Section 721(a).[50] Generally, there are three circumstances where the Code Section 721(a) nonrecognition rule would not apply:

- A contributing partner can realize gain on the contribution of property to a partnership if the contributing partner is relieved of liabilities in the transaction in an amount in excess of the basis of that partner's partnership interest. Consequently, if property contributed to a partnership is subject to an encumbrance that is less than the adjusted basis of the property to the contributing partner, the existence of the encumbrance should not cause the recognition of gain on the contribution.

- Code Section 721(a) does not apply to contributions to "investment partnerships" that are considered "investment companies" under Code Section 721(b).

- The contribution must not be part of a "disguised sale" taxable under Code Section 707(a).

None of the above circumstances should be applicable to Investor's cash contribution of [$163.6 million] subject to the [$100 million] loan because:

- The amount of the loan the contributed property was subject to was less than the amount of cash contributed.[51]

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[50] *See* Treas. Reg. Section 1.721-1(b)(1) which refers to "contributions of money or other property."
[51] Under Code Section 731(a), if the amount of money distributed or deemed distributed to a partner exceeds the adjusted basis of the partner's partnership interest, the partner has gain to the extent of such excess. As subsequently discussed, Investor's adjusted basis in its partnership interest exceeds the amount of money distributed or deemed distributed.

- Under Code Section 721(b), the nonrecognition rule of Code Section 721(a) does not apply to gain realized upon a contribution of property to a partnership "investment company." Generally, this rule applies if the contribution results in diversification of the transferor's assets. The intent of Code Section 721(b) is to prevent tax-free diversification of securities portfolios. In the instant case, both Investor and the Investment Advisor are contributing solely cash to the partnership. Accordingly, there is no diversification and Section 721(b) should not apply.

- Under Code Section 707(a)(2)(B), a contribution of property by a partner to a partnership may be recharacterized as a sale if the partnership distributes to the contributing partner cash or other property that is consideration for the contribution. Code Section 707(a)(2)(B), by definition, only applies to transactions deemed to be sales. In the instant case, Investor is contributing cash where there is no inherent gain or loss potential.[52]

Accordingly, based upon the Code Section 721(a) general rule of nonrecognition of gain or loss and the non-application of exceptions to that rule, we are of the opinion that it is more likely than not that Investor will not recognize gain or loss with respect to its contribution of the cash subject to loan to Partnership.

3. <u>Investor's Capital Contribution - Code Section 1274</u>

Code Section 1274(c) provides that if any person in connection with the sale or exchange of property assumes any debt instrument, or acquires any property subject to any debt instrument, Code Sections 1274 and 483[53] do not apply to the debt instrument unless the terms and conditions of the debt instrument are modified in connection with the assumption or acquisition. Treas. Reg. Section 1.1274-5(a) further addresses the application of Code Section 1274 to an assumption of a debt instrument. The Regulation states that Code Section 1274 does not apply to a debt instrument if the debt instrument is assumed, or property is taken subject to the debt instrument, in connection with a sale or exchange of property, unless the terms of the debt instrument, as part of the sale or exchange, are modified in a manner that would constitute an exchange under Code Section 1001. The same rule applies under Treas. Reg. Section 1.483-1(d).

The Code Section 1001 Regulations provide a two-tier test to determine whether there has been a deemed exchange of a debt instrument. Any alteration to the terms of a debt instrument must be tested to determine if a "modification" of the debt instrument has occurred. If so, the modification must then be tested to determine whether it is "significant". A significant modification results in a deemed exchange of the original debt instrument for a modified instrument. The deemed exchange will be a realization event under Treas. Reg. Section 1.1001-1(a) and could potentially give rise to gain or

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[52] Treas. Reg. Section 1.707-3(b)(1) specifically excludes money or the obligation to contribute money from the definition of what constitutes "property transferred by a partner."
[53] Code Sections 1274 and 483 generally apply to ensure adequate interest is charged and paid on an obligation whenever a sale or exchange of property occurs involving the issuance of a debt instrument.

loss, to cancellation of indebtedness income for the issuer, and/or to a change in accounting for interest on the new instrument.[54]

A modification is broadly defined as any alteration, addition, or deletion of a legal right or obligation of the issuer or holder of a debt instrument whether evidenced by an amendment of the instrument, conduct of the parties, or otherwise.[55] An alteration that results in a new obligor, an addition or deletion of a co-obligor, or a change (in whole or in part) in the recourse nature of the debt, is treated as a modification, even if allowed by the terms of the original debt instrument.[56] Accordingly, Partnership's assumption of the nonrecourse liability results in a modification of the debt instrument under Code Section 1001.[57]

Treas. Reg. Section 1.1001-3(e)(1) provides the general rule for determining whether a modification is significant. Under the Regulation, a modification is significant only if, based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant. In addition, Treas. Reg. Section 1.1001-3(e) further provides five specific rules for determining the significance of a modification in defined situations. The general rule applies only when no specific rule applies. The five specific rules cover:

- Changes in yield
- Changes in the timing of payments
- Changes in the obligor or security
- Changes in the nature of the debt
- Changes in accounting or financial covenants

In testing for significance, Treas. Reg. Section 1.1001-3(e)(4)(ii) provides that the substitution of a new obligor on a nonrecourse debt instrument is not a significant modification. Treas. Reg. Section 1.1001-3(e)(4) also addresses the implications associated with a change in security. With respect to a change in security, Treas. Reg. Section 1.1001-3(e)(4)(iv)(B) provides that a modification that releases, substitutes, adds or otherwise alters a substantial amount of collateral for, a guarantee on, or other form of credit enhancement for, a nonrecourse debt instrument is a significant modification.

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[54] If an assumption of a debt instrument involves a modification that triggers an exchange under Code Section 1001, Treas. Reg. Section 1.1274-5(b)(1) provides that the modification is treated as a separate transaction taking place immediately before the sale or exchange.
[55] Treas. Reg. Section 1.1001-3(c).
[56] Treas. Reg. Section 1.1001-3(c)(2)(i).
[57] Treas. Reg. Section 1.1001-3(f)(5)(i) provides that for purposes of testing whether an assumption is an exchange under Code Section 1001, the terms "issuer" and "obligor" are interchangeable and refer to the issuer of a debt instrument or a successor obligor.

In general, the only collateral for the loan is the loan proceeds. These proceeds are held in a collateral pool. The loan covenants generally limit the types and quality of investments that may be made in the collateral pool. Such investments include the investments contemplated in the Investment Fund. There is no "substitution of collateral" because the collateral does not change, it is at all times the loan proceeds. The investor is not providing separate collateral. The loan covenants were not altered or amended upon the assumption of the loan by Partnership. Accordingly, there was no alteration made to the debt instrument that would constitute a modification under Treas. Reg. Section 1.1001-3(c)(1) or change in security as defined under Treas. Reg. Section 1.1001-3(e)(4).[58]

Based upon the foregoing analysis, we are of the opinion that it is more likely than not that Partnership's assumption of Investor's nonrecourse debt instrument will not result in application of Code Section 1274 or Code Section 483 since the assumption will not constitute an exchange under Code Section 1001.

4. <u>Investor's Capital Contribution - Treas. Reg. Section 1.61-12(c)(2)</u>

Treas. Reg. Section 1.61-12(c)(2) provides that an issuer generally does not realize gain or loss upon the repurchase of a debt instrument. The term "repurchase" includes the retirement of a debt instrument, the conversion of a debt instrument into stock of the issuer, and the exchange (including an exchange under Code Section 1001) of a newly issued debt instrument for an existing debt instrument.

An issuer will realize income from the discharge of indebtedness if a debt instrument is repurchased at an amount less than its adjusted issue price as determined within the meaning of Treas. Reg. Section 1.1275-1(b). The amount of discharge of indebtedness income is determined under Code Section 108 and is generally equal to the excess of the adjusted issue price over the repurchase price. If the issuer repurchases the debt instrument at a premium, the issuer may be entitled to a repurchase premium deduction equal to the excess of the repurchase amount over the adjusted issue price.

Investor's contribution of the [$163.6 million] cash subject to the debt of [$100 million] should not constitute a repurchase of a debt instrument under Treas. Reg. Section 1.61-12(c)(2) for the following reasons:

- The debt instrument has not been retired;
- The debt instrument has not been converted into stock of the issuer; and

[58] *See* PLR 9801047 (October 3, 1997) which contains a fact pattern whereby the obligation to repay the entire nonrecourse loan was "fully and identically secured" and, as a result, there was no significant modification under Treas. Reg. Section 1.1001-3(e)(4)(iv)(B).

- The debt instrument has not been exchanged for purposes of Code Section 1001 (see above discussion related to determination of whether a modification constitutes an exchange.)

The conclusion that Treas. Reg. Section 1.61-12(c)(2) does not result in discharge of indebtedness income is supported under Code Section 108 which governs income from discharge of indebtedness. Code Section 108 is premised upon the borrower obtaining an economic benefit if a repayment obligation is discharged for less than the amount due. The seminal case in determining when a taxpayer has realized income from discharge of indebtedness is United States v. Kirby Lumber ~~v. Commissioner~~[59]. The theory established in Kirby Lumber is "that the debtor realizes discharge of indebtedness income when a debt reduction results in a freeing of assets." In Kirby Lumber, the taxpayer purchased its own bonds at a discount in the open market. The taxpayer's assets were increased by the cash received for the bonds and by the repurchase of some of those bonds at less than par. Thus, the taxpayer, to the extent of the difference between what it received for those bonds and what it paid in repurchasing them, had an asset which had ceased to be offset by any liability, with a result that after the transaction the taxpayer had greater assets than it had before.

Pursuant to the theory established in Kirby Lumber, the reduction in the taxpayer's liabilities and the corresponding positive adjustment in the balance sheet constituted the realization of income. Although courts have acknowledged the difficulties in applying a single test to determine whether a reduction of debt results in realization of discharge of indebtedness income, the following analysis serves as a useful starting point: (1) at the inception of the loan transaction, were the borrowed funds excluded from the taxpayer's income upon receipt because of the offsetting obligation to repay; and (2) if so, has the taxpayer's obligation to repay been canceled, forgiven or reduced.

Based upon the foregoing analysis, we are of the opinion that it is more likely than not that Investor will not recognize income under Treas. Reg. Section 1.61-12(c)(2) upon contribution of the loan proceeds to Partnership because:

- At the inception of the loan transaction, the borrowed funds were excluded from Investor's income due to the offsetting obligation to repay; and

- The debt has not been discharged, cancelled, forgiven, or reduced upon contribution to the Partnership.

C. Characterization of Debt Instrument

Investor obtained the [$100 million] loan to partially fund its participation in the Investment Fund. As discussed, the loan was a fixed rate debt instrument with a [7] year term and interest payable quarterly at a rate of [16] percent per annum. Investor subsequently contributed the loan proceeds subject to the loan to Partnership. Partnership

[59] United States v. Kirby Lumber ~~v. Commissioner~~, 284 U.S. 1 (1993).

then entered into a fixed-for-floating rate interest swap for a [7] year term to reduce its risks related to a change in interest rates.

Prior to the release of Treas. Reg. Section 1.1275-6, the integration of a debt instrument and a hedge was permitted only in limited situations[60] and generally was considered to be a favorable result by taxpayers and commentators. On June 14, 1996, the Service released Final Regulations concerning debt instruments with original issue discount, contingent payment debt instruments, and the anti-abuse rule for OID.[61] The purpose of the Regulations under Treas. Reg. Section 1.1275-6 was to extend the integration treatment to financial instruments that perfectly hedge a qualifying debt instrument into a synthetic fixed or floating rate obligation. Although the integration rules are taxpayer elective, an anti-abuse rule allows the Service relatively broad powers to force integration.

1. <u>Qualifying Debt Instruments and "Section 1.1275-6 Hedges"</u>

Treas. Reg. Section 1.1275-6(a) applies to either issuers or holders of qualifying debt instruments. This Regulation provides for the integration of a qualifying debt instrument and "Section 1.1275-6 hedges" if certain requirements are met and if the combined cash flows of the components are substantially equivalent to those of a fixed or variable rate debt instrument. The purpose of the Regulations is to "permit a more appropriate determination of the character and timing of income, deductions, gains or losses than would be permitted by separate treatment of the components."

Treas. Reg. Section 1.1275-6(b)(4) provides that if its provisions apply to a qualifying debt instrument and hedge, the integrated transaction is deemed to create a synthetic debt instrument with the same cash flows as the combined cash flows of the qualifying debt instrument and hedge. This integrated instrument generally is subject to the Treas. Reg. Section 1.1275-6 Regulations rather than the rules to which each component of the transaction would be subject on a separate basis.

Under Treas. Reg. Section 1.1275-6(b), a qualifying debt instrument is any debt instrument other than:

- A tax-exempt obligation as defined in Code Section 1275(a)(3);
- A debt instrument to which Code Section 1272(a)(2)(6) applies (certain interests in or mortgages held by a REMIC, and certain other debt instruments with payments subject to acceleration); or
- A debt instrument that is subject to Treas. Reg. Sections 1.483-4 or 1.1275-4(c) (certain contingent payment debt instruments issued for non-publicly traded property).

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[60] Examples include integration under Treas. Reg. Section 1.988-5, 1.446-4, and 1.1221-2.
[61] T.D. 8674, 61 Fed. Reg. 30133 (June 14, 1996).

A Section 1.1275-6 hedge is any financial instrument if the combined cash flows of the financial instrument and the qualifying debt instrument permit the calculation of a yield to maturity under the principles of Code Section 1272, or the right to the combined cash flows would qualify under Treas. Reg. Section 1.1275-5 as a variable rate debt instrument that pays interest at a floating rate or rates (except for the requirement that the interest payments be stated as interest). A financial instrument can be a Section 1.1275-6 hedge only if it is issued substantially contemporaneously with, and has the same maturity as, the qualifying debt instrument. In addition, a financial instrument that hedges currency risk is not a Section 1.1275-6 hedge.

For purposes of determining what constitutes a Section 1.1275-6 hedge, Treas. Reg. Section 1.1275-6(b)(3) defines a financial instrument as a spot, forward, or futures contract; an option; a notional principal contract; a debt instrument, or a similar instrument, or a combination or series of financial instruments. Stock is not a financial instrument for purposes of this Regulation.

2. <u>Requirements for Integration by Taxpayer</u>

A taxpayer may integrate a qualifying debt instrument and a Treas. Reg. Section 1.1275-6 hedge if the taxpayer meets all of the following requirements provided in Treas. Reg. Sections 1.1275-6(c)(1)(i) through (vii):

- The taxpayer must adequately satisfy the identification requirements of Treas. Reg. Section 1.1275-6(e) by entering and retaining as part of its books and records information related to issuance and acquisition of the qualifying debt instrument and the Section 1.1275-6 hedge;

- None of the parties to the hedge may be related unless the related party uses a mark-to-market tax accounting method;

- Both the qualifying debt instrument and the Section 1.1275-6 hedge are entered into by the same individual, partnership, trust, estate, or corporation;

- If the taxpayer is a foreign person engaged in a U.S. trade or business, all items of income and expense associated with the integrated transaction (other than interest expense subject to Treas. Reg. Section 1.882-5) would, in the absence of the integration rules, be effectively connected income during the synthetic debt instrument's term;

- Within 30 days immediately preceding the issue date of the synthetic debt instrument, the taxpayer did not terminate, or leg out[62] of, an integrated transaction containing the qualifying debt instrument, any other debt instrument that is part of the same issue, or the Section 1.1275-6 hedge,

[62] "Legging" into and out of integrated transactions is described in Treas. Reg. Sections 1.1275-6(d).

- The qualifying debt instrument must be issued on or before, or substantially contemporaneously with, the date of first payment on the Section 1.1275-6 hedge, regardless of whether the payment is made or received by the taxpayer; and

- The taxpayer cannot have entered into a straddle[63] prior to the issue date of the synthetic debt instrument containing the Section 1.1275-6 hedge or the qualifying debt instrument.

3. Integration by Commissioner

Even if a taxpayer does not integrate a qualifying debt instrument and a Treas. Reg. Section 1.125-6 hedge, the Commissioner may do so if the combined cash flows on the qualifying debt instrument and financial instrument are substantially the same as the combined cash flows required for the financial instrument to be a Section 1.1275-6 hedge. Treas. Reg. Section 1.1275-6(c)(2) provides that the Commissioner may not integrate a transaction unless the qualifying debt instrument is subject to Treas. Reg. Section 1.1275-4 (related to "contingent payment debt instruments"[64]) or Section 1.1275-5 (related to "variable rate debt instruments") and pays interest at an objective rate. Under Treas. Reg. Section 1.1275-5, a "variable rate debt instrument" is a debt instrument that meets all of the following conditions:

a) The issue price of the debt instrument must not exceed the total noncontingent principal payments by more than an amount equal to the lesser of:

   i) .015 multiplied by the product of the total noncontingent principal payments and the number of complete years to maturity from the issue date, or

   ii) 15 percent of the total noncontingent principal payments.

b) The debt instrument must only provide for stated interest (compounded or paid at least annually), at:

   i) one or more qualified floating rates,

   ii) a single fixed rate and one or more qualified floating rates,

   iii) a single objective rate, or

   iv) a single fixed rate and a single objective rate that is a qualified inverse floating rate.

[63] For this purpose, "straddle" is defined under Code Section 1092(c).
[64] A "contingent payment debt instrument" is defined under Treas. Reg. Section 1.1275-4 as any debt instrument that provides for one or more contingent payments.

c) The debt instrument must provide that a qualified floating rate or objective rate in effect at any time during the term of the instrument is set at a current value of that rate.

d) The debt instrument must not provide for any contingent principal payments.

Because, under the facts in the instant case, the qualifying debt instrument is a fixed rate debt instrument, Treas. Reg. Section 1.1275-6(c)(2) does not provide the Commissioner with authority to integrate the loan and interest rate swap. Furthermore, the inability of the Commissioner to integrate a hedge with a fixed rate debt instrument was specified in the preamble to the Final Regulations[65] concerning the anti-abuse rule for original issue discount, as follows:

> <u>Section 1.1275-6 INTEGRATION RULES:</u>
> "Commentators generally approved of the integration rules in the proposed Regulations, and those rules are adopted with only two significant changes. First, the final Regulations allow (but do not require) the integration of a hedge with a fixed rate debt instrument. For example, a taxpayer may integrate a fixed rate debt instrument and a swap into a VRDI. Although the hedging transaction Regulations (Section 1.446-4) cover many of these transactions, the integration rules provide more certain treatment. The final Regulations, however, do not allow the Commissioner to integrate a hedge with either a fixed rate debt instrument or a VRDI that provides for interest at a qualified floating rate. In these cases, treating the hedge and the debt instrument separately is a longstanding rule that generally clearly reflects income."

Based upon the foregoing, we are of the opinion that it is more likely than not that the fixed rate debt instrument and interest rate swap will not be integrated under Treas. Reg. Section 1.1275-6(c)(2).

D.: <u>Liquidation of Investor's Interest in Partnership: Basis in Distributed Property</u>

On [date], at the end of [Stage I] of the Investment Fund, Investor opted not to further participate in the investment program by entering into [Stage II]. As a consequence, Investor's interest in Partnership was liquidated on [date].[66]

Code Sections 731(a) and 731(b) generally provide for both partner and partnership nonrecognition treatment for liquidating distributions. However, a partner recognizes

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[65] T.D. 8674, 61 Fed. Reg. 30133 (June 14, 1996).

[66] Partnership did not terminate as a result of the liquidation of Investor's Partnership interest. Under Code Section 708(a), an existing partnership is considered as continuing if it is not terminated. Since there were two remaining partners, Investment Advisor's two LLCs, there was no termination under Code Section 708(b)(1)(A). In addition, there was no "sale or exchange" of 50 percent or more of total partnership capital and profits as a result of the liquidation of Investor's 90 percent interest because a liquidation is not considered a "sale or exchange" for purposes of Code Section 708(b)(1)(B). Treas. Reg. Section 1.708-1(b)(1)(ii).

gain under Code Section 731(a)(1) to the extent that "money" distributed exceeds the partner's basis in its interest in the partnership. Losses are not recognized by a partner with respect to a liquidating distribution except as provided for in Code Section 731(a)(2). Treas. Reg. Section 1.731-1(a)(2) denies loss treatment if "any property" other than money, inventory, or unrealized receivables is distributed.

The liquidating distribution to Investor consisted of [amount] in cash (money) and [amount] in foreign currency contracts. Code Section 731(c)(1)(A) defines "money" to include "marketable securities", and the term "marketable securities" is defined in Code Section 731(c)(2) as including foreign currency contracts.[67] However, Code Section 731(c)(3) provides that the inclusion of marketable securities as money under Code Section 731(c)(1) shall not apply if the partnership is an "investment partnership" and each partner is an "eligible partner."

An "investment partnership" is defined in Code Section 731(c)(3)(C) as any partnership that is not engaged in a trade or business and substantially all of the assets of which have always consisted of money; corporate stocks; notes, bonds, or other evidences of indebtedness; foreign currencies; notional principal contracts; and interest in or derivative financial instruments in any of the listed assets. An "eligible partner" is any partner who has not contributed to the partnership any property other than the aforementioned.

Code Section 731(c)(3)(C)(ii) states that any activity undertaken as an investor, trader, or dealer in any of the listed assets is not a trade or business activity. Treas. Reg. Section 1.731-2(e) further provides that a partnership is not engaged in a trade or business as a result of the receipt of commitment fees, break-up fees, guarantee fees, director's fees, or similar fees that are customary in and incidental to activities of a partnership as an investor, trader, or dealer. Accordingly, based upon the activities undertaken, Partnership is not engaged in a trade or business for purposes of applying the Code Section 731(c) rules. The sole asset contributed by the members to Partnership was cash. Accordingly, each partner should qualify as an eligible partner for purposes of Code Section 731(c)(3)(C)(i) and Partnership is not engaged in a trade or business as defined in Code Section 731(c)(3)(C)(ii). The foreign currency contracts, therefore, should not constitute money for purposes of Code Section 731(a). Consequently, because as discussed below, Investor's adjusted basis in its partnership interest exceeded the amount of cash distributed, Investor will recognize no gain with respect to the liquidating distribution.

Upon a complete liquidation of a partner's partnership interest, Code Section 732(b) provides that the basis of any distributed property is equal to the partner's basis in its partnership interest immediately prior to the distribution, reduced by any actual cash received. Under Code Section 732(c), if the basis of the distributee's partnership interest

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[67] Pursuant to Code Section 731(c)(2)(A), marketable securities are financial instruments and foreign currency contracts which are, as of the date of distribution, actively traded within the meaning of Code Section 1092(d)(1). Treas. Reg. Section 1.1092(d)-1(a) provides that actively traded personal property "includes any property for which there is an established financial market." "Financial instruments" include stocks and other equity interests, evidences of indebtedness, options, forward or future contracts, notional principal contracts, and derivatives.

after reduction for any money received exceeds the partnership's basis in distributed unrealized receivables and inventory, each of these assets is allocated a basis equal to its basis to the partnership and the balance of the partner's basis in its partnership interest is allocated to other distributed assets as follows:

- First, each other distributed asset is provisionally assigned a basis equal to its pre-distribution partnership basis.
- If the provisional bases so assigned are less than the remaining basis to be allocated, the excess basis is allocated first to increase the bases of any appreciated assets so as to reduce all differences between values and bases proportionately, with any remaining excess basis allocated to all other distributed assets in proportion to their respective fair market values.

Accordingly, Investor's adjusted basis in its partnership interest is first reduced by actual cash received of [amount] and the residual amount is allocated to the foreign currency and financial instruments distributed in accordance with the above methodology.

Since Investor contributed cash to Partnership, the initial basis to Investor of the partnership interest is the amount of money contributed, [$163.6 million].[68] However, Investor contributed the [$163.6 million] subject to a nonrecourse loan of [$100 million]. Code Section 752(b) provides that any decrease in a partner's individual liabilities by reason of assumption by the partnership of such liabilities shall be considered as a distribution of money to the partner by the partnership which under Code Section 733 reduces the basis of the partner's partnership interest.[69]

The basis of Investor's partnership interest is effectively the amount of the money contributed to the partnership reduced by the net liability relief (the difference between Investor's entire loan liability transferred to the partnership[70] and Investor's share of the liability as a partner.)[71] Treas. Reg. Section 1.752-3 provides that a partner's share of nonrecourse liabilities equals the sum of: (1) the partner's share of the partnership's Code Section 704(b) taxable gain; (2) the partner's Code Section 704(c) minimum gain; and (3) the partner's share of the partnership's excess nonrecourse liabilities. Accordingly, Investor's basis of [$163.6 million] from its cash contribution is reduced by the [$10 million] net amount of the Code Sections 752(a) and 752(b) adjustments.[72]

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[68] Code Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, *including money*, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount of gain recognized under Section 721(b) to the contributing partner.
[69] Treas. Reg. Section 1.752-1(f).
[70] Code Section 752(b).
[71] Code Section 752(a).
[72] The [$100 million] debt assumed by Partnership less the [$90 million] (90%) share allocated to Investor pursuant to Treas. Reg. Section 1.752-3.

All changes in partnership "liabilities" result in constructive cash contributions and distributions. Accordingly, Investor's share of partnership liabilities decreased by [$90 million] as a result of Investor liquidating its Partnership interest. As a consequence, under Code Section 752(b) the [$90 million] decrease is treated as a cash distribution to Investor thereby reducing its basis in its partnership interest to [$63.6 million].[73]

Upon liquidation of Investor's Partnership interest, we are of the opinion that it is more likely than not that Investor's adjusted basis amount of [$63.6 million, plus or minus its allocable share of Partnership income or loss] in its Partnership interest is first reduced by actual cash received of [amount] and the residual amount is allocated to the foreign currency and financial instruments distributed.

E. <u>Applicability of the Code Section 465 "At Risk" Rules and Code Section 469</u>

Generally, the "at risk" provisions limit the ability of certain taxpayers to currently deduct the losses attributable to certain activities to the extent those losses exceed the taxpayer's "amount at risk" in the "activity". Code Section 465(a) provides that in the case of an individual engaged in an "activity" to which the section applies, any "loss from such activity" for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is "at risk for such activity" *at the close of the taxable year.*

The Code Section 465 "at risk" rules apply to individuals directly and to individuals in their capacity as partners in a partnership.[74] The "at risk limitation" of Code Section 465 does not apply to a partnership, it applies to the partners.[75] Consequently, the Code Section 465 "at risk" rules have potential applicability to Investor both with respect to its direct investments and its investments through Partnership.

The determination of the extent to which the taxpayer is "at risk" is made on the basis of the facts existing as of the close of the taxable year.[76] Prop. Treas. Reg. Section 1.465-1(a) provides that the amount of the loss is allowed as a deduction only to the extent that the taxpayer is "at risk" *with respect to the activity at the close of the taxable year.* The determination of the amount the taxpayer is "at risk" in cases where the activity is engaged in by an entity separate from the taxpayer is made as of the close of the taxable year of the entity unless otherwise stated.

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[73] A partner's initial basis for his partnership interest is increased pursuant to Code Section 705(a)(1) by his distributive share of partnership taxable income. Under Code Section 705(a)(2), a partner's basis is decreased (but not below zero) by the amount of cash distributed to him; the basis of any property distributed to him by the partnership; and his distributive share of partnership losses and nondeductible expenditures of the partnership not properly chargeable to capital account. Treas. Reg. Section 1.752-1(c) provides that any decrease in a partner's share of partnership liabilities is treated as a distribution of money by the partnership to that partner.

[74] The "at risk" rules apply to trusts and estates as well. *See* Code Section 542(a)(2) and S. Rep. No. 94-938, 94th Cong., 2d Sess. 48 (1976), 1976-3 C.B. at 86 (the "Senate Report"); *see also* Code Section 641(b) (the taxable income of an estate or trust is computed in the same manner as an individual).

[75] HR Rep. No. 432, 98th Cong., 2d Sess. 1597 (1984).

[76] Prop. Treas. Reg. Section 1.465-1(a).

Accordingly, the analysis with respect to activities undertaken by a partnership is based upon viewing the partnership as a separate entity and making the determination of the amount "at risk" at the partner level. Prop. Treas. Reg. Section 1.465-41 uses the following example of a calendar year individual taxpayer and a partnership with a taxable year ending on June 30 to demonstrate an application of this concept:

> Example (5). On July 1, 1976, C, along with many other persons, forms partnership W. C is a calendar year taxpayer and partnership W is on a taxable year ending June 30. On July 1, 1976, C contributes $3,000 to W. On August 1, 1976, W borrows a sum of money for which C's allocable share of personal liability is $7,500. On October 1, 1976, W borrows a sum of money under a nonrecourse financing arrangement with respect to which C's allocable share is $10,000. On March 1, 1977, W repays a portion of the loan for which C is personally liable, thereby reducing C's personal liability to $6,000. C's allocable share of W's losses for the taxable year ending June 30, 1977, is $13,000. On September 1, 1977, C contributes unencumbered personal assets with an adjusted basis of $6,000 to W. On November 1, 1977, W repays another portion of the loan for which C is personally liable, reducing C's personal liability to $5,000. On December 1, 1977, W repays part of the nonrecourse loan thereby reducing C's allocable portion of the amount outstanding to $8,000. The amount of loss deduction which C is allowed for 1977 is determined as follows:

Amount at risk in activity as of 7/1/76 (prior to contribution)	$0

Plus:

Contribution -- 7/1/76	3,000
Allocable share of loan	7,500
	$10,500
Less:	
Allocable share of net reduction in personal liability	1,500
Amount at risk in activity as of 6/30/77	$9,000

> Although C's allocable share of W's losses for the taxable year ending June 30, 1977, is $13,000, *C's allowable loss deduction is limited to the amount at risk as of the close of the partnership's taxable year.* Thus, C's loss deduction for the taxable year ending December 31, 1977, is $9,000. The $4,000 not allowed as a loss deduction in 1977 will be treated as a deduction in 1978. The fact that prior to December 31, 1977, but after the close of W's taxable year on June 30, 1977, C made a contribution to W does not increase the amount of loss which C may deduct for 1977. That amount is limited to the amount C was at risk in the activity as of the close of W's taxable year.

Prop. Reg. Section 1.465-39(c) further provides that the amount a taxpayer is "at risk" in an activity "at the close of a taxable year of the taxpayer" is determined by:

- Increasing the amount "at risk" in the activity by all factors occurring during the taxable year which increase the amount at risk; and

- Decreasing the amount "at risk" in the activity by all factors occurring during the taxable year which decrease the amount "at risk".

In the above example, the "loss from the activity" was a loss generated by a partnership with a June 30 taxable year that overlapped the taxable year of the individual. In the instant case, Partnership liquidated during the taxable year of Investor and did not generate a "loss from the activity". The assets distributed by Partnership to Investor as non-taxable liquidating distributions[77] were contributed by Investor to its existing portfolio of investments. As discussed below, such contribution should constitute a contribution to an "activity" under Code Section 465(b)(1). Accordingly, the determination of whether there is a "loss from the activity" would be based upon the income or loss derived from Investor's investment portfolio during the taxable year. The investment portfolio for such purposes would consist of the investment assets distributed to Investor as liquidating distributions and contributed by Investor to its "activity" and the pre-existing marketable securities and other financial instruments[78].

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[77] The liquidating distributions made to Investor were effectively non-taxable distributions because there was no gain or loss recognized under Code Section 731.

[78] The "activity" being undertaken by Investor through a separate legal entity (as the concept of separate legal entity is used in Prop. Reg. Section 1.465-1(a)) effectively terminated at the date of Partnership's liquidation.

In the instant case, Code Section 465 does not apply to the activity undertaken through Partnership because no loss was generated from the activity. From a Code Section 465 perspective, the assets distributed to Investor upon liquidation in a non-taxable transaction were withdrawn from the "old activity" being undertaken by Partnership and contributed to a separate existing "activity" being undertaken by Investor. Accordingly, the determination of the extent to which the taxpayer is "at risk" is made on the basis of the facts existing as of the close of the taxable year of Investor, the only taxpayer with the potential of generating a "loss from the activity". Consequently, the activity undertaken through a separate entity, Partnership, during the taxable year is not impacted by the Code Section 465 "at risk" limitation rules.

I. <u>Activities Subject to the Code Section 465 Rules</u>

Code Section originally applied to four types of activities: holding, producing, or distributing motion picture films or video tapes; farming; leasing certain tangible personal property; or exploring for, or exploiting, oil and gas resources.[79] Congress extended the application of the "at risk" rules in 1978 to exploring for, or exploiting, geothermal deposits and to each activity engaged in by the taxpayer in carrying on a trade or business or for the production of income not described in Code Section 465(c)(1).[80] In 1986, the "at risk" rules were extended to cover real estate.

In applying the "at risk" rules, a two-step analysis is required. The scope of an activity must be first defined and then it must be determined whether separate activities should be aggregated or segregated for purposes of applying the "at risk" rules. The Code Section 465 Proposed Regulations provide only limited guidance regarding how to determine the scope of the activities in which a taxpayer is engaged. If two activities are interrelated, it is not clear whether there are two activities or only one.

Code Section 465 applies to each activity engaged in by the taxpayer in carrying on a trade or business or for the production of income.[81] Although a partnership itself is not subject to the "at risk" rules, the nature of any activity involving a partner is determined at the partnership level. Investor engages in its activity with respect to the investments made by Partnership for the production of income. Thus, the "at risk" activity of Investor includes its investments through Partnership. In addition, Investor invests directly in marketable securities and other financial instruments on its own account. Investor's direct investments in marketable securities and other financial instruments also constitute an "at risk" activity. Accordingly, Investoc's investment portfolio consists of a combination of Investor's direct investments and investments through Partnership. By design, Investor's investment strategy necessitates an integration of risk positions with respect to all the investments composing the portfolio in order to optimize investment returns. Accordingly, in an economic sense Investor's investment activities are interdependent and integrated.

[79] Code Section 465(c)(1).
[80] Code Section 465(c)(1)(E); Code Section 465(c)(3).
[81] Code Section 465(c)(3).

However, for purposes of Code Section 465, Investor's direct investment activity and its investment through Partnership would constitute two separate "at risk" activities. With respect to carrying on a trade or business under the Code Section 465(c)(3) rules, if a taxpayer actively participates in the management of such trade or business, then all activities comprising the trade or business are aggregated for purposes of the "at risk" rules.[82] No such rules are provided for the production of income. In addition, Code Section 465(c)(3)(C) provides that activities are aggregated or treated as separate activities to the extent prescribed by Treasury Regulations. No such Regulations have been proposed or adopted since enactment of the provision in 1978.

Until Regulations are released defining parameters for aggregation and segregation of activities relating to the production of income, Investor should be permitted to combine all directly-held investment activities undertaken pursuant to an integrated investment portfolio strategy into one activity. Because Prop. Treas. Reg. Section 1.465-1(a) treats partnerships as a separate entity for purposes of applying the "at risk" rules, we believe that the intended treatment of activities undertaken by partnerships is to view such activities as separate from related activities undertaken directly by the individual partner. In the instant case, Investor's interest in Partnership was liquidated before the end of its taxable year. The assets withdrawn from that activity upon liquidation were contributed to the investment activity being undertaken by Investor on its own account. Accordingly, because Investor is now engaged in only one activity, investment activities on its own account, the aggregation concept is not applicable.

2. <u>The Amount "At Risk"</u>

For purposes of Code Section 465, a taxpayer is considered "at risk" for an activity with respect to the amount of money and the adjusted basis of other property contributed by the taxpayer to the activity and the amount borrowed for use in an activity to the extent that the taxpayer is personally liable for repayment of such amount or has pledged property, other than property used in the activity, as security for such borrowed amount (to the extent of the net fair market value of the taxpayer's interest in such property).[83] A taxpayer is not considered "at risk", however, with respect to amounts protected against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements.[84]

An amount borrowed is not "at risk" with respect to an activity if the amount is borrowed from any person who has an interest in the activity (other than an interest as a creditor in the activity) or from a related person to a person (other than the taxpayer) having such an interest.[85] This rule applies with respect to any activity engaged in by the taxpayer in

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[82] Code Section 465(c)(3)(B).
[83] Code Sections 465(b)(1) and (2).
[84] Code Section 465(b)(4).
[85] Code Section 465(b)(3).

carrying on a trade or business or for the production of income only to the extent provided in Regulations.[86] No such Regulations have been proposed or issued.

A taxpayer's amount "at risk" in a partnership is increased by the amount of the partner's distributive share of taxable and tax-exempt income generated from the activity.[87] Code Section 465(b)(5) provides that if in any taxable year the taxpayer has a loss from an activity to which Code Section 465 applies, the amount with respect to which a taxpayer is considered to be "at risk" in subsequent taxable years with respect to that activity is reduced by that portion of the loss which is allowable as a deduction.

The legislative history underlying the enactment of Code Section 465 provides that the "at risk" amount for a partner is computed with reference to the basis of the partner's partnership interest.[88] The linkage between Code Sections 752 and 465 is corroborated by PLR 9036013[89] where the Service stated that the economic risk of loss analysis of Code Section 752 applied to determine a partner's "at risk" amounts.

In Follender v. Commissioner,[90] the Tax Court rejected the Service's position that present value concepts are to be imposed on the "at risk" rules under Code Section 465. Based upon the lack of support in the legislative history or the statutory language of Code Section 465, the Tax Court refused to find an "implied limitation of the borrowed amount to present value," observing that "Congress has been explicit in the areas it has chosen to require present value calculations." The court further stated that "the statute does not allow for present value calculation, expressly or implicitly." Accordingly, the amount of debt contributed to an activity is the "face" amount of the debt, the principal payable.[91]

There are two general areas of divergence in the application of the principles of the Code Section 465 at risk rules and the Code Section 704(d) partnership loss allowance rules. The first difference is that a partner can acquire basis through nonrecourse financing for Code Section 704(d) purposes; whereas, under Code Section 465(b)(4), nonrecourse financing is generally insufficient to create an amount at risk for Code Section 465

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[86] Code Section 465(c)(3)(D); Alexander v. Commissioner, 95 T.C. 467, rev'g on motion for reconsideration, TC Memo 1990-141.

[87] Prop. Treas. Reg. Sections 1.465-22, 1.465-23, and 1.465-66. *See also* Lansburgh v. Commissioner, 92 T.C. 448 (1989), (taxpayer's "at risk" amount increased to extent the taxpayer recognizes income with respect to the activity) and Allen v. Commissioner, 55 T.C.M. (CCH) at 688 (1988), (gain recognized on the disposition of the activity or an interest in the activity increases the taxpayer's amount "at risk"). These adjustments reflect the fact that the "at risk" amount is determined in a manner consistent with the determination of the taxpayer's adjusted basis, except that certain nonrecourse debt amounts and amounts protected against loss are not included. *See* the Senate Report at 50.

[88] S. Rep. No. 938, 94th Cong., 2d Sess. 50 n.8 (1976).

[89] PLR 9036013 (June 8, 1990).

[90] Follender v. Commissioner, 89 T.C. 943 (1987).

[91] As previously discussed, the application of the time-value-of-money concepts in the Code Section 465 context parallels the base Code Section 752 logic. In the Code Section 752 context, time-value-of money concepts are only applied in two defined situations: (1) a special rule for nonrecourse liabilities with interest guaranteed by a partner and (2) with respect to an unreasonable delay of a partner's obligation to make payments to the partnership.

purposes.[92] Second, in the event a partnership interest is sold and the selling partner has suspended, unallowed Code Section 704(d) losses, subsequent gain on the sale of the partnership interest cannot be used to free-up the Code Section 704(d) loss carryover amount. The partnership's taxable year closes with respect to the selling partner under Code Section 706(c)(2)(A) and the basis for the partner's partnership interest at that date is zero.[93] This can be contrasted with the Code Section 465 rules which allow an offset of losses suspended under Code Section 465 against income from the sale of a partnership interest, as such income is treated as "income from the activity."[94] In effect, the Code Section 465 limitation applies at the partner level, while the Code Section 704(d) limitation isolates the disallowed loss at the partnership level.[95]

With respect to the instant case, the determination of the extent to which Investor is "at risk" is made on the basis of the facts existing as of the close of Investor's taxable year. At the close of Investor's taxable year, Investor had liquidated its interest in Partnership in a non-taxable transaction and the investment assets distributed to Investor were contributed to its existing activity consisting of directly held investment assets. Accordingly, in determining the amount "at risk" the analysis should look to what was done with the assets distributed to Investor as liquidating distributions. Such assets were contributed to the investment activity being undertaken by Investor on its own account. Based on the foregoing analysis, we believe that it is more likely than not that Investor's Code Section 465 "at risk" amount for its taxable year ending on [December 31, 1999] includes the cash and the adjusted basis of the assets distributed to Investor as liquidating distributions by Partnership.

3. <u>Application of Code Section 469</u>

Conceptually similar to the application of the Code Section 465 "at risk" rules, the passive activity loss rules of Code Section 469 do not apply directly to partnerships or S corporations, but (as a result of the entity's flow-through nature) apply to the partners or shareholders.[96] Thus, Code Section 469 should apply to Investor.

Code Section 469(c) defines a passive activity as one involving the conduct of a trade or business in which the taxpayer does not materially participate. Material participation is the involvement by the taxpayer on a sufficiently regular, continuous, and substantial basis.[97] Taxpayers meeting the material participation test are considered "active" participants, and those not meeting the material participation tests are considered

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[92] Accordingly, in the instant case, Investor's initial basis in its partnership interest after contribution of cash subject to the loan is [$141.8 million] and Investor's Code Section 465 "at risk" amount is [$63.6 million].
[93] In <u>Sennett v. Commissioner</u>, 80 T.C. 825, *aff'd per curiam*, 752 F2d 428 (9th Cir. 1985), the Tax Court concluded that a partner's suspended Code Section 704(d) deductions expire upon the sale of his partnership interest.
[94] Prop. Treas. Reg. Section 1.465-66(a).
[95] The underlying logic is that at the point that an investor terminates its entire interest in an investment, Code Section 465 should not preclude deduction of any suspended losses.
[96] Code Section 469(a)(2).
[97] Code Section 469(h)(1).

"passive" participants. Under Code Section 469(h)(2), a limited partner is presumed not to materially participate in a limited partnership, resulting in classification of the limited partnership interest as a passive activity.

The passive activity loss rules were designed to deny the losses generated by passive activities until the investor terminates its interest in the activity and it is determined that the activity generated an economic loss. In addition, Congress specifically wished to deny taxpayers the opportunity to deduct passive losses against other sources of income such as income from personal services and portfolio investments.[98]

Consequently, Code Section 469(e)(1) excludes from passive activity income any portfolio income, expenses, gains, and losses of that activity. Portfolio income is described under Code Section 469(e)(1) as gross income from interest, dividends, annuities, and royalties not derived in the ordinary course of a trade or business. Portfolio expenses are expenses directly allocable to portfolio income, including allocable interest expense under Treas. Reg. 1.163-8T. Portfolio gains and losses include those resulting from the disposition of assets generating portfolio income and from the disposition of other assets held for investment. Portfolio gains and losses shall not, however, include disposition of an interest in a passive activity.

With respect to the instant case, Investor's Partnership interest generally will be considered a passive activity under the presumption in Code Section 469(h)(2). However, Investor's participation in the Investment Fund will generate allocable Partnership income that meets the definition of portfolio income[99]; and, thus, we are of the opinion that it is more likely that not that such income will be excluded under Code Section 469(e)(1) from the passive activity loss limitation rules.

F. <u>Other Tax Provisions and Judicial Doctrines</u>

In arriving at our conclusions, we have considered several other Code provisions, as well as certain judicial doctrines that, if applicable, could impact the tax results of this transaction. These other Code provisions and doctrines are the application of the anti-abuse rules under Treas. Reg. Section 1.1275-2(g) and Treas. Reg. Section 1.701-2; and the application of the business purpose/economic substance/step transaction doctrines.

1. <u>Application of Anti-abuse Rule under Treas. Reg. Section 1.1275-2(g)</u>

The anti-abuse rule of Treas. Reg. Section 1.1275-2(g) provides that if a principal purpose in engaging in a transaction is to achieve a result that is unreasonable under Code Sections 163(e), 1271 through 1275, or any related Code Section, the Commissioner can apply or depart from the Regulations to achieve a reasonable result. Whether a result is considered unreasonable will depend upon the facts and circumstances surrounding the transaction. A significant fact in making this determination will be whether the treatment

[98] S. Rep. No. 313, 99th Cong., 2d Sess. 713-746 (1986).
[99] As defined in Code Section 469(e)(1) and Treas. Reg. Section 1.469-2T(c)(3).

of a debt instrument is expected to have a substantial effect on the issuer's or holder's U.S. tax liability. A result will not be considered unreasonable, however, in the absence of an expected substantial effect on the present value of the taxpayer's tax liability.

The anti-abuse rule provides three examples of the application of its principles. The examples illustrating the anti-abuse rule focus on the following situations:

- Use of the option rules in Treas. Reg. Section 1.1272-1(c)(5) to limit the holder's interest income includible in the period prior to the call date;
- Use of a contingent payment debt instrument to substantially reduce the holder's interest income by virtue of the application of Treas. Reg. Section 1.1275-4(c); and
- Use of a convertible debt instrument to avoid ordinary issue discount.

None of the examples is on point with the facts in the instant case. The facts of the instant case can be distinguished from the examples illustrating abuse since the issuer properly amortizes the loan issuance premium into income as an offset to its otherwise allowable interest expense deductions; and similarly, upon repayment of the loan, income or deduction is properly computed under the provisions of Treas. Reg. Section 1.163-13 and Treas. Reg. Section 1.61-12, respectively.

We are not aware of any authority applying the anti-abuse provisions to a case outside of the examples provided in the Regulations, such as to a case similar to the instant case. In analyzing whether the tax consequences contained herein are unreasonable under Code Sections 163(e), 1271 through 1275, or any related Code Section, it is useful to determine how a different application of the rules might result in a more reasonable calculation of the present value of the issuer's tax liability. For example, the Service may apply the anti-abuse rule to change the manner in which the issuer computes:

- The issue price of the loan;
- The accrual of interest expense and amortization of loan premium; and
- The income or deduction upon retirement of the loan.

It is unlikely the Service could apply the anti-abuse rule to change the issue price of the loan since the issue price is a statutory determination under Code Section 1273(b)(2), and the Service has no authority under the anti-abuse regulations to depart from the statute.

However, if the Service were to change the issue price of the loan, such change would have the effect of understating or overstating the proper measurement of taxpayer's interest expense under the constant yield method prescribed under the OID rules and Regulations. This misstatement would occur due to the difference in the loan's stated interest rate and prevailing market rates.

Furthermore, any increase or decrease in the issue price would impact the calculation of income from the discharge of indebtedness or repurchase premium deduction upon retirement of the loan. An increase by the Service in the loan's issue price would increase the accrued interest expense during the loan term, but decrease the repurchase premium in the year paid. Similarly, a decrease in the loan's issue price by the Service would decrease the accrued interest expense during the loan term, and increase the Partnership's repurchase premium deduction in the year the loan is paid. As a result, it appears unlikely that the Service could apply the anti-abuse rules to the facts of the instant case to achieve a more reasonable tax result.

Based on the existing authority, and the facts and circumstances of the existing case, we are of the opinion that it is more likely than not that the described tax consequences of Investor's issuance of the debt instrument will not have a substantial effect on the issuer's U.S. tax liability that could be construed as unreasonable in light of the purposes of Code Sections 163(e), 1271 through 1275, or any related Code Section.

2. <u>Application of Anti-abuse Rules under Treas. Reg. Section 1.701-2</u>

The partnership anti-abuse regulations articulate two broad rules. The first, which we refer to as the "intent of subchapter K" rule, is articulated in Treas. Reg. Section 1.701-2 paragraphs (a) through (d). It provides a framework within which to determine whether a transaction violates the intent of subchapter K, and identifies the remedial steps that the Service may take to correct perceived transgressions. The second, which we refer to as the "abuse of entity" rule is embodied in paragraphs (e) and (f) of Treas. Reg. Section 1.701-2. This rule addresses situations in which a partnership is utilized, in lieu of an alternative business entity (e.g., a corporation), for a purported abusive purpose. When properly invoked, the Commissioner has the authority to treat the partnership as an aggregate of its partners to "carry out the purpose of any provision of the Internal Revenue Code or the regulations promulgated thereunder."[100]

Intent of Subchapter K Rule

The partnership anti-abuse abuse regulations purport to grant the Commissioner authority to recast partnership transactions to achieve tax results that are consistent with the intent of Subchapter K. The anti-abuse rule applies only if both (1) the taxpayer has a principal purpose to achieve substantial federal tax reduction, and (2) that tax reduction is inconsistent with the intent of Subchapter K. Treas. Reg. Section 1.701-2. The regulations identify three requirements for demonstrating compliance with the "intent" of Subchapter K:

- The partnership must be bona fide and each partnership transaction or series of related transactions (individually or collectively, the transaction) must be entered into for a substantial business purpose.

[100] Treas. Reg. Section 1.701-2(e).

- The form of each partnership transaction must be respected under substance over form principles.

- The tax consequences under Subchapter K to each partner of partnership operations and of transactions between the partner and the partnership must accurately reflect the partners' economic agreement and clearly reflect the partner's income. Clear reflection of income is not required in instances where the inaccurate reflection of income is clearly contemplated by the particular Code or regulation provision being applied. Treas. Reg. Section 1.701-2(a).

The preamble to the final regulations explains that the first two "intent" requirements are intended as restatements of existing judicial doctrines.[101] As such, these requirements should be considered satisfied where it is determined that the judicial authorities regarding "business purpose" and "substance over form" are satisfied. As subsequently discussed in the <u>Application of the Business Purpose/Economic Substance/Substance over Form Doctrines</u> section of our opinion, we believe that it is more likely than not that these judicial authorities are satisfied. Thus, consistent with these findings, we believe that it is more likely than not that the first two "intent" requirements are satisfied.

To demonstrate compliance with the third "intent of Subchapter K" requirement, a taxpayer must show that the tax consequences under subchapter K to each partner of partnership operations and of transactions involving a partner and the partnership accurately reflect the partners' economic arrangement and clearly reflect the partner's income. Clear reflection of income is not required, however, where the inaccurate reflection of income is clearly contemplated by the particular Code or regulation provision being applied. The regulations set forth factors and examples that provide some limited guidance with respect to this requirement.

The Seven Factors

In an instance that a partnership is formed or availed of with a principal purpose to reduce substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of subchapter K, the Commissioner can recast the transaction for federal tax purposes to achieve tax results that are consistent with the intent of subchapter K. Whether a partnership is used in a manner inconsistent with the intent of subchapter K is determined based upon all the facts and circumstances. The seven factors set forth below may be indicative, but do not necessarily establish, that the partnership is used in such a manner. These factors are illustrative only, and therefore may not be the only factors taken into account in making the determination under Treas. Reg. Section 1.701-2. Moreover, the weight given to any factor depends on all the facts and circumstances. The absence or presence of any factor described does not create a presumption that a partnership was (or was not) used in such a manner. Relevant factors include:

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[101] T.D. 8588, 1995-7 I.R.B. 5, 8; *See also* <u>Federal Taxation of Partnerships and Partners</u>, McKee, Nelson, and Whitmire, Chapter 1.05[2][a].

- The present value of the partners' aggregate federal tax liability is substantially less than had the partners owned the partnership's assets and conducted the partnership's activities directly;

- The present value of the partners' aggregate federal tax liability is substantially less than would be the case if purportedly separate transactions that are designed to achieve a particular end result are integrated and treated as steps in a single transaction. For example, this analysis may indicate that it was contemplated that a partner who was necessary to achieve the intended tax results and whose interest in the partnership was liquidated or disposed of (in whole or in part) would be a partner only temporarily to provide the claimed tax benefits to the remaining partners;

- One or more partners who are necessary to achieve the claimed tax results have a nominal interest in the partnership, are substantially protected from any risk of loss from the partnership's activities (through distribution preferences, indemnity or loss guaranty agreements, or other arrangements), or have little or no participation in the profits from the partnership's activities other than a preferred return that is in the nature of a payment for the use of capital;

- Substantially all of the partners (measured by number or interests in the partnership) are related (directly or indirectly) to one another;

- Partnership items are allocated in compliance with the literal language of Treas. Reg. Sections 1.704-1 and 1.704-2 but with results that are inconsistent with the purpose of Code Section 704(b) and those regulations. In this regard, particular scrutiny is paid to partnerships in which income or gain is specially allocated to one or more partners that may be legally or effectively exempt from federal taxation (for example, a foreign person, an exempt organization, an insolvent taxpayer, or a taxpayer with unused federal tax attributes such as net operating losses, capital losses, or foreign tax credits);

- The benefits and burdens of ownership of property nominally contributed to the partnership are in substantial part retained (directly or indirectly) by the contributing partner (or a related party); or

- The benefits and burdens of ownership of partnership property are in substantial part shifted (directly or indirectly) to the distributee partner before or after the property is actually distributed to the distributee partner (or a related party).

Treas. Reg. Section 1.701-2(c), subparagraphs (1) through (7).

Examples

Example 10:

In Example 10 of the regulations, A, B, and C are partners in a partnership PRS, which has for several years been engaged in substantial bona fide business activities. For valid business reasons, the partners agree that A's interest in PRS, which has a value and basis of $100x, will be liquidated with a nondepreciable asset and related equipment with two years of cost recovery remaining. Under Code Sections 732(b) and (c), A's $100x basis in A's partnership interest will be allocated between the nondepreciable asset and the equipment received in the liquidating distribution in proportion to PRS's bases in those assets. These rules result in a federal tax advantage to A, with no offsetting detriment to B or C. In selecting the assets to be distributed to A, the partnership had a principal purpose to take advantage of the fact that A's basis in the assets will be determined by reference to A's basis in A's partnership interest, thus, in effect, shifting a portion of A's basis from the nondepreciable asset to the equipment, which in turn would allow A to recover that portion of its basis more rapidly.

The example sets forth the law as follows: Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. The decision to organize and conduct business through PRS is consistent with this intent. In addition, the first two "intent of subchapter K" requirements are satisfied. The validity of the tax treatment of this transaction is therefore dependent upon whether the transaction satisfies (or is treated as satisfying) the proper reflection of income standard. Subchapter K is generally intended to produce tax consequences that achieve proper reflection of income. However, the third "intent" rule provides that if the application of a provision of subchapter K produces tax results that do not properly reflect income, but the application of that provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision (and the transaction satisfies the first two "intent" requirements), then the application of that provision to the transaction will be treated as satisfying the proper reflection of income standard.

Applying the law to the facts, the example concludes that the transaction is treated as satisfying the proper reflection of income standard included in the third "intent" requirement. A's basis in the assets distributed to it was determined under Code Sections 732(b) and (c). The transaction does not properly reflect A's income due to the basis distortions caused by the distribution and the shifting of basis from a nondepreciable to a depreciable asset. However, the basis rules of Code Section 732, which in some situations can produce tax results that are inconsistent with the proper reflection of income standard, are intended to provide simplifying administrative rules for bona fide partnerships that are engaged in transactions with a substantial business purpose. Taking into account all the facts and circumstances of the transaction, the application of the basis rules under Code Section 732 to the distribution from PRS to A, and the ultimate tax consequences of the application of that provision to subchapter K, are clearly contemplated.

__Example 11:__

this example, partnership PRS has for several years been engaged in the development ad management of commercial real estate projects. X, an unrelated party, desires to :quire undeveloped land owned by PRS. X expects to hold the land indefinitely after its :quisition. Pursuant to a plan a principal purpose for which is to permit X to acquire and old the land but nevertheless to recover for tax purposes a substantial portion of the urchase price for the land, X contributes $100x to PRS for an interest therein. ubsequently, PRS distributes to X in liquidation of its interest in PRS the land and nother asset. The second asset is an insignificant part of the economic transaction but is nportant to achieve the desired tax results. Under Code Sections 732(b) and (c), X's asis in its partnership interest is allocated between the assets distributed in proportion to eir bases to PRS. Thereafter, X plans to sell the second asset for its value so that X will, effect, recover a substantial portion of the purchase price of the land almost nmediately. In selecting the assets to be distributed to X, the partners had a principal urpose to take advantage of the fact that X's basis in the assets is determined under Code ections 732(b) and (c). Thus, in effect, a portion of X's basis economically allocable to e land that X intends to retain shifts to an inconsequential asset that X intends to dispose f quickly. This shift provides a federal tax advantage to X with no offsetting detriment to ny of PRS's other partners.

lthough Code Section 732 recognizes that basis distortions can occur in certain tuations, the provision is intended only to provide ancillary, simplifying tax results for ona fide partnership transactions that are engaged in for substantial business purposes. 'ode Section 732 is not intended to serve as the basis for plans or arrangements in which consequential or immaterial assets are included in the distribution with a principal urpose of obtaining substantially favorable tax results by virtue of the statute's implifying rules. The transaction does not properly reflect X's income due to the basis istortions caused by the distribution that result in shifting a significant portion of X's asis to this inconsequential asset. Moreover, the proper reflection of income standard is ot treated as satisfied, because, taking into account all the facts and circumstances, the pplication of Code Section 732 to this arrangement, and the ultimate tax consequences at would result, were not clearly contemplated by that provision of subchapter K. In ddition, by using a partnership, the partners' aggregate federal tax liability would be ubstantially less than had they owned the partnership's assets directly. On these facts, the xample concludes that PRS has been formed and availed of in a manner that is consistent with the intent of subchapter K.

he Investor and the third "intent" test

n the case of the Investor who makes a contribution to the Partnership, the factors and xamples provide insight as to whether the transactions engaged in by the Investor and 'artnership satisfy (or are treated as satisfying) the proper reflection of income standard mbodied in the third "intent of subchapter K" test. Subchapter K is intended to permit nvestor and other taxpayers to conduct joint business activity through a flexible conomic arrangement without incurring an entity-level tax. Organizing and conducting usiness through the Partnership is consistent with this intent. Subchapter K is generally intended to produce tax consequences that achieve proper reflection of income. However, this "intent" requirement recognizes that the application of certain provisions of subchapter K may not produce tax results that properly reflect income. In such cases, the application of the provision to the transaction is treated as satisfying the proper reflection of income standard if the application of that provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision.

Investor's basis in its interest in the Partnership is increased for the cash contributed and decreased by liabilities that are no longer allocated to the Investor. As described above, the Investor's basis in the Partnership is *not* decreased by the amount of the bond premium obligation because such obligation is not treated as a "liability" for purposes of Code Section 752. As a result of this treatment of the bond premium obligation, the transaction may not properly reflect Investor's income as the basis in Investor's Partnership interest shifts (pursuant to Code Section 732) to the assets distributed to Investor when its interest in the Partnership is liquidated. However, these rules (Code Sections 752 and 732) are intended (notwithstanding the potential that tax results inconsistent with the proper reflection of income standard may occur) to provide simplifying administrative rules for bona fide partnerships that are engaged in transactions with a substantial business purpose. In particular, the Code Section 752 regulations do not account for the effect of the time value of money (except in limited circumstances not applicable here) to simplify the application of those rules to partnership transactions.

The instant case is readily distinguishable from Example 11. In Example 11, the plan or arrangement to reduce X's federal tax liability was structured so that X could obtain the tax results with minimal economic risk (i.e., X's participation in the partnership is terminated subsequent to its contribution to the partnership "at a time when the value of the partnership's assets have not materially changed"). The Investor, however, is not afforded such protections. Investor's interest in Partnership is liquidated only after being exposed to the risks associated with the Investment Fund. While Investor could exit the Investment Fund after certain intervals of time and request to be redeemed from the Partnership, Investor's economic return from the Partnership is dependent upon the Partnership's performance while Investor is a member. In addition, Investor is not compelled as a legal or practical matter to exercise its rights to exit the Investment Fund. See Treas. Reg. Section 1.701-2(d) *Example 4* (concludes that transaction including an option to exit a partnership does not violate partnership anti-abuse provisions). Example 11 also utilizes an inconsequential or immaterial asset to achieve the desired tax results. In Investor's case, the assets distributed in liquidation of its interest in the partnership are cash and interests in foreign currency. These assets are at the very essence of the Investment Fund and are integral to the economic objectives pursued by the Investor.

Based on the foregoing, we believe that it is more likely than not that Investor's investment in the Investment Fund through the Partnership will not be recast pursuant to the "intent of subchapter K" rule.

Abuse of Entity Rule

Under this rule, the Service is allowed to treat a partnership as an aggregate of its partners in whole or in part as appropriate to carry out the purpose of any provision of the Internal Revenue Code or the regulations promulgated thereunder. Treas. Reg. Section 1.701-2(e)(1). This rule will not apply in situations where a provision in the Code or the regulations prescribes entity treatment for a partnership (either in whole or in part) and that treatment and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision. Treas. Reg. Section 1.701-2(e)(2)(i) and (ii). The abuse of entity rule is separate and distinct from the intent of subchapter K rule. In other words, the Service may invoke the abuse of entity rule to ignore the subject partnership, and analyze the tax effects of a transaction as if they were engaged in directly by the partners of the partnership.

The Service illustrates the abuse of entity rule by way of three examples. The first two examples identify situations where the interposition of a partnership is intended to avoid application of unfavorable provisions applicable to corporations. Example 1 involves a transaction that tries to avoid limitations imposed by Code Section 163(e)(5). Example 2 involves a transaction attempting to avoid the application of Code Section 1059. Both of these Code sections specifically authorize regulatory authority to stop partnership techniques to keep these sections from applying. The Service would utilize its ability to invoke the abuse of entity rule in these types of situations.

Example 3 describes the use of a domestic partnership by a domestic U.S. corporation to improve that corporation's ability to utilize its share of foreign tax credits in respect of foreign country taxes expected to be incurred by a foreign corporation wholly-owned by the partnership. In this case, the Service observes that Code Sections 957(c) and 7701(a)(30) together require that the partnership be treated as an entity with respect to the issue of defining a U.S. shareholder and thus determining controlled foreign corporation (CFC) status. The example also asserts that the use of the domestic partnership to qualify the foreign corporation as a CFC, and thus for the favorable foreign tax credit look-through rules of Code Section 904(d)(3), was clearly contemplated by Congress. Accordingly, the example concludes that the Service in this instance would be prevented from recasting the partnership as an aggregate of its partners by operation of Treas. Reg. Section 1.701-2(e). Treas. Reg. Section 1.701-2(f) *Example 3*.

In contrast to the "intent of subchapter K" rule the Service can invoke the abuse of entity rule at Treas. Reg. Section 1.701-2(e) to carry out the "purpose of any provision of the Internal Revenue Code or the regulations promulgated thereunder". Moreover, the Service claims the power under this rule to treat a partnership as an aggregate of its partners regardless of whether the partnership is imbued with economic substance. Accordingly, the Service could potentially invoke this rule if it determined that the tax consequences of the transaction involving the Investor and Partnership were, in the Service's view, in conflict with the "purpose of any provision" of the Code or regulations.

The only constraint to which the Service's general capacity to invoke the abuse of entity rule is Treas. Reg. Section 1.701-2(e)(2). Under this rule, the treatment of a partnership as an entity for purposes of applying a particular provision of the Code is respected if (i) the provision prescribes the treatment of a partnership as an entity, in whole or in part, and (ii) that treatment, and the ultimate tax results (which flow from that treatment), are clearly contemplated by that provision.. Treas. Reg. Section 1.701-2(e)(2)(i) and (ii).

The meaning of the phrase "prescribed entity treatment" is illustrated in Treas. Reg. Section 1.701-2(f) *Example 3. This example* asserts that Code Sections 957(c) and 7701(a)(30), when taken together, require that a partnership be treated as an entity for purposes of determining who is a U.S. shareholder in a foreign corporation and, thus, determining controlled foreign corporation (CFC) status. Code Section 7701(a)(30) states that the definition of the term "U.S. Person" includes a domestic partnership. Code Section 957(c) provides that, for purposes of Subpart F (and the CFC rules), the term "U.S. Person" has the meaning assigned to it by Code Section 7701(a)(30). Accordingly, for purposes of the CFC rules, a domestic U.S. partnership which holds stock in a CFC is treated as a U.S. shareholder. Evidently, the Service believes that entity treatment is "prescribed" in such a case because the partnership's entity-level stock ownership is respected (not dis-aggregated and attributed to its partners) for purposes of determining the level of U.S. shareholder stock ownership in a foreign corporation.

The tax benefits associated with Investor's investment in the Partnership are not derived by avoiding or enhancing results achieved under a Code section outside of subchapter K. Rather, it is subchapter K itself, in particular Code Sections 752 and 732, which drives the tax results for Investor. Both Code Sections 752 and 732 treat a partnership as an entity as opposed to an aggregate of its partners. Such treatment of a partnership as an entity is clearly contemplated by Code Sections 752 and 732. In these circumstances, we believe that it is more likely than not that the Partnership will not, for purposes of determining the federal tax treatment of Investor's investment in the Investment Fund through the Partnership, be recast as an aggregate of its partners pursuant to the "abuse of entity" rule.

3. Application of the Business Purpose/Economic Substance/Substance over Form Doctrines

In order for losses arising from investments in financial instruments to be deductible, the transaction or series of transactions that gave rise to such losses must have economic substance, a business purpose, and a form that reflects their substance. A series of transactions will not be respected unless the transactions have economic substance separate and distinct from the economic benefit achieved solely by tax reduction.

Judicial Development of the Business Purpose/Economic Substance/ Substance over Form Doctrines

The seminal case dealing with the necessity of having economic substance and a business purpose to effectuate a substantive tax transaction is Gregory v. Helvering, decided in

1935.[102] In Gregory, the taxpayer attempted to use the Code's reorganization provisions to convert a taxable dividend of corporate property into a capital gain transaction involving that same property. The taxpayer in Gregory owned 100% of a corporation that owned operating assets as well as passive, appreciated marketable securities. The taxpayer wanted to extract the securities from the corporation and sell them, but wanted to avoid dividend treatment. To accomplish this result, the taxpayer formed a new corporation ("Newco") and had the corporation holding the securities transfer the securities to Newco in exchange for Newco stock. The Newco stock was then distributed to taxpayer who immediately thereafter liquidated Newco. The taxpayer then sold the marketable securities and reported a capital gain. The series of transactions were undertaken over a six day period.

Gregory is typically described as a business purpose case. It is also, a substance over form case and is indicative of how the doctrines interrelate. The Supreme Court began its analysis of the transaction by stating that "if a reorganization in reality was effected...the ulterior [i.e., tax avoidance] purpose ...will be disregarded. The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted...But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended."[103]

The above observation by the Court acknowledges that a taxpayer may use the form of a transaction to minimize taxes, but there must be an underlying business purpose. Specifically, the Court noted that:

> "when subdivision (B) speaks of a transfer of assets by one corporation to another, it means a transfer made 'in pursuance of a plan of reorganization' of corporate business; and not a transfer of assets by one corporation to another in pursuance of a plan having no relation to the business of either, as plainly is the case here. Putting aside, then, the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred, what do we find? Simply an operation having no business or corporate purpose – a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner."[104]

Accordingly, even if a taxpayer purports to reorganize a business and executes the transaction in a form which fits within the Code's definition of a tax-free transaction, the courts will look beyond the form to determine whether the purported business reorganization, in substance, occurred. In addition, a taxpayer must have a business purpose to support a transaction that is structured to reduce taxes.

[102] Gregory v. Helvering, 293 U.S. 465 (1935).
[103] Gregory v. Helvering, 293 U.S. 465, 468 (1935).
[104] Gregory v. Helvering, 293 U.S. 465, 469 (1935).

In 1960, the Supreme Court, citing Gregory, held that, just as there was never a business reorganization in Gregory, there was never a business loan in Knetsch v. United States.[105] The Court noted that it was "patent that there was nothing of substance to be realized by Knetsch from this transaction beyond a tax deduction."[106] The taxpayer in Knetsch purchased 10, 30-year deferred annuity savings bonds, financed by a down payment and funds borrowed from the issuer against their cash surrender value. The basis for the Court's conclusion that the transaction was a sham was that the taxpayer was paying interest to the issuer of the bonds at the rate of 3.5 percent on its loan to him, while the investment was growing in value by only 2.5 percent. The net annual cash loss of 1 percent was incurred only to achieve a tax deduction for the interest paid.

Whereas Gregory and Knetsch involved relatively transparent tax avoidance schemes, the subsequently decided sale-leaseback cases involved more sophisticated transactions which combined differing levels of tax avoidance and non-tax motives. The seminal case in the sale-lease back area is the Supreme Court's decision in Frank Lyon Co. v. United States [107] In the 1978 decision, the Supreme Court held that where there is a genuine multiple-party transaction with economic substance, which is compelled or encouraged by business or regulatory realities; is imbued with tax independent considerations; and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the parties.

In 1990, the Court of Appeals for the Second Circuit construed the Supreme Court's opinion in Frank Lyon Co. to affect the form vs. substance issue as follows:

> While we exalt substance over form, we do not ignore the form. The touchstone in determining whether the form of an agreement should govern is the opinion of the Supreme Court in Frank Lyon, which held that agreements which were intended to have economic substance, as opposed to mere tax avoidance, should be given effect for tax purposes...That opinion set forth several factors...The first factor inquires whether there is a legitimate non-tax business reason for the form; in other words, were the parties motivated at least in part by reasons unrelated to taxes?... The second...factor requires that the agreement have non-tax "economic substance."...We have construed that factor to require a "change in the economic interests of the relevant parties."...[108]

Application of the Step-Transaction Doctrine

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[105] Knetsch v. United States, 364 U.S. 361 (1960).
[106] Knetsch v. United States, 364 U.S. 361, 366 (1960).
[107] Frank Lyon Co. v. United States, 435 U.S. 561 (1978).
[108] In Newman v. Commissioner, 902 F.2d 159 (2d Cir. 1990), the court vacated and remanded the decision of the Tax Court and concluded that an individual taxpayer was not precluded by former section 46(e)(3) from claiming the investment tax credit on equipement that was subject to an operating agreement. The court held that the operating agreement between an employer and an independent trucking contractor was a valid contract and not a lease.

The judicially created doctrine of substance over form is sometimes referred to as the step-transaction doctrine. In general, the step-transaction doctrine has been used by the courts to determine whether the substance of a series of transactions undertaken by a taxpayer should prevail over the form of the transactions as constructed by the taxpayer. Application of the step-transaction doctrine by the courts can be described as amorphous. One of the more insightful observations that has been made in applying the doctrine was by Judge Easterbrook in Sears Roebuck & Co. v. Commissioner:[109] "substance prevails over empty forms." As articulated by the Tax Court, the step-transaction doctrine "treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result."[110]

In cases where the courts have found that the taxpayer has entered into a series of transactions that are in substance a single or indivisible transaction, they have applied the step-transaction doctrine to disregard the intermediary steps and give credence only to the end result.[111] The courts have traditionally applied three basic formulations of the doctrine. These are the "binding commitment", the "mutual interdependence", and the "end result" tests.[112]

The "binding commitment" test. The "binding commitment" test is the narrowest and most formalistic of the three formulations of the step-transaction doctrine. This approach integrates a series of transactions only if there is a binding legal commitment to undertake each of the steps.[113] The "binding commitment" test is primarily directed at transactions where the transactions under consideration span several tax years and at the time the first transaction is undertaken, there is a binding commitment to undertake the subsequent transactions.[114]

The "end result" test. In contrast to the "binding commitment" test, which looks to formal commitment as evidence of taxpayer intent, the "end result" test integrates a series of steps into a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be undertaken for the purpose of reaching an ultimate result.[115] The broadest in scope of the three approaches, the "end result test" focuses upon the subjective intent of the parties involved and whether, as revealed by the

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[109] Sears Roebuck & Co. v. Commissioner, 972 F.2d 858, 862 (7th Cir. 1992).
[110] Esmark, Inc. v. Commissioner, 90 T.C. 171, 195 (1988), *aff'd without published opinion*, 886 F.2d 1318 (7th Cir. 1989).
[111] *See e.g.*, Cal-Maine Foods, Inc. v. Commissioner, 93 T.C. 181, 198 (1989).
[112] McDonald's Restaurants of Illinois, Inc. v. Commissioner, 688 F.2d 520, 524-525 (7th Cir. 1982); Cal-Maine Foods, Inc. v. Commissioner, 93 T.C. 181, 198-199 (1989); and Penrod v. Commissioner, 88 T.C. 1415, 1429 (1987).
[113] Commissioner v. Gordon, 391 U.S. 83, 96 (1968).
[114] Commissioner v. Gordon, 391 U.S. 83, 96; Redding v. Commissioner, 630 F.2d 1169, 1175 (7th Cir. 1980), *cert. denied* 450 U.S. 913 (1981), *rev'g* 71 T.C. 597 (1979); and King Enterprises, Inc. v. U.S., 418 F.2d 511, 518 (Ct. Cl. 1969).
[115] King Enterprises, Inc. v. U.S., 418 F.2d at 511, 516 (Ct. Cl. 1969).

substance of the transaction, the ultimate result was intended from the outset.[116] Where such intent has been present, courts have been disposed to combine purportedly separate steps and bind taxpayers to the tax consequences of an integrated transaction. However, the courts have generally been reluctant to recharacterize a transaction by inventing steps not actually taken by the taxpayer under scrutiny.[117]

The "mutual interdependence" test. The "mutual interdependence" test requires the integration of a series of transactions only if each transaction is so interdependent on the others that the legal relationships created by each step is fruitless without the completion of the series.[118] This approach focuses not upon ultimate results but rather on the relationship between steps.[119] Its application is appropriate in instances where it is "unlikely that any one step would have been undertaken except in contemplation of the other integrating acts...."[120] For example, where the taking of one purportedly separate step in a transaction has been contingent on completion of another, courts have been unwilling to accord the steps independent significance and have integrated them into a single transaction for tax purposes.[121]

When such interlocking legal relationships are absent, however, courts have been reluctant to integrate multi-step transactions under the "mutual interdependence" approach. In Redding, for example, the taxpayer had received a distribution of transferable stock warrants from a corporation in which the taxpayer held common stock. The warrants entitled the taxpayer to purchase, for additional consideration, stock in the corporation's wholly-owned subsidiary. The taxpayer exercised all the warrants issued to him and purchased stock in the subsidiary. The Tax Court, in applying the step-transaction doctrine, concluded that the warrant distribution and acquisition of subsidiary stock ought to be treated as a single transaction involving the distribution of the subsidiary's stock to the taxpayer. Having also concluded that the other necessary requirements of Code Section 355 had been met, the Tax Court held that the overall transaction qualified as a Code Section 355 spin-off and should therefore be tax-free to the taxpayer.[122] On appeal by the Service, however, the Seventh Circuit, in reversing the Tax Court, refused to construe the warrant distribution and subsequent stock purchase as a single transaction under the "mutual interdependence" test.[123]

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[116] King Enterprises, Inc. v. U.S. 418 F.2d at 511, 518 (Ct. Cl. 1969).
[117] Esmark, Inc. v. Commissioner, 90 T.C. at 196 (1988).
[118] American Bantam Car Company v. Commissioner, 11 T.C. 397 (1948), *aff'd per curiam*, 177 F.2d 513 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950). *See also* Redding v. Commissioner, 630 F.2d. at 1177; Dyess v. Commissioner, 65 T.C.M (CCH) at 2717 (1993) *aff'd*, 25 F.3d 1119 (5th Cir. 1994).
[119] McDonald's Restaurants of Illinois, Inc. v. Commissioner, 688 F.2d at 524.
[120] Kuper v. Commissioner, 533 F.2d 152, 156 (5th Cir. 1976).
[121] Associated Wholesale Grocers, Inc. v. U.S., 927 F.2d 1517 (10th Cir. 1991).
[122] Redding v. Commissioner, 71 T.C. at 597.
[123] Redding v. Commissioner, 630 F.2d at 1178. The Redding judgment was based on the fact that none of the shareholders of the corporation (including the taxpayers) was under any obligation to exercise the warrants distributed to them. In addition, the warrants were transferable to nonshareholders, and the underwriters involved had agreed to purchase (at a price somewhat reduced from the actual exercise price of the warrants themselves) any stock of the subsidiary not acquired by exercise of the warrants. Therefore, as the appeals court pointed out, "the money would have come in and the stock gone out with or without the exercise of the warrants." Redding v. Commissioner, 630 F.2d at 1177. Noting that the primary objective of

When the step-transaction doctrine is employed to eliminate transitory steps, it overlaps and becomes indistinguishable from the business purpose doctrine (under which the unnecessary step is disregarded because it was lacking in business purpose) and the substance over form doctrine (nullifying the unnecessary step as a formality that merely obscures the substance of the transaction). In Tandy Corp. v. Commissioner,[124] the Tax Court stated:

> "When a taxpayer adheres strictly to the requirements of a statute intended to confer tax benefits, whether or not steps in an integrated transaction, when the result of the steps is what is intended by the parties and fits within the particular statute, and when each of the several steps and the timing thereof has economic substance and is motivated by valid business purposes, the steps shall be given effect according to their respective terms."[125]

The Tax Court's logic in Tandy Corp. is consistent with the Service's position in Revenue Ruling 79-250.[126] In the ruling the Service stated that formally separate transactions will be respected and that the step-transaction doctrine will not apply if each transaction demonstrates independent economic significance, is not subject to attack as a sham, and was undertaken for valid business purposes and not for mere tax avoidance.

In the instant case, the discrete transactions undertaken were the following:

- Investor entered into the [$100 million] loan with a third party bank.
- Investor contributed [$163.6 million] in cash to Partnership in a Code Section 721 transaction.
- The Partnership undertook substantive investment activities.
- Investor opted to withdraw from the Investment Fund and his partnership interest was redeemed by Partnership.
- Investor sold the assets received as liquidating distributions.

We are of the opinion that it is more likely than not that each of the above steps will be respected and the step-transaction doctrine will not apply because:

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the warrant distribution was the raising of new capital, the court also decided that it had economic significance independent of any individual shareholder's decision to exercise and to actually acquire the subsidiary's stock. Hence, the necessary level of interdependence between the two steps was lacking, and the court found little evidence that the corporation had acted in concert with its shareholders to achieve the joint objective of a tax-free spin off of the subsidiary. Redding v. Commissioner 630 F.2d at 1178.

[124] Tandy Corp. v. Commissioner, 92 T.C. 1165 (1989).

[125] Tandy Corp. v. Commissioner, 92 T.C. 1165, 1173 (1989).

[126] Revenue Ruling 79-250, 1979-2 C.B. 156.

- It is our opinion that Investor is the true borrower and Investor entered into the loan for a valid business purpose. (i.e., by leveraging its capital contribution to Partnership outside the partnership, Investor was able to guarantee a minimum initial amount of financial leverage.)

- The transactions entered into by Investor, as a member in Partnership, had inherent economic risks where there was the potential for gain or loss and Investor has represented that it had a reasonable expectation of making a pre-tax profit.

- Investor, the Investment Advisor and [Deutsche Bank] each acted independently and at arm's length with respect to the transactions described herein.

- There was no legally binding agreement, written or otherwise, that compelled Investor to complete the transactions in the way described herein.

- There were no written agency agreements (apart from a standard investment advisory agreement) consummated with respect to the transactions undertaken pursuant to the Investment Fund and none of the parties involved held itself out to a third party as an agent of any of the others with respect to these transactions.

Application of the Business Purpose/Economic Substance Doctrines

In Revenue Ruling 99-14,[127] the Service set forth its views on how the economic substance and business purpose doctrines applied within the context of "lease-in, lease-out" ("LILO") deals. In the analysis of its position that the transaction did not produce the sought after tax result of deductible lease and interest payments, the Service discussed its view of the relevant authorities. The underlying economics of the transactions described in the revenue ruling are significantly different from those of the instant case[128]; however, a number of the cases cited in the ruling have potential applicability to the instant case.

In the ruling, the Service concluded that the LILO transaction lacked the potential for significant economic consequences other than the creation of tax benefits based upon the following observations:

- During the primary term of the sublease[129], the taxpayer's obligations to provide property were completely offset by its right to use property;

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[127] Revenue Ruling 99-14, 1999-13 IRB 1.

[128] In a typical LILO transaction, as is the case in many sale-leaseback transactions, there is minimal, if any, inherent economic risk incurred as a result of the circular flow of cash payments. Most leveraged leases are structured based upon the guidelines contained in Revenue Procedure 75-21, 1975-1 C.B. 715, which has only a nominal profit requirement.

[129] In a LILO transaction, property is leased to the taxpayer under a "headlease" and the taxpayer immediately leases the property back under a "sublease".

- The taxpayer's obligations to make debt service payments on the loans were completely offset by the taxpayer's right to receive rent on the sublease; and

- The taxpayer's economic exposure to the headlease residual was rendered insignificant by an option structure and the pledge of the securities that defeased the other party's option payment.

The Service concluded that the "only real economic consequence" of the LILO transaction during the 20-year primary term of the sublease was the taxpayer's pre-tax return. The Service then concluded that the pre-tax return was too insignificant, when compared to the taxpayer's after-tax yield, to support a finding that the transaction had significant economic consequences other than the creation of tax benefits.[130]

The Service initially cited Frank Lyon Co. v. United States[131] in the ruling. The Service stated that in assessing the economic substance of a transaction, a key factor is whether the transaction has any practical economic effect other than the creation of tax losses. The Service further observed that courts have refused to recognize the tax consequences of a transaction that does not appreciably affect the taxpayer's beneficial interest except to reduce tax and that the presence of an insignificant pre-tax profit is not enough to provide a transaction with sufficient economic substance to be respected for tax purposes. Knetsch v. United States, ACM Partnership v. Commissioner and Sheldon v. Commissioner[132] were cited in support of its observations.

The Service noted that in determining whether a transaction has sufficient economic substance to be respected for tax purposes, courts have recognized that offsetting legal obligations, or circular cash flows, may effectively eliminate any real economic significance of the transaction. For example, in Knetsch, the taxpayer purchased an annuity bond using nonrecourse financing. However, the taxpayer repeatedly borrowed against increases in the cash value of the bond. Thus, the bond and the taxpayer's borrowings constituted offsetting obligations. As a result, the taxpayer could never derive any significant benefit from the bond. The Supreme Court found the transaction to be a sham, as it produced no significant economic effect and had been structured only to provide the taxpayer with interest deductions.

In Sheldon, the Tax Court denied the taxpayer the purported tax benefits of a series of Treasury bill sale-repurchase ("repo") transactions because they lacked economic substance. In the transactions, the taxpayer bought Treasury bills that matured shortly after the end of the tax year and funded the purchase by borrowing against the Treasury

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[130] Revenue Ruling 99-14 is effectively a restatement of the Service's position on how to interpret the "for profit" standard as articulated in Notice 98-5, 1998-3 IRB 49. In the notice, the Service takes the position that a taxpayer is not entitled to foreign tax credits from an arrangement where "the reasonably expected economic profit is insubstantial compared to the value of the foreign tax credits expected to obtained as a result of the arrangement."
[131] Frank Lyon Co. v. United States, 435 U.S. 561, 583-584 (1978).
[132] Knetsch v. United States, 364 U.S. 361, 366 (1960); ACM Partnership v. Commissioner, 157 F.3d 231, 248 (3d Cir. 1998); Sheldon v. Commissioner, 94 T.C. 738, 768 (1990).

bills through simultaneously entering into a series of repo transactions.[133] The taxpayer accrued the majority of its interest deduction on the borrowings in the first year while deferring the inclusion of its economically offsetting interest income from the Treasury bills until the second year. In ten out of the eleven repo transactions in question, the repos each bore an interest rate higher than the yield of the corresponding Treasury bill. The court concluded that "the situation in form and substance is no different from that in Goldstein."[134] The Tax Court in a nine to seven decision denied the taxpayer the tax benefit of the transactions because the real economic impact of the transactions was "infinitesimally nominal and vastly insignificant when considered in comparison with the claimed deductions."[135]

The Sheldon majority focused on the year-end timing of the transactions, their non-existent or negligible profit potential, and the usage of repos to maturity to conclude that, like the transactions in issue in Goldstein, the repo transactions had no tax independent purpose:

> "We recognize that taxpayers may structure their transactions so as to obtain the maximum benefit legally obtainable. . . Here, however, the sole objective was to obtain the interest deduction. This is abundantly evidenced by the use of repos to market with locked-in losses in the transactions with no potential for any profit. In instances where intermediate repos could have or did generate some gain from the carry, these amounts were nominal, either fixed or short-term and stable and, in any event, merely reduced fixed losses by relatively insignificant amounts."

The dissenting judges believed that the majority misapplied Goldstein and, in fact, created a new and inappropriate standard for testing interest deductions. In the dissent's view, the proper Goldstein test for determining whether interest is deductible is whether the underlying transaction has a tax independent purpose. Accordingly, the majority erred in introducing a profit objective standard and concluding that the de minimis profit potential deprived taxpayers of interest deductions. The dissent in Sheldon was willing to recognize the applicability of Goldstein to trades that ended in repos to maturity that effectively locked in losses and negated profitability. However, the dissenting judges were unwilling to condemn the trades in aggregate because, in the dissents view, the taxpayer was, at times, exposed to the risk of profit and loss.

Again focusing on a transaction that did not appreciably affect the taxpayer's beneficial interest, the Service observed that in ACM Partnership the taxpayer entered into a near-

[133] The taxpayer in Sheldon purchased Treasury bills and, in order to finance the purchase, simultaneously entered into a series of repo transactions (in which it sold the T-bills back to the dealers from which it had purchased them and agreed to repurchase the T-bills in the future for the same prices plus interest).
[134] Goldstein v Commissioner, 364 F.2d 734 (2nd Cir. 1966), is subsequently discussed.
[135] Sheldon v. Commissioner, 94 T.C. 738, 769 (1990). In total, the transactions produced $18,381 of net gain on an investment of $1 million. The point of controversy in Sheldon was the court's observation that the non-tax business purpose should be weighed against the tax purpose. The court noted the profits generated were nominal and insignificant when considered in comparison with the claimed deductions. Although the cases discussed above uniformly support the notion that a taxpayer must have some business purpose, none of the cases attempt to quantify the amount of business purpose necessary for a taxpayer to prevail.

simultaneous purchase and sale of debt instruments. Taken together, the purchase and sale "had only nominal, incidental effects on [the taxpayer's] net economic position."[136] The court held that transactions that do not "appreciably" affect a taxpayer's beneficial interest, except to reduce tax, are devoid of substance and are not respected for tax purposes.[137]

In Revenue Ruling 99-14, the Service's analysis did not cite the case that many view, including the Tax Court in ACM Partnership, as the cornerstone "for-profit" standard case, Goldstein v. Commissioner. Goldstein involved a taxpayer's attempt to use a "T-bill roll" to shelter her Irish Sweepstakes winnings. The plan called for Mrs. Goldstein to borrow a total of $945,000 from two banks with interest at approximately 4% and to invest in Treasury Bills yielding 1.5%. Mrs. Goldstein prepaid the interest on her loans in the first year. This prepayment, which she deducted as interest, sheltered much of the Sweepstakes winnings. Eventually, the T-bills were sold at a loss on Mrs. Goldstein's behalf and her notes were canceled. The Tax Court disallowed the deductions holding that the transactions were not real and held out no prospect for economic benefit other than tax losses. Citing Knetsch, the Tax Court, noted specifically that "if saving 1958 income taxes was the *only significant benefit* to be derived ... then the Knetsch and Bridges cases require that the deductions for so-called prepaid interest must be denied."[138]

To determine whether any "significant benefit" did accrue to the taxpayer, the Tax Court analyzed the underlying economics of the investment and concluded that:

> "to have realized anything substantial beyond recovering her said outlay, the Treasury notes would have had to be sold considerably in excess of par, notwithstanding that they bore interest of only 1.5%, and were to mature at par only a short time later ... [Thus, the taxpayer] could not reasonably have had any purpose or intention through the foregoing transactions to appreciably affect her beneficial interest except to reduce her taxes."[139]

On appeal, the Second Circuit disagreed with the Tax Court in holding that the loans were shams. In this regard, the court noted that the Goldsteins had entered into the transactions with independent financial institutions, that the loans remained outstanding for six months rather than just a few days and that the notes were recourse. The Second Circuit affirmed the Tax Court, nevertheless, because it found that the Goldsteins had entered into the loan transaction for the sole purpose of securing a large interest deduction. The court noted that "the interest deduction should be permitted whenever it can be said that taxpayer's desire to secure an interest deduction is *only one of mixed motives* that prompts the taxpayer to borrow funds .... there must be *some substance* to the loan arrangement beyond the taxpayer's desire to obtain tax benefits [emphasis added]."[140]

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[136] ACM Partnership v. Commissioner, 157 F.3d 231, 250 (3rd Cir. 1997).
[137] ACM Partnership v. Commissioner, 157 F.3d 231, 248 (3rd Cir. 1997).
[138] Goldstein v Commissioner, 44 T.C. 299 (1965).
[139] Goldstein v. Commissioner, 44 T.C. 299, 300 (1965).
[140] Goldstein v. Commissioner, 364 F.2d 734, 740 (2nd Cir. 1966).

A recent court case addressing the business purpose doctrine is ACM Partnership. On October 13, 1998, a divided Third Circuit partly affirmed the Tax Court's decision in ACM Partnership v. Commissioner.[141] The court affirmatively held that the economic substance doctrine precluded the partnership's deduction of losses attributable to the purchase and resale of Citicorp notes but, however, allowed deductions for "actual economic losses" associated with ACM's ownership of LIBOR notes.

ACM has certain parallels, and significant distinctions, to the instant case. The facts of the case were as follows. In 1988, Colgate incurred a large capital gain on the sale of one of its subsidiaries. Colgate used the proceeds of the subsidiary sale to retire short-term debt and also issued newly established long-term debt in connection with a newly established ESOP. As a result of the debt issuance, Colgate believed that it had a disproportionately large level of long-term debt. Colgate concluded that by acquiring its own debt through a partnership, rather than by simply refinancing it directly, it could pick the most advantageous market timing to actually refinance the debt. In 1989, Merrill Lynch devised a contingent installment note sale transaction structured through a partnership that would generate tax losses to offset the gain generated on the subsidiary sale.[142]

The Tax Court was asked to decide three issues: (1) whether the transaction should be disregarded because it lacked economic substance; (2) whether one of ACM's partners, the ABN affiliate, was actually a lender rather than partner; and (3) whether certain partnership allocations lacked substantial economic effect under Code Section 704(b). Because the court found for the Service on the first issue, it did not address the other two issues. In reaching its conclusion, the court discussed a number of major business purpose cases including, among others, Gregory v. Helvering; Knetsch v. U.S.; Frank

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[141] ACM Partnership v. Commissioner, 157 F.3d 231 (3rd Cir. 1997).

[142] Consistent with its plan to manage its long-term debt position and to shelter the subsidiary capital gain, in October of 1989, affiliates of ABN Bank ("ABN"), Colgate and Merrill formed ACM Partnership. The ABN, Colgate and Merrill affiliates contributed $169.3 million, $35 million and $600,000 to the partnership and received partnership interests of approximately 82.63%, 17.07% and .29%, respectively. Initially, the partnership placed its $205 million into a bank account earning interest at 8.75%.
On November 3, 1989, the partnership purchased $205 million of floating rate notes from Citicorp that had a yield of 8.78%. Three weeks later, in order to generate the cash needed to finance the purchase of Colgate long-term debt held by third parties, the partnership sold $175 million of the Citicorp notes in a taxable installment sale transaction to the Bank of Tokyo and Banque Francaise du Commerce Exterieur. In the sale, the partnership received $140 million in cash and LIBOR-based installment notes with a present value of $35 million. Colgate argued that the interest rate sensitivity of the notes allowed the partnership to hedge the interest rate exposure that it had as a holder of the Colgate debt.
Colgate took the position that by the operation of the installment sale Regulations, the partnership could only use $29 million of its total $175 million basis in the Citicorp notes to offset the $140 million in cash proceeds. As a result, the partnership recognized $111 million of taxable income in its first year. The income was allocated to the partners in accordance with their partnership percentages so that more than 80% was allocated to the ABN affiliate, which was not subject to U.S. tax and which paid no tax in its country of incorporation. Under the Code Section 453 basis rules, the nearly $146 million in basis that was not available to offset the gain on the sale was reallocated to the LIBOR notes. The LIBOR notes thus became built-in loss assets with a value of $35 million and a basis of $146 million.

Lyon Company v. U.S.; and Goldstein v. Commissioner.[143] The court focused particular attention on Goldstein and a major part of the court's ultimate conclusion is based upon the Goldstein analysis.

The Tax Court in ACM provided the following test for making its economic substance determination:

> "The transaction must be rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in light of the taxpayer's economic situation and intentions. Both the utility of the stated purpose and the rationality of the means chosen to effectuate it must be evaluated in accordance with commercial practices in the relevant industry."

The court then provided guidance concerning when a transaction is "rationally related" to the taxpayer's situation. According to ACM, a rational relationship will ordinarily not be found unless the taxpayer had a reasonable expectation that the nontax benefits of the transaction would at least equal the transaction costs. This conclusion effectively follows Goldstein, where the court held that it does not make economic sense to pay 4% for a chance to earn 1.5%.

Based upon a detailed analysis, the Tax Court concluded that the relevant portions of the ACM transactions were economic shams which were devoid of any non-tax business purpose and which did not have a rational nexus to Colgate's stated purpose of liability management. In reaching this conclusion, the court effectively bifurcated the ACM transaction into those components that provided the claimed tax benefit and all other components of the transaction. Although the court found that Colgate had made an overall pre-tax profit on its ACM investment, even after taking into account transaction costs, the court also found that the pre-tax profit of the tax benefit components did not exceed their transaction costs.[144]

In its analysis of the economic substance doctrine, the Third Circuit started its economic substance/business purpose discussion from the same basic starting point as the Tax Court, Gregory v. Helvering.[145] In Gregory v. Helvering, the Supreme Court held that the form of a transaction must be looked through in order to determine its substance. In this regard, the transaction must be viewed as a whole, and each step is relevant. Whether the taxpayer's transactions had sufficient economic substance to be respected turns on both

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[143] Gregory v. Helvering, 293 U.S. 465 (1935); Knetsch v. U.S., 364 U.S. 361 (1960); Frank Lyon Company v. U.S., 435 U.S. 561 (1978); and Goldstein v. Commissioner, 364 F.2d 734 (2d Cir. 1966), *aff'g* 44 T.C. 284 (1965).

[144] The Tax Court found that at the time it entered into the partnership, Colgate's only real opportunity to earn a profit was through an increase in the credit quality of the issuers of the notes, or a 400-500 basis point increase in three month LIBOR interest rates. The Tax Court found no impact on credit quality was possible as the lenders were already highly rated at the time of the transaction. Moreover, the Tax Court did a six year review of three month LIBOR rates and did not find an increase of even 300 basis points in the necessary time frame. Since the analysis of the historical data showed no reasonable basis for expecting a profit, the Tax Court ruled against ACM.

[145] Gregory v. Helvering, 293 U.S. 465 (1935).

the "objective economic substance of the transactions" and the "subjective business motivation" behind them. These are not, the Third Circuit pointed out, "discrete prongs of a "rigid two-step analysis" but rather are related factors in the analysis of whether the transaction had sufficient substance, apart from its tax consequences, to be respected."[146]

The Third Circuit subsequently refined the Tax Court's economic substance analysis by clarifying that the objective economic consequence test is first applied and then the subjective business motivation is examined, should a taxpayer not satisfy the objective test. The court stated that the inquiry into whether the taxpayer's transactions had sufficient economic substance to be respected for tax purposes turns on both the "objective economic substance of the transactions" and the "subjective business motivation" behind them.

The ACM's court's position is an affirmation of the Fourth Circuit's two-pronged subjective and objective tests contained in the Rice's Toyota World v. Commissioner decision [147]. The Rice's Toyota World case effectively provides that a transaction is not a sham if it has either "business purpose" (subjective) or "economic reality" (objective). Assuming a transaction has either (or both) of the prongs it should not be viewed as a sham. The ACM court reaffirmed that "business purpose" and "economic reality" (or economic substance) do not consitute discrete prongs of a "rigid two-step analysis," but rather represent related factors, both of which inform the analysis of whether the transaction had sufficient substance to be respected for tax purposes.

To better understand the Third Circuit's position, it should be contrasted with the Second Circuit's Goldstein[148] decision where the court focused on the primacy of actual economic returns in assessing business purpose. The Second Circuit did not attempt to engage in any subjective/objective dichotomy in determining business purpose, but undertook a relatively sophisticated economic analysis to determine whether there was a reasonable expectation of non-tax economic profit. The Third Circuit incorporates the Goldstein logic in its "subjective business motivation" analysis, which looks to intended business purpose and anticipated profitability.

In its appeal ACM contended that because its transactions on their face satisfied each requirement of the contingent installment sale provisions, it properly deducted the losses arising from its "straightforward application" of these provisions which required it to recover only one sixth of the basis in the Citicorp notes during the first of the six years over which it was to receive payments.[149] Thus, ACM contended it properly subtracted the remaining basis in the LIBOR notes which included the remaining five sixths of the basis in the Citicorp notes used to acquire them. Consequently, ACM argued it properly subtracted the approximately $ 96 million remaining unrecovered basis in the LIBOR notes from the approximately $ 11 million consideration it received upon disposition of

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[146] ACM Partnership v. Commissioner, 157 F.3d 231, 247 (3rd Cir. 1997).
[147] Rice's Toyota World v. Commissioner, 752 F.2d 89 (4th Cir. 1985).
[148] Goldstein v. Commissioner, 364 F.2d 734 (2nd Cir. 1966).
[149] Temp. Treas. Reg. Section 15a.453-1(c).

those notes and correctly recognized and reported the gains and losses arising from its sale or exchange of property in accordance with Code Section 1001. In his dissent, Circuit Judge McKee agreed.

The Third Circuit's logic in coming to its decision first looked to the objective aspects of the economic substance analysis and then to the subjective aspects. With respect to the objective analysis, ACM asserted that the Tax Court was bound to respect the tax consequences of ACM's exchange of Citicorp notes for LIBOR notes because, under Cottage Savings,[150] an exchange of property for "materially different" assets is a substantive disposition whose tax effects must be recognized. The majority found Cottage Savings inapposite, reasoning that the mortgages relinquished by the savings and loan association afforded it "legally distinct entitlements" from the ones it received.[151]

The court observed that the distinctions between the exchange at issue in this case and the exchange before the Court in Cottage Savings predominate over any superficial similarities between the two transactions. The court noted that the taxpayer in Cottage Savings had an economically substantive investment in assets which it had acquired a number of years earlier in the ordinary course of its business operations. The investment had declined in actual economic value by over $ 2 million from approximately $ 6.9 million to approximately $ 4.5 million from the time of acquisition to the time of disposition.[152]

Based upon Cottage Savings, the Third Circuit majority effectively expanded upon the terminology used by the ACM Tax Court by introducing the concept of a "bona fide" loss. The court noted that the Supreme Court emphasized in Cottage Savings that deductions are allowable only where the taxpayer has sustained a "bona fide" loss as

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[150] Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991).
[151] In Cottage Savings, the taxpayer, a savings and loan association, owned fixed rate mortgages whose value had declined as interest rates had risen during the preceding decade. The taxpayer simultaneously sold those mortgages and purchased other mortgages which were approximately equal in fair market value, but far lower in face value than the mortgages which the taxpayer relinquished. The Court found that the exchange for different mortgages of equivalent value afforded the taxpayer "legally distinct entitlements," and thus was a substantive disposition which entitled the taxpayer to deduct its losses resulting from the decline in value of the mortgages during the time that the taxpayer held them.
[152] In Cottage Savings, the taxpayer's relinquishment of assets (so altered in actual economic value over the course of a long-term investment) stood in "stark contrast" to ACM's relinquishment of assets that it had acquired 24 days earlier *under circumstances which assured that their principal value would remain constant and that their interest payments would not vary materially from those generated by ACM's cash deposits* (emphasis added). The court further distinguished the two transactions by making the following observation:

> "while the dispositions in Cottage Savings and in this case appear similar in that the taxpayer exchanged the assets for other assets with the same net present value, beneath this similarity lies the more fundamental distinction that the disposition in Cottage Savings precipitated the realization of *actual economic losses* arising from a long-term, economically significant investment, while the disposition in this case was without economic effect as *it merely terminated a fleeting and economically inconsequential investment, effectively returning ACM to the same economic position it had occupied before the notes' acquisition 24 days earlier*." (Emphasis added).

determined by its "[s]ubstance and not mere form."[153] According to ACM's own synopsis of the transactions, the contingent installment exchange would not generate actual economic losses. Rather, ACM would sell the Citicorp notes for the same price at which they were acquired, generating only tax losses which offset precisely the tax gains reported earlier in the transaction with no net loss or gain from the disposition.

In order to understand the court's use of the "bona fide" loss logic and determine the applicability of the resulting dicta in other contexts, one must carefully read footnote 31. In the footnote the court differentiates a "bona fide" loss from the ACM loss:

> "While it is clear that a transaction such as ACM's that has neither objective non-tax economic effects nor subjective non-tax purposes constitutes an economic sham whose tax consequences must be disregarded, and equally clear that a transaction that has both objective non-tax economic significance and subjective non-tax purposes constitutes an economically substantive transaction whose tax consequences must be respected, it is also well established that where a transaction objectively affects the taxpayer's net economic position, legal relations, or non-tax business interests, it will not be disregarded merely because it was motivated by tax considerations. See, e.g., Gregory, 293 U.S. at 468-69, 55 S.Ct. at 267 ("if a reorganization in reality was effected . . . the ulterior purpose will be disregarded"), Northern Indiana Pub. Serv. Co., 115 F.3d at 512 (emphasizing that Gregory and its progeny "do not allow the Commissioner to disregard economic transactions . . . which result in actual, non-tax-related changes in economic position" regardless of "tax-avoidance motive" and refusing to disregard role of taxpayer's foreign subsidiary which performed a "recognizable business activity" of securing loans and processing payments for parent in foreign markets in exchange for legitimate profit); Kraft Foods Co. v. Commissioner, 232 F.2d 118, 127-28 & n.19 (2d Cir. 1956) (refusing to disregard tax effects of debenture issue which "affected . . . legal relations" between taxpayer and its corporate parent by financing subsidiary's acquisition of venture used to further its non-tax business interests). In analyzing both the objective and subjective aspects of ACM's transaction in this case where the objective attributes of an economically substantive transaction were lacking, we do not intend to suggest that a transaction which has actual, objective effects on a taxpayer's non-tax affairs must be disregarded merely because it was motivated by tax considerations."

The Third Circuit majority's position is best stated in United States v. Wexler: "the general rule on sham transactions in this circuit is well-established, 'If a transaction is devoid of economic substance *** it simply is not recognized for federal income tax purposes ... this denial of recognition means that a sham transaction, devoid of economic substance, cannot be the basis for a deductible loss.'"[154]

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[153] Cottage Savings Association v. Commissioner, 499 U.S. at 567-68 (1991), (quoting Treas. Reg. Section 1.165-1(b)).
[154] United States v. Wexler, 31 F.3d 117, 122 (3d Cir. 1994).

After concluding that the taxpayer did not satisfy its objective economic consequence portion of the economic substance analysis, the Third Circuit then looked to the subjective aspects of the economic substance analysis. In its subjective purpose inquiries, the court determined that the transactions were not intended to serve ACM's professed non-tax purposes and were not reasonably expected to generate a pre-tax profit (a Goldstein-type of analysis). The court stated in footnote 44 that "where such objective economic effects are lacking, scrutiny of the subjective intent behind the transactions becomes an important means of determining whether the transactions constitute a scheme with "no purpose other than tax avoidance" that may not give rise to deductible losses even where the statute contains no express requirement that the transaction serve a non-tax business purpose."

The Third Circuit observed that ACM's stated business purpose for engaging in the transactions, to provide an interim investment until ACM needed its cash to acquire Colgate debt and as a hedge against interest rate risk, did not comport with economic reality or with what actually transpired. In addition, the court agreed with the Tax Court's conclusion that there was no pre-tax profit potential using the Tax Court's bifurcation approach to analyze profitability. Accordingly, the Third Circuit concluded that ACM did not satisfy the subjective business motivation test.

Despite all the recent focus on the ACM case, the ACM decision is merely an endorsement of the principles previously set forth in cases such as Goldstein, Sheldon and Wexler. Beyond the base logic of these cases, it is our view that ACM stands for the simple proposition that a transaction with no reasonable potential for pre-tax profit cannot be salvaged because the taxpayer also has unrelated profit-generating activity.

In an another case involving the Merrill Lynch investment program, ASA Investerings Partnership v. Commissioner,[155] the Tax Court ruled that the arrangement between the taxpayer and the accommodating Dutch bank was formed for the purpose of generating tax losses and was not a valid partnership. Like the ACM transaction, the plan involved a partnership with a foreign partner. The partnership invested in high-grade, floating rate private placement notes, and sold the notes for cash and LIBOR-indexed installment notes. Also, like the ACM transaction, the ASA transaction entailed interest rate swaps that virtually eliminated the risks to the accommodating parties involved in the transaction. As in ACM, the Service argued that the Dutch bank was not a partner, but a lender, since the Dutch bank had no entrepreneurial risk in the partnership.

The Tax Court agreed stating that no business purpose existed for the partnership. This conclusion was supported by the existence of hedges and side agreements entered into for the purpose of ensuring the Dutch bank received its required return at little risk. Although partnership formalities were observed and the Dutch bank was not promised a guaranteed return, the bank was receiving a lender's return under the guise of partnership profits. Because partnership profits were insufficient, the parties had to enter into arrangements outside the partnership agreement.

[155] ASA Investerings Partnership v. Commissioner, T.C. Memo. 1998-305.

The facts in the instant case can be distinguished from ASA in that a profit motive existed for Investor and the Investment Advisor in entering into the Partnership, and a valid partnership was formed. The pooling of the partners' assets to manage a substantial amount of property is a valid reason to use a partnership, and need not be conducted through a corporation.[156] The investment vehicle chosen by the Investment Advisor was a limited liability company treated as a partnership for U.S. income tax purposes. Both the Investment Advisor and Investor contributed funds to Partnership pursuant to the Limited Liability Company Agreement. All investments, disbursements, and ongoing activities, including maintenance of capital accounts, are required under the Agreement to be accounted for under generally accepted accounting principles. Unlike the lender relationship described in ASA, the Investment Advisor will share in partnership profits during the term of the partnership, will receive the amount of its capital account upon liquidation of the partnership, and will be fully subject to the risks of partnership investments.

In summary, the case law applying the business purpose/economic substance doctrine consistently require that the following factors be satisfied: . .

The transactions entered into by an investor must have inherent economic risks where there is the potential for gain or loss and the investor must be able to demonstrate a reasonable potential for making a pre-tax profit;

- In determining whether there is a potential profit, unrelated transactions should not be taken into account.

Based upon Investor's representation that Investor independently reviewed the economics underlying the Investment Fund before entering into the program and believed there was a reasonable opportunity to earn a reasonable pre-tax profit from the transactions undertaken, the first requisite is satisfied. Based upon the Investment Advisor's description of the Investment Fund, the profit from the Investment Fund arises from an integrated investment strategy. Accordingly, there are no unrelated transactions providing incremental profit potential.

In addition to the requisite profit motive for entering into the investment strategy, the Service could challenge Investor's business purpose for the structuring of its financing to participate in the Investment Fund. As discussed, the ACM Tax Court stated that "the transaction must be rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in light of the taxpayer's economic situation and intentions. Both the utility of the stated purpose and the rationality of the means chosen to effectuate it must be evaluated in accordance with commercial practices in the relevant industry."[157] The court observed that a rational relationship will ordinarily not be found

[156] Chisholm v. Commissioner, 79 F.2d 14 (2nd Cir.), cert. denied, 296 U.S. 641 (1935).
[157] ACM Partnership v. Commissioner, T.C. Memo. 1997-115, 118.

unless the taxpayer had a reasonable expectation that the nontax benefits of the transaction would at least equal the transaction costs.

As noted, to participate in the Investment Fund, Investor was required to commit a sufficient level of funding to the program so as to afford the Investment Advisor with the capital to act upon extraordinary market opportunities. The [$100 million] loan was integral to Investor's financing structure in that the use of the premium loan arrangement resulted in an integrated investment strategy whereby there was complementary levels of investment risks and financing risks at all times during the term of the Investment Fund. By having the loan premium, it was possible to match the investment risks with the financing risks. Investor entered into the [$100 million] loan in its individual capacity and then contributed the loan proceeds and additional cash to Partnership. By leveraging its capital contribution to Partnership outside the partnership, Investor was able to guarantee a minimum initial amount of financial leverage. This leveraging effect is especially important during the first two stages of the Investment Fund where investment returns are premised upon investments in low and moderate risks positions. In essence, Investor has an inherently high profit potential on its investment capital even though the investment strategy is relatively conservative in the first two stages.

Whereas the above sets forth the commercial rationale for Investor's choice of financing structure; in assessing business purpose, of most importance relative to existing case law is that Investor had the expectation of a pre-tax profit from participating in the Investment Fund that exceeded its financing costs. We are of the opinion that it is more likely than not that Investor will satisfy the requisite business purpose requirement with respect to participation in the Investment Fund and as to the financing arrangement utilizing the loan premium structure. Although not consistent with the other cases, the Sheldon case provides that there must be not only a reasonable chance of making a pre-tax profit, but the reasonably expected pre-tax profit must be greater than de minimis.[158] In the instant transaction, the expectation was that this standard would also be met.

A potentially more difficult issue would arise if the motive to make a pre-tax profit must be greater than the tax benefit sought. Several courts have indicated that they would consider whether the profit motive was greater than the tax motive.[159] However, requiring that the profit motive be primary would be inconsistent with other areas of the tax law that have adopted a more generalized business purpose requirement either judicially (such as in reorganizations) or statutorily (such as Code Section 269).

Notwithstanding that the transactions in the instant case have the requisite economic substance, Code Sections 165(c) and 183, where applicable, impose additional limitations on the ability of individuals to claim deductions for losses. Code Section 165 applies to loss deductions, and Code Section 183 applies to all deductions. If an individual incurs a loss from the disposition of the assets in the individual's trade or business or in a

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[158] Sheldon v. Commissioner, 94 T.C. 738 (1990).
[159] Fox v. Commissioner, 82 T.C. 1001 (1984) and Estate of Baron v. Commissioner, 83 T.C. 542 (1984), *aff'd*, 798 F.2d 65 (2d Cir. 1986).

transaction entered into for profit, Code Sections 165(c) and 183 generally permit the allowance of such loss.

The Regulations under Code Section 165 do not amplify the meaning of "for profit," whereas the Regulations under Code Section 183 do. The determination of whether a transaction has been undertaken for profit for purposes of Code Section 183 is based on all the facts and circumstances. Treas. Reg. Section 1.183-2(b) lists nine specific factors that are to be taken into account in making this determination. The Regulation also provides that "Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into the activity... with the objective of making a profit."[160]

Code Section 183(a) and Treas. Reg. Section 1.183-1, Code Section 165(c)(2) and Treas. Reg. Section 1.165-1(c) all require that individuals incurring a loss from a transaction not involving a trade or business have a profit motive. Thus, these two statutes and regulatory provisions parallel each other. Notwithstanding the literal language of Code Sections 165(c)(2) and 183, some courts have imposed a judicial gloss on Code Section 165(c)(2), and to some extent on Code Section 183(a), that holds that the taxpayer's *primary* motive must be to generate pre-tax profits from the activity.[161]

In Fox, the Tax Court based its expansion of the language of the statute on dictum found in Helvering v. National Grocery Co.,[162] an accumulated earnings case. The Tax Court's reasoning in Fox seems questionable as there is little in the National Grocery decision to support the Tax Court's contention that the Supreme Court intended to change the meaning of Code Section 165(c)(2) in this way. The Court in Fox also based its decision on an earlier Code Section 165(c)(2) case, Smith v. Commissioner.[163] In Smith, however, the Tax Court did not impose the "primary" test articulated in Fox, but rather stated at page 391:

> "The mere fact that petitioners may have had a strong tax avoidance motive in entering into their commodity tax straddles does not in itself result in a disallowance of petitioner's losses under Code Section 165(c)(2), provided petitioners also had a non-tax profit motive for their investments at the time. Knetsch v. United States, 348 F.2d 932 (Ct. Cl. 1965). Such hope of deriving an economic profit aside from the tax benefits need not be reasonable so long as it is bona fide. Bessenyey v. Commissioner, 45 T.C. 261 (1965), *aff'd*, 1379 F.2d 252 (2d. Cir. 1967)."

[160] See Johnson v. United States, 11 Cl. Ct. 17, 27 (1986), which held that the taxpayer had a profit motive where the activity was engaged in with the objective of making, and a reasonable chance of making, a reasonable pre-tax profit.
[161] Fox v. Commissioner, 82 T.C. 1001 (1984).
[162] Helvering v. National Grocery Co., 304 U.S. 282, 289 n.5 (1938).
[163] Smith v. Commissioner, 78 T.C. 350 (1982), *aff'd*, 820 F.2d 1220 (4th Cir. 1987).

Much of the confusion that arises in this area results from misreadings of dicta and former court's findings. Originally, the term "primarily" was a notion developed to determine how a mixed personal-profit transaction was to be characterized and not how a commercial transaction was to be treated.[164] As illustrated by the multitude of decided cases, no single, uniform standard exists for applying the primary profit motive test. This lack of uniformity can be attributed in part to the varying language and standards used by the courts to identify and apply the primary test. Additionally, the courts' failure to explicitly indicate the method used to compare a taxpayer's various objectives exacerbates the confusion surrounding the application of the primary test.

Judge Swift of the U.S. Tax Court discussed the proposition that the primary profit motive test has not been developed uniformly by the courts in his concurring opinion in Peat Oil & Gas Assocs. v. Commissioner.[165] Judge Swift noted:

> "The courts have not been consistent in the language used to describe the quantity or level of profit objective that must be established .... The inconsistent profit-objective language that has been used has included, among other language, the following: "Basic", "dominant", "primary", "predominant", "substantial", "reasonable", "bona fide", and "actual and honest". As one court commented, we have been glutted with tests. Many such tests proliferate because they give the comforting illusion of consistency and precision. They often obscure rather than clarify."

For a further discussion of the lack of uniform language used by courts to describe the primary test, see Rose v. Commissioner[166] discussing different words used to describe the profit objective test; and Johnson v. United States[167] discussing various profit objective tests applied by the Tax Court.

Both the Fox and Smith cases, as well as the bulk of subsequent cases involving the "primary" profit motive standard under Code Section 165(c)(2), arose in connection with commodities straddle transactions in which, looking at the transactions as a whole, the taxpayer had little or no opportunity to earn any meaningful profit. On the other hand, we are not aware of any cases applying the "primary" profit motive standard under Code Section 165(c)(2) involving taxpayers who had any meaningful profit motive or potential. Accordingly, the Code Section 165(c)(2) cases go into little detail in analyzing the degree of profit motive required where both a profit motive and non-profit motives exist. Such cases merely reiterate the primary profit motive standard, and hold that since only non-profit, tax motives exist, the profit motive requirement of Code Section 165(c)(2) is not met. Some cases under Code Section 183, on the other hand, do engage in an analysis of weighing profit motives against non-profit motives. Since Code Section 183 contains

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[164] *See* Austin v. Commissioner, 298 F.2d 583 (2d Cir. 1962).
[165] Peat Oil & Gas Assocs. v. Commissioner, 100 T.C. 271 (1993).
[166] Rose v. Commissioner, 88 T.C. 411-14 (1987).
[167] Johnson v. United States, 11 Cl. Ct. 17 (1986).

nearly identical language as Code Section 165(c)(2), the case law decided under Code Section 183 is instructive in interpreting Code Section 165(c)(2).

One such case under Code Section 183 is Estate of Baron v. Commissioner.[168] In Baron, a master recording case, the Tax Court rejected the primary profit motive test and used an "intermediate" test in which it balanced profit against tax benefits. This test required a weighing "in the context of all the factors involved in determining the existence of the requisite profit objective, rather than applying a 'primary or dominant' test for nontax factors ... or a sole objective test for the tax benefits." In Baron, the Tax Court looked at the taxpayer's profit potential under the more optimistic profit projections given the taxpayer at the time of the transaction, and determined that such profit potential was insignificant when compared to the tax savings and the taxpayer's overall lack of interest in the transaction. Accordingly, the Tax Court held that the taxpayer did not have an adequate profit motive under Code Section 183.

The Court of Claims subsequently offered yet another view of the profit motive test in Johnson v. United States.[169] Johnson involved a wrap lease of computer equipment, in which the taxpayer had both tax and profit motives for entering into the lease. It rejected the primary profit motive test, stating that such test only applies in the hobby loss area, and not to business losses, and held that a taxpayer satisfies the profit motive requirement if at the time of the transaction, the taxpayer had a reasonable expectation of making a reasonable pre-tax profit. Applying this test, the Court of Claims held that the taxpayer therein had such a reasonable expectation, rejecting the Service's argument that the profit expectation of 6 percent was too low. The Court explicitly stated that tax motives were irrelevant – the sole question was whether the taxpayer in fact had a profit motive.

As discussed above, Investor had a reasonable expectation of a reasonable pre-tax profit from its investments. Since Investor had a profit motive and a reasonable expectation of profit, the analysis of the Tax Court in Baron and the Court of Claims in Johnson is more on point to the instant situation than Fox and its progeny, which involved straddle cases in which the potential for economic profit was minimal or non-existent. Thus, we believe the better argument is that the "primarily for profit" test articulated in Fox will not apply where the taxpayer is motivated at least in part by profit potential, and that a test similar to that applied by the Tax Court in Smith (bona fide hope of deriving an economic profit), the Tax Court in Baron (a weighing of all factors, including tax motivations), and the Court of Claims in Johnson (reasonable expectation of a reasonable profit, with tax motivations disregarded) will instead by applied under both Code Sections 165(c)(2) and 183.

G. Foreign Currency Implications

Upon liquidation of Investor's interest in Partnership, Investor received foreign currency and financial instruments as liquidating distributions from Partnership. The statutory

[168] Estate of Baron v. Commissioner, 83 T.C. 542 (1984), *aff'd* 798 F.2d 65 (2d Cir. 1986).
[169] Johnson v. United States, 11 Cl. Ct. 17 (1986).

regime for foreign currency transactions is contained in Code Sections 985-989. U.S. income taxation of foreign currency transactions is based on the concept of functional currency. Each taxpayer has a functional currency and all other currencies are deemed nonfunctional currencies.

Investor, as an [individual], is considered to have the U.S. dollar as its functional currency.[170] A partnership is potentially a "qualified business unit" of its partners.[171] To qualify as a qualified business unit, separate books and records must be maintained and its activities must constitute a trade or business that undertakes economic activities which result in deductions under Code Section 162 or Code Section 212. The investment activities undertaken by Partnership should be sufficient to satisfy the trade or business requirement and Partnership maintains separate books and records. Accordingly, Partnership should be considered a qualified business unit of Investor.[172] Partnership must treat the U.S. dollar as its function currency because it is a domestic partnership.[173] As a result of Partnership being deemed a qualified business unit, its income or loss is computed separately in U.S. dollars, its functional currency, and such dollars amounts need not be translated into a different functional currency upon distribution to Investor since both Investor and Partnership use the U.S. dollar as their respective functional currency.[174]

Nonfunctional currencies constitute "property" for U.S. federal income tax purposes that can generate exchange gain and loss. As property, a taxpayer establishes a basis in a nonfunctional currency and recognizes gain or loss under Code Section 1001 if the amount realized upon disposition of the foreign currency exceeds or is less than such basis. The basic recognition rules under Code Sections 1001, 1256 and 1092 are then applied to determine the timing of any foreign currency gain or loss.[175] Entry into an offsetting contract is not a recognition event under Code Section 988 unless economic benefit is derived from the offsetting position or in the event that the offsetting contracts are traded on an exchange that typically treats such positions as a termination.[176]

Code Section 988 states that the character of gain or loss from the disposition of foreign currency is ordinary. Under Code Section 988(a) exchange gains and losses from Code Section 988 transactions are characterized as ordinary, subject to the taxpayer electing

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[170] Code Section 985(b).
[171] Treas. Reg. Section 1.989(a)-1(b)(2)(I).
[172] Treas. Reg. Sections 1.989(a)-1(c) and 1.989(a)-1(e) Example (6).
[173] Under Code Section 988(a)(3)(B), residence of a partnership generally is based on the Code Section 7701(a)(30) rules which determine whether the partnership is a U.S. person or a foreign person. Code Section 7701(a)(30) defines a U.S. person as a domestic partnership which is further defined in Code Section 7701(a)(4) as one that is created or organized in the United States or under the laws of the United States or of any state.
[174] Conversely, the preamble to the proposed Code Section 987 Regulations indicates that a remittance from a partnership with one functional currency to a partner with a different functional currency will trigger a Code Section 987 gain or loss, and that the Code Section 987 gain or loss will result regardless of whether the remittance is taxable under Code Section 731.
[175] Treas. Reg. Section 1.988-2(a)(1).
[176] Treas. Reg. Section 1.988-2(d)(2).

capital treatment for forward contracts, futures contracts and options pursuant to Code Section 988(a)(1)(B).[177] Code Section 988 overrides other sections of the Code for purposes of determining character, including Code Section 1234A (gains and losses from terminations of rights and obligations with respect to personal property and certain Code Section 1256 contracts).

Code Section 988(a) reads as follows:

> General rule. Notwithstanding any other provision of this chapter–
> (1) Treatment as ordinary income or loss.
> (A) In general. Except as otherwise provided in this section, any foreign currency gain or loss attributable to a section 988 transaction shall be computed separately and treated as ordinary income or loss (as the case may be).
> (B) Special rule for forward contracts, etc. Except as provided in regulations, a taxpayer may elect to treat any foreign currency gain or loss attributable to a forward contract, a futures contract, or option described in subsection (c)(1)(B)(iii) which is a capital asset in the hands of the taxpayer and which is not a part of a straddle (within the meaning of section 1092(c), without regard to paragraph (4) thereof) as capital gain or loss (as the case may be) if the taxpayer makes such election and identifies such transaction before the close of the day on which such transaction is entered into (or such earlier time as the Secretary may prescribe).

"Section 988 transactions" are defined in Code Section 988(c)(1). Code Section 988 transactions include certain forward contracts, futures contracts, options and "similar financial instruments".[178] Dispositions of nonfunctional currencies are also Code Section 988 transactions.[179]

The term "similar financial instrument" includes a notional principal contract only if the payments required to be made or received under the contract are determined with reference to a nonfunctional currency.[180] A notional principal contract is a contract such as a swap, cap, floor, or collar that "provides for the payment of amounts by one party to

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[177] To elect capital treatment, a taxpayer must clearly identify the transaction on its books and records on the date it enters into the transaction. In order to qualify for the election, the contract must: (1) be a capital asset in the hands of the taxpayer; (2) not be part of a straddle under Code Section 1092(c) (without regard to Code Sections 1092(c)(4) and (e)); and (3) not be a regulated futures contract or nonequity option to which an election has been made for treatment as a Code Section 988 transaction. With respect to Code Section 1256 contracts, the election for capital treatment does not impact Code Section 1256 governing the character of the gain or loss recognized on the respective contract. Accordingly such contracts are marked to market under Code Section 1256(a) and any gain or loss realized receives 60/40 capital treatment. Since all foreign currency transactions entered into by Partnership were on foreign exchanges not constituting "qualified" exchanges under Code Section 1256, none of foreign currency transactions qualify as Code Section 1256 transactions.

[178] Code Section 988(c)(1)(B)(iii).

[179] Code Section 988(c)(1)(C)(i).

[180] Treas. Reg. Section 1.988-1(a)(2)(iii)(B)(1).

another at specified intervals calculated by reference to a specified index upon a notional principal amount in exchange for specified consideration or a promise to pay similar amounts." For purposes of the foreign currency rules, a notional principal contract (as well as a futures, forward, and option contract) only includes an instrument where the underlying property to which the instrument ultimately relates is money (e.g., the functional currency), nonfunctional currency, or property the value of which is determined by reference to an interest rate.[181]

Code Section 988(c)(1)(B)(iii) includes future contracts and other financial instruments denominated in a nonfunctional currency as Code Section 988 transactions, even though such instruments are marked-to-market under Code Section 1256.[182] However, Code Section 988(c)(1)(D)(i) removes "regulated futures contracts" and "nonequity options" governed by Code Section 1256 from Code Section 988 designation. Under Code Section 988(c)(1)(D)(ii), a one-time election can be made to designate regulated futures contracts and nonequity options as Code Section 988 transactions so as to obtain ordinary income or loss treatment.

For a futures contract to constitute a "regulated futures contract", the value of the contract must be determined on a system of marking-to-market, and the contract must be traded on, or subject to the rules of a "qualified board or exchange". As such, the value of futures contracts is recalculated each day, based on the closing or settlement price for that particular contract for the day. All gains are fully credited to, and all losses are fully debited from, all open futures positions each day. Code Section 1256(g)(7) defines "qualified board or exchange" to include only certain domestic exchanges (national exchanges registered with the SEC) and boards of trade (those designated by the Commodity Futures Trading Commission), and such other exchange, board of trade or market as designated by Regulations. To date, the only foreign exchanges that constituted "qualified boards of exchange" are Mercantile Division of the Montreal Exchange and the International Futures Exchange (Bermuda) Ltd. All futures contracts denominated in a foreign currency and not traded on either an appropriate domestic exchange or board of trade or a designated foreign exchange are not governed by Code Section 1256. All transactions undertaken by Partnership were on foreign exchanges not designated as "qualified boards of exchange" under Code Section 1256(g)(7).

An option denominated in a foreign currency is a "nonequity option" under Code Section 1256(g)(3) if it does not relate to stock (or to the value of stock) and is traded on a

[181] Treas. Reg. Section 1.988-1(a)(2)(iii)(B)(2). For example, Code Section 988 transactions do not include stock or other types of personal property even if such property is denominated in a foreign currency. Effectively, a taxpayer is not allowed to bifurcate a transaction in order to allow for Code Section 988 treatment. However, Code Section 988 governs all acquisitions and dispositions of nonfunctional currencies even if the overall context of the transaction is not covered by Code Section 988. For example, in the situation where a taxpayer acquires a foreign currency to purchase a commodity, Code Section 988 applies to the disposition of the foreign currency at the time of purchase of the commodity.

[182] Code Section 988(c)(1)(D)(i); Treas. Reg. Section 1.988-1(a)(7). Under Code Section 1256, contracts that constitute "Section 1256 contracts" are marked to market at the end of each tax year. The gain or loss with respect to each contract is treated as 40 percent short-term capital gain or loss and 60 percent long-term capital gain or loss.

"qualified board or exchange". Any option denominated in a foreign currency which is not traded on a "qualified board or exchange" is not a "nonequity option" within the scope of Code Section 1256. Accordingly, since all transactions were undertaken on foreign exchanges not designated as "qualified" under Code Section 1256(g)(7), Code Section 1256(g)(3) is not applicable.

Even though any regulated futures contracts and nonequity options entered into by Partnership should not be designated as Code Section 1256 transactions, Partnership made a protective election under Code Section 988(c)(1)(D)(ii) to treat such instruments as Code Section 988 transactions on the first day of its taxable year. Based upon these definitions, the dispositions of Investor's nonfunctional foreign currency (and contracts in such currencies) are "section 988 transactions".

"Foreign currency gain or loss" is defined in Code Section 988(b). In general, this section limits foreign currency gain or loss to that realized by reason of changes in exchange rates. Treas. Reg. Section 1.988-2(d)(4) treats all gain or loss from forward contracts, futures contracts, options or similar financial instruments defined in Code Section 988(c)(1)(B)(iii) as foreign currency gain or loss.

Treas. Reg. Section 1.988-2 provides guidance with respect to the recognition and computation of exchange gain or loss. In general, the provisions of the Code applicable to the sale or disposition of property apply, e.g., Code Section 1001. Accordingly, Treas. Reg. Section 1.988-2(a)(2) defines a realized exchange loss as the excess of the adjusted basis of nonfunctional currency over the amount realized. "Adjusted basis" is defined in Treas. Reg. Section 1.988-2(a)(2)(iii) as the basis determined under the applicable provisions of the Code, e.g., Code Sections 1011 through 1023. Code Section 1011 makes specific reference to basis determined under subchapter K, (e.g., Code Section 732.) Neither these regulations, nor the preamble to these regulations, limit the amount of exchange gain or loss on the disposition of nonfunctional foreign currency to that portion of the gain or loss attributable to a change in exchange rates. Instead, the regulations simply apply the mechanical provisions of other Code sections in order to determine the amount of gain or loss and then characterize all of such gain or loss as exchange gain or loss.[183]

The regulations under Code Section 988 contain two anti-abuse provisions. Treas. Reg. Section 1.988-1(a)(11) provides the Commissioner with the authority to include or exclude transactions from Code Section 988. Under this anti-abuse provision, the Commissioner may recharacterize a transaction (or series of transactions) as a Code

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[183] Code Section 988(b)(1). It appears that this regulatory approach was adopted based upon the legislative history of the amendments made to Code Sections 988(b) and (c) in the Technical and Miscellaneous Revenue Act of 1988. The House, Senate and Conference Committees each included identical language in their reports describing the measurement and recognition of foreign currency gain or loss. The Committees said: "Further, any gain or loss on a nonfunctional currency disposition is foreign currency gain or loss regardless of whether the difference between acquisition and disposition prices is due to spot rate movements between acquisition and disposition dates, forward discount or premium, bid-asked spreads, or other factors". Treasury's all gain/loss approach is based upon this directive.

Section 988 transaction if the effect of such transaction is to avoid Code Section 988. In addition, the Commissioner may exclude a transaction (or series of transactions) which in form is a Code Section 988 transaction from the provisions of Code Section 988 if the substance of the transaction indicates that it is not properly considered a Code Section 988 transaction. With respect to both inclusion and exclusion of transactions, the essence of the anti-abuse provision is whether there is a "sham transaction" where the Commissioner should recharacterize the transactions based upon its substance. The one example under the regulation sets forth the following fact pattern:

- Individual holds appreciated foreign currency with a fair market value of $400 and a basis of $100.
- On October 16, 1989, Individual transfers appreciated currency to a newly formed U.S. corporation in a Code Section 351 transaction.
- On the same day, October 16, Individual sells the stock of U.S. corporation for $400.

Because the sale of stock is a substitute for the direct disposition of the foreign currency, the Commissioner may recharacterize the transaction as a Code Section 988 transaction under the logic of the regulation. In the example, the sole purpose for transferring the appreciated foreign currency to the newly formed corporation was to obtain capital gain treatment. The transaction was effectively a "sham transaction" under existing case law in that (1) the Code Section 351 transfer and subsequent sale of stock were on the same day and (2) there was no economic substance underlying the activities of the corporation.

In the instant case, there are significant investment activities undertaken by Partnership and we have concluded that there is economic substance to the transactions undertaken in that Investor will satisfy the requisite business purpose requirement and the Code Sections 165(c) and 183(a) profit motive requirements. Accordingly, the "sham transaction" doctrine should not apply.

The second anti-abuse provision is contained in Treas. Reg. Section 1.988-2(f). Under the regulation, the Commissioner has the authority to recharacterize the timing, source and character of transactions described in Treas. Reg. Section 1.988-1(a)(1) to the extent the substance of such transactions (described in Treas. Reg. Section 1.988-1(a)(1)) differs from its form. Treas. Reg. Section 1.988-2(f) provides:

> "If the substance of a transaction described in 1.988-1(a)(1) differs from its form, the timing, source and character of gains or losses with respect to such transaction may be recharacterized by the Commissioner in accordance with its substance. For example, if a taxpayer enters into a transaction that it designates a "currency swap contract" that requires the prepayment of all payments to be made or to be received (but not both), the Commissioner may recharacterize the contract as a loan. In applying the substance over form principle, separate transactions may be integrated where appropriate."

Whereas all Code Section 988 transactions are accorded ordinary tax treatment (subject to the taxpayer making the Code Section 988(a)(1)(B) election), Code Section 988 relies primarily on the basic recognition rules of the Code such are Code Section 1001, 1256, and 1092, to determine the timing of foreign currency gain or loss. Although the Code Section 988 defers generally to Code Section 446 regarding timing rules for notional principal contracts, currency swaps are subject to a special set of timing rules contained under Treas. Reg. Section 1.988-2(e)(2).

The transactions described in Treas. Reg. Section 1.988-1(a)(1) as "section 988 transactions" are:

- A disposition of nonfunctional currency
- The acquisition of a debt instrument or becoming the obligor under a debt instrument denominated in terms of a nonfunctional currency
- Accruing an item of income or expense (e.g., payable and receivables) denominated in terms of a nonfunctional currency
- The acquisition of a forward contract, futures contract, option, or similar financial instrument denominated in terms of a nonfunctional currency

Treas. Reg. Section 1.988-2(f) provides the example of a taxpayer entering a transaction designated as a currency swap contract that is recharacterized by the Commissioner as a loan as a result of substance of the transaction. Accordingly, the special timing rules under Code Section 988 would not apply and the characterization rules as to being treated as exchange gain or loss (and not as interest income and expense) would not apply. An example in the regulation also uses a transaction that was designated by the taxpayer as a currency swap but was recharacterized by the Commissioner as a spot purchase of foreign currency combined with a forward sale. The only impact was the timing of income recognition.

We believe that these examples are indicative of the types of abuses contemplated by the Commissioner in that they relate to the conundrum of characterization of the form of complex financial instruments. In general, complex financial instruments can be categorized as forward contracts, contingent debt instruments or notional principal contracts. The primary reason that the Code distinguishes between the alternative categorizations is that whereas each of the three financial instruments possess effectively the same economic characteristics, each instrument is taxed differently for U.S. federal income tax purposes. As to tax outcome, the key conceptual differences between the three financial instruments are generally the character and timing of resulting income and the necessity of accruing for an interest component.

The general form of transactions undertaken in the Investment Fund is buying and selling foreign currency forward contracts and currency swaps. Depending upon the structure of the forward contracts, there could be some exposure of recharacterization of the transaction as being in substance a notional principal contract. With respect to currency swaps, there is the potential exposure to the type of recharacterization contained in the example. However in all potential scenarios, the recharacterized transaction would constitute a Code Section 988 transaction. Accordingly, the only potential impact is on timing of income recognition. Because of the short-term nature of the contracts entered into (less than one year), recharacterization as a loan or debt is not applicable. Accordingly, there should be no exposure to the character of any exchange gain or loss being recharacterized as interest.

With respect to the non-cash liquidating distributions made to Investor, we are of the opinion that it is more likely than not that Investor's taxable loss recognized upon subsequent disposition of nonfunctional currency assets will be characterized as ordinary loss pursuant to Code Section 988 and the regulations thereunder.

Conclusion

Based on and subject to the facts, documentation, representations and assumptions described and our discussion and analysis of the relevant statutory provisions and judicial doctrines, we are of the opinion that under current U.S. federal income tax law there is a greater than 50 percent likelihood (i.e., it is "more likely than not") that the following positions will be upheld if challenged by the Internal Revenue Service:

- The [$60 million] loan premium does not constitute a liability, but represents an addition to the [$100 million] loan to be amortized under Treas. Regulation Section 1.163-13 against the issuer's interest expense over the life of the loan;

- Investor will recognize no gain or loss upon receipt of the loan proceeds of [$100 million], including the loan premium of [$60 million];

- Investor will be recognized as the true borrower of the loan.

- Investor will recognize no gain or loss with respect to its capital contribution of [$163.6 million] to Partnership subject to the [$100 million] loan;

- The Commissioner will have no authority under Treas. Reg. Section 1.1275-6(c)(2) to integrate the fixed rate debt instrument and interest rate swap;

- Upon liquidation of Investor's Partnership interest, Investor's adjusted basis amount of [63.6 million, plus or minus its allocable share of Partnership income or loss] in its Partnership interest is first reduced by actual cash received of [amount] and the residual amount is allocated to the foreign currency and financial instruments distributed;

- The difference between the basis allocated to the foreign currency and financial instruments received in liquidating distributions and the proceeds received upon disposition of such foreign currency and financial instruments will be deductible by Investor as an ordinary loss under Code Sections 165(a) and 988(a). [*In the event Partnership makes a Code Section 988(a)(1)(B) election, or if Investor sells his partnership interest, the loss is a capital loss deductible under Code Section 165(a) subject to Code Section 165(f) which provides that losses from sales or exchanges of capital assets are allowed only to extent allowed in Code Sections 1211 and 1212.*];

- Investor's Code Section 465 "at risk" amount for its taxable year ending on [December 31, 1999] includes the cash and the adjusted basis of the assets distributed to Investor as liquidating distributions by Partnership;

- Partnership income meets the definition of portfolio income and such income will be excluded under Code Section 469(e)(1) from the passive activity loss limitation rules;

- Investor's issuance of the debt instrument will not have a substantial effect on the issuer's U.S. tax liability that could be construed as unreasonable in light of the purposes of Code Sections 163(e), 1271 through 1275, 701-777 or any related Code Section.

Our conclusions are based on the completeness and accuracy of the above-stated facts, representations and assumptions. If any of the foregoing is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. We are relying upon the relevant provisions of the Internal Revenue Code of 1986 as amended, the Regulations thereunder, and the judicial and administrative interpretations thereof, all as in effect as of the date of this letter. These authorities are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes also could have an effect on the validity of our conclusions. Unless separately engaged to do so in writing, we will not update our advice for subsequent changes or modifications to the law and Regulations or to the judicial and administrative interpretations thereof.

Very truly yours,

KPMG LLP

RSB: rsb

Watson, Mark T

˙om:	Eischeid, Jeffrey A
nt:	Thursday, August 12, 1999 8:53 AM
˙o:	Baumann, Dale; Carbo, Deke; Henderson, Tracie; Lipschultz, Brent; Speiss, Timothy; Watson, Mark; Zaudtke, David
Cc:	Ziegelheim, Carol
Subject:	FW: Potential BLIPS leads

What do you all think?

Jeff

-----Original Message-----
From: Ziegelheim, Carol
Sent: Wednesday, August 11, 1999 8:12 PM
To: Eischeid, Jeffrey A
Subject: FW: Potential BLIPS leads

Jeff

Attached is a website address that may be helpful in generating potential BLIPS leads.

The website generates a list of insiders at Company X who have bought/sold/gifted any amount of stock over the past two years, how much stock, price sold, and some other info that give you a pretty good idea of the gain. It is the most thorough and easy-to-use list I 've seen. You can looking up companies where we have relationships, looking for executives with gains of $20MM+ and then review the list for possible BLIPS.

˙e "Insider Focus" section of Bloomberg
ɹrt with www.yahoo.com, then choose Yahoo Finance, then enter the stock symbol, then hit Research: SEC filings,then under More info - Insiders.

You get a list of names and their trading history.

Let me know if you want me to use this to put together target list to help identify BLIPS leads?

Carol Ziegelheim
201-505-3573

Permanent Subcommittee on Investigations
EXHIBIT #95jj

Francesco Piovanetti
Sent: 08/17/1999 12:35 PM

To: MARY OWEN
cc: William Boyle
Subject: Bond Linked Index Premium Strategy

Dear Mary,

Per our conversation, I am forwarding you a copy of the DB-Central Tax approval of the BLIPS transaction. Also, John Ross has reviewed and approved the transaction.

As discussed, we would like for you to send us a note, similar to this one, giving confirmation to the transaction program from a Compliance Dept. perspective.

Feel free to call me (x.7318) or Bill Boyle (x.5773) if you have any questions.

Regards,

Francesco Piovanetti
Structured Transactions Group

---------------------- Forwarded by Francesco Piovanetti on 08/17/99 11:06 AM ---------------------------

From: **mary.harmon@db.com on 08/10/99 07:07 PM GMT**

To: william.boyle@db.com; Francesco Piovanetti
cc: Arnd Sieling; john.t.wadsworth@db.com; paul.glover@db.com
Subject: Bond Linked Index Premium Strategy

Corporate Tax/ Americas and GCI Corporate Tax approve DB's participation through loans, interest rate swaps and foreign currency transactions with clients of KPMG brought to it by Presidio Advisors who are engaging in the above-named structure with Presidio. This approval is subject to the following transaction limits: (1) the aggregate amount of funding (principal plus premium or "total proceeds") by DB in all transactions entered into may not exceed $3 billion and (2) the total number of such transactions participated in by DB may not exceed 25. This approval is also subject to: (1) the standard ongoing review of subsequent documentation and marketing materials by Corporate Tax/ Americas ; (2) the receipt of appropriate representations, forms of which I have reviewed, from KPMG, Presidio Advisors and the individual investors that state, among other things, that (i) DB did not help develop or market the transaction and (ii) the investor is not relying on DB for legal, tax or accounting advice; and (3) the receipt of a final opinion from Shearman and Sterling, which is satisfactory to Corporate Tax/ Americas, regarding certain tax and registration issues.

Permanent Subcommittee on Investigations
EXHIBIT #95kk

Francesco Piovanetti

Sent: 08/20/1999 03:37 PM

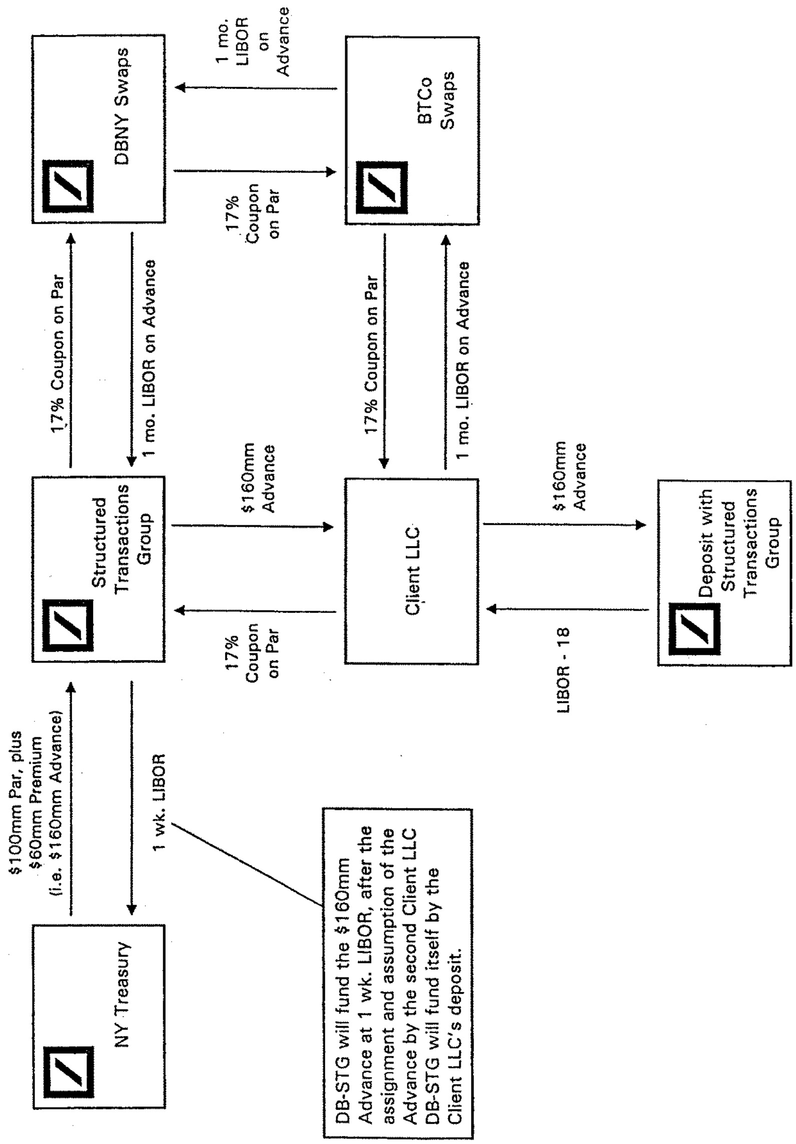
To: NICHOLLAS HIDES, David K Thomas-Control, Michael Dougherty
cc: William Boyle
Subject: BLIPS Flowchart

Per your request, I am forwarding a preliminary flow-chart for your review. Let's discuss as soon as possible.

Regards,

Francesco

flowchart.ppt


DBNY Swaps
BTCo Swaps
1 mo. LIBOR on Advance
17% Coupon on Par
17% Coupon on Par
1 mo. LIBOR on Advance
17% Coupon on Par
1 mo. LIBOR on Advance
Structured Transactions Group
$160mm Advance
Client LLC
$160mm Advance
Deposit with Structured Transactions Group
17% Coupon on Par
LIBOR - 18
$100mm Par, plus $60mm Premium (i.e. $160mm Advance)
1 wk. LIBOR
NY Treasury
DB-STG will fund the $160mm Advance at 1 wk. LIBOR, after the assignment and assumption of the Advance by the second Client LLC DB-STG will fund itself by the Client LLC's deposit.

Redacted by Permanent Subcommittee on Investigations Strategic Investment Fund, LLC

Supplement dated September 1999 to
Confidential Memorandum
Dated August 1999

Presidio Growth LLC
333 Hayes Street, San Francisco, California 94102

This Supplement should be read in conjunction with and supplements the Confidential Memorandum dated August 1999 of the Strategic Investment Funds. This Supplement provides additional information with respect to a specific fund.

Number: 1078

Name of Offeree: Redacted by Permanent Subcommittee on Investigations

Permanent Subcommittee on Investigations
EXHIBIT #95mm

Name of the Fund:

Redacted by Permanent Subcommittee on Investigations Strategic Investment Fund, LLC (the "Fund")

Management Fee:

During the period ended December 31, 1999, the Management Fee will equal 1.003% of the fair market value of Fund's total assets (without deduction for any liabilities) on the date the initial capital contributions are paid to Fund.

Initial Capital Contribution and Capital Account Balance:

On the date designated by the Managing Member (the "Closing Date"), each Class A Member will contribute $54,700,000 in cash to the capital of the Fund which assets will be encumbered by the Class A Member's obligations under the Credit Agreement Between Redacted by Permanent Subcommittee on Investigations and Deutsche Bank AG, Cayman Islands Branch (the "Credit Agreement").

After giving effect to capital contributed and related encumbrances, the Class A Member's initial capital account balance will be $1,400,000. At the closing, the Fund will assume the Class A Member's obligation under the Credit Agreement.

The Closing Date is ______________, 1999 or such later date as the Managing Member shall determine.

Subsequent Capital Contributions:

Each Class A Member may be required to make additional capital contributions from time to time in an aggregate amount up to $5,600,000.

Credit Agreement:

The obligations being assumed by the Fund from the Class A Member under the Credit Agreement include certain covenants that may restrict the Fund in the implementation of its investment strategy. Certain of these restrictions are summarized below. An investor should read the Credit Agreement and understand its possible implications on the Fund's investment strategies. Capitalized terms not defined below have the same meaning as in the Credit Agreement.

Asset Coverage. The Credit Agreement will require that the Fund maintain a Collateral Value which is equal to at least 101.25% of the Fund's Maximum Obligations.

Collateral Value is defined in the Credit Agreement to mean the sum of (a) the Dollar equivalent of all cash and (b) the sum of the Values of all outstanding Permitted Investments (as defined below) (other than any Permitted Investments of a type described in clause (c) of the definition of "Permitted Investments"), in each case then credited to or deposited or maintained in the Collateral Account.

Maximum Obligation is defined in the Credit Agreement to mean, as of any date of determination, an amount equal to the sum of:

(a) the Fund's liability to pay the aggregate outstanding principal amount of the Note and all accrued interest thereon from (and including) the Payment Date immediately preceding such determination date (or, if such determination date is on or prior to the Initial Payment Date, from (and including) the Borrowing Date), to (but excluding) such determination date,

(b) the aggregate of all other amounts owing to the Bank (or any of its Affiliates) as of such determination date hereunder and under the Pledge Agreements, including, without limitation, the Prepayment Amount, if any, and the Breakage Fee, if any, in each case calculated as if such determination date were the Prepayment Date, and

(c) an amount (whether positive or negative) equal to (i) the net amount that would be payable as of such date by the Fund to the Bank (or any of its Affiliates) under or in connection with any Permitted Investment (as defined below) of a type described in paragraph (c)(i) of the definition of "Permitted Investments", less (ii) the net amount that would be payable by the Bank (or any of its Affiliates) to the Fund as of such date under or in connection with each such Permitted Investment, in each case as determined by the Bank (A) in good faith in accordance with the "value-at-risk" methodology generally applied by Deutsche Bank at the time to calculate such net amounts as if each such Permitted Investment were terminated on such determination date and (B) without regard to any interest rate cap, floor, collar or similar term or provision contained in any such Permitted Investment limiting, or having the effect of limiting, the maximum and/or minimum interest rate applicable thereunder.

As a consequence, if the Collateral Value declines below 101.25% of the Maximum Obligations, the amounts payable under the Credit Agreement, including the Prepayment Amount, if any, and the Breakage Fee, would become due and payable immediately. In such circumstances, the Fund may be forced to sell its assets at prices that the Managing Member does not believe are desirable and which may result in the loss of a portion or all of the Members' equity in the Fund.

Permitted Investments. The Credit Agreement will restrict the Fund (which restriction will also be set forth in the Fund's Limited Liability Company Agreement) to the following types of investments:

(a) any of the following denominated in Dollars: (i) time deposits of Deutsche Bank (or any of its Affiliates) with maturities of 90 days or less, (ii) Class B Shares of Deutsche Bank AG, New York Branch's Temporary

Investment Fund and (iii) investments in Deutsche Bank AG, New York Branch's U.S. Money Market Fund,

(b) fixed income securities purchased through Deutsche Bank (or any of its Affiliates) with remaining maturities of 90 days or less issued by any governmental or corporate issuer, the outstanding long or short term unsecured debt of which is rated in one of the two highest rating categories by an internationally recognized statistical rating organization, if such fixed income securities are (i) denominated in Dollars or (ii) denominated in Euros (or in the currency of any of the United Kingdom of Great Britain and Northern Ireland, the Federal Republic of Germany, Japan, Canada and Italy),

(c) Any (i) interest rate swap transactions and (ii) interest rate options entered into with Deutsche Bank (or any of its Affiliates) as the counterparty requiring settlement not later than the Maturity Date,

(d) Foreign currency spot, forward or option transactions entered into with Deutsche Bank (or any of its Affiliates) as the counterparty requiring settlement in not more than six months for Dollars or Euros with respect to the currencies listed in clause (b)(ii) above and the following additional currencies: Hong Kong dollar, Argentine Peso, Egyptian dollar, Saudi Riyal, Danish Kroner, and subject to the approval of the Bank, any other currency that the Borrower shall request, or

(e) Such other investments as may be requested by the Borrower and acceptable to the Bank in its sole discretion.

For purposes of valuing the Permitted Investments, "Value" is defined in the Credit Agreement to mean:

(a) in the case of any Permitted Investment of a type described in clause (a), (b) or (c) of the definition of "Permitted Investments", an amount equal to the market value of such Permitted Investment (in Dollars) as of such date, as determined by the Bank in good faith in accordance with the "value-at-risk" methodology generally applied by Deutsche Bank at the time to value investments of such type; and

(b) in the case of any Permitted Investment of a type described in clause (d) and (e) of the definition of "Permitted Investments", (taken together on a portfolio basis giving effect to all such Permitted Investments then outstanding), an amount equal to (i) the sum of the market values (in Dollars) of all such Permitted Investments as of such date (as determined by the Bank in good faith in accordance with the "value-at-risk" methodology generally applied by Deutsche Bank at the time to value investments of such type), minus (ii) the net maximum peak exposure of the Borrower in respect of all such Permitted Investments as of such date (as determined by the Bank in good faith in accordance with the "value-at-risk" methodology generally applied by Deutsche Bank at the time to determine its maximum exposure in respect of investments of such type); and

(c) in the case of any Permitted Investment of a type described in clause (e) of the definition of "Permitted Investments", an amount determined as of such date by the Bank in good faith in accordance with the "value-at-risk" methodology generally applied by Deutsche Bank at the time to value investments of such type.

For the purposes of paragraph (c) under the definition of Permitted Investments above, "Maturity Date" is defined in the Credit Agreement to mean the seventh anniversary of the Borrowing Date.

Unknown

From: Zaudtke, David P
Sent: Wednesday, September 01, 1999 1:09 PM
To: Eischeid, Jeffrey A
Cc: Pedersen, Robert A
Subject: RE: Help

Jeff:

I would suggest Ralph Pike in Chicago.

Thanks.

David P. Zaudtke
kpmg LLP
4200 Norwest Center
90 South Seventh Street
Minneapolis, MN 55402
Work 612-305-5686
Fax 612-305-5040
Cell 612-840-3411
e-mail dzaudtke@kpmg.com

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Monday, August 30, 1999 7:22 AM
To: Zaudtke, David P
Subject: RE: Help

REDACTED

Ranee is a manager in Cleveland working the BLIPS deals. She also did a good job with OPIS transactions. She was actually recommended by Larson. I haven't communicated with Pedersen about this issue Still OK?

Jeff

-----Original Message-----
From: Zaudtke, David P
Sent: Saturday, August 28, 1999 12:49 PM
To: Eischeid, Jeffrey A
Subject: RE: Help

Jeff:

Who is Ranee Fear??? I guess I don't have much control over my team. Was this a Pedersen recommendation??? If so I agree and approve.

Thanks,

David P. Zaudtke
kpmg LLP
4200 Norwest Center
90 South Seventh Street
Minneapolis, MN 55402
Work 612-305-5686
Fax 612-305-5040
Cell 612-840-3411
e-mail dzaudtke@kpmg.com

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Friday, August 27, 1999 4:24 PM
To: Baumann, Dale; Carbo, Deke; Henderson, Tracie; Lipschultz, Brent; Speiss, Timothy; Watson, Mark; Zaudtke, David
Subject: Help
Importance: High

I (or more precisely, Presidio) needs you to nominate a "deputy" in your area to monitor BLIPS trades and the paperwork process. As you know, several different signings are required. Any delays or mistakes in completing the paperwork creates terrific administrative problems at DB and Presidio. Any suggestions? Robin Paule has been suggested for the West and Ranee Fear has been suggested for the Midwest. Both have already had some experience with the process. Let me know what you think.

Thanks, Jeff

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS - managing deal flow
Sent: 1999-09-13 13:04:35.886
Date: 1999-09-13 13:04:35.948
X-Folder: BLIPS

I'm in basic agreement with all of your comments. Kerry, are you available for today's KPMG Innovative Strategies conference call at 5 p.m. EST to discuss your flowchart and improvements to the KPMG side of the process?

Jeff
-----Original Message-----
From: John Larson [SMTP:jlarson@presidioadv.com]
Sent: Saturday, September 11, 1999 9:48 PM
To: eischeid@kpmg.com; rbickham@kpmg.com
Cc: bob pfaff; kbratton@presidioadv.com
Subject: BLIPS - managing deal flow

Jeff/Randy-
As you know, we have until 10/15 at the latest to close loans and 10/22 to activate the FX trading etc. (the 60 day countdown). Currently we have approximately 25- 28 deals on our active list with another 25 or so on our "highly likely" list. Hence the total expected backlog is at least 50 deals. I know that your count gives a slightly higher number, perhaps indicating a backlog of 60. As of Friday, we had closed only 3 loans. This gives us only 5 weeks to complete all the closings.

We think it is possible to complete all the backlog in the available time if everything proceeds according to the closing schedules that Kerry developed. I am, however, very concerned about adding more deals to the already huge backlog. Therefore, my suggestion is to cut back on the sales effort, without closing the door on a few more significant deals. Accordingly, I propose that we raise the limit on new sales solicitations to deals of $50 or greater effective this Monday. I also suggest that we inform everyone that the limit will be raised again in 10 days or so to $100 (?).

I know this change will upset some KPMG partners who are still trying to set up more meetings. I also suspect that they will be even more upset if they sell a new deal now that we are unable to deliver. Those are the two choices I see.

Apart from limiting the addition of new deals, there are other incremental process changes that we have made and will continue to make. While this is really a subject for a more detailed discussion, I will note two ideas that I have discussed with Randy, Steve, and Kerry. First, we need to get key KPMG people in certain areas to liase very closely with Presidio and the clients/investors in their area. We have been experiencing problems with slow and incomplete turnaround of information requests and signature pages that could be mitigated by much closer local monitoring.

Second, as an experiment last week I spent a day working out of DB's New York office. I found that being there I was able to trouble shoot very effectively. This made me think that a temporary Presidio outpost at the bank might be helpful. Conceivably, stationing someone knowledgeable from KPMG at the bank might also be good.

Iohn L.

Unknown

From:	Amir Makov [amakov@presidioadv.com]
Sent:	Tuesday, October 05, 1999 5:39 PM
To:	Nancy.Donohue@db.com; Qi.Zhou@db.com
Cc:	John Rolfes; eischeid@kpmg.com; rbickham@kpmg.com; bob pfaff; john larson; Kerry Bratton
Subject:	Re: Assistance from KPMG - DB

Hi Qi,

I'm forwarding your message to the appropriate people at KPMG.

Before KPMG starts looking for a person, it is necessary for us to know that the bank is willing to have a KPMG person present at Deutsche bank and working there. Your bank's internal risk department may view having a KPMG person on the premiss as a potential conflict of interest. Also, from a risk point of view, I thought DB did not want to appear as a facilitator of the transactions. DB is acting purely as a lender and a counter party to the trades.

Please have Bill Boyel speak with me before we proceed on this (I don't have his email address so I couldn't add him to the cc list).

I'm also not sure what resources KPMG has to offer the bank in NYC.

Thanks,

Amir.

>>> <Qi.Zhou@db.com> 10/05/99 03:09PM >>>

Amir:

Nancy informed me that you are helping us obtain help from KPMG.
Thank you very much.

We would like to have assistance on the following tasks for the Blips trade.

To support Corporate Fanance Services on:
DB-Internet
Open customers
Open accounts
Open facilities
Book/reverse loans
Book deposits
Make fee payments
Review documentation
Coordinate with Private Bank, STG, Relative Value Desk to ensure all of above pieces are completed.

To support Nancy Donohue with:
Filing for a/c docs, tickets, and confirms.
A/C opening in BT and DB systems
Writing loan and deposit tickets
Writing swap and cap tickets for BT and DB
Filling out loan facility forms
Filling out customer capture forms
Coordinate with Private Bank, STG, FX, and A/C dept.

Please let me know if you have any questions.
Thanks and regards,
Qi

KPMG 0042557

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95pp

Message0044	
Subject:	FW: Presidio Supplemental Hours
From:	Ammerman, Douglas K
Date:	1/26/2000 3:32:16 PM
To:	Carbo, Deke G
CC:	Ito, Dennis A
Message Body	

Deke,

Thanks again for your incredible efforts on behalf of the PFP practice this year.

As you may know, I am in the process of drafting a letter to Presidio outlining the additional hours and expenses that have been incurred by our firm in connection with the BLIPS capacity issues. In that regard, I would appreciate your help in providing me with your estimation of the expenses attributable to you, Shannon, Brent and Todd. While the attached list from Dennis identifies hours, it is silent in connection with expenses.

I appreciate your input.

Doug Ammerman
Personal Financial Planning
KPMG LLP
Orange County Office
(714) 850-4455
Fax (714) 850-4410
dammerman@KPMG.com

-----Original Message-----
From: Wong, Annie
Sent: Monday, January 24, 2000 8:34 AM
To: Ammerman, Douglas K
Cc: Bickham, Randall S; Carbo, Deke G
Subject: FW: Presidio Supplemental Hours

Doug,
Per Dennis' request, attached is an updated list of Presidio supplemental hours (this includes Deke's list).

-----Original Message-----
From: Ito, Dennis A
Sent: Monday, January 24, 2000 7:45 AM
To: Wong, Annie
Subject: RE: Presidio Supplemental Hours

Looks okay to me. Please forward to Doug, cc: Deke and Randy Bickham.

-----Original Message-----
From: Wong, Annie
Sent: Friday, January 21, 2000 4:40 PM
To: Ito, Dennis A
Subject: RE: Presidio Supplemental Hours

OK - here is what we have:

<< File: BLIPStime.xls >>

-----Original Message-----
From: Ito, Dennis A
Sent: Thursday, January 20, 2000 12:37 PM
To: Wong, Annie
Subject: RE: Presidio Supplemental Hours

We may have to go back to Julie, Melanie, Adam, etc and get them to approximate the number of hours they spent at Presidio because we want "at Presidio" time. Add Richard and Kathy's time, too. Build the spreadsheet to also reflect a total fee column (i.e., rate times hours). Then, add Deke's schedule to it. In fact, you can use Deke's format. I'll review one last time, then we'll send to Doug.

Thanks!

Dennis A. Ito
Personal Financial Planning
kpmg LLP
San Francisco Office
(415) 951-7884
(415) 397-1128 Fax
dito@kpmg.com

-----Original Message-----
From: Wong, Annie
Sent: Thursday, January 20, 2000 12:19 PM
To: Ito, Dennis A
Subject: Presidio Supplemental Hours
Importance: High

Dennis,
Attached is a spreadsheet outlining the time/expense pertaining to Presidio. Note that some of these hours included time that was not actually spent at the Presidio site, but were pertaining to Presidio/Randy Bickham. In saying that, let me know if you need me to change anything. Also, this spreadsheet was compiled by taking all the time/expense that were transferred to the various western BLIPS contracts. Not sure if that is correct, but it's sort of difficult to tally and differentiate all the time and expenses spent at the Presidio site and those that were just spent on BLIPS work pertaining to Presidio.

<< File: BLIPStime.xls >>

-----Original Message-----
From: Ito, Dennis A
Sent: Thursday, January 13, 2000 3:53 PM
To: Wong, Annie

Subject: FW: Presidio Supplemental Hours

Please include the hours and expenses our SFO people have spent on BLIPS at Presidio offices and forward the composite on to Doug for his use. Let's discuss before you send as I would like to see what the total looks like. Thanks

-----Original Message-----
From: Carbo, Deke G
Sent: Thursday, January 13, 2000 3:50 PM
To: Ito, Dennis A
Subject: FW: Presidio Supplemental Hours

-----Original Message-----
From: Carbo, Deke G
Sent: Monday, December 20, 1999 10:18 AM
To: Ammerman, Douglas K
Subject: FW: Presidio Supplemental Hours

Doug:

The time charged and out of pocket expenses associated with the four people who worked on the HVB deals in New York are as follows:

Deke Carbo 160.0 $ 15,599
Shannon Liston 160.0 $ 14,376
Brent Lipschultz 217.0 None
Todd Bloom 224.0 $ 18,026

Let me know if you would like to discuss anything related to this before you contact Presidio. I will be out at a SW area PFP partners meeting beginning at 12:00 CST today. Will be in most of tomorrow.

Deke

-----Original Message-----
From: Carbo, Deke G
Sent: Friday, December 17, 1999 8:50 AM
To: Ammerman, Douglas K
Subject: RE: Presidio Supplemental Hours

Doug:

I will compile the time and expense associated with the four people who worked on the HVB deals for us in NY. Arguably, this is the only additional time we incurred since time would have been spent in the field implementing those transactions anyway.

I hesitate to characterize this time as resulting from Presidio inefficiencies. Having worked with the Presidio folks closely while in NY, their clear feeling is they were adequately staffed for the number of transactions KPMG told them to expect. In fact, they undoubtedly feel they did a great job identifying additional capacity and getting a new bank comfortable with the transaction in a very short time through Pfaff's relationship at HVB.

Deke

-----Original Message-----
From: Ammerman, Douglas K
Sent: Thursday, December 16, 1999 6:10 PM
To: Ito, Dennis A; Watson, Mark T; Baumann, Dale R; Eischeid, Jeffrey A; Henderson, Tracie K; Carbo, Deke G
Cc: Lanning, John T; Stein, Jeff (US/Vice Chairman)
Subject: Presidio Supplemental Hours

In the near future, I will be speaking with Presidio regarding a recoupment of the additional time charges that we incurred related to perceived "inefficiencies" at Presidio. As you may recall, due to DB capacity issues, additional time was expended by our partners, managers and staff in facilitating the additional BLIPS transactions. I will be meeting with Presidio to resolve what hopefully will be a fair reimbursement of the additional time that we incurred in performing services that arguably should have been performed by Presidio. In that regard, I would appreciate your feedback before December 21. Please outline the individuals and expenses that should be included in my discussions.

Thank you in advance for your assistance.

John & Jeff, Jeff and I intend to discuss this matter with you before discussing this with Presidio.

Doug Ammerman
Personal Financial Planning
KPMG LLP
Orange County Office
(714) 850-4455
Fax (714) 850-4410
dammerman@KPMG.com

Attachment
BLIPStime.xls

Outlook Header Information
Conversation Topic: Presidio Supplemental Hours Subject: FW: Presidio Supplemental Hours From: Ammerman, Douglas K Sender Name: Ammerman, Douglas K To: Carbo, Deke G CC: Ito, Dennis A Delivery Time: 1/26/2000 3:32:16 PM Creation Time: 2/7/2000 10:08:11 AM Modification Time: 2/7/2000 10:08:11 AM Submit Time: 1/26/2000 3:32:16 PM Importance: 1/1 Priority: 1/0 Sensitivity: 1/0 Flags: 1/17 Size: 1/33904

Unknown

From: Ito, Dennis A
Sent: Tuesday, February 01, 2000 8:37 AM
To: Eischeid, Jeffrey A; Mcconnachie, Barbara; Watson, Mark T
Cc: Wong, Annie
Subject: RE: Presidio

Jeff - The time associated with the SF personnel represents 100% of the hours we spent assisting Presidio on Presidio's premises with Presidio related/requested activity. These numbers do not include hours related to what Dale or Jack or others may have spent directly with our clients in setting up back accounts, etc. Essentially, we had 3 people (Julie Gee, Melanie Marmion, and Kathy Lin) at Presidio most of September and October, one additional person (Adam Tabak) in October, and one person (Richard Schuppek) all of December. A rough calculation of hours suggests a total of 1,240 hours [(160 hrs x 3) + (160 hrs x 1) + (160 hrs x 1) = $1,240] vs the 1,306 listed on the sheet, so I believe it passes the smell test.

Dennis A. Ito
Personal Financial Planning
kpmg LLP
San Francisco Office
(415) 951-7884
(415) 397-1128 Fax
dito@kpmg.com

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Monday, January 31, 2000 12:13 PM
To: Mcconnachie, Barbara; Ito, Dennis A; Watson, Mark T
Subject: RE: Presidio

By and large the attachments look fine to me. I note that the Calif. numbers differ fairly significantly from Dale's email of 12/20/99. Is this because we made some attempt to discern what hours were Presidio related/requested and what related to KPMG activities? In any event, I would recommend that we make that kind of determination with respect to the New York team's activities (Deke, Shannon, Brent and Todd). In other words, they not only did information gathering for bank account openings (typically a KPMG function), they also processed account opening documents (a Presidio function). Some type of separation/distinction seems warranted.

As to expenses and rates, I expect they will want some type of breakdown as to the nature of the expenses and will probably ask for some amount of reduction on the rates that approximates our cost of service (whatever that is....) By the way, is Brent's rate really $475?

Jeff

-----Original Message-----
From: Mcconnachie, Barbara
Sent: Monday, January 31, 2000 2:06 PM
To: Eischeid, Jeffrey A; Ito, Dennis A; Watson, Mark T
Subject: Presidio

Doug asked that you review the attached and let him know if you have any input.

<< File: Presidio.doc >> << File: Presidio Supplemental Hours.doc >>

Thanks,

Barbara McConnachie
Personal Finenical Planning
Executive Administrative Assistant
Orange County Office
(714) 850-4401

Presidio Supplemental Hours
As of January 21, 2000

Employee	Hours	Hourly Rate	Equals	Expenses	Total
Julie Gee	256.0	250	64,000	983	64,983
Melanie Marmion	445.0	275	122,375	123	122,498
Kathy Lin	256.5	250	64,125	476	64,601
Richard Schuppek	139.0	200	27,800	119	27,919
Adam Tabak	210.0	175	36,750	142	36,892
Deke Carbo	160.0	475	76,000	15,599	91,599
Shannon Liston	160.0	450	72,000	14,376	86,376
Brent Lipschultz	217.0	475	103,075	0	103,075
Todd Bloom	224.0	225	50,400	18,026	68,426
Total			616,525	49,844	666,369

January 27, 2000

Mr. John Larson
Presidio
333 Hayes Street
San Francisco, California 94102

Dear John:

Thanks again for getting together in San Francisco. We are appreciative of our positive working relationship with Presidio and look forward to continued success in the future.

As a follow-up to our meeting, I have attached a summary indicating the amount of supplemental hours and expenses incurred by us assisting you in facilitating various BLIPS transactions. As mentioned, this additional effort and the related expenses were not anticipated but were required to assist you in closing various transactions.

After you review the attached, I would like to discuss our recoupment of the indicated amount.

Very truly yours,

KPMG LLP

Douglas K. Ammerman
Managing Partner

DKA:mbm

Attachment

cc: John Lanning
Jeff Stein

Presidio Supplemental Hours
As of January 21, 2000

Employee	Hours	Hourly Rate	Equals	Expenses	Total
Julie Gee	256.0	250	64,000	983	64,983
Melanie Marmion	445.0	275	122,375	123	122,498
Kathy Lin	256.5	250	64,125	476	64,601
Richard Schuppek	139.0	200	27,800	119	27,919
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Deke Carbo	160.0	475	76,000	15,599	91,599
Shannon Liston	160.0	450	72,000	14,376	86,376
Brent Lipschultz	217.0	475	103,075	0	103,075
Todd Bloom	224.0	225	50,400	18,026	68,426
Total			616,525	49,844	666,369

Sequential

From: Elgin, Evelyn [eelgin@KPMG.com]
Sent: Monday, September 13, 1999 10:54 AM
To: Warley, Carol G
Cc: Watson, Mark T
Subject: RE: Tax Shelter Cases

Carol,

That is a horror story. I must say I'm not familiar with the story or case. Perhaps someone should do a Lexis search, although, in my experience, court cases rarely state the level of opinion. Also, to answer your other question, I am not aware of penalties being imposed on individuals (in Big 5 or national law firms or in the client) when MLTN opinions have been issued by Big 5 firms or large national law firms. Penalties on individual professionals, however, probably are likely to be decided out of court to avoid publicity.

Eve

> -----Original Message-----
> From: Warley, Carol G
> Sent: Sunday, September 12, 1999 12:49 PM
> To: Elgin, Evelyn
> Cc: Watson, Mark T
> Subject: Tax Shelter Cases
> Importance: High
>
> Eve, I am a pfp partner in the Houston office. I was curious as to
> whether or not you are familiar with a case involving Grant Thornton from
> either the late 80s or early 90s where the outcome was the following:
>
> Grant Thornton issued a more likely than not opinion letter but penalties
> were imposed
> The Grant Thornton tax partner involved ended up in jail
>
> This particular horror story told to one of my Blips targets by a buddy
> changed his mind. He had given a verbal ok to proceed and then got cold
> feet when he heard this story. Are you aware of penalties being
> imposed on individuals when more likely than not opinions have been issued
> by other Big Five firms or large national firms?
>
>
> kpmg
>
> Carol Warley
> PFP
> 713-319-2180 phone
> 713-319-2040 fax
> cwarley@kpmg.com e mail
>

Heil, Matthew C

From: Burchartz, Janie J on behalf of Rivkin, David
Sent: Tuesday, September 14, 1999 4:57 PM
To: Heil, Matthew C
Subject: FW: Blips Timing

-----Original Message-----
From: Eischeld, Jeffrey A
Sent: Monday, September 13, 1999 8:30 AM
To: Baumann, Dale; Belcher, Gregory; Bickham, Randall; Bloom, Richard; Carbo, Deke; Desany, Edmond; Eischeld, Jeffrey; Fergus, Terrence; Gray-RALEIGH, Mike; Hasting, Carl; Henderson, Tracie; Jordan, Robert; Lipschultz, Brent; Liston, Shannon; Mccrimlisk, George; McGrath, Kevin; Nuckolls, John; Pace, Katherine; Paule, Robin; Perez, Robert; Poreba, Edward; Remo, DeeAnn; Rivkin, David; Shatzman, Janice; Slattery, Daniel; Smolin, Jay; Speiss, Timothy; Spitz, William; Staebler, Victoria; Tendler, Neil; Warley, Carol; Watkins, B; Watson, Mark; Weems, Pamela; Zaudtke, David; Zysik, Jeffrey
Subject: FW: Blips Timing

-----Original Message-----
From: Kerry Bratton [SMTP:kbratton@presidioadv.com]
Sent: Friday, September 10, 1999 2:22 AM
To: blipschultz@kpmg.com; cbranan@kpmg.com; chasting@kpmg.com; csabedra@kpmg.com; cwarley@kpmg.com; dbaumann@kpmg.com; dcarbo@kpmg.com; drivkin@kpmg.com; eischeid@kpmg.com; gpowell@kpmg.com; jmcmahon@kpmg.com; jmnuckolls@kpmg.com; michaelgray@kpmg.com; mwatkins@kpmg.com; rbickham@kpmg.com; rbloom@kpmg.com; rfear@kpmg.com; rjordan@kpmg.com; rpaule@kpmg.com; sliston@kpmg.com; tanapier@kpmg.com; tkhenderson@kpmg.com; wspitz@kpmg.com
Cc: amakov@presidioadv.com; jlarson@presidioadv.com; mshaw@presidioadv.com; Rmarchese@presidioadv.com; rpfaff@presidioadv.com; sbuss@presidioadv.com
Subject: Blips Timing

Attached please find the following documents:

1) Example Timeline 9_5.xls: This is the updated spreadsheet with the proposed Blips transaction timing. Please note that we have made a few modifications:

(a) We will work to send the IP2 to the investor on about T-2 (please note that the contents of this package are listed at the bottom of the schedule)
(b) On about T+2 we will send the investor transfer instructions. These instructions are dated T+6, authorizing DB to transfer the cash from the investor's DB account to the Fund LLC's DB account. The investor must sign these instructions and fax them to Rick Stockton at DB on T+6 by 10am EST.

(2) LLC_Info.doc
Just a reminder, that we need this completed and faxed to us in order to begin the transaction process. Following receipt of this document, we can form the Borrower LLC, Angie can apply for the ID# and we can complete the account opening documents.

The information requested on the other information sheet "AcctOpen_Info.xls" is needed as soon as possible since the bank needs this information to open the account.

Please call/email me or Steven Buss if you have any questions.

Best regards,

Kerry

Example Timeline 9_5.XLS   LLC_Info.doc   AcctOpen_Info.doc

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95uu

KPMG 0007201

Proposed Timeline

Week Day	Date	Day #	Process Timing	Description
				Investor receives Potential Investor Package ("PIP") at Presidio presentation
M	06-Sep	1		LLC formed (after we receive completed "Information to Form Borrower LLC")
T	07-Sep	2		Account Opening Documents prepared and sent to Investor (after we receive "Information to Open Accounts and Borrow Funds")
W	08-Sep	3		
Th	09-Sep	4	T-6	DB receives account opening documents & all KYC information from Investor
F	10-Sep	5	T-5	
S	11-Sep	6		
S	12-Sep	7		
M	13-Sep	8	T-4	
T	14-Sep	9	T-3	1) Investor receives credit documents from Walter Conston 2) Investor receives Borrower LLC wire instructions from Presidio
W	15-Sep	10	T-2	1) Walter Conston receives the signed credit documents from Investor 2) Investor receives Investor Package 2 ("IP2") from Presidio 3) Investor wires capital contribution to DB account for Borrower LLC
Th	16-Sep	11	T-1	Pre-closing 1
F	17-Sep	12	T	1) As of Date (closing) 2) Walter Conston receives executed IP2 documents from Investor
S	18-Sep	13		
S	19-Sep	14		
M	20-Sep	15	T+1	Borrowing Date
T	21-Sep	16	T+2	Investor receives Fund LLC wire instructions from Presidio
W	22-Sep	17	T+3	
Th	23-Sep	18	T+4	
F	24-Sep	19	T+5	
S	25-Sep	20		
S	26-Sep	21		
M	27-Sep	22	T+6	1) Pre-closing 2 2) Investor faxes transfer instructions to DB by 10am EST
T	28-Sep	23	T+7	Determination Date

<u>PIP (Potential Investor Package) Contents:</u>
1) Confidential Memorandum
2) Form of Limited Liability Company Agreement
3) Investor Questionnaire and Subscription Agreement
4) Supplemental Investor Questionnaire
5) Supplemental Investor Questionnaire II
6) Presidio Growth, LLC's Form ADV Part II

<u>IP2 (Investor Package 2) Contents:</u>
1) Supplement to Confidential Memorandum
2) Amended & Restated Fund Limited Liability Agreement
3) Subscription Agreement
4) Agreement as to Initial Capital Contribution
5) Assignment and Assumption Agreement
6) Form W-9

Proprietary Material
Confidentiality Requested

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=12022
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=12022
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: POST 10-31-99 BLIPS TRANSACTIONS/SANCOA
Sent: 1999-09-20 15:16:30.100
Date: 1999-09-20 15:16:30.501
X-Folder: Sales Assistance

WHAT IS YOUR CURRENT POSTURE RE IMPLEMENTATION OF A 1999 BLIPS TRANSACTION TO CLOSE IN EARLY FY2000 TO OFFSET FY2000 INCOME?

WE ARE DISCUSSING A TRANSACTION WITH CLIENT WHO LIKELY WILL SELL COMPANY FOR OVER $100 MILLION IN A 'POOLING' IN 1999 AND DISPOSE OF THE RECEIVED STOCK IN 2000 AT EARLIEST OPPORTUNITY.THE COMPANY IS IN THE FORM OF A PARTNERSHIP AND IS OWNED BY TWO S CORPORATIONS AND A SWISS FOREIGN CORPORATION. OUR CLIENTS OWN THE S CORPORATIONS.

I PRESUME THAT WE COULD IMPLEMENT A BLIPS IN NOVEMBER OR DECEMBER 1999(AFTER THE GUNFIRE DIES DOWN AND THE SMOKE CLEARS) ASSUMING NO INTERVENING ADVERSE LEGISLATION?

From jlarson@presidioadv.com
From: jlarson@presidioadv.com
To: john.rolfes@db.com
Subject: Increase in interest rate
Sent: 1999-09-23 22:27:58.000
Date: [no data]
X-Folder: BLIPS

John-
As discussed, based on current interest rates, it appears that we can reduce the amount of total borrowing (face amount + loan premium) by increasing the coupon amount to approximately 19.6%. We have recently used a 17.4% coupon. This change could be made for next Monday's loans. Please confirm that this would be helpful in increasing the bank's lending capacity for our deals.

Based on my rough calculations, the reduction in total borrowing expected due to raising the coupon amount would be approximately $450 million.

JL

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=18727
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=18727
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS Update
Sent: 1999-09-27 16:36:44.584
Date: 1999-09-27 16:36:47.121
X-Folder: Sales Assistance

We are continuing to aggressively pursue all opportunities to remedy our over-capacity issue with BLIPS. While the current situation is quite dynamic, I wanted to again provide you with a brief status report.

As it now stands, we have 21 transactions that are on our "A" list. This list consists of important clients who currently cannot be accommodated by Deutsche Bank's existing capacity. We additionally have 22 clients waitlisted that, for a variety of reasons, are subordinate to the "A" list.

Possible Solutions

OPIS

In my message on Friday, I indicated that UBS would be unwilling to pursue OPIS unless it was registered as a tax shelter. As of a few minutes ago, it is my understanding that UBS has capitulated on this position and will no longer require registration. In that regard, I will be contacting each of the OPIS candidates this morning to determine which transactions can be accommodated using this product. In short, each transaction that can be shifted to OPIS should create a corresponding opportunity to service waitlisted clients.

Additional Capacity

As mentioned on Friday, we are working with Hypovariens Bank to facilitate additional BLIPS transactions. The initial impression is that Hypo will facilitate approximately $400MM in trades. Hypro's credit committee approval is expected this Thursday which will be followed by board approval a week from today.

In conversations with John Larson, it is our impression that Deutsche Bank will expand their capacity if Hypo also participates in BLIPS.

In anticipation that Hypo will provide additional capacity, Deke Carbo spent last weekend in San Francisco at Presidio and is currently in New York to help coordinate documentation that will be required. Deke will be working with Brent Lipschultz and can be reached this week at 212.893.2695.

Alternate Strategy

The conference that was originally scheduled for Wednesday this week has been accelerated to 2:30 EDT today. Following that conference call, I will provide you with details regarding our ability to offer a alternate product which may provide relief to our waitlisted clients.

Please call with any questions.

Doug Ammerman
Personal Financial Planning
KPMG LLP

Orange County Office
(714) 850-4455
Fax (714) 850-4410
dammerman@KPMG.com

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=10028
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=10028
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: Meeting - Financial Capital Strategies and Total Tax Minimization
Sent: 1999-10-05 15:42:28.568
Date: 1999-10-05 15:42:29.316
X-Folder: Sales Assistance

I suggest we talk about IS generally, with a brief overview of the types of transactions that have been successfully embraced by the marketplace, and what is in store before year end 1999.

Thanks

TPS

-----Original Message-----
From: Croston, Paul W
Sent: Tuesday, October 05, 1999 9:51 AM
To: Eischeid, Jeffrey A; Speiss, Timothy P
Cc: Remo, DeeAnn; Belcher, Gregory P; Farnesi, Frank A; Duty, James V; Haynor, Daryl J
Subject: RE: Meeting - Financial Capital Strategies and Total Tax Minimization
Importance: High

If we pull BLIPS from the schedule, we need to have a substitute strategy, with a slide, to Sonia Ross TODAY. The alternative is to just have someone discuss the Innovative Solutions group in general, with no specific strategy. Let me know asap.

Paul
Paul W. Croston
KPMG, LLP
Financial Capital Strategies
Richmond, VA
Phone: 804-697-4270
Fax: 804-788-0021
Email: pcroston@kpmg.com

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Tuesday, October 05, 1999 9:15 AM
To: Speiss, Timothy P; Croston, Paul W
Cc: Remo, DeeAnn; Belcher, Gregory P; Farnesi, Frank A; Duty, James V
Subject: RE: Meeting - Financial Capital Strategies and Total Tax Minimization

I'd recommend you pull BLIPS from the agenda since it should no longer be marketed.

Jeff

-----Original Message-----
From: Speiss, Timothy P
Sent: Monday, October 04, 1999 5:19 PM
To: Croston, Paul W

Cc: Remo, DeeAnn; Belcher, Gregory P; Farnesi, Frank A; Duty, James V; Eischeid, Jeffrey A
Subject: RE: Meeting - Financial Capital Strategies and Total Tax Minimization

Ok, thanks.

TPS

-----Original Message-----
From: Croston, Paul W
Sent: Monday, October 04, 1999 5:19 PM
To: Speiss, Timothy P
Subject: RE: Meeting - Financial Capital Strategies and Total Tax Minimization

BLIPS is the only one on this year's agenda. It is a tight timetable set by Walter Duer.

Paul
Paul W. Croston
KPMG, LLP
Financial Capital Strategies
Richmond, VA
Phone: 804-697-4270
Fax: 804-788-0021
Email: pcroston@kpmg.com

-----Original Message-----
From: Speiss, Timothy P
Sent: Monday, October 04, 1999 4:25 PM
To: Long, Stephanie L; Farnesi, Frank A
Cc: Croston, Paul W; Remo, DeeAnn; Belcher, Gregory P; Haynor, Daryl J; Duty, James V; Chopack, John J
Subject: RE: Meeting - Financial Capital Strategies and Total Tax Minimization

I will attend.

Paul, let me know about presenting any/all PFP strategies - you cited BLIPS (knowing we are focusing only on year 2000), others. In the future, can we include additional PFP Innovative Strategies ? ; I appreciate your comments/.interest.

DeeAnn/Greg, Paul will call you re presenting at the NoVa/D.C. roadshow earlier in the day on 10/7/99.

Thanks

TPS

-----Original Message-----
From: Long, Stephanie L
Sent: Monday, October 04, 1999 4:12 PM

To: US-PHL Ptrs-Tax; US-PHL Mgrs-Tax; US-ALN Tax Managers; Mattei, Frank J; Bundscho, John R; Hoffman, Steven M; Harles, Ellen J; Mcgonigal, Bonita J; Nye, Jeanne L; Stillwagon, David A
Cc: Haynor, Daryl J
Subject: FW: Meeting - Financial Capital Strategies and Total Tax Minimization
Importance: High

This is a reminder about Thursday's FSC/TTM Roadshow. If you haven't RSVP'd and would like to attend, please let me know ASAP.

-----Original Message-----
From: Farnesi, Frank A
Sent: Monday, September 27, 1999 6:31 PM
To: Angeleri, Frank; Bone, Thomas; Farnesi, Frank; Hoffman, Steven; Hudock III, Emanuel; Mattei, Frank; Murphy, Robert; Norton, Sandra; Silver, Lawrence; Washburn, Christopher; Antoni, David; Bundscho, John; Bush, Robert; Coleman, Edward; Curran, James; Fitzpatrick, Catherine; Graham, James; Guerin, Megan; Repack, Robert; Rooney, Philip; Smeltzer, John; Toscano, Carlo; Zuber, Timothy
Cc: Mageras, Daniel P; Chopack, John J; Long, Stephanie L; Ross, Sonia D
Subject: Meeting - Financial Capital Strategies and Total Tax Minimization

As you know, our Financial Capital Strategies and Total Tax Minimization Practices have combined, resulting in a formidable teaming of experts that are expected to drive world-class products and services to market. This meeting will review the group's vision and definition, highlights of the business plan, and spend most of the time on the market strategy and action

The combination of FCS/TTM will result in an array of world-class products and strategies that you will want and need to introduce to your major accounts and targets. Because of the importance of this meeting, attendance for tax partners and senior managers in Philadelphia is required. Assurance partners are strongly encouraged to attend. In conjunction with this combination we have scheduled a roadshow for the following date:

DATE: October 7, 1999
TIME: 2:00 - 5:00
PLACE: 1400A

Please mark your calendars accordingly, and confirm your attendance with Stephanie Long as soon as possible.

frank
Frank A. Farnesi
ffarnesi@kpmg.com
215-299-3160
215-299-1650(fax)

Proprietary Material
Confidentiality Requested

Kamran Naqvi

Sent: 10/12/1999 08:25 PM

To: William Boyle (william.boyle@db.com), Michael Dougherty (michael.dougherty@db.com), Paul Mchugh, Kamran Naqvi, FRANCESCO PIOVANETTI (FRANCESCO.PIOVANETTI@db.com), Jill Silk, Brian Tuohy, Qi Zhou

cc:

Subject: Presidio Exposure Report 10/12

- monito~4.xls

DB BLIPS 6525

Permanent Subcommittee on Investigations

EXHIBIT #95zz

Trigger = 101.50%

Account Name	Loan Value	Premium	Total Initial Equity (BPs of Premium)	Total Initial Equity	Friction Total Cost (BPs of Premium)	Friction Total Cost (USD)	Total DB Fees (BPs of Premium)
	$ 6,500,000	$ 3,900,000	639	$ 249,167	103.4	$ 40,339	125.0
	$ 163,000,000	$ 100,000,000	778	$ 7,777,770	103.3	$ 1,032,567	125.0
	$ 50,000,000	$ 30,000,000	778	$ 2,333,331	103.0	$ 309,052	125.0
	$ 83,300,000	$ 50,000,000	778	$ 3,888,885	100.9	$ 504,478	125.0
	$ 33,300,000	$ 20,000,000	778	$ 1,555,555	82.3	$ 164,673	125.0
	$ 66,700,000	$ 40,000,000	778	$ 3,111,108	118.9	$ 475,783	125.0
	$ 108,300,000	$ 65,000,000	778	$ 5,055,551	71.1	$ 461,951	125.0
	$ 133,300,000	$ 80,000,000	778	$ 6,222,216	94.7	$ 757,649	125.0
	$ 50,000,000	$ 30,000,000	778	$ 2,333,331	94.7	$ 284,121	125.0
	$ 33,300,000	$ 20,000,000	778	$ 1,555,555	96.4	$ 192,897	125.0
	$ 110,000,000	$ 66,000,000	778	$ 5,133,328	96.5	$ 636,718	125.0
	$ 101,700,000	$ 61,000,000	778	$ 4,744,440	96.5	$ 588,530	125.0
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	95.6	$ 191,193	125.0
	$ 58,300,000	$ 35,000,000	778	$ 2,722,220	114.8	$ 401,646	125.0
	$ 53,300,000	$ 32,000,000	778	$ 2,488,888	94.5	$ 302,307	125.0
	$ 43,300,000	$ 26,000,000	778	$ 2,022,220	94.5	$ 245,623	125.0
	$ 28,300,000	$ 17,000,000	778	$ 1,322,221	94.5	$ 160,597	125.0
	$ 41,600,000	$ 25,000,000	778	$ 1,944,443	94.5	$ 236,167	125.0
	$ 95,000,000	$ 57,000,000	778	$ 4,433,329	93.4	$ 532,377	125.0
	$ 500,000,000	$ 300,000,000	778	$ 23,333,310	93.2	$ 2,796,117	125.0
	$ 16,700,000	$ 10,000,000	778	$ 777,777	93.2	$ 93,212	125.0
	$ 166,700,000	$ 100,000,000	778	$ 7,777,770	92.9	$ 928,512	125.0
	$ 50,000,000	$ 30,000,000	778	$ 2,333,331	115.7	$ 347,244	125.0
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	115.7	$ 231,487	125.0
	$ 36,700,000	$ 22,000,000	778	$ 1,711,109	115.8	$ 254,654	125.0
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	115.7	$ 231,487	125.0
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	115.7	$ 231,487	125.0

Redacted by Permanent Subcommittee on Investigations

Time Interval for Run Checks: 10

Total DB Fees (USD)	Equity After Friction Cost and Fees (BPs of Premium)	Equity After Friction Cost and Fees (USD)	Equity Level at Which Trigger is Hit (USD)	Equity Cushion Before Trigger (USD)	Trigger (Expected FX)	Trigger (MTM FX)	Trigger1	Trigger2
$ 48,750	410.5	$ 160,078	$ 156,000	$ 4,078	101.532%	101.638%		
$ 1,250,000	549.5	$ 5,495,203	$ 3,945,000	$ 1,550,203	102.080%	102.187%		
$ 375,000	549.8	$ 1,649,279	$ 1,200,000	$ 449,279	102.052%	102.166%		
$ 625,000	551.9	$ 2,759,407	$ 1,999,500	$ 759,907	102.060%	102.207%		
$ 250,000	570.4	$ 1,140,882	$ 799,500	$ 341,382	102.130%	102.299%		
$ 500,000	533.8	$ 2,135,325	$ 1,600,500	$ 534,825	101.992%	102.153%		
$ 812,500	581.7	$ 3,781,100	$ 2,599,500	$ 1,181,600	102.172%	102.305%		
$ 1,000,000	558.1	$ 4,464,567	$ 3,199,500	$ 1,265,067	102.083%	102.240%		
$ 375,000	558.1	$ 1,674,210	$ 1,200,000	$ 474,210	102.083%	102.239%		
$ 250,000	556.3	$ 1,112,658	$ 799,500	$ 313,158	102.078%	102.252%		
$ 825,000	556.3	$ 3,671,610	$ 2,640,000	$ 1,031,610	102.076%	102.250%		
$ 762,500	556.3	$ 3,393,410	$ 2,440,500	$ 952,910	102.078%	102.250%		
$ 250,000	557.2	$ 1,114,361	$ 799,500	$ 314,861	102.081%	102.318%		
$ 437,500	538.0	$ 1,883,074	$ 1,399,500	$ 483,574	102.009%	102.298%		
$ 400,000	558.3	$ 1,786,579	$ 1,279,500	$ 507,079	102.085%	102.320%		
$ 325,000	558.3	$ 1,451,597	$ 1,039,500	$ 412,097	102.085%	102.321%		
$ 212,500	558.3	$ 949,124	$ 679,500	$ 269,624	102.085%	102.321%		
$ 312,500	558.3	$ 1,395,776	$ 999,000	$ 396,776	102.086%	102.322%		
$ 712,500	559.4	$ 3,188,452	$ 2,280,000	$ 908,452	102.088%	102.262%		
$ 3,750,000	559.6	$ 16,787,193	$ 12,000,000	$ 4,787,193	102.089%	102.262%		
$ 125,000	559.6	$ 559,565	$ 400,500	$ 159,065	102.086%	102.259%		
$ 1,250,000	559.9	$ 5,599,258	$ 4,000,500	$ 1,598,758	102.090%	102.263%		
$ 375,000	537.0	$ 1,611,087	$ 1,200,000	$ 411,087	102.004%	102.228%		
$ 250,000	537.0	$ 1,074,067	$ 799,500	$ 274,567	102.006%	102.230%		
$ 275,000	537.0	$ 1,181,455	$ 880,500	$ 300,955	102.003%	102.227%		
$ 250,000	537.0	$ 1,074,067	$ 799,500	$ 274,567	102.006%	102.230%		
$ 250,000	537.0	$ 1,074,067	$ 799,500	$ 274,567	102.006%	102.230%		

Unknown

From: Eischeid, Jeffrey A
Sent: Thursday, October 14, 1999 8:42 AM
To: Baumann, Dale; Belcher, Gregory; Bickham, Randall; Bloom, Richard; Carbo, Deke; Desany, Edmond; Eischeid, Jeffrey; Fergus, Terrence; Gray-RALEIGH, Mike; Hasting, Carl; Henderson, Tracie; Jandl, George; Jordan, Robert; Lipschultz, Brent; Liston, Shannon; Mccrimlisk, George; McGrath, Kevin; Nuckolls, John; Pace, Katherine; Paule, Robin; Pedersen, Robert; Perez, Robert; Pike, Ralph; Poreba, Edward; Remo, DeeAnn; Rivkin, David; Shatzman, Janice; Slattery, Daniel; Smolin, Jay; Speiss, Timothy; Spitz, William; Staebler, Victoria; Tendler, Neil; Warley, Carol; Watkins, B; Watson, Mark; Weems, Pamela; Zaudtke, David; Zysik, Jeffrey
Cc: Ammerman, Douglas K; Branan, Carolyn; Duty, James; Goldberg, William; Ito, Dennis
Subject: Caution

A number of us are finalizing the marketing (including engagement letters) of year 2000 BLIPS transactions. Given the difficulties we have had over the last few weeks securing bank capacity, it is crucial that we manage our clients' expectations regarding their ability to actually implement a BLIPS trade. In other words, provide no guarantees!! We can only commit to using our best efforts to introduce them to a transaction. At this point it is unlikely that we will have bank lending capacity "guaranteed" until after the first of the year. Having said that, I am highly confident that we can meet our existing "commitments".

If you have any questions, please call me.

Jeff

Permanent Subcommittee on Investigations
EXHIBIT #95aaa

Memorandum

To:	Matthew Dunn	Treasury/Asset & Liability Management
	Michael Blakley	Risk Management Products
	Clairmonte David	Treasury/Back Office
From:	Dick Pankuch	Structured Finance
Date:	October 14, 1999	

Subject: Foreign exchange, swap, interest rate caps and Euro deposits for the Premium Loan Used for Strategic investments (P.L.U.S.) transaction

---

HVB Structured Finance is funding a series of 7 year collateralized premium loans with principal plus premium totaling USD 949.2 million (the "Loans"). The purpose of the Loans is to finance investment activities of Delaware LLCs ("the Borrowers"), each of which at inception is owned by an individual or a trust.

In addition to the Loans, the Borrowers will also enter into a series of other transactions with HVB New York Branch Treasury and HVB Risk Management Products, which are described in HVB-Presidio Meeting Memorandum.

A synthetic USD deposit for the Borrowers is also created by using EUR deposit and EUR forwards. Treasury will maintain the EUR forward position such that at any time the value of the deposit is the USD principal plus USD interest for the period the fund is in deposit.

As a part of their trading strategy (see HVB-Presidio Meeting Memorandum), the Borrowers will establish short positions in exotic currencies (e.g. HKD, ARS). **This position exposes our collateral to market risk. HVB Structured Finance will hedge that risk by purchasing call options on these currencies positions from Treasury.**

Please review the attached document and sign.

Agreed:

____________________ ____________________

HVB Structured Finance Inc. Date

____________________ ____________________

HVB New York Treasury. Date

____________________ ____________________

HVB Risk Management Products Date

____________________ ____________________

HVB Treasury/Back Office Date

Ken Tarr To: John Rolfes/NewYork/DBNA/DeuBa@DBNA
cc: Paul W Higgins, allan.cuttle@db.com
Subject: Re: Increase in BLIPs Funding Limit
Sent: 10/14/1999 05:34 PM

Gentlemen,
Since I was not at the Ross meeting and Peter Scarurro was, the minutes reflect what he said. It appears we have a situation here of "history is written by the survivors".
KJT

-- Message History --

From: **John Rolfes on 10/14/99 04:25 PM**

To: Ken Tarr/NewYork/DBNA/DeuBa@DBNA; Paul W Higgins; Allan Cuttle
cc:
Subject: Re: Increase in BLIPs Funding Limit

Attached please find an e-mail response from Ivor Dunbar who was actually present at the meeting with John Ross. It seems that the PB Management Committeee minutes do not accurately reflect what transpired at the meeting with John Ross. This should put the matter to rest regarding the amount that has been officially approved to 55 deals and $3 billion in loan premium.

---------------------- Forwarded by John Rolfes on 10/14/99 04:22 PM ----------------------

From: **Ivor Dunbar on 10/14/99 09:14 PM GMT**

To: John Rolfes
cc:
Subject: Re: Increase in BLIPs Funding Limit

Your recollection is incorrect. No discussion of the 25 limit took place - this was purely a Tax Dept suggestion.

When we presented the product to John Ross we proposed total premia of $3bn and between 40 & 60 deals (subject to approval of the Tax Department).

Hope that clarifies the matter.

Ivor

Permanent Subcommittee on Investigations
EXHIBIT #95ccc

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=28052
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=28052
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: OPIS
Sent: 1999-10-19 15:57:00.492
Date: 1999-10-19 15:57:01.523
X-Folder: OPIS Y2K deals

oh well. By the way, regarding those two OPIS deals we spoke about yesterday - I met with the guys yesterday to sign all the paperwork. I think they are each doing $40 million. I'll fax you the engagement letters.

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Tuesday, October 19, 1999 5:25 AM
To: Paule, Robin M
Subject: RE: OPIS

Thanks. Too late for BLIPS as we know it. We'll have to tee the referral up for BLIPS II.

Jeff

-----Original Message-----
From: Paule, Robin M
Sent: Monday, October 18, 1999 5:27 PM
To: Eischeid, Jeffrey A
Subject: OPIS

No need to apologize. I've been called alot worse than "pushy".

Speaking of pushy, I received a call from a referral of a client who did an OPIS and BLIPS deals this year. He wants to do a BLIPS in 2000. Is it too late to put him on the list? It's a 3 person $25 million (minimum) deal.

Thanks.

Robin Paule
KPMG Warner Center
(818)227-6934 PHONE
(818)227-6964 FAX
rpaule@kpmg.com

Unknown

From: Gutman, Harry L
Sent: Wednesday, October 27, 1999 1:35 PM
To: Eischeid, Jeffrey A
Subject: RE: BLIPS

Thanks...We have already had one call from Denver offering help. Hopefully your memo will stop that.

Hank
Harry L. Gutman
KPMG Washington National Tax
Partner in Charge
Federal Tax Legislative and Regulatory Services
202-533-3044 (Tel)
202-533-8546 (Fax)
hgutman@kpmg.com

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Wednesday, October 27, 1999 4:25 PM
To: Baumann, Dale; Belcher, Gregory; Bickham, Randall; Bloom, Richard; Carbo, Deke; Desany, Edmond; Eischeid, Jeffrey; Fergus, Terrence; Gray-RALEIGH, Mike; Hesting, Carl; Henderson, Tracie; Jandl, George; Jordan, Robert; Lipschultz, Brent; Liston, Shannon; Mccrimlisk, George; McGrath, Kevin; Nuckolls, John; Pace, Katherine; Paule, Robin; Pedersen, Robert; Perez, Robert; Pike, Ralph; Poreba, Edward; Remo, DeeAnn; Rivkin, David; Shatzman, Janice; Slattery, Daniel; Smolin, Jay; Speiss, Timothy; Spitz, William; Staebler, Victoria; Tendler, Neil; Warley, Carol; Watkins, B; Watson, Mark; Weems, Pamela; Zaudtke, David; Zysik, Jeffrey
Cc: Ammerman, Douglas K; Gutman, Harry L
Subject: BLIPS
Importance: High

I just finished a conference call with Doug Ammerman and Hank Gutman. Rest assured that Hank and his team are actively involved in trying to insure that our clients interests are being protected. Please refrain from calling Hank and his team for updates. The volume of calls they are getting from PFP is distracting them from their dealings with Treasury and Congress. They simply can not tell us what the outcome will be and they can not accurately predict the timing. Their current best guess for meaningful information is November 10th.

Finally, it is quite important that you discourage your clients and their other advisors from undertaking any type of lobbying activity on their own. It is likely that such activities will be counterproductive.

If you have any questions, please call me.

Jeff

KPMG 0003636

Permanent Subcommittee on Investigations
EXHIBIT #95eee

Unknown

From:	DeLap, Larry
Sent:	Friday, October 29, 1999 3:03 PM
To:	Watson, Mark T
Cc:	Eischeid, Jeffrey A; Ammerman, Douglas K; Smith, Richard H (WNT); Elgin, Evelyn
Subject:	FW: BLIPS

BLIPSel2.doc

Mark -

I'll be in Washington National Tax next week, beginning on Tuesday. Can we meet to discuss this?

Larry

-----Original Message-----
From: Elgin, Evelyn
Sent: Friday, October 29, 1999 5:52 PM
To: DeLap, Larry; Fletcher, Lea; Grogan, Linda A; Hedley, Rachel F; Winters, AnneMarie
Subject: Varied

Larry --

- They'll, of course, get you your office for Tues thru Fri of next week. They screwed up, but will rearrange things.
- BLIPs -- I taked with Jeff Eischeid today about a number of issues involved in the new legislative proposal that apparently would hit BLIPs (Senate Finance Committee version of Taxpayer Relief Act of 1999 -- I believe it's part of the extenders bill -- I'm sure you know about it). Just a general discussion. I said I'd talk with you more about it.

<u>The proposal</u>. In the case of partnerships, statute would apply to assumption of liability after October 18, 1999 or such later date as may be prescribed by regulations.

<u>Some issues</u>.

If statute is enacted before taxpayer files return, but no regs at that time:

- could we still issue a MLTN opinion? I said that's initially a subchapter K call, but answer would seem to turn on how direct a hit the legislation is on BLIPs and whether legislation is effective on enactment given the statement that legislation takes effect on 10/18 or such later date as may be prescribed by regs. (Richard Smith thinks it may not be a direct hit.)
- if we couldn't issue a MLTN opinion, would we still feel ok about penalties (in that penalty rules look to law in effect on date of filing).?
- could taxpayer file a return based on estimates (to get return in as quickly as possible) and then amend later --i.e., would time for filing for penalty purposes (i.e., for testing whether you have a MLTN level of certainty) be time filed original or amended return?
- what kind of guidance are we going to make to BLIPs team to help them provide consistent and good answers to now-worried clients, especially given that we're not opining on penalties?
- what form should our guidance to clients take? Jeff suggested phone calls. I said I was not so sure -- we might want to apprise clients of risks in writing given what's at stake.

Proprietary Material
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Permanent Subcommittee on Investigations
EXHIBIT #95fff

KPMG 0003643

I don't recall if there's anything in our BLIPs engagement letter that would affect our conclusions on any of the above isssues (e.g., comparable to the statement in TRACT opinions that we'd update for 1999 developments).

Eve

From: </O=KPMG/OU=US/CN=RECIPIENTS/CN=20483>
To: </O=KPMG/OU=US/CN=RECIPIENTS/CN=20499>
Sent: Monday, January 11, 1999 12:00 AM
Subject:

We would be supportive, but haven't done anything lately that I am aware of.

Colleen: Do you still have the list that was created a while back?

Mark Springer
KPMG Tax Innovation Center
202-533-3076
maspringer@kpmg.com

-----Original Message-----
From: Warley, Carol G
Sent: Monday, November 08, 1999 9:59 PM
To: Eischeid, Jeffrey A
Cc: Springer, Mark A
Subject: RE:

REDACTED

OK

I will catch you sometime between Wed and Fri. They aren't on the blips grandfathered list fyi.

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Monday, November 08, 1999 5:05 PM
To: Warley, Carol G
Cc: Springer, Mark A
Subject: RE:

OK - I should get in late tomorrow night. In Chicago today and tomorrow. For what it's worth, Mark Springer and some of the other WNT folks have been strategizing about this target group as a class. Marketing has done some target lists, etc. I think they would be very supportive, even with the profile risk.

Jeff

-----Original Message-----
From: Warley, Carol G
Sent: Friday, November 05, 1999 4:20 PM
To: Eischeid, Jeffrey A
Subject:

There is a group of high profile plantiff attorneys that will be getting approximately 1 billion possibly next year. They want to talk about our tax products. Lets discuss this next week. This is a high profile group so I am not sure the risk is worth it. They have met with Andersen regarding a WEST type

Permanent Subcommittee on Investigations
EXHIBIT #95ggg

strategy. They have had a pitch from PWC re Boss but haven't met with them yet.

kpmg

Carol Warley
PFP
713-319-2180 phone
713-319-2040 fax
cwarley@kpmg.com e mail

Kamran Naqvi
Sent: 11/29/1999 11:43 AM

To: Paul Mchugh
cc: Nancy Donohue, Brian Tuohy
Subject: Re: Presidio Monitoring Report Attached

____________________________ Reply Separator ________________________________
Subject: Re: Presidio Monitoring Report Attached
Author: Paul Mchugh
Date: 11/29/1999 10:04 AM

Hi Guys, I'm back. Can Brian and I get an updated report, please?

Paul

____________________________ Reply Separator ________________________________
Subject: Presidio Monitoring Report Attached
Author: Nancy Donohue
Date: 11/8/1999 7:06 PM

- mon1129.xls

Trigger = 101.50%

Time Interval for Run Checks 10

Account Name	Loan Value	Premium	Total Initial Equity (BPs of Premium)	Total Initial Equity	Friction Total Cost (BPs of Premium)	Friction Total Cost (USD)	Total DB Fees (BPs of Premium)	Total DB Fees (USD)	Equity After Friction Cost and Fees (BPs of Premium)	Equity After Friction Cost and Fees (USD)
[redacted]										
	$ 66,700,000	$ 40,000,000	778	$ 3,111,108	89.6	$ 358,256	125.0	$ 500,000	563.2	$ 2,252,852
	$ 108,300,000	$ 65,000,000	778	$ 5,055,551	68.0	$ 441,742	125.0	$ 812,500	584.8	$ 3,801,309
	$ 133,300,000	$ 80,000,000	778	$ 6,222,216	91.4	$ 731,447	125.0	$ 1,000,000	561.3	$ 4,490,769
	$ 50,000,000	$ 30,000,000	778	$ 2,333,331	91.4	$ 274,296	125.0	$ 375,000	561.3	$ 1,684,035
	$ 33,300,000	$ 20,000,000	778	$ 1,555,555	93.1	$ 186,152	125.0	$ 250,000	559.7	$ 1,119,403
	$ 110,000,000	$ 66,000,000	778	$ 5,133,328	93.1	$ 614,459	125.0	$ 825,000	559.7	$ 3,693,869
	$ 101,700,000	$ 61,000,000	778	$ 4,744,440	93.1	$ 567,958	125.0	$ 762,500	559.7	$ 3,413,962
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	92.6	$ 185,109	125.0	$ 250,000	560.2	$ 1,120,445
	$ 58,300,000	$ 35,000,000	778	$ 2,722,220	111.2	$ 389,240	125.0	$ 437,500	541.6	$ 1,895,480
	$ 53,300,000	$ 32,000,000	778	$ 2,488,886	91.6	$ 293,047	125.0	$ 400,000	561.2	$ 1,795,839
	$ 43,300,000	$ 26,000,000	778	$ 2,022,220	91.6	$ 238,099	125.0	$ 325,000	561.2	$ 1,459,121
	$ 28,300,000	$ 17,000,000	778	$ 1,322,221	91.6	$ 155,677	125.0	$ 212,500	561.2	$ 954,044
	$ 41,600,000	$ 25,000,000	778	$ 1,944,443	91.6	$ 228,933	125.0	$ 312,500	561.2	$ 1,403,010
	$ 95,000,000	$ 57,000,000	778	$ 4,433,329	90.7	$ 517,092	125.0	$ 712,500	562.1	$ 3,203,737
	$ 500,000,000	$ 300,000,000	778	$ 23,333,310	90.5	$ 2,715,672	125.0	$ 3,750,000	562.3	$ 16,867,638
	$ 16,700,000	$ 10,000,000	778	$ 777,777	90.5	$ 90,531	125.0	$ 125,000	562.2	$ 562,246
	$ 166,700,000	$ 100,000,000	778	$ 7,777,770	90.2	$ 901,698	125.0	$ 1,250,000	562.6	$ 5,626,072
	$ 50,000,000	$ 30,000,000	778	$ 2,333,331	112.7	$ 338,152	125.0	$ 375,000	540.1	$ 1,620,179
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	112.7	$ 225,426	125.0	$ 250,000	540.1	$ 1,080,128
	$ 36,700,000	$ 22,000,000	778	$ 1,711,109	112.7	$ 247,987	125.0	$ 275,000	540.1	$ 1,188,122
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	112.7	$ 225,426	125.0	$ 250,000	540.1	$ 1,080,128
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	112.7	$ 225,426	125.0	$ 250,000	540.1	$ 1,080,128
	$ 66,700,000	$ 40,000,000	778	$ 3,111,106	104.7	$ 418,818	125.0	$ 500,000	548.1	$ 2,192,292
	$ 66,700,000	$ 40,000,000	778	$ 3,111,106	104.7	$ 418,818	125.0	$ 500,000	548.1	$ 2,192,292
	$ 71,600,000	$ 43,000,000	778	$ 3,344,441	104.6	$ 449,722	125.0	$ 537,500	548.2	$ 2,357,219
	$ 50,000,000	$ 30,000,000	778	$ 2,333,331	104.8	$ 314,372	125.0	$ 375,000	548.0	$ 1,643,959
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	104.8	$ 209,573	125.0	$ 250,000	548.0	$ 1,095,981
	$ 51,700,000	$ 31,000,000	778	$ 2,411,109	97.6	$ 302,454	125.0	$ 387,500	555.2	$ 1,721,155
	$ 59,200,000	$ 35,500,000	778	$ 2,761,108	97.6	$ 346,358	125.0	$ 443,750	555.2	$ 1,971,000
	$ 101,600,000	$ 61,000,000	778	$ 4,744,440	97.6	$ 595,118	125.0	$ 762,500	555.2	$ 3,366,822
	$ 36,700,000	$ 22,000,000	778	$ 1,711,109	90.3	$ 198,633	125.0	$ 275,000	562.5	$ 1,237,476
	$ 16,700,000	$ 10,000,000	778	$ 777,777	84.4	$ 84,373	125.0	$ 125,000	568.4	$ 568,404
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	84.4	$ 168,721	125.0	$ 250,000	568.4	$ 1,136,833
	$ 100,000,000	$ 60,000,000	778	$ 4,666,662	93.7	$ 562,096	125.0	$ 750,000	559.1	$ 3,354,566
	$ 125,000,000	$ 75,000,000	778	$ 5,833,328	93.7	$ 702,620	125.0	$ 937,500	559.1	$ 4,193,208
	$ 313,300,000	$ 188,000,000	778	$ 14,622,208	93.7	$ 1,761,225	125.0	$ 2,350,000	559.1	$ 10,510,983
	$ 50,900,000	$ 30,500,000	778	$ 2,372,220	93.7	$ 285,750	125.0	$ 381,250	559.1	$ 1,705,220
	$ 83,300,000	$ 50,000,000	778	$ 3,888,885	93.7	$ 468,404	125.0	$ 625,000	559.1	$ 2,795,481
	$ 46,700,000	$ 28,000,000	778	$ 2,177,776	93.7	$ 262,320	125.0	$ 350,000	559.1	$ 1,565,456
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	90.5	$ 180,962	125.0	$ 250,000	562.3	$ 1,124,572
	$ 131,600,000	$ 79,000,000	778	$ 6,144,436	90.5	$ 714,945	125.0	$ 987,500	562.3	$ 4,441,993
	$ 66,700,000	$ 40,000,000	778	$ 3,111,108	90.5	$ 361,989	125.0	$ 500,000	562.3	$ 2,249,119
	$ 236,600,000	$ 142,000,000	778	$ 11,044,433	90.5	$ 1,285,013	125.0	$ 1,775,000	562.3	$ 7,984,420
	$ 58,300,000	$ 35,000,000	778	$ 2,722,220	90.5	$ 316,724	125.0	$ 437,500	562.3	$ 1,967,996
	$ 68,300,000	$ 41,000,000	778	$ 3,188,888	90.5	$ 371,021	125.0	$ 512,500	562.3	$ 2,305,365
	$ 291,700,000	$ 175,000,000	778	$ 13,611,098	95.0	$ 1,663,052	125.0	$ 2,187,500	557.7	$ 9,760,546
	$ 33,300,000	$ 20,000,000	778	$ 1,555,554	95.0	$ 190,053	125.0	$ 250,000	557.8	$ 1,115,501
	$ 166,700,000	$ 100,000,000	778	$ 7,777,770	95.0	$ 950,319	125.0	$ 1,250,000	557.7	$ 5,577,451
	$ 100,000,000	$ 60,000,000	778	$ 4,666,662	95.0	$ 570,196	125.0	$ 750,000	557.7	$ 3,346,476
	$ 57,400,000	$ 34,500,000	778	$ 2,683,331	95.0	$ 327,831	125.0	$ 431,250	557.8	$ 1,924,250
	$ 177,200,000	$ 106,200,000	778	$ 8,259,992	95.5	$ 1,014,554	125.0	$ 1,327,500	557.2	$ 5,917,938
		$ 2,936,600,000								

ESTIMATES		
	Fees	$ 36,707,500
	Friction Gains	$ 3,261,375
	Trading P&L	$ 4,200,000
	Total	$ 44,168,875

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Equity Level at Which Trigger Is Hit (USD)	Equity Cushion Before Trigger (USD)	Trigger (Expected FX)	Trigger (MTM FX)
[redacted]			
$ 1,600,500	$ 652,352	102.102%	102.137%
$ 2,599,500	$ 1,201,809	102.183%	102.212%
$ 3,199,500	$ 1,291,269	102.096%	102.130%
$ 1,200,000	$ 484,035	102.095%	102.130%
$ 799,500	$ 319,903	102.090%	102.126%
$ 2,640,000	$ 1,053,869	102.089%	102.124%
$ 2,440,500	$ 973,482	102.089%	102.124%
$ 799,500	$ 320,945	102.092%	102.154%
$ 1,399,500	$ 495,980	102.022%	102.097%
$ 1,279,500	$ 516,339	102.095%	102.157%
$ 1,039,500	$ 419,621	102.096%	102.157%
$ 679,500	$ 274,544	102.096%	102.158%
$ 999,000	$ 404,010	102.097%	102.158%
$ 2,280,000	$ 923,737	102.098%	102.133%
$ 12,000,000	$ 4,867,638	102.099%	102.134%
$ 400,500	$ 161,746	102.096%	102.131%
$ 4,000,500	$ 1,625,572	102.100%	102.134%
$ 1,200,000	$ 420,179	102.016%	102.062%
$ 799,500	$ 280,628	102.017%	102.064%
$ 880,500	$ 307,622	102.015%	102.061%
$ 799,500	$ 280,628	102.017%	102.064%
$ 799,500	$ 280,628	102.017%	102.064%
$ 1,600,500	$ 591,792	102.045%	102.090%
$ 1,600,500	$ 591,792	102.045%	102.090%
$ 1,722,000	$ 635,219	102.044%	102.089%
$ 1,200,000	$ 443,959	102.045%	102.115%
$ 799,500	$ 296,481	102.047%	102.117%
$ 1,240,500	$ 480,655	102.071%	102.111%
$ 1,420,500	$ 550,500	102.072%	102.111%
$ 2,439,000	$ 947,822	102.073%	102.112%
$ 880,500	$ 356,976	102.096%	102.134%
$ 400,500	$ 167,904	102.119%	102.156%
$ 799,500	$ 337,333	102.123%	102.160%
$ 2,400,000	$ 954,566	102.067%	102.134%
$ 3,000,000	$ 1,193,208	102.067%	102.134%
$ 7,519,500	$ 2,991,483	102.087%	102.135%
$ 1,221,000	$ 484,220	102.065%	102.133%
$ 1,999,500	$ 795,981	102.067%	102.135%
$ 1,120,500	$ 444,956	102.066%	102.133%
$ 799,500	$ 325,072	102.100%	102.172%
$ 3,162,000	$ 1,279,993	102.097%	102.169%
$ 1,600,500	$ 648,619	102.098%	102.170%
$ 5,679,000	$ 2,305,420	102.099%	102.171%
$ 1,399,500	$ 568,496	102.099%	102.172%
$ 1,639,500	$ 665,865	102.099%	102.171%
$ 7,000,500	$ 2,760,046	102.082%	102.167%
$ 799,500	$ 316,001	102.083%	102.169%
$ 4,000,500	$ 1,576,951	102.082%	102.167%
$ 2,400,000	$ 946,476	102.082%	102.167%
$ 1,378,500	$ 545,750	102.084%	102.174%
$ 4,251,000	$ 1,666,938	102.078%	102.169%

Unknown

From: John Larson [jlarson@presidioadv.com]
Sent: Monday, December 13, 1999 7:18 AM
To: Kerry Bratton
Cc: eischeid@kpmg.com
Subject: Wires to KPMG

Kerry-
I discussed some of the issues related to the KPMG payments with Jeff last week. He understands that we need to prioritize our efforts to insure that the investors get out of the funds and dispose of their high basis assets before we worry about organizing 67 separate wires to KPMG. Based on the volume of faxes and messages we are receiving at Presidio, I think it is fair to say that some of Jeff's partners don't quite get it. One thing that Jeff and I discussed was having KPMG set up a single internal clearing account so that all payments to them could be wired to a single account rather than separate accounts for each partner or office. I think this would be helpful. I'll call you and Jeff later to discuss what else we can do.

For today I agree that we should set all requests aside due to the huge transaction volume. Over the next few days we can then focus on how to handle this without disruptions.

JL

KPMG 0003689

Permanent Subcommittee on Investigations
EXHIBIT #95iii

Unknown

From: Paule, Robin M
Sent: Friday, December 17, 1999 9:43 AM
To: Warley, Carol G; Watson, Mark T; Schrier, John V; Baumann, Dale R; Belcher, Gregory P; Bickham, Randall S; Bloom, Richard J; Carbo, Deke G; Desany, Edmond H; Eischeid, Jeffrey A; Fergus, Terrence P; Gardner, John H; Gray, Mike - RALEIGH; Hasting, Carl D; Henderson, Tracie K; Jandl, George P; Jordan, Robert M; Lees, Robert; Lipschultz, Brent S; Liston, Shannon L; Mccrimlisk, George H; McGrath, Kevin J; Nuckolls, John M; Ohle, John B; Pace, Katherine A; Pedersen, Robert A; Perez, Robert L; Pike, Ralph; Poreba, Edward W; Pye, Nicholas I; Ransome, Justin P; Remo, Dee Ann; Rivkin, David; Sanders, Russell T; Shatzman, Janice B; Slattery, Daniel M; Smolin, Jay M; Speiss, Timothy P; Spitz, William L; Staebler, Victoria A; Tendler, Neil J; Vail, Daniel T; Watkins, B M; Weems, Pamela D; Zaudtke, David P; Ziegelheim, Carol; Zysik, Jeffrey C; Schrier, John V; Stone, Tracy T
Subject: Invoices for BLIPS

As it now appears that Presidio will be facilitating the payment of our invoices, it would save them (and our clients) a lot of time and effort if we standardized our wire instructions to them. I have prepared a cover letter and wire instructions which I sent out with my invoices. All the client has to do is sign the bottom of the wire instructions and fax to Kerry. You should, of course, fill in the blanks with their LLC name and the amount to be wired.

Attached are the letters.

invoice cover letter   WIRELETTER21.DOC

Robin Paule
KPMG Warner Center
(818)227-6934 PHONE
(818)227-6964 FAX
rpaule@kpmg.com

Permanent Subcommittee on Investigations
EXHIBIT #95jjj

December 16, 1999

To: «Name»
«Entity»

From: Your Name
KPMG LLP

Enclosed is our invoice for services related to your Bond-Linked Issue Premium Structure ("BLIPS") investment.

As you are probably aware, funds related to the liquidation of your BLIPS investment are now held in an account at Deutsche Bank AG ("DB"). In order to substantiate the tax treatment of our fees related to this transaction, it is prudent to pay our invoice prior to December 31, 1999.

In order to facilitate payment of our invoice prior to year end, we have attached wire instructions permitting Presidio to instruct DB to wire funds directly from your DB account to KPMG.

Please sign the attached wire instructions and fax to:

Kerry Bratton
c/o Presidio Advisory Services, LLC
Fax: (415)284-7284

If you have any questions, please call me at (818)227-6934.

To: Kerry Bratton
Presidio Advisory Services, LLC
415/284-7284 Fax

From: «NAME»
«ENTITY»

You are hereby instructed to wire transfer $«AMOUNT» from «ENTITY» to KPMG LLP. The wire instructions are as follows:

MELLON BANK
THREE MELLON BANK CENTER, ROOM 2713
PITTSBURGH, PENNSYLVANIA 15259
ACCT# [redacted] ABA# [redacted]

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on Investigations

Thank you,

____
«NAME»
«ENTITY»

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: Basis question
Sent: 1999-12-21 16:28:23.466
Date: 1999-12-21 16:28:23.545
X-Folder: BLIPS

FYI... The interest portion of the operating loss should be 65 basis points, not 90.

275 bp for management fee
100-125 bp for trading loss
25 bp for swap payment
8 bp for guaranteed payment
65 bp for interest

Angie

-----Original Message-----
From: Napier, Angie
Sent: Tuesday, December 21, 1999 11:22 AM
To: 'Kerry Bratton'
Subject: RE: Basis question

Thanks Kerry.

-----Original Message-----
From: Kerry Bratton [SMTP:kbratton@presidioadv.com]
Sent: Tuesday, December 21, 1999 11:15 AM
To: tanapier@kpmg.com
Subject: RE: Basis question

Yes, all swap activity is in the net interest number.

KB

Kerry Bratton
Presidio Advisory Services, LLC
Phone: (415) 284-7282
Fax: (415) 284-7284

>>> "Napier, Angie" <tanapier@kpmg.com> 12/21/99 08:09AM >>>
I want to make sure I have this correct: the 25 bp for the swap is included in the 90 interest expense number.

Angie

> -----Original Message-----
> From: Kerry Bratton [SMTP:kbratton@presidioadv.com]
> Sent: Tuesday, December 21, 1999 11:05 AM
> To: tanapier@kpmg.com
> Subject: RE: Basis question
>
> No the swap should not be a separate component. It is in the net interest
> expense number.
>

>
>
> Kerry Bratton
> Presidio Advisory Services, LLC
> Phone: (415) 284-7282
> Fax: (415) 284-7284
>
Redacted by Permanent Subcommittee on Investigations
> >>> "Napier, Angie" <tanapier@kpmg.com> 12/21/99 08:00AM >>>
> The problem is that when we add up all the components by basis points for
[redacted] it is 150K more loss that we actually have.

> 275 basis points for management fee
> 100 bp for trading loss
> 25 bp swap payment
> 8 bp guaranteed payment
> 90 bp interest
>
> Do these bp components look right?
>
> Angie
> > -----Original Message-----
> > From: Kerry Bratton [SMTP:kbratton@presidioadv.com]
> > Sent: Tuesday, December 21, 1999 10:48 AM
> > To: tanapier@kpmg.com
> > Subject: Re: Basis question
> >
> > No that sounds about right. This is the net interest expense number.
> >
> > KB
> >
> > Kerry Bratton
> > Presidio Advisory Services, LLC
> > Phone: (415) 284-7282
> > Fax: (415) 284-7284
> >
> > >>> "Napier, Angie" <tanapier@kpmg.com> 12/21/99 07:42AM >>>
> > Kerry,
> >
> > Is the interest portion of the operating loss 90 basis points? I
> thought
> > it
> > was a smaller number?
> >
> > Angie
> >
> >
> >
> **
> > ***
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****

Unknown

From:	Watson, Mark T
Sent:	Monday, January 03, 2000 10:46 AM
To:	Bickham, Randall S; Ammerman, Douglas K; Eischeid, Jeffrey A
Cc:	Larkins, Richard G; Smith, Richard H (WNT)
Subject:	BLIPS 2000

Richard Larkins is currently reviewing the BLIPS 2000 white paper and we anticipate reaching a *preliminary* conclusion as to whether the strategy is *technically* viable (or can be modified such that it will be technically viable) by January 15. If there are no insurmountable technical hurdles, then the economic substance committee will review the strategy. My goal is to reach a definitive conclusion as to whether the strategy works (from both a technical perspective and an economic substance perspective) by January 31.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-533-3092 (phone)
202-533-8451 (fax)

Unknown

From:	Bloom, Richard J
Sent:	Monday, January 31, 2000 3:39 PM
To:	Eischeid, Jeffrey A
Cc:	Tendler, Neil J
Subject:	Client Comments - BLIPS

REDACTED

As we discussed, here are some comments that I received from regarding his dealings with Presidio.

Amir was very short in his comments and not very cordial. had questioned how much each party in the transaction received in fees and Amir indicated that it was none of their business to know the fees. Amir also indicated that all they need to be concerned with is that the cost is 7% and they should assume they will lose this amount. [redacted] indicated to me that he was not trying to negotiate the fees, only to understand what the fees were. As you and I have discussed, it appears that this is a fair question to ask from a business and investment perspective. [redacted] also felt that the attorney hired by Presidio may be a "junior" type attorney and may not be used to the questions that he and his associates asked. Overall, the impression was that Amir needs to understand client needs better.

The purpose of the message is just to let you know how our clients are perceiving Presidio and to let you know what is being said in certain telephone conversations. I would like to learn from this and correct any mistakes that are happening now so they do not happen in the future (similar to how you handled the mentioning of banks to potential clients).

As an aside, Amir did suggest that someone from KPMG be on all telephone conversations when Presidio is speaking with a potential client. He mentioned this only in the context of I think this may be a good idea although I think it may be applicable nationwide and if we do this, I think Presidio must make themselves more available because it is difficult to schedule conference calls with them at times.

Please let me know if you have any questions.

Thanks,

Richard Bloom
Senior Manager
Personal Financial Planning

150 John F. Kennedy Parkway
Short Hills, New Jersey 07078
Phone: 973-912-6470
Fax: 973-912-6168
Email:rbloom@kpmg.com

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Permanent Subcommittee on Investigations
EXHIBIT #95mmm

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: Blips Opinion Letter
Sent: 2000-02-02 20:52:59.815
Date: 2000-02-02 20:53:00.002
X-Folder: Opinions - BLIPS

It may be more efficient to review the four templates before we begin inputting data. At the point of your review, we would have already started inputting data into 135 opinion letters and any changes to the letter would requires changes to possibly 135 letters. It would be a lot easier to correct four templates if you do not agree with the changes that we have made.

Angie

-----Original Message-----
From: Watson, Mark T
Sent: Wednesday, February 02, 2000 3:30 PM
To: Brennan, James
Cc: Napier, Angie; Eischeid, Jeffrey A; McGrath, Kevin J
Subject: RE: Blips Opinion Letter

Jim, I think using four different opinion letters is a good idea, and I will review them at the final review stage. As for the information, a list of the loan amounts, premium amounts, and what the investors received upon exiting is necessary information. In addition, however, I would like a checklist of some sort that verifies that all of the various documents associated with the transaction (e.g., credit agreement, LLC agreement, etc.) exist and were executed.

-----Original Message-----
From: Brennan, James
Sent: Tuesday, February 01, 2000 10:49 PM
To: Watson, Mark T
Cc: Napier, Angie; Eischeid, Jeffrey A; McGrath, Kevin J
Subject: RE: Blips Opinion Letter

Mark,
We can provide a list of the loan amounts, premium amounts and what the investors received upon exiting. Is this adequate?

FYI, we have created four different opinion letter templates depending on what the investor received upon liquidating or selling his partnership interest (i.e., (1) sale-cash only; (2) cash and financial instruments; (3) cash and foreign currency; (4) cash, financial instruments, and foreign currency). The opinion as it reads now makes numerous reference to all four scenarios irrespective of which exit strategy the investor actually employed. Therefore, to provide our clients with a more personalized opinion letter (e.g., not canned language), we decided to remove inappropriate references where applicable. We are working on these now and they will be reviewed by Kevin McGrath, Angie and me. We have made only minor changes to scenarios 2-4, however, scenario 1 requires the additional step of deleting all references to liquidation. Do you see any problems in doing this (e.g., context changes to 465) and do you want to approve these changes now, or will you do this at final review stage?

Jim

-----Original Message-----
From: Watson, Mark T
Sent: Tuesday, February 01, 2000 4:22 PM
To: Napier, Angie
Cc: Eischeid, Jeffrey A; Brennan, James; Ransome, Justin P
Subject: RE: Blips Opinion Letter

Angie, I agree, we do not need all of the paper work. However, I need something (other than the opinion letter itself) that I can use to verify that the facts stated in the opinion letter are correct.

-----Original Message-----
From: Napier, Angie
Sent: Tuesday, February 01, 2000 9:24 AM
To: Watson, Mark T
Cc: Eischeid, Jeffrey A; Brennan, James; Ransome, Justin P
Subject: RE: Blips Opinion Letter

Mark, It is more difficult than it sounds..... Each opinion letter has 2 binders which are both 2 inches think (a lot of paperwork) and there are 135 opinion letters.

If you do want all this paperwork sent to WNT, we need the files sent back to Atlanta and I need a copy of the finalized signed opinion letter from the engagement partner as well.

I'm not sure you will need all the paperwork to review the opinion letters. Each will have been through 2 levels of review before they are sent to you. One level of review with tick all the data for the opinion and the second will be a substantive review. Then it will be sent to WNT.

Angie

-----Original Message-----
From: Watson, Mark T
Sent: Tuesday, February 01, 2000 9:13 AM
To: Napier, Angie
Cc: Eischeid, Jeffrey A; Brennan, James; Ransome, Justin P
Subject: RE: Blips Opinion Letter

Angie, please send all BLIPS opinion letters and the accompanying documents to Justin Ransome. Justin will coordinate the WNT review. We (i.e., WNT) can then send the final opinion letters on to the appropriate partner/manager for their signature and delivery to the client.

-----Original Message-----
From: Napier, Angie
Sent: Monday, January 31, 2000 9:39 AM
To: Watson, Mark T
Cc: Eischeid, Jeffrey A; Brennan, James
Subject: RE: Blips Opinion Letter

Thanks for the finalized opinion letter.

Jeff would like all the BLIPS opinion letters sent to you for a final review before they are released. Before they are sent to you, they will have been through 2 levels of review. It will be at least a month before any opinions are ready to be sent out. We need to discuss the logistics of how you would like the opinion letters sent to you and how they will be sent to the appropriate KPMG partners for delivery to the client.

Angie

-----Original Message-----
From: Watson, Mark T
Sent: Friday, January 28, 2000 5:02 PM
To: Napier, Angie
Cc: Eischeid, Jeffrey A
Subject: FW: Blips Opinion Letter

Angie, just to clarify, the attached opinion letter is the final version. It is ready to go.

-----Original Message-----
From: Ransome, Justin P
Sent: Friday, January 28, 2000 4:57 PM
To: Napier, Angie
Cc: Watson, Mark T
Subject: Blips Opinion Letter

Amy,

Attached is the Blips Opinion letter as revised by Mark Watson and myself.

<< File: Blips_op.doc >>

new

From:	DeLap, Larry
Sent:	Tuesday, February 15, 2000 11:22 AM
To:	Bielstein, Mark M; Garguilo, Patrick T
Cc:	Russell, Kenneth D
Subject:	RE: BLIPS

Please note that the product was approved for marketing to a limited number of individual clients. Marketing of BLIPS ceased in the fall. There should not be anyone in the firm who is marketing it now. During the period it was being marketed, it should not have been marketed to any corporations (other than an S corporation).

Ken can contact me for any other information he desires.

Larry

-----Original Message-----

From: Bielstein, Mark M
Sent: Tuesday, February 15, 2000 1:54 PM
To: Garguilo, Patrick T; DeLap, Larry
Cc: Russell, Kenneth D
Subject: RE: BLIPS

Patrick - We did look at BLIPS. I will send you the information that I have on this product.

Mark Bielstein
(212) 909-5419

-----Original Message-----

From: Garguilo, Patrick T
Sent: Tuesday, February 15, 2000 1:30 PM
To: DeLap, Larry
Cc: Russell, Kenneth D; Bielstein, Mark M
Subject: BLIPS

I spoke with Ken Russell, one of the partners on Deutche Bank (DB), today. He inquired as to whether we, as a firm, have signed off on a tax product called BLIPS. Specifically, has DPP Tax signed off on the product and has DPP Assurance given an accounting write-up.

It appears that DB, KPMG and Precidio Advisors have developed the product and Ken is being told that KPMG signed off on all aspects of the product.

Please let me know if you are aware of this product and give me the name of the developers and any other information you may have so that I can relay this to the Ken.

If you are unaware of the product, please let me know.

Patrick T. Garguilo
kpmg
pgarguilo@kpmg.com
Phone (212) 909-5947
Fax (212) 909-5690

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95ooo

KPMG 0009270

From: McGrath, Kevin J
Sent: Wednesday, February 16, 2000 9:24 AM
To: Napier, Angie; Brennan, James; Mangien, Jeffrey
Subject: FW: BLIPS opinion letter

consider yourselves advised......

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Tuesday, February 15, 2000 7:17 PM
To: McGrath, Kevin J
Subject: FW: BLIPS opinion letter

Your thoughts? Please advise Angie, Jeff and Jim we may be making some changes....

-----Original Message-----
From: Monahan, Jean C
Sent: Tuesday, February 15, 2000 2:30 PM
To: Bickham, Randall S
Cc: Eischeid, Jeffrey A; Rivkin, David; Hol, Matthew C
Subject: BLIPS opinion letter

We just received the attached from Gibson Dunn & Crutcher regarding their comments on the BLIPS reps and opinion letter. We have not reviewed this yet but wanted to give you as much time as possible. We would appreciate you comments and guidance on where we have some flexibility and where we should push back on Gibson Dunn.

Also, to the extent that RJ Rubel's opinion is reliant on the reps and facts in our opinion letter, we will have to give Brown & Wood a heads up on these comments.

Thank you.

Jean

-----Original Message-----
From: Knutson, Scott M. [mailto:sknutson@gdclaw.com] <mailto:[mailto:sknutson@gdclaw.com]>
Sent: Friday, February 11, 2000 4:01 PM
To: 'drivkin@kpmg.com'
Cc: Tolles, Stephen L.; Schaller, Gordon A.
Subject: Plain Memo

10229892_4.DOC

<<10229892_4.DOC>>

David, attached are my comments regarding the draft BLIPS tax opinion to be rendered by KPMG. The memo does not discuss the Brown & Wood tax opinion because I do not have the most recent draft. While I have not seen the current Brown & Wood tax opinion, based on a review of the B&W opinion we received last October I think many of the comments set forth in the attached memorandum will equally apply to the B&W tax opinion. Also, I am sending this to you prior to comments from Steve Tolles (who is being copied on this e-mail), and Steve might have some additional comments when we have a conference call to discuss the tax opinions.

Please call when you are ready to discuss. Scott.

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95ppp

KPMG 0044453

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=43216
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=43216
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPs Memo -- Final, Final Version
Sent: 2000-03-03 14:28:32.984
Date: 2000-03-03 14:28:33.234
X-Folder: Opinions - BLIPS

Two things --- Mark Watson had Justin call me to tell me to put the Boss Notice in the BLIPS opinion (partly because Gibson & Dunn has requested us to do so). I told him I wouldn't do it w/o asking you first. He just wants a paragraph saying that we've already addressed all the authorities cited by the IRS so the Notice shouldn't apply. I don't think it will be too much a problem. Second, Justin wants me to forward him the Gibson & Dunn memo. I told him I didn't have it. Apparently Mark can't get it to Justin because he doesn't have access to a fax machine. Should I go ahead and forward it to him? (Jim or I or someone surely has it on the computer).

From rruble@brownwoodlaw.com
Received: from usnssexcl8.kweb.us.kpmg.com (localhost [127.0.0.1]) by
usnssexcl8.kweb.us.kpmg.com with SMTP (Microsoft Exchange Internet Mail Service
Version 5.5.2448.0)
id XB40PRB9; Wed, 17 Nov 1999 11:52:23 -0500
Received: from kpmg.com (unverified) by usnssexcl8.kweb.us.kpmg.com
(Content Technologies SMTPRS 2.0.15) with SMTP id
<B0004672442@usnssexcl8.kweb.us.kpmg.com> for <eischeid@kpmg.com>;
Wed, 17 Nov 1999 11:52:14 -0500
Received: from pa0016cl.kpmg.com by kpmg.com(Pro-8.9.2/Pro-8.9.2) with ESMTP id
LAA26144 for <Eischeid@kpmg.com>; Wed, 17 Nov 1999 11:52:13 -0500 (EST)
Received: by pa0016cl.kpmg.com; id LAA16746; Wed, 17 Nov 1999 11:51:56 -0500
(EST)
Received: from nyfwl.brownwoodlaw.com(208.140.184.10) by pa0016cl.kpmg.com via
smap (3.2)
id xma004377; Wed, 17 Nov 99 11:12:02 -0500
Received: by Nynotes3.Brownwoodlaw.com(Lotus SMTP MTA v1.2 (600.1 3-26-1998))
id 8525682C.005915C2 ; Wed, 17 Nov 1999 11:13:02 -0500
X-Lotus-FromDomain: BWLLP
From: "R. J. Ruble" <rruble@brownwoodlaw.com>
To: Eischeid@kpmg.com
Message-Id: <8525682C.00585372.00@Nynotes3.Brownwoodlaw.com>
Date: Wed, 17 Nov 1999 11:11:57 -0500
Subject: BLIPS opinions
X-Folder: Opinions - BLIPS

Sorry I missed you in NY yesterday. I gather things went well. When you get a chance I'd like to catch up.

Previously you and I had discussed Shannon comparing the B&W and KPMG opinions to make sure they were in sync. Did that happen? We also need to update the opinions for the True case the Saba case and the extenders bill.

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=21552
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=21552
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: Process for WNT final review - BLIPS
Sent: 2000-03-07 20:47:40.046
Date: 2000-03-07 20:52:14.859
X-Folder: Opinions - BLIPS

I am available this afternoon and on Friday anytime.

-----Original Message-----
From: Napier, Angie
Sent: Tuesday, March 07, 2000 9:59 AM
To: Eischeid, Jeffrey A; Watson, Mark T; McGrath, Kevin J; Bickham, Randall S; Ransome, Justin P
Cc: Brockway, David H
Subject: RE: Process for WNT final review - BLIPS

Mark,

When are you available? I will coordinate a conference call.

Angie

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Tuesday, March 07, 2000 9:53 AM
To: Watson, Mark T; Napier, Angie; McGrath, Kevin J; Bickham, Randall S; Ransome, Justin P
Cc: Brockway, David H
Subject: RE: Process for WNT final review - BLIPS

I suggest you schedule a conf. call ASAP to discuss the Gibson Dunn comments and determine what changes, if any, you would like to make to the opinion template. We are quickly running out of time to complete the opinions before the filing of the Investors' income tax returns. Angie, will you coordinate a call?

Jeff

-----Original Message-----
From: Watson, Mark T
Sent: Tuesday, March 07, 2000 8:41 AM
To: Napier, Angie; McGrath, Kevin J; Eischeid, Jeffrey A; Bickham, Randall S
Cc: Brockway, David H
Subject: FW: Process for WNT final review - BLIPS

Before we start sending opinion letters to anyone, or communicating "the process," I suggest that we determine whether we need to modify the opinion letter in response to the Gibson, Dunn memo. At the very least, we need to modify the opinion to address Notice 99-59, a task I have already asked Kevin McGrath to complete.

-----Original Message-----
From: Ransome, Justin P
Sent: Tuesday, March 07, 2000 7:56 AM
To: Watson, Mark T
Subject: FW: Process for WNT final review - BLIPS

Mark, would you like to comment?

-----Original Message-----
From: Napier, Angie
Sent: Monday, March 06, 2000 7:58 PM
To: Ransome, Justin P
Subject: FW: Process for WNT final review - BLIPS

I plan to send an e-mail to the IS team by Wed. regarding this process. Please let me know if you do not agree with the process.

Thanks,
Angie

-----Original Message-----
From: Napier, Angie
Sent: Tuesday, February 22, 2000 12:53 PM
To: Ransome, Justin P
Cc: Watson, Mark T; Eischeid, Jeffrey A; Brennan, James; Mangieri, Jeffrey
Subject: Process for WNT final review - BLIPS

Justin,

In the next few weeks we will begin sending the BLIPS opinion letters to you for a final review. As we complete our review in Atlanta for each opinion, we will e-mail the opinion letter to you. If you find any changes that need to be made, make these changes electronically to the opinion letter. After your review, e-mail the opinion letter back to me and the e-mail will serve as your sign-off on the opinion letter. Please do not forward the opinion letter directly to the KPMG IS partner because we must ensure that the client has signed off on the representations before the opinion letter is forwarded to the KPMG IS partner for delivery to the client.

Let me know if you have any suggestions for this process. Also, if you are missing any information to perform a final review, let me know as soon as possible.

Thanks for your assistance,

Angie Napier
Personal Financial Planning
kpmg LLP
Phone: (404) 614-8602
Fax: (404) 222-3435
tanapier@kpmg.com

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Our conclusions are limited to the conclusions specifically set forth herein and are based on the completeness and accuracy of the above-stated facts, assumptions and representations. If any of the foregoing facts, assumptions or representations is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. We are relying upon the relevant provisions of the Internal Revenue Code of 1986, as amended, the regulations thereunder, and the judicial and administrative interpretations thereof. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our conclusions. We will not update our advice for subsequent changes or modifications to the law and regulations or to the judicial and administrative interpretations thereof.

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From /O=KPMG/OU=US/CN=RECIPIENTS/CN=18774
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=18774
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: Redlined Brown & Wood opinion
Sent: 2000-03-07 19:46:51.066
Date: 2000-03-07 19:46:53.062
X-Folder: Opinions - BLIPS

Hi Jeff,

We were wondering if you have heard from RJ and whether we can get a redlined version (comparing their current opinion template with the original one back in September). Last time we communicated, it was determined that we should refrain from contacting RJ directly and to route all inquiries through you.

Thank you.

Jean Monahan
kpmg LLP
Phone: 619-525-3227
Fax: 619-525-3395

From: Watson, Mark T
Sent: Wednesday, March 08, 2000 2:03 PM
To: Napier, Angie; McGrath, Kevin J; Bickham, Randall S
Cc: Eischeid, Jeffrey A; Wiesner, Philip J
Subject: BLIPS Opinion Letters

With the exception of addressing Notice 99-59, we have decided to issue the BLIPS opinion letters *without* modification for the other issues raised in the Gibson, Dunn memo. (If absolutely necessary, I guess we could modify the opinion letters for the Gibson, Dunn clients that entered into a BLIPS transaction.) Thus, Kevin, please draft some language that addresses Notice 99-59 (a few sentences should do) and send it to me for mv review. Once the Notice 99-59 language is finalized and added to the opinion, we can proceed with completing the opinions.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-533-3092 (phone)
202-533-8451 (fax)

From: Napier, Angie
Sent: Sunday, February 20, 2000 4:52 PM
To: Eischeid, Jeffrey A
Cc: Brennan, James; Mangieri, Jeffrey
Subject: FW: Blips Opinion Letter - Process to release opinion

Jeff,

I am in the process of determining the logistics of releasing the opinion letters. The last step of review is to send the opinion letters to Mark for a final review. At this point in the process, the Investor representation letter will NOT have been sent to the Investors for signature. It may NOT be a good idea for Mark to release the opinion letters to the KPMG IS partner before the investors sign the representation letters.

In the past we have not released opinion letters until the IS partner faxed us the Investor rep letter. We may want Mark to e-mail the opinion letter back to us so we can create the Investor rep letter. Next we would e-mail the Investor rep letter to the KPMG IS partner for client signature. This will be additional work, but the importance of the Investor rep letter may require this additional step. In any event, we need to have a copy of the signed investor rep letters for the files.

What do you think?

-----Original Message-----
From: Napier, Angie
Sent: Monday, January 31, 2000 9:39 AM
To: Watson, Mark T
Cc: Eischeid, Jeffrey A; Brennan, James
Subject: RE: Blips Opinion Letter

Thanks for the finalized opinion letter.

Jeff would like all the BLIPS opinion letters sent to you for a final review before they are released. Before they are sent to you, they will have been through 2 levels of review. It will be at least a month before any opinions are ready to be sent out. We need to discuss the logistics of how you would like the opinion letters sent to you and how they will be sent to the appropriate KPMG partners for delivery to the client.

Angie

-----Original Message-----
From: Watson, Mark T
Sent: Friday, January 28, 2000 5:02 PM
To: Napier, Angie
Cc: Eischeid, Jeffrey A
Subject: FW: Blips Opinion Letter

Angie, just to clarify, the attached opinion letter is the final version. It is ready to go.

-----Original Message-----
From: Ransome, Justin P
Sent: Friday, January 28, 2000 4:57 PM
To: Napier, Angie
Cc: Watson, Mark T
Subject: Blips Opinion Letter

Amy,

Attached is the Blips Opinion letter as revised by Mark Watson and myself.

<< File: Blips_op.doc >>

Permanent Subcommittee on Investigations
EXHIBIT #95ttt

Unknown

From: DeLap, Larry
Sent: Friday, March 03, 2000 9:36 AM
To: Mccrimlisk, George H
Cc: O'brien, Timothy LA J; Ammerman, Douglas K; Ito, Dennis A; Eischeid, Jeffrey A
Subject: FW: TOP 3 OPPORTUNITIES

George -

BLIPS is no longer approved for marketing and should not be on attached listing.

Larry

-----Original Message-----
From: Benz, Kristin
Sent: Thursday, March 02, 2000 6:47 PM
To: Arkoosh, James M; Baumann, Dale R; Hardaway, Melissa D; Galgano, Joseph G; Bottini, Wayne F; Calderon, Nancy; Carbo, Deke G; Castanias, Teresa H; Cheng, Dora K; Chinn, Alan B; Critzer, Margaret L; DeLap, Larry; Dougherty, Timothy M; Edwards, Douglas K; Harrison, Mark E; Hoedt, Eric J; Hopkins, Tom; Ito, Dennis A; Ivey, Claire; Joseph, Gratian A; Kingston, Susan J; Kolbe, Del D; Krutilla, Gary M; MacDonald, John R; Misaka, Kirk D; Mulhern, James P; Potter, Donald L; Rotelli, Thomas M; Rutlen, Steven J; Segur, Daniel L; Shah, Nilesh K; Silicani, Edward F; Skrip, Martin J; Songey, Jim H; Thomas, Russell C; Watson, Don R; Wise, Richard; Wong, Janet S (US/Silicon Valley); Yano, Michiko
Cc: Midlock, Eugene J
Subject: TOP 3 OPPORTUNITIES

Top3Targets3-2-00.xls

As we discussed at our meeting this morning, please find attached an updated list of the Top 3 Opportunities for you to review. It's listed by office, by partner last name.

Please let me know if you have any corrections, additions, or deletions.

Thanks,

Kristin

Unknown

From:	Napier, Angie
Sent:	Monday, March 13, 2000 4:21 PM
To:	Eischeid, Jeffrey A
Cc:	Brennan, James; Mangieri, Jeffrey
Subject:	BLIPS basis template

Jeff,

Will you review & sign-off on the attached BLIPS basis template? I would like to distribute this template to the IS team so they can finalize their basis calculations. Kerry has already started sending out K-1s, so team members will need this template soon.

Thanks,

REVISED
ASISTEMPLATE-BLIPS.XL...

Angie Napier
Personal Financial Planning
kpmg **LLP**
Phone: (404) 614-8602
Fax: (404) 222-3435
tanapier@kpmg.com

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REDACTED

Inputs for Basis Calculation:

Loan	$50,000,000
Premium	$30,000,000
Cash Contribution (ONLY INPUT IF NOT 7% OF PREMIUM)	$2,100,000
Interest Income treated as additional cash contribution (From Bank 1099)	$95,625
Value of Class A interest (Should equal total distributions to investor)	$634,119

Ordinary loss calculation: (From K-1)	
Income (loss) from trading Line- 7 Detail	($191,000)
Interest income	$696,672
STCL from Swaption	($26,622)
Interest expense	($905,178)
Bank Fee- Line 11 Detail	($73,951)
Guaranteed Payment to Class B Partner- Line 11 Detail	($25,000)
Loss from Investment Fund	($525,079)

Breakage Fees -capitalized	$165,000
Management Fees - capitalized (ONLY INPUT IF NOT 275 BP OF PREMIUM)	$825,000
Cash Distributed	$400,000
KPMG fees (ONLY INPUT IF NOT 125 BASIS PTS. OF PREMIUM)	$375,000
Shares of Stock Distributed	3,750.00
FMV Stock Distributed	60,937
Proceeds of Stock Sold in 1999	80,000
Number of Shares of Stock Sold in 1999	3,750
Euros Distributed	173,182.00
FMV of Euros Distributed	173,182
Proceeds of Euros Sold in 1999	180,000
Number of Euros Sold in 1999	173,182.00

Check Figure $31,910,625.00

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REDACTED

Equity Contribution:	
Loan	50,000,000
Premium	30,000,000
Cash Contribution	2,100,000
Interest Income treated as additional cash contribution (Fi	95,625
Loss from Investment Fund	525,079
Less Cash Distributed	(400,000)
Plus KPMG fees	375,000
Less reduction in liability	(50,000,000)
Capital Loss or Basis of Property Distributed	32,695,704

Allocation of Basis to Property Distributed:

Property	FMV	Percentage	Basis of Property Distributed	Allocated Basis
FMV of stock on date of withdrawal	60,937	100.00%	$32,695,704.00	$32,695,704.00
FMV of foreign currency on date of withdrawal	0	0.00%	$32,695,704.00	$0.00
Total FMV on date of withdrawal	60,937	100.00%		$32,695,704.00

Stock:		
Proceeds of shares sold		$80,000.00
Tax basis of shares sold:		
- Total basis in stock	32,695,704	
- Divided by total number of shares	3,750	
- Per shares basis in stock	8,719	
- Multiplied by the number of shares sold	3,750	
Tax basis of shares sold		$32,695,704.00
1999 Capital loss on sale of stock		($32,615,704.00)

Foreign Currency:		
Proceeds of foreign currency conversion		$180,000.00
Tax basis of foreign currency:		
- Total basis in foreign currency	0	
- Divided by total number of EUR	173,182	
- Basis per EUR	0	
- Multiplied by the number of EURs sold	173,182	
Tax Basis in foreign currency converted		$0.00
1999 Ordinary loss on conversion of foreign currency		$180,000.00

Summary:	
Operating Loss	525,079
Capital Loss	(32,615,704)
Ordinary Loss	180,000
Total Loss	(31,910,625)
Check Figure	(31,910,625)
	In Balance

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Financial Engineering (FNE) **Draft: A. McCarthy**
"Presidio" Structure **Cash Management**
Outline of Standard Procedures - Loans, DDAs, F/X, Swaps **March 15, 2000**

1. Customer profiles established pursuant to receipt of tax identification forms and documents required for KYC.
2. USD Demand Deposit and Euro accounts opened as per instruction by Financial Engineering.
3. Equity contributions received via wire transfer to customer DDA ("Stage 1" or "Borrower" account).
4. LIPS tickets passed by FNE to Loans Servicing for loan funding. Offset accounts on LIPS tickets to reflect Borrower DDA number.
5. Loan Servicing credit proceeds of Loan Funding to Borrower DDA - does not pass through Loan Clearing Account.
6. Money Market invests loan proceeds and equity contribution same day at rate agreed upon with FNE.
7. Deposit remains invested for period pre-defined by FNE. Deposit to mature in agreement with the assumption of the loan by "Stage 2" or Strategic Investment Fund, "SIF".
8. Deposit matured and credited into Borrower/Stage 1 DDA on loan repayment date.
9. Loan Servicing **repays original loan,** (although it is an assignment of the original loan, Midas will not allow simple transfer of loan but instead an actual "new" booking), by debiting Borrower/Stage 1 DDA with **back-value to original funding date.**
10. Loan servicing **credits new loan proceeds** to SIF/Stage 2 DDA (assuming the loan of the Borrower) **with back-value of the original loan** booked to Borrower/Stage 1.
11. Because only loan was re-booked, the **equity contribution plus any interest** earned from original deposit needs **to be transferred to SIF/Stage 2 DDA** with value of that day. NO back-value required for this portion.

Permanent Subcommittee on Investigations
EXHIBIT #95www

HVCD00003

Unknown

From: Baumann, Dale R
Sent: Thursday, March 16, 2000 5:30 PM
To: Eischeid, Jeffrey A; Bickham, Randall S
Subject: Insurance Policy for Strategies

At one time someone mentioned an insurance company that was issuing policies related to strategies that came with a big 5 or law firm MLN opinion letter. Do either of you know who that is and if they are still doing it? Are they insuring just against the penalties. I have a client (grandfathered blips deal) who asked if insurance was available with respect to strategies.

Dale Baumann
kpmg Silicon Valley Office - Mountain View

(650) 404-5307
(650) 960-0952
dbaumann@kpmg.com

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Our advice in this email message is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the stated facts, assumptions and/or representations included. In rendering our advice, we may consider tax authorities that are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our advice. We will not update our advice for subsequent changes or modifications to the law and regulations, or to the judicial and administrative interpretations thereof.

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Unknown

From: Bloom, Richard J
Sent: Sunday, March 19, 2000 5:53 AM
To: Eischeid, Jeffrey A
Subject: Voice Mail

Jeff,

As indicated in my voice mail last week, I was wondering if it is possible to extend the first phase of the investment strategy in BLIPS from 60 days to a longer period (say 120 days). This may give the client a better to chance to make an economic profit in the transaction since they will be in the investment program longer. We have the time now for clients that enter the transaction now (as opposed to last year when most clients entered in September and October). Any thoughts?

Richard Bloom
Senior Manager
Personal Financial Planning

150 John F. Kennedy Parkway
Short Hills, New Jersey 07078
Phone: 973-912-6470
Fax: 973-912-6168
Email:rbloom@kpmg.com

Permanent Subcommittee on Investigations
EXHIBIT #95yyy

Unknown

From: Baumann, Dale R
Sent: Monday, March 27, 2000 11:28 AM
To: Eischeid, Jeffrey A
Cc: Ito, Dennis A
Subject: RE: Grandfathered BLIPS

Waiting to see. The wife is out of town until later this week and we are going to re-visit with her as soon as she gets back.

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Monday, March 27, 2000 11:18 AM
To: Baumann, Dale R
Subject: RE: Grandfathered BLIPS

How did it go on Friday?

-----Original Message-----
From: Baumann, Dale R
Sent: Friday, March 17, 2000 11:20 AM
To: Eischeid, Jeffrey A
Cc: Ito, Dennis A; Ammerman, Douglas K
Subject: Grandfathered BLIPS

Another heads up, we have another Grandfathered BLIPS deal that would probably be in the $100 to $120 million range. They finally sold their stock in early 2000 and are now very interested in entering into a strategy to mitigate that gain. Dennis and I have scheduled a follow-up visit for next Friday and expect to have Amir from Presidio there also. Please let me know if the slots fill up prior to that time so we don't make the presentation again if there isn't even a chance of a slot being open.

We will obviously manage their expectations that they may not get one of the remaining slots.

Dale Baumann
kpmg Silicon Valley Office - Mountain View

(650) 404-5307
(650) 960-0952
dbaumann@kpmg.com

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Permanent Subcommittee on Investigations
EXHIBIT #95zzz

Day	Date	Event for HVB Description	HVB Internal Group	Amount
		0 0		575,555.58
-8	16-May-00	Accounts open - Borrower LLC HVB Customer Number, Borrwer USD DDA, EUR DDA	FNE, Amy	
		Accounts open - Fund LLC Fund USD DDA, EUR DDA, MIDAS/WELIS/INTAS	FNE, Amy, Shakil	
-8	16-May-00	Start receiving Investors cash equity in Borrower USD DDA	FNE, Amy	
0	24-May-00	Loan Premium & Principal funded to Borrower USD DDA using dummy loan interest rate (17%) + Cash Equity	FNE, Dawn	 - -
0	24-May-00	Borrwers deposit loan & cash equity for 9 days	Matt Dunn	-
2	26-May-00	Investor sends wire transfer instruction to transfer from Borrwer DDA to Fund DDA value 6/2/2000	FNE, Amy	
9	2-Jun-00	Deposit Principal		-
9	2-Jun-00	Interest on 9 day deposit @ 6.6075%	Matt Dunn	-
9	2-Jun-00	Presidio Resource contribution	Matt Dunn	-
9	2-Jun-00	Presidio Growth contribution	Matt Dunn	-
9	2-Jun-00	Custodian fee payable to HVB	FNE, Amy	-
		Interest Rate Cap Premium		(40,000.00)
		Total Cash in USD		(40,000.00)
9	2-Jun-00	Set Swap Rate and Loan Interest retroactively to 5/24/2000	Mike Blakely	
9	2-Jun-00	Exchange USD Amount to EUR Amount	Matt Dunn	USD 0
9	2-Jun-00	Deposit EUR for 1 mth	Matt Dunn	
9	2-Jun-00	Client buys USD / sell EUR 1 mth forward	Matt Dunn	
9	2-Jun-00	Deposit residual USD Amount till 6/24	Matt Dunn	(40,000)
9	2-Jun-00	Client shorts HKD 2 mth forward	Matt Dunn	USD 70,000,000
9	2-Jun-00	Client shorts ARS 2 mth forward	Matt Dunn	USD 35,000,000

Redacted by Permanent Subcommittee on Investigations

Event for HVB Description	Amount
Accounts open - Borrower LLC HVB Customer Number, Borrwer USD DDA, EUR DDA	
Accounts open - Fund LLC Fund USD DDA, EUR DDA, MIDAS/WELIS/INTAS	
Start receiving Investors cash equity in Borrower USD DDA	
Loan Premium & Principal funded to Borrower USD DDA using dummy loan interest rate (17%) + Cash Equity	 98,600,000 2,590,000
Borrwers deposit loan & cash equity for 9 days	101,190,000
Investor sends wire transfer instruction to transfer from Borrwer DDA to Fund DDA value 6/2/2000	
Deposit Principal	101,190,000.00
Interest on 9 day deposit @ 6.6075%	160,828.86
Presidio Resource contribution	259,000.00
Presidio Growth contribution	28,774.90
Custodian fee payable to HVB	(92,500.00)
Interest Rate Cap Premium	(74,000.00)
Total Cash in USD	101,472,103.76
Set Swap Rate and Loan Interest retroactively to 5/24/2000	
Exchange USD Amount to EUR Amount	USD 98,600,000
Deposit EUR for 1 mth	
Client buys USD / sell EUR 1 mth forward	
Deposit residual USD Amount till 6/24	2,872,104
Client shorts HKD 2 mth forward	
Client shorts ARS 2 mth forward	

Permanent Subcommittee on Investigations
EXHIBIT #95A

HVB 002213

unknown

From: DeLap, Larry
Sent: Wednesday, May 31, 2000 2:28 PM
To: Norton, Sandra H
Cc: Eischeid, Jeffrey A
Subject: RE: "BLIPS"? Help

Sandy -

BLIPS is no longer an approved offering. There were a limited number of "grandfathered" clients to whom BLIPS had been offered prior to its discontinuance as a solution, but who had decided to wait until 2000 to enter into the transactions. I would have thought that all the grandfathered clients would have entered into the engagement letters well before now, but perhaps this is one of the duly authorized grandfathers. Jeff Eischeid, Atlanta, is responsible for maintaining the list of grandfathered BLIPS clients. Please verify with Jeff that this person is on the list. If so, all the steps in my May 24, 1999 message still apply.

Larry

-----Original Message-----
From: Norton, Sandra H
Sent: Wednesday, May 31, 2000 2:21 PM
To: DeLap, Larry
Subject: "BLIPS"? Help

Larry,
I just received a draft engagement letter re: provision of consulting services for Client with respect to participation in an investment program involving investments in foreign currency positions, where client will engage Presidio Growth LLC re: investment advisory services and trading strategies.

KPMG plans to meet with client to discuss Federal income tax implications and provide an opinion letter that address federal income tax consequences of the deal.

I'm being asked to approve certain changes to indemnification (we will not be indemnified for claims made by governmental agencies) and limitation of liability (increase limit to amount of fees - 250K in this instance as opposed to 50K originally proposed).

Can you please tell me if this is still an approved engagement? The last email I was able to find from you on BLIPS was dated 5/24/99 where you outlined all the steps that must be performed before going forward with the engagement. If this email is still applicable, then I need to review the steps with the tax partner to make sure that everything has been done.

Thanks for your help.

Regards,
Sandy
Sandra H. Norton
KPMG LLP

Philadelphia
215-299-4778 (telephone)
215-299-1625 (fax)
snorton@kpmg.com

Presidio Forward FX trade ticket

LLC account	Full position	HVB transaction #	
trade date	7/27/00	settlement date	# 10/31/00
amount and currency delivered by LLC			102,285,600 ARS
amount and currency delivered by HVB			$ 102,000,000 USD
forward FX rate	1.0028		
HVB Sales	M. DUNN	Presidio trader	E. LONG

Notes: **Full position** **buys USD forward vs ARS**

Business day convention: following
Business day calendar: **New York and Buenos Aires**

ARS spot forward points

LLC NAME	ARS To Deliver	USD to Receive	MTM By Counterparty
Redacted by Permanent Subcommittee on Investigations	30,836,100	30,750,000	#N/A
	22,563,000	22,500,000	#N/A
	26,323,500	26,250,000	#N/A
	22,563,000	22,500,000	#N/A
Total	102,285,600	102,000,000	#N/A

1/15/03
Days (805)

Revaluation

Days	Points
8	8.00
32	32.50
61	85.00
92	137.50
182	315.00
SPOT	0.9998
Points	#N/A
Forward Rate	#N/A
MTM	#N/A
P/L	**#N/A**

HVB 002446

Permanent Subcommittee on Investigations
EXHIBIT #95C

TRANCHE 4 - 00 RETURNS. INVESTMENT COMPLETED. NO OPINION

Memorandum of Oral Advice

October __, 2000

On _______, my partner, _____________, and I discussed Notice 2000-44 with ___________. We provided him with a copy of the Notice and informed him that we wish to notify him about it because the Notice is a rule that has the weight of a published revenue ruling with respect to penalties. We also told him that the Notice does not constitute new substantive tax law but does reflect the opinion of the IRS. We also advised him that the Notice is a clear indication of the position that Treasury and IRS will assert in audits and court cases with respect to certain loss transactions and that the structure of the BLIPS transaction was substantially similar to the structure of one of the transactions described in the Notice.

We discussed the current legislative and judicial environment regarding "tax shelters" and suggested that he consider whether he should claim the loss on his 2000 income tax return in view of the publication of the Notice. We urged him to obtain other professional advice about what to do in his own individual best interests.

We discussed a number of relevant factors, including: the increased likelihood of an audit examination (including the increased possibility of KPMG being required to provide IRS/Treasury with the names of its clients engaged in similar transactions); the potential for penalties; the client's ability to rely on the KPMG and Brown & Wood opinions; and an apparent diminished probability of favorably settling an examination at the administrative level.

We also discussed the option of filing the return claiming the loss, in which case we recommended that the client consider including in the return a Form 8275 disclosing the BLIPS transaction. Additional disclosure may be beneficial in qualifying for the "good faith" exception to the potential penalties. We reiterated that the client should discuss disclosure and the reporting position with another tax advisor; that the decision to disclose was strictly the client's; and that we would prepare the return as he directed.

Our client had the following comments and questions:

____

____.

[Client decided to file and claim the deduction without seeking other advice. Client was again advised to engage another advisor to provide him with advice concerning the matter, including whether client could continue to rely on the tax opinions provided by KPMG and Brown & Wood to avoid penalties.]

[Client decided to disclose/not disclose.]

[The client asked us to pay for another advisor, but we declined to do so.]

<u>TRANCHE 2</u> - 99 RETURN NOT YET FILED

Memorandum of Oral Advice

October __, 2000

On _______, my partner, ______________, and I discussed Notice 2000-44 with ____________. We provided him with a copy of the Notice and informed him that we wish to notify him about it because the Notice is a rule that has the weight of a published revenue ruling with respect to penalties. We also told him that the Notice does not constitute new substantive tax law but does reflect the opinion of the IRS. We also advised him that the Notice is a clear indication of the position that Treasury and IRS will assert in audits and court cases with respect to certain loss transactions and that the structure of the BLIPS transaction was substantially similar to the structure of one of the transactions described in the Notice.

We discussed the current legislative and judicial environment regarding "tax shelters" and suggested that he consider whether he should claim the loss on his 1999 income tax return in view of the publication of the Notice. We urged him to obtain other professional advice about what to do in his own individual best interests.

We discussed a number of relevant factors, including: the increased likelihood of an audit examination (including the increased possibility of KPMG being required to provide IRS/Treasury with the names of its clients engaged in similar transactions); the potential for penalties; the client's ability to rely on the KPMG and Brown & Wood opinions; and an apparent diminished probability of favorably settling an examination at the administrative level.

We also discussed the option of filing the return claiming the loss, in which case we recommended that the client consider including in the return a Form 8275 disclosing the BLIPS transaction. Additional disclosure may be beneficial in qualifying for the "good faith" exception to the potential penalties. We reiterated that the client should discuss disclosure and the reporting position with another tax advisor; that the decision to disclose was strictly the client's; and that we would prepare the return as he directed.

Our client had the following comments and questions:

____

____.

[Client decided to file and claim the deduction without seeking other advice. Client was again advised to engage an independent, professional tax advisor to provide him with advice concerning the matter, including whether client could continue to rely on the tax opinions provided by KPMG and Brown & Wood to avoid penalties.]

[Client decided to disclose/not disclose

[The client asked us to pay for another advisor, but we declined to do so.]

<u>TRANCHE 1</u> - 99 RETURN FILED

Memorandum of Oral Advice

October__, 2000

On ______, my partner, ______________, and I discussed Notice 2000-44 with ____________. We provided him with a copy of the Notice and informed him that we wish to notify him about it. We also told him that the Notice does not constitute new substantive tax law but does reflect the opinion of the IRS. We also advised him that the Notice is a clear indication of the position that Treasury and IRS will assert in audits and court cases with respect to certain loss transactions and that the structure of the BLIPS transaction was substantially similar to the structure of one of the transactions described in the Notice.

We discussed the current legislative and judicial environment regarding "tax shelters" and suggested that he review his decision to claim the losses on his 1999 income tax return in view of the publication of the Notice. We urged him to obtain other professional advice about what to do in his own individual best interests.

We discussed a number of relevant factors, including: the increased likelihood of an audit examination (including the increased possibility of KPMG being required to provide IRS/Treasury with the names of its clients engaged in similar transactions); the potential for penalties; the client's ability to rely on the KPMG and Brown & Wood opinions; and an apparent diminished probability of favorably settling an examination at the administrative level.

In addition to the option of amending the return to eliminate the loss deductions, we also discussed the opportunity provided by the Notice to amend the return to provide additional disclosure about the BLIPS transaction, whether or not the client changed his reporting position with respect to the losses. Additional disclosure may be beneficial in qualifying for the "good faith" exception to the potential penalties. We reiterated that the client should discuss disclosure and the reporting position with another tax advisor; that the decision to disclose was strictly the client's; and that we would prepare, or not prepare, any amended return as he directed.

Our client had the following comments and questions:

____

____.

The client ultimately decided to [amend/not amend] the individual income tax returns to remove the loss deductions. [Where client decides not to amend to remove the loss deductions and did not decide to consult another advisor: Client was again advised to engage another advisor to provide him with advice concerning the matter, including whether client could continue to rely on the tax opinions provided by KPMG and Brown & Wood to avoid penalties.]

The client ultimately decided to [amend/not amend] the individual income tax returns to disclose.

[The client asked us to pay for another advisor, but we declined to do so.]

FRM 13
08.06.00
Thorpe

Stellungnahme DRAFT

Presidio - Plafond
Increase from USD 1500mio to USD 2250mio.

Comments

- No change in the transaction structure.
- Good experience with previous transactions.
- Investors have, so far, chosen to liquidate before the second (180 day) phase. ie after 60 days.
- Increased staffing providing a dedicated person to administer the transactions.
- 5 transaction administrative limit to be controlled by FRM 4.

Recommendation

FRM 13 recommends the increase in the Plafond based on successful execution of previous transactions, low credit risk and excellent profitability. Our recommendation is subject to the FRM 13 Stellungnahme of [ ] and a satisfactory review by FRM 4 of operational procedures and performance.

Unknown

From:	Napier, Angie
Sent:	Thursday, October 12, 2000 12:20 PM
To:	Eischeid, Jeffrey A
Subject:	Finishing BLIPS 2000

I spoke to Jeff Mangieri regarding the status of BLIPS 2000. He said that there are 12 BLIPS 2000 opinion letters which have not been sent to WNT. These are BLIPS which ended post 8/28/2000. I told Jeff that I would appreciate it if he would finish the opinions and send them to WNT before he leaves. He stated that he would discuss with you. Once you have a chance to discuss this, please let me know what his role will be in finishing this project.

Thanks!!

Angie Napier
Personal Financial Planning
kpmg **LLP**
Phone: **(404) 614-8602**
Fax: **(404) 222-3435**
tanapier@kpmg.com

Permanent Subcommittee on Investigations
EXHIBIT #95F

Unknown

From: Bickham, Randall S
Sent: Wednesday, December 06, 2000 9:12 AM
To: Eischeid, Jeffrey A
Subject: RE: Salina Partnership case

Jeff-

The critical issue in BLIPS was when the liability arose and the amount. Both issues are impacted by the notion of contingency which was never mentioned in Salina, whereas the full Tax Court held on the contingency issue in LaRue and Long.

Randy

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Wednesday, December 06, 2000 5:02 AM
To: Bickham, Randall S
Subject: FW: Salina Partnership case

fyi

-----Original Message-----
From: DePew, Joseph H
Sent: Tuesday, December 05, 2000 7:32 PM
To: Eischeid, Jeffrey A
Subject: Salina Partnership case

Jeff,

After reading the *Salina Partnership v. Commissioner*, T.C. Memo 2000-352 and the BLIPS standard opinion, I think that BLIPS may have problems in addition to notice 2000-44.

On pages 12 (summary), 22-27 (analysis) of the BLIPS opinion we find that it is more likely than not that the (dollar amount of) loan premium amount will not constitute a liability of investor or Partnership for purposes of Code section 752. Both the Court in *Salina* (p. 33-51) and the BLIPS opinion letter (p. 22-27) cites and discuss Rev Rul 88-77, Rev Rul 73-301, Rev Rul 95-26, Temp Reg section 1.752-1T, *Helmer v. Commissioner*, and *Deputy v du Pont*. The Court, in Salina, however reasons to a very different result than the BLIPS opinion letter. The Court finds that a short sale creates a partnership liability under IRC section 752. The BLIPS opinion finds that the loan premium does not constitute a liability under IRC section 752. The Courts analysis of the authorities is very different than that of the BLIPS. BLIPS analysis is however, in my opinion similar to that of the petitioner in *Salina*. The Court in Salina stated that the petitioner's interpretation of *Deputy v. du Pont* overstated the holding in that case, I believe that the BLIPS interpretation is similar to the Petitioners. Anyway, my reading of *Salina* would indicate that the section of the BLIPS opinion on IRC 752 now has hazards, and thus under *Salina* the loan premium amount would constitute a liability under IRC 752. I believe, but am not sure that it an essential piece of what makes BLIPS work in theory. Have you looked at this?

Thanks,

Joe

Joseph DePew
Tax Controversy Services
jdepew@kpmg.com
tel 404-614-4757
fax 404-222-3451
kpmg

assumptions and representations. If any of the foregoing facts, assumptions or representations is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. We are relying upon the relevant provisions of the Internal Revenue Code of 1986, as amended, the regulations thereunder, and the judicial and administrative interpretations thereof. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our conclusions. We will not update our advice for subsequent changes or modifications to the law and regulations or to the judicial and administrative interpretations thereof.

new

From:	Crean, Leonora L
Sent:	Monday, April 30, 2001 10:40 AM
To:	Newsham, Elizabeth (London); Urwin, Tony
Cc:	Robbins, James M; Shifke, Mark; Schrier, John V; Tuckner, Todd; DeLap, Larry
Subject:	RE: Your Fax re: BLIPS

Elizabeth/Tony--

We are currently not marketing or developing and do not intend to market or develop transaction structures substantially similar to BLIPS. However, we would be pleased to know more about your client and will certainly keep them in mind with respect to other transactions. Please feel free to give me a ring if you wish to discuss further.

Regards.

Lee

-----Original Message-----

From:	Schrier, John V
Sent:	Sunday, April 29, 2001 10:17 PM
To:	Tuckner, Todd; Newsham, Elizabeth (London); Urwin, Tony
Cc:	Crean, Leonora L; Robbins, James M; Shifke, Mark
Subject:	RE: Your Fax re: BLIPS

BLIPS was (arguably) shut down by IRS Notice 2000-44, in which it was described. It is my understanding that there are some things in the hopper, and in fact I've been directly involved with one, but they are different in many regards. I would be happy to elaborate given additional facts pertaining to the original inquiry.

-----Original Message-----

From:	Tuckner, Todd
Sent:	Sunday, April 29, 2001 9:35 AM
To:	Newsham, Elizabeth (London); Urwin, Tony
Cc:	Crean, Leonora L; Robbins, James M; Shifke, Mark; Schrier, John V
Subject:	Your Fax re: BLIPS

Elizabeth/Tony: I received your fax late last week re: the Bond Linked Issue Premium Structure, also directed to Lee and Jamie. My knowledge on the status of this solution is very peripheral - perhaps Lee has more direct knowledge or is closer to the folks in Washington National Tax who do. I have a fair recollection, in concurrence with your understanding, of something coming from the IRS National Office that effectively shut down the structure about a year ago. I don't recall specifically what, nor am I aware of any next generation structure. But given the revenue generated by BLIPS last year for the US firm, it wouldn't surprise me if something were in the hopper that purported to achieve a reasonably similar result. Perhaps Jamie or Lee can shed more light. I also copied Mark Shifke and John Schrier, should they have any insights to share. Kind regards. Todd

Permanent Subcommittee on Investigations
EXHIBIT #95H

Unknown

From:	Eischeid, Jeffrey A
Sent:	Monday, January 14, 2002 8:32 AM
To:	Henderson, Tracie K
Cc:	McGrath, Kevin
Subject:	RE:

I trust Amir but I am very uncomfortable with the idea that Presidio could be putting client assets at risk - particularly if the client is not completely informed of the risk.

-----Original Message-----
From: Henderson, Tracie K
Sent: Friday, January 11, 2002 7:58 PM
To: Eischeid, Jeffrey A
Cc: McGrath, Kevin
Subject: RE:

Amir tells me this is "delta hedging" and "dynamic hedging" (i.e, he is watching it everyday). If he doesn't do anything else, and $/yen goes to $150, let's say, the client would lose more than he invested. Amir assures me this won't happen. He said, if it would help me sleep at night, he could buy puts/calls at 140 (or whatever). I told him to use his judgment.

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Friday, January 11, 2002 7:37 PM
To: Henderson, Tracie K
Subject: RE:

REDACTED

Ouch. I guess the European maturity date is why DB calculated such a steep discount to current FMV. Who is at risk on the short? I trust they can't lose more than they invested.

-----Original Message-----
From: Henderson, Tracie K
Sent: Friday, January 11, 2002 6:28 PM
To: Eischeid, Jeffrey A
Subject: FW:

FYI....This is correct, but it does not adequately show the downside: If $/yen closes below 131.5 in March, there is no $2,250,000. Or, if $/yen climbs significantly, into the 140's, the liability on the naked short position can actually exceed 2,250,000.

-----Original Message-----
From: John Larson [mailto:jlarson@presidioadv.com]
Sent: Friday, January 11, 2002 11:17 AM
To: lrothenberg@loeb.com
Cc: bwexler@loeb.com
Subject: Re:

Lloyd -
Sorry for the delay. I had to talk to our head trader who was travelling. Here are some of the high points to date:

* The dollar/yen options are binary - european style. That is they payoff either at 4:1 or zero depending on whether the yen is at 131.5 (this number is approximate since I am writing this from my notes) or more at the maturity date in March. In dollars this means that the aggregate payment for the options of approx. $560,000 could be worth approx. $2,250,000.

Proprietary Material
Confidentiality Requested

KPMG 0033418

Permanent Subcommittee on Investigations
EXHIBIT #95I

* As of the first of this year, the yen was trading at around 132.0, above the strike price.
*Early termination of the positions was discussed with the FX trading desk at Deutsche Bank, however, the approx. $750,000 offered by the bank was too low to accomplish our goal of a pre-tax cash-on-cash profit.
* Since we could not cash out at an acceptable price, we have been dynamically hedging the positions to limit downside risk and increase the probability of getting a good price when the options mature, or at least get closer to maturity.
* The first hedging trade was executed Wednesday. Our trader sold (shorted) a dollar call-yen put with a strike price of 131.5. LLCs received approx. $590,000 for writing these options. Entering into these options insures that if the yen trades below 131.5 in March, will keep the $590,000 even the binary option would be worthless. It also insures that if $/yen closes between 131.5 and approx. 134.0 in March, they will earn between $2,250,000 and $2,840,000 (2,250,000 + 590,000).
* Since there is also a risk that $/yen could close above 134.0 in March, you should anticipate further trades like the one described above as we add to the hedging to further increase the likelihood of a significant profit.

John L.

>>> <lrothenberg@loeb.com> 01/10/02 08:50PM >>>
John:

Please let me know where we stand on the summary. are pressing to see the analysis.

Lloyd

Lloyd L. Rothenberg
Loeb & Loeb LLP
345 Park Avenue
New York, NY 10154-0037
Direct Dial: 212-407-4937
Facsimile: 212-407-4990
Email: lrothenberg@loeb.com

REDACTED

ANNOUNCEMENT 2002-2 CLIENT LETTER (VERSION #2 — BLIPS (to extent not under exam and issue raised))
DRAFT: Friday, May 02, 2003

Dear Client:

We are writing to advise you of an IRS Announcement aimed at encouraging taxpayers to disclose tax shelters and other questionable items reported on their tax returns. The IRS is offering a limited window of opportunity during which taxpayers may voluntarily disclose certain transactions to the IRS and avoid the application of portions of the section 6662 accuracy-related penalty. If you qualify under the Announcement for the penalty waiver, we believe that a prompt disclosure may provide you with significant protection against certain penalties and that, absent special circumstances, you should make a prompt disclosure in accordance with the Announcement.

Announcement 2002-2, along with News Release IR-2001-121, allows taxpayers the opportunity to avoid liability for the following section 6662 penalties: (1) negligence or disregard of rules or regulations; (2) substantial understatement of income tax; (3) substantial or gross valuation misstatement (except for any portion of an underpayment attributable to a net section 482 transfer price adjustment, unless the documentation rules are satisfied); and (4) substantial overstatement of pension liabilities.

Disclosure under this initiative does not affect whether the IRS will impose any civil penalties (other than the components of the accuracy-related penalty listed above) or pursue any potential criminal violations. Importantly, Announcement 2002-2 states that a taxpayer's disclosure of an item creates no inference that the taxpayer's tax treatment of the item was improper or that the accuracy-related penalty would apply if there were an underpayment of tax. The Announcement also notes that taxpayers that do not disclose under this initiative are not prevented from demonstrating that they qualify for the reasonable cause exception to the accuracy-related penalty.

The disclosure initiative applies to all items except items resulting from transactions that involve or contain:

- A step that did not occur, but for which the taxpayer claimed a tax benefit
- The fraudulent concealment of the amount or source of any item of gross income
- The concealment of the taxpayer's interest in, or signature or other authority over, a financial account in a foreign country
- The concealment of a distribution from, a transfer of assets to, or that the taxpayer was a grantor of, a foreign trust or
- The treatment of personal, household, or living expenses as deductible business expenses.

You have until the earlier of (1) April 23, 2002, or (2) the date the item or another item arising from the same transaction is raised during an examination to make the disclosure required by the Announcement. The Announcement explains that an item is an issue raised during an examination "if the person examining the return (the examiner) communicates to the taxpayer knowledge about the specific item ***or*** on or before December 21, 2001, the examiner has made a request to the taxpayer for information, and the taxpayer could not make a complete response to that request without giving the examiner knowledge of the specific item" (emphasis added). If you submit the disclosure pursuant to Announcement 2002-2 and you are not under examination, the disclosure must be sent to the Office of Tax Shelter Analysis (OTSA); otherwise the disclosure should be given to the examiner

Under section 6662(a), a 20 percent penalty may be imposed against a taxpayer for an underpayment of tax due to: (1) negligence or disregard of rules or regulations; (2) substantial understatement of income tax (i.e., more than a 10% understatement); (3) substantial income tax valuation misstatement; (4) substantial overstatement of pension liabilities; and (5) substantial estate or gift tax valuation understatement. In the case of a gross valuation misstatement, section 6662(h) allows the imposition of a 40 percent penalty. Section 6664 generally allows a taxpayer to avoid an accuracy-related penalty by a showing of reasonable cause and good faith.

Under Internal IRS guidelines issued on December 20, 2001, examiners are required to consider the section 6662 accuracy-related penalty for any underpayment attributable to a taxpayer's participation in a "listed transaction" — i.e., one that has been identified by the IRS as having significant tax avoidance potential. (The current list is contained in Notice 2001-51, 2001-34 I.R.B. 190.) These guidelines also require examiners to contact Large and Mid-Size Business (LMSB) field counsel and OTSA once they have identified and evaluated facts regarding a "potentially abusive tax shelter" — e.g., a transaction that meets two out of the five characteristics in Reg. section 1.6011-4T(b)(3) or where there is no business purpose, or in which a significant purpose is the avoidance or evasion of federal income tax, and the tax benefits claimed are unusual or not of a kind clearly contemplated by the Code. In the case of "listed transactions", the examiner must obtain approval of the Director of Field Operations (DFO) to impose or not impose the accuracy-related penalty. In the case of "potentially abusive tax shelters," the examiner must obtain approval of the DFO to impose the penalty. If you submit the disclosure pursuant to Announcement 2002-2, however, the guidelines do not require the involvement of any IRS personnel beyond the examiner.

In [Year], you entered into a transaction that the government may consider to be substantially similar to the transaction described in Notice 2000-44, 2000-2 C.B. 255. Any transaction substantially similar to the transaction described in Notice

2000-44 is a "listed transaction" and is subject to the procedures set forth above if you are, or come under, examination. The IRS has made a request for information to KPMG which, in the IRS's view, would require us to provide them with a list of our clients who have participated in this or similar transactions, along with related documentation. We also understand that the IRS has recently asked for information related to this transaction from at least one taxpayer. Therefore, it is highly likely that KPMG or another investment, legal, or tax advisor, will be required to provide to the IRS a list of investors in this transaction.

If the IRS learns of the transaction from another source and raises it in an examination of your return, you will be precluded from taking advantage of the penalty waiver unless you have complied with the Announcement prior to the date the IRS raises the issue on an examination of your return.

We recommend that you make the disclosure required by the Announcement for the following reasons: (1) to avoid any potential imposition of the accuracy-related penalty; (2) to avoid the expenses and resources potentially associated with contesting an imposition of the penalty; and (3) to put yourself in a better settlement and/or litigation position as to the tax issues involved in the transaction.

As KPMG advised you on the transaction and may have a potential conflict of interest, you may want to consider seeking the advice of another tax professional concerning whether to disclose under the Announcement. If, having considered whether to seek the advice of another professional, you decide that you want KPMG to help you with preparing the disclosure statement and filing it with the IRS, we will request that you sign a waiver of any potential conflict of interest.

Because of IRS focus on this area and the time limit imposed by the Announcement, we recommend that you not delay in considering the disclosure opportunity provided by the Announcement if your transaction is not yet under examination and if your tax year affected by the transaction is not yet closed.

[Relationship Partner] will be contacting you to discuss this important matter further.

Sincerely,

Jeff Eischeid
National Partner-in-Charge of [ ]
KPMG LLP

Attachments: Announcement 2002-2
News Release, IR-2001-121

Binary Option Strategy Marketing Points

__Improvements Over BLIPS__

1. Major push-back on BLIPS was pricing. This deal is 5% cost rather than 7%.
2. BLIPS – only one investment option and nobody ever made money. This one, you can make money by merely making the right investment and predicting the correct movement. Better able to "blend" the investment choice with investment patterns of the client (unless ordinary loss is desired).
3. Elimination of huge leverage requirement (BLIPS $53mm of debt for every $20mm deal). Here – elimination of traditional borrowing and related cost.

__Lack of KPMG Opinion Letter__

1. You only need one opinion letter for penalty protection. Must be a brand-name firm – either accounting or law.
2. Penalty is safer in the hands of an attorney than in the hands of an accountant.
3. Some concern that our acting in dual role of promoter and opinion writer jeopardizes opinion letter and therefore our clients.

__Miscellaneous__

1. Cost if you went directly to the investment broker would be 6% to 7%. We negotiated a 5% cost for our clients. 3.1% net after tax cost on capital and 2.75% on ordinary.
2. Don't beg for push-back. Don't apologize for lack of KPMG opinion letter.
3. What we're being paid for:
   a. Price break on the transaction which covers our portion of the fee.
   b. Shepard the process and help make sure the execution goes smoothly.
   c. This is complex transaction requiring daily monitoring of the investment positions.
   d. Perform tax projections to determine needs and plan for incorporation of the transaction into your return presentation and investment mix.
   e. Prepare your tax return (if you are including in the fee).

Permanent Subcommittee on Investigations
EXHIBIT #95K

Voice Mail Message
From: Larry DeLap
To: Jeff Zysik

1. You asked if someone in Washington could take a look at the SHAM/Economic Substance. Phil Wiesner should take a look at that.

2. I had prepared a e:mail regarding LIPS on the plane but I can't connect with e:mail because of secure ID problems. I will read it:

   Initial comments on the Penalties and Business Purpose/Economic Substance Sections.

   1. The conclusions in the last paragraphs under "the substantial understatement penalty" and "negligence penalty" need to come out.

   2. I don't understand the rationale for the economic substance discussion to focus only on the asset side and for the exclusion of any "step transaction" discussion.

   3. $150 million is received from a bank in connection with a borrowing; 60 days later $150 million is paid to that bank in settlement of the borrowing. Why can't the IRS maintain that the substance of that transaction was a loan of $150 million, rather than a loan of $100 million with a $50 million "premium."

   4. The faxed "introduction" sets forth various restrictions the bank will place on the partnership. These restrictions are known before there is any borrowing. Why can't the IRS assert that the substance of the transaction was a loan from the bank to the partnership so the investors basis in its partnership interest is limited to the non-borrowed $2 million capital contribution.

   5. In any case it is unclear there could be a reasonable expectation of a pre-tax profit, taking into account the transaction fees, particularly if there appears to be an intention to wind up the investment after only 60 days. The draft does say that "the original intent of the parties was to participate in all three investment stages of the investment program". If that were true there might be a credible reasonable expectation of a reasonable profit. However, that is not one of the representations. If it were a representation, it would not seem credible if there were a consistent pattern of investors staying in only for the first stage.

   6. I find the discussion of ACM puzzling. We point out that the third circuit said, "In order to be deductible a loss must reflect actual economic consequences sustained in an economically substantive transaction and cannot result solely from the application of a tax accounting rule." Footnote 31 to the ACM case is then sited and the following is emphasized: "It is also well established that where a transaction objectively effects the taxpayers net economic position, legal relations, or non-tax business interest, it will not be disregarded merely because it was

Permanent Subcommittee on Investigations
EXHIBIT #95L

motivated by tax considerations." In the instant case, I don't see where the loan transaction effects the investors "net economic position" (the borrowing and repayment are a wash) "legal relations," or "non-tax- business interest."

Attachment 5

Plafond Structure

The Plafond structure differs in several respects from the specific structure presented here for approval, however, the risks (financial/collateral monitoring, operational) remain virtually identical. The significant differences are:

1. HVB will make a single, joint and several bank loan, to the LLCs.
2. Instead of transferring ownership of the LLCs to the Investment Company, the Investors/Trusts will cause the LLCs to transfer their assets and our bank loan to the Investment Company in exchange for a membership interest in the Investment Company.
3. To entities related to Presidio, Presidio Growth and Presidio Resources, will hold a combined 10% interest in the Investment Company.
4. The Investment Company itself, rather than individual LLCs, will then enter into the respective hedges and swaps with HVB; i.e. one set of trades per transaction

Under U.S. Law, once the Investment Company assumes the loan on a non-recourse basis, we have effectively a new loan to the Investment Company secured by its assets.

We have reviewed this structure with counsel. They believe it is sound from a risk perspective.

Permanent Subcommittee on Investigations
EXHIBIT #95M

HVB – Presidio meeting

- The basic agreement
  - Total HVB fee is 125 bps of loan premium plus costs (not plus "normal" markup)
  - In addition, Presidio agrees to execute all FX trades at the full bid – ask spreads
    - Presidio buys on the offer
    - Presidio sells on the bid

- Coupon setting and the swap
  - The swap and the loan must have matched cashflows and matched maturities
    - The swap coupon must equal the loan coupon
    - The start (effective) date of the swap must be the same as the start of the loan (date T in Presidio's model)
    - The trade date (T+7) must be the same as the rate determination date
  - Except as provided in the credit documents, there is no cost (and no bid –ask spread) for prepaying the swap and loan prior to maturity
  - The same discount factors used to price the loans at any given must be used to price the swap
  - SWAP SUMMARY: BY ENTERING INTO THE SWAP, THE LOAN LIABILITY IS CONVERTED INTO A LIBOR FLAT LOAN ON THE ENTIRE CASH PROCEEDS. THE COMBINED NET PRESENT VALUE OF THE SWAP PLUS THE LOAN IS ALWAYS EQUAL TO TOTAL CASH PROCEEDS.

- Funding Friction and the Euro trades
  - After entering into the swap, the effective borrowing cost will be LIBOR flat on the entire loan proceeds
  - The agreed rate of return on our cash (whether in dollars or synthetic Euro plus forwards) is LIBOR minus 25 bps starting on day T.
  - Effectively, the funding friction is: 25 bps times cash proceeds times number of days (approx. 60 to 67) divided by 360.
  - This agreement applies both to dollar deposits and Euro deposits hedged into dollars.

- Spot rates – FX forwards
  - As agreed, the when we exit the FX positions, the spot rate for the HK dollar and Argentina peso positions will be the screen rate. (Bloomberg or Reuters)
  - In case of disagreement, a printout of the screen should determine the spot rate.
  - In the case of Argentina, if there is no devaluation and no appreciation of the peso, the spot rate should be 1:1.

- FX forwards – bid/ask spreads
  - It has been agreed that we will pay full bid-ask spreads on the FX forwards.
  - If HVB acts as broker in these trades, we reserve the right to review trade tickets.

Permanent Subcommittee on Investigations
EXHIBIT #95N

HVB 000347

- If HVB acts as a principal in these trades, the forward rates must equal the screen/market forward rates.

- Interest rate cap
  - In addition to the swap, the Fund plans to buy LIBOR caps
  - The rationale for the caps is to add convexity – it is not a source of additional fees.
  - The agreed price of the cap is 20 bps of the loan premium amount.
  - The notional amount of the caps equals the notional amount of the loans.
  - The caps are an asset with a fair market value. When we prepay the swap and sell back the caps, we expect to receive fair value for the caps. (At DB we expect to receive 15 bps (of the loan premium) when we sell the caps back to the bank.

________, 2000

PRIVATE & CONFIDENTIAL
[AddresseeName]
[StreetLine1]
[StreetLine2]
[CityStateZip]

Dear [AddresseeName]:

We would like to discuss with you various planning alternatives to reduce your income tax liability.

Among the alternatives you may wish to consider is an investment program involving foreign currency and/or other option contracts promoted by [Presidio Growth LLC or Helios Financial LLC] (Investment Program).

We have provided tax advice to [Presidio or Helios] relative to their structuring of their Investment Program.

The Internal Revenue Service may maintain that the Investment Program is a potentially abusive tax shelter and that the promoters are required to register it as a tax shelter and maintain a list of all participants in the Investment Program for inspection by the IRS upon request. Neither [Presidio or Helios] nor KPMG currently plans to register the Investment Program as a tax shelter or maintain a list of all participants therein.

If you were to decide to participate in their Investment Program, we would be able to sign your tax return (if prepared or reviewed by us), but would not provide a written or oral opinion to you on the likelihood of the expected tax results of the Investment Program withstanding an IRS challenge.

If you should have an interest in the Investment Program, it is imperative that you discuss the investment aspects of the program with an independent investment advisor and the tax and legal aspects thereof with competent counsel prior to deciding whether to invest. Furthermore, in view of the accuracy related penalty rules as described in the enclosed memorandum, you should first determine that a reputable independent tax advisor would be willing to provide you with a written opinion that the expected tax results of the Investment Program are more likely than not to prevail if challenged by the tax authorities.

Should you decide to invest in the Investment Program, you agree that you will engage KPMG to provide certain tax services, not including issuance of a tax opinion letter, in exchange for a substantial fixed fee. A separate engagement letter will be agreed between us that sets forth the fixed fee and clearly articulates KPMG's role and the scope of our responsibilities and services. The tax advisory services we would expect to provide include:

- Meet with you and your other advisors to discuss the U.S. federal income tax implications associated with participating in the Investment Program.
- Respond to questions you or your other advisors may have concerning tax considerations of participation in the Investment Program.
- Review and provide comments on the written tax opinion provided by legal counsel.
- If requested, prepare or review your federal and state income tax returns reflecting the tax results of participation in the Investment Program.

Please sign the enclosed copy of this letter to confirm your agreement with the terms of this letter and return it to us within [10] days. If you have any questions, please call me.

Very truly yours,

KPMG LLP

[WriterName]
[WriterTitle]

ACCEPTED:

[AddresseeName]

______________________________ ________________

Signature Date

ROUTING/REVIEW INSTRUCTIONS

bcc:
Jeffrey Eischeid, Atlanta

________, 2000

PRIVATE & CONFIDENTIAL
[AddresseeName]
[StreetLine1]
[StreetLine2]
[CityStateZip]

Dear [AddresseeName]:

We are pleased you have engaged KPMG LLP ("KPMG") to provide certain tax consulting services to [AddresseeName] ("Client") with respect to Client's participation in an investment program involving investments in foreign currency and/or other option positions (the "Investment Program"). This letter confirms the scope and related terms of our engagement.

[For purposes of this letter, references to "Client" shall be deemed to include all signatories to this letter and each such signatory shall be deemed to be an individual party hereto for all undertakings and agreements of Client contained herein. All signatories to this letter agree to execute this letter in their individual capacities, as well as their capacities as officers, shareholders, partners and/or directors of Client.]

[This letter must be signed by Client and each direct or indirect owner of Client. If a person required to sign by the preceding sentence is an entity, the signature must be made by an individual authorized to act on behalf of, and bind, the entity.]

Background

KPMG understands that Client intends to engage Presidio Growth LLC ("Presidio"), a registered investment advisor, to provide Client with investment advisory services and trading strategies with respect to the foreign currency and/or other option contracts entered into pursuant to the Investment Program.

The purchase of such foreign currency and other option contracts, as well as other financial instruments, would involve full economic risk to Client in the foreign currency and other markets with price movements (up or down) in the purchased and sold securities. Client may realize either profits or losses based upon the price movement of the foreign currency and other option contracts as well as other financial instruments. Client has informed us that no one has provided Client with any assurances or guarantees that Client would make money in any of these transactions on a pre-tax or after-tax basis.

Client acknowledges that it would be at all times subject to market risks for both reward and loss. We have recommended to Client that Client seek independent advice concerning the investment aspects of the proposed transactions before agreeing to participate in the transactions. Investor hereby agrees to engage competent counsel to advise Client regarding the legal and tax issues arising in connection with Client's proposed participation in the Investment Program.

Client has independently determined that there is a reasonable opportunity for Client to earn a reasonable pre-tax profit from the Investment Program in excess of all associated fees and costs, and this determination has been confirmed by Presidio and/or other investment advisors.

KPMG's Role as Tax Advisor

Pursuant to this engagement, KPMG will provide only the following services with respect to your participation in the Investment Program:

- Meet with you and your other advisors to discuss the U.S. federal income tax implications associated with participating in the Investment Program.
- Respond to questions you or your other advisors may have concerning tax considerations of participation in the Investment Program.
- Review and provide comments on the written tax opinion to be provided by ________.
- If requested, prepare or review your federal and state income tax returns reflecting the tax results of participation in the Investment Program.

Client acknowledges that the various oral tax advice provided by KPMG will be based on the facts, representations and assumptions that you and Presidio submit to us and we will not independently gather, verify, audit or investigate the accuracy or completeness of this information. Inaccuracy or incompleteness of the information provided to us could have a material effect on our conclusions. In rendering our advice, we will consider the applicable provisions of the Internal Revenue Code of 1986, as amended, the regulations thereunder, and judicial and administrative interpretations thereof, all as in effect as of the date of the opinion letter. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect the nature or validity of our advice. Unless you specifically engage us to do so in writing, we will not update our advice for subsequent changes or modifications to the law and regulations, or to the judicial and administrative interpretations thereof.

It is expressly understood that KPMG will not provide Client with an opinion on the U.S. federal, foreign, or state income tax consequences associated with participation in the Investment Program. It is further understood that Client will seek a tax opinion from the law firm of _______________ concerning such participation.

Client recognizes that the Investment Program is aggressive in nature and that the Internal Revenue Service might challenge the intended results of the Investment Program and could prevail under any of various tax authorities. Client also acknowledges receipt of a memorandum that discusses certain penalties that might be asserted by the Internal Revenue Service should it challenge any tax deductions or tax losses that might be claimed by Client with respect to participation in the Investment Program.

Client recognizes that KPMG is not a registered broker-dealer and will not be providing services to Client as a broker-dealer or investment advisor. In the course of this engagement, all services provided by KPMG will be strictly as a tax advisor to Client and KPMG will not undertake any activity that would require registration as a broker-dealer or investment advisor under the federal securities laws.

Federal Confidential Communications Privilege

A confidentiality privilege under Internal Revenue Code Section 7525 may pertain to certain communications between KPMG personnel and Client regarding federal tax advice provided pursuant to this engagement. By retaining KPMG, you agree that KPMG is instructed to claim the privilege on your behalf, with respect to any applicable communications, up and until such time as you may waive any such privilege in writing. As disclosure of any such confidential communications to the Internal Revenue Service or other third party may cause any confidentiality privilege to be waived, you should notify us if the Internal Revenue Service or other third party requests information about any tax advice or tax advice documents provided by us.

Client understands that KPMG makes no representation, warranty or promise, and offers no opinion with respect to the applicability of such confidentiality privilege to any communication and agrees to hold KPMG harmless should the privilege be determined not to apply to any or all communications. Client agrees to indemnify KPMG for any attorneys' fees and other costs and expenses incurred by KPMG in defending the confidential communications privilege on Client's behalf.

Professional Fees

Client agrees to pay KPMG a fixed fee of $_________ for the services described above. Client agrees, by accepting the terms of this letter, to pay all invoices to KPMG within 30 days of receipt.

The amount of our fee is not dependent on the amount of Client's investment in the Investment Program, the investment results of the Investment Program, the tax advice provided, or on the amount of any tax savings projected or achieved by Client.

Limitation on Liability and Indemnification

By signing this engagement letter, Client agrees to indemnify KPMG and its affiliates, partners, principals, and personnel (collectively, the " Indemnified Parties") from and against any and all losses, claims, damages, and liabilities, including reasonable attorney's fees and other expenses or costs of litigation (collectively, "Damages"), arising out of or relating to this engagement letter and KPMG's services hereunder (including claims by third parties), except to the extent caused by the gross negligence or intentional misconduct of KPMG.

In the event any Indemnified Party is requested pursuant to subpoena or other legal process to produce documents relating to this engagement in judicial or administrative proceedings to which such Indemnified Party is not a party, Client shall reimburse the Indemnified Party at standard billing rates for the Indemnified Party's professional time and expenses, including reasonable attorney's fees, incurred in responding to such requests.

KPMG shall have no liability to Client, under any circumstances, for any special, incidental or consequential damages, including without limitation loss of profits, even if KPMG has been advised of the possibility of such damages.

KPMG's maximum aggregate liability to Client, whether a claim be in contract, tort, or otherwise, for all claims arising out of or relating to this engagement letter or any services rendered under this letter, shall be limited to fifty thousand dollars ($50,000).

Other

All written or oral advice provided by KPMG to Client will be for Client's information and use only and may not be relied upon by any third party without the express advance written permission of KPMG.

All of the provisions of this Section, entitled Limitation on Liability and Indemnification, shall survive indefinitely any termination or expiration of this Agreement.

In the event that any term or provision of this Agreement shall be held to be invalid, void, or unenforceable, then the remainder of this Agreement shall not be affected, impaired or invalidated, and each such term and provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

This Agreement is to be construed in accordance with the laws of the state of New York.

Please sign the enclosed copy of this letter to confirm your agreement with all of the terms expressed in this engagement letter and return it to us within [10] days. If you have any questions, please call me.

Very truly yours,

KPMG LLP

[WriterName]
[WriterTitle]

Enclosure

ACCEPTED:

[AddresseeName]

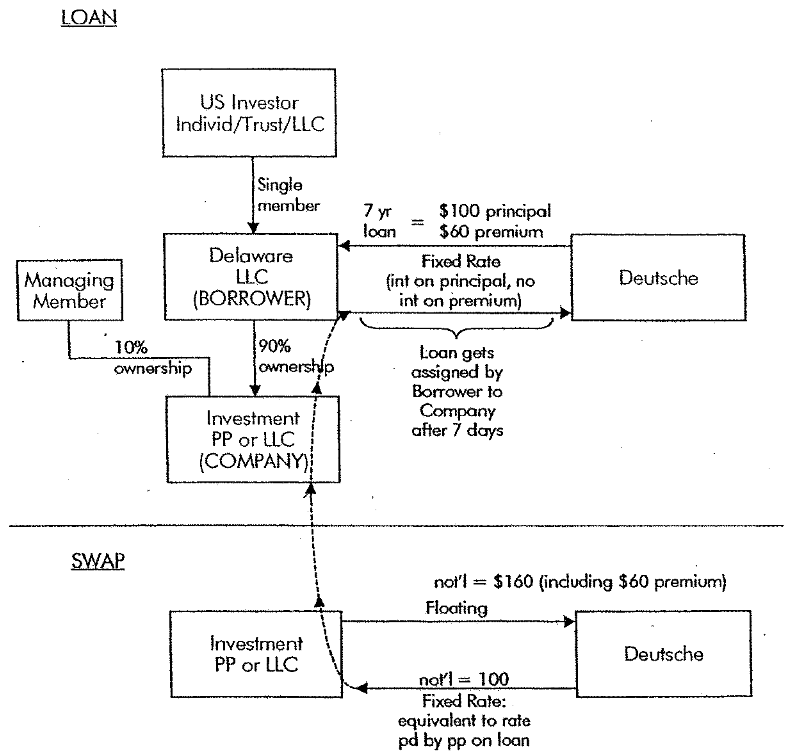
____________________________ _______________
Signature Date

[If the Addressee is not an individual, add lines for all direct or indirect owners of addressee.]

ROUTING/REVIEW INSTRUCTIONS

bcc:
Jeffrey Eischeid, Atlanta
Mark Watson, WNT
business unit professional practice partner – tax

"BLIPS" TRANSACTION



Deutsche has floating rate exposure to investment pp
Forwards no collat but 3.3 of exposure and then will terminate

615138.ppt

Permanent Subcommittee on Investigations
EXHIBIT #95Q

DB BLIPS 0202

S&S DRAFT
07/12/99

EXHIBIT F TO THE
CREDIT AGREEMENT

FORM OF OPINION OF HALE AND DORR LLC

[As of Date], 1999

To Deutsche Bank AG, Cayman Islands Branch and
Deutsche Bank AG, New York Branch
31 West 52nd Street
New York, New York 10019

Deutsche Bank AG,
Head Office
Taunesanlage 12
60272 Frankfurt
Germany

[Borrower Name2]; [Investor Name2]

Ladies and Gentlemen:

We have acted as special counsel to [Borrower Name2], a Delaware limited liability company (the "Borrower"), in connection with the preparation, execution and delivery of (i) the Credit Agreement dated as of [As of Date], 1999 (the "Credit Agreement"), between the Borrower and Deutsche Bank AG, Cayman Islands Branch (the "Bank"), and (ii) the International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement dated as of [As of Date], 1999, among Deutsche Bank AG, New York Branch (the "Counterparty") as Party A and the Borrower as Party B, together with the Schedule thereto and as supplemented by the confirmations thereunder (the "Master Agreement").

This opinion is furnished to the Bank pursuant to Section 4.02(b) of the Credit Agreement and to the Counterparty pursuant to Section 4(a)(ii) of the Master Agreement. Unless otherwise defined herein, terms defined in the Credit Agreement are used herein as therein defined.

In that connection, we have examined a counterpart of each of the following documents:

(a) the Credit Agreement;

(b) the Note;

(c) the Master Agreement;

(d) the Pledge and Security Agreement;

(e) the Account Control Agreement;

(f) the Certificate of Formation, resolutions and other corporate records of the Borrower and certificates of public officials, in each case as amended through the date hereof; and

(g) the other documents furnished by the Borrower pursuant to Article 4 of the Credit Agreement.

The documents described in the foregoing clauses (a) through (e) are collectively referred to herein as the "Credit Documents".

In addition, we have examined originals or copies of such other corporate records of the Borrower, certificates of public officials and of the sole member of the Borrower and agreements, instruments and other documents as we have deemed necessary as a basis for the opinions expressed below. As to certain matters of fact material to the opinions expressed herein, we have relied on the representations made in the Credit Agreement and the other Credit Documents and certificates of public officials and the sole member of the Borrower. We have not independently established the facts so relied on.

In our examination of the documents referred to above, we have assumed without independent investigation (a) the due authorization, execution and delivery of each of the Credit Documents by each of the parties thereto (other than the Borrower), (b) the genuineness of all signatures, (c) the authenticity and completeness of the originals of the documents submitted to us and (d) the conformity to originals of any documents submitted to us as copies.

Based upon the foregoing and upon such investigation as we have deemed necessary, we are of the opinion that:

1. The Borrower (a) is a limited liability company, duly organized, validly existing and in good standing under the laws of the State of Delaware, (b) has the power and authority to own its property and assets, to manage its affairs and to transact the business in which it proposes to engage, and (c) is duly qualified as a foreign company and in good standing in each jurisdiction where the ownership, leasing or operation of its property, or the conduct of its business, requires such qualification.

2. The Borrower has duly executed and delivered each Credit Document. The execution, delivery and performance by the Borrower of each Credit Document, the granting of the security interests by the Borrower in the Pledge and Security Agreement and the consummation of the other transactions contemplated by the Credit Documents are within the Borrower's powers (corporate or otherwise), have been duly authorized by all necessary action (corporate or otherwise), and do not and will not (a) contravene the Borrower's Certificate of Formation or other constitutive documents, (b) result in the violation of any United States Federal or Delaware law, statute, rule or regulation or any order, writ, injunction or decree of any court or governmental instrumentality (including, without limitation, Regulation X, T or U of the Board of Governors of the Federal Reserve System) or any order, writ, judgment, injunction, decree, determination or award applicable to the Borrower, (c) conflict with or be inconsistent with or result in the breach of, or constitute a default under, or result in the acceleration of (or entitle any party to accelerate) the maturity or any obligation of the Borrower including but not limited to any loan agreement, indenture, contract, mortgage, deed of trust, lease or other instrument binding on or affecting the Borrower or any of its properties or (d) except for the Liens created under the Pledge and Security Agreement, result in or require the creation or imposition of any lien upon or security interest in any of the property or assets of the Borrower pursuant to the terms of any agreement, contract or instrument to which the Borrower is a party or by which it or any of its property or assets is bound or to which it may be subject.

3. No order, consent, approval, license, authorization or validation of, or filing, recording or registration with or exemption or other action by, any governmental or public body or authority (or any subdivision thereof) or any other third party, is required to authorize, or is required in connection with, (a) the due execution, delivery, recordation, filing or performance by the Borrower of any Credit Document or for the consummation of the transactions contemplated thereby, (b) the grant by the Borrower of the Liens granted by it pursuant to the Pledge and Security Agreement, (c) the perfection or maintenance of the Liens created by the Pledge and Security Agreement (including the priority thereof purported to be created thereby) or (d) the exercise by the Bank of its rights under the Credit Documents or the remedies in respect of the Collateral pursuant to the Credit Documents, except as have been duly obtained, taken, given or made prior to the date hereof and are in full force and effect.

4. To the best of our knowledge after investigation, there is no action, suit, investigation, litigation or proceeding affecting the Borrower pending or threatened before any court, governmental agency or arbitrator that (a) is reasonably likely to affect the business, condition (financial or otherwise), operations, performance or properties of the Borrower or (b) purports to affect the legality, validity or enforceability of any Credit Document or any of the transactions contemplated thereby.

5. The Borrower is the legal and beneficial owner of all of the Pledged Collateral pledged by it under the Pledge and Security Agreement, free and clear of any Lien, except for the Liens created under the Credit Documents.

6. We have participated in the organization of the Borrower, including the investment by the Investor therein, and in the development and implementation of strategies pursuant to which entities similar to the Borrower and the Investor have been and/or in the future may be organized to participate in transactions ("Other Transactions") similar to the transactions contemplated by the Credit Agreement and the Master Agreement and, based upon such participation, are of the opinion that neither such organization nor such participation considered by themselves or in connection with the Other Transactions requires any registration under Section 5 of the Securities Act of 1933, as amended, or result in the creation of any "investment company" under (and within the meaning of) the Investment Company Act of 1940, as amended.

Our opinions above are limited to the laws of the State of Delaware and the Federal law of the United States, and we do not express any opinion herein concerning any other law.

This opinion letter should be interpreted in accordance with the Legal Opinion Principles of the Committee on Legal Opinions of the Section of Business Law, American Bar Association, 53 Business Lawyer 831 (1998).

This opinion is based upon currently existing statutes, rules, regulations and judicial decisions, and we disclaim any obligation to advise you of any change in any of these sources of law or subsequent legal or factual developments which might affect any matters or opinions set forth herein.

Please note that we are opining only as to the matters expressly set forth herein, and no opinion should be inferred as to any other matters. A copy of this opinion may be delivered to each transferee or assignee of any of the Bank's rights under the Credit Agreement and/or the other Credit Documents, and each such person may rely on this opinion as if it were addressed to it and had been delivered to it on the date hereof. Subject to the foregoing, this opinion is solely for your benefit in connection with the consummation of the transactions contemplated by the

Credit Agreement and may not be quoted or relied upon by any other person or used for any other purpose without our prior written consent.

Very truly yours,

S&S DRAFT
07/12/99

EXHIBIT G TO THE CREDIT AGREEMENT

FORM OF OPINION OF NEW YORK COUNSEL TO BORROWER

[As of Date], 1999

To Deutsche Bank AG, Cayman Islands Branch and
Deutsche Bank AG, New York Branch
31 West 52nd Street
New York, New York 10019

Deutsche Bank AG,
Head Office
Taunesanlage 12
60272 Frankfurt
Germany

[Borrower Name2]; [Investor Name2]

Ladies and Gentlemen:

We have acted as special New York counsel to [Borrower Name2], a Delaware limited liability company (the "Borrower"), in connection with the preparation, execution and delivery of (i) the Credit Agreement dated as of [As of Date], 1999 (the "Credit Agreement"), between the Borrower and Deutsche Bank AG, Cayman Islands Branch (the "Bank") and (ii) the International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement dated as of [As of Date], 1999, among Deutsche Bank AG, New York Branch (the "Counterparty") as Party A and the Borrower as Party B, including the Schedule thereto and as supplemented by the confirmations thereunder (the "Master Agreement").

This opinion is furnished to the Bank pursuant to Section 4.02(b) of the Credit Agreement and to the Counterparty pursuant to Section 4(a)(ii) of the Master Agreement. Unless otherwise defined herein, terms defined in the Credit Agreement are used herein as therein defined. Further, for purposes of this opinion letter, (a) the terms defined in Article 8 or 9 of the Uniform Commercial Code in effect in the State of New York (the "New York UCC") are used herein as such terms are defined in such Article 8 or 9, and (b) "Federal Book-Entry Regulations"

Permanent Subcommittee on Investigations
EXHIBIT #95S

means (A) the federal regulations contained in Subpart B ("Treasury/Reserve Automated Debt Entry System (TRADES)") governing book-entry securities consisting of U.S. Treasury bonds, notes and bills and Subpart D ("Additional Provisions") of 31 C.F.R. Part 357, 31 C.F.R. § 357.10 through § 357.14 and § 357.41 through § 357.44, including related defined terms in 31 C.F.R. § 357.2); and (B) to the extent substantially identical to the Federal book-entry regulations referred to in clause (A) above, the federal regulations governing other book-entry securities.

In that connection, we have examined a counterpart of each of the following documents:

(a) the Credit Agreement;

(b) the Note;

(c) the Master Agreement;

(d) the Pledge and Security Agreement;

(e) the Account Control Agreement;

(f) acknowledgment copies of each of the financing statements (the "Financing Statements") under the New York UCC naming the Assignee as the debtor and the Bank as the secured party, which Financing Statements have been filed in the respective filing offices listed in Schedule 1 hereto (the "Filing Offices"); and

(g) the other documents furnished by the Borrower pursuant to Article 4 of the Credit Agreement.

The documents described in the foregoing clauses (a) through (e) are collectively referred to herein as the "Credit Documents".

In addition, we have examined originals or copies of such other corporate records of the Borrower, certificates of public officials and of the sole member of the Borrower and agreements, instruments and other documents as we have deemed necessary as a basis for the opinions expressed below. As to certain matters of fact material to the opinions expressed herein, we have relied on the representations made in the Credit Agreement and the other Credit Documents and certificates of public officials and the sole member of the Borrower. We have not independently established the facts so relied on.

In our examination of the documents referred to above, we have assumed without independent investigation (a) the due authorization, execution and delivery of each of the Credit

Documents by each of the parties thereto, (b) the genuineness of all signatures, (c) the authenticity and completeness of the originals of the documents submitted to us and (d) the conformity to originals of any documents submitted to us as copies.

In addition, we have assumed that:

(1) the Borrower has rights (to the extent necessary to grant a security interest) in the Pledged Collateral existing on the date hereof and will have rights (to such extent) in property which becomes Pledged Collateral after the date hereof; and

(2) for purposes of our opinion in paragraph 4 below, (A) Deutsche Bank AG, New York Branch (the "Collateral Securities Intermediary") is a "securities intermediary" within the meaning of Section 8-102(a)(14) of the New York UCC and the Federal Book-Entry Regulations; (B) the Collateral Account is a "securities account" within the meaning of Section 8-501(a) of the New York UCC; and (C) all property from time to time credited to the Collateral Account will be "financial assets" within the meaning of Section 8-102(a)(9) of the New York UCC.

Based upon the foregoing and upon such investigation as we have deemed necessary, we are of the opinion that:

1. Each of the Credit Documents is the legal, valid and binding obligation of the Borrower, enforceable against the Borrower in accordance with its terms.

2. The Pledge and Security Agreement creates in favor of the Bank, as security for the payment of the Secured Obligations (as defined therein), a valid security interest in the Pledged Collateral described therein in which a security interest may be created under Article 9 of the New York UCC (the "Article 9 Collateral"), and all filings and other actions necessary or desirable to perfect and protect such security interests have been duly taken.

3. The Bank will have, upon the filing in the Filing Offices of the Financing Statements, a perfected security interest in that portion of the Article 9 Collateral in which a security interest is perfected by filing a financing statement under the New York UCC.

4. The Bank will have a perfected security interest in the Pledged Collateral described in the Pledge and Security Agreement consisting of security entitlements in financial assets from time to time credited to the Collateral Account upon the Borrower, the Bank and the Collateral Securities Intermediary entering into the Account Control Agreement, pursuant to which the Collateral Securities Intermediary has agreed to comply with entitlement orders with respect to the Collateral Account (and the financial assets from

time to time credited thereto) originated by the Bank without further consent by the Borrower. Assuming that (a) the Bank does not have notice of any adverse claim to any such financial assets at the time such financial assets are credited to the Collateral Account, and (b) the security interest of the Bank in the Collateral Account and such financial assets is perfected as described above, no action based on an adverse claim to any such financial assets may be asserted against the Bank.

5. To the extent that the Collateral Account constitutes a "deposit account" (within in the meaning of Section 9-105(e) of the New York UCC), the security interest granted by the Borrower in the Collateral Account and the funds from time to time deposited therein as original collateral (*i.e.*, those funds that do not constitute proceeds of Permitted Investments (the "Original Funds")) pursuant to the Pledge and Security Agreement is excluded from the purview of Article 9 of the New York UCC pursuant to Section 9-104(l) thereof. Nevertheless, if the matter (although not free from doubt) were properly presented, a New York court applying New York substantive common law should hold that the Pledge and Security Agreement, together with the establishment and maintenance of the Collateral Account in accordance therewith and with the Account Control Agreement, should create in favor of the Bank a valid lien on and security interest in the Collateral Account and such funds contained therein, securing the payment of the Secured Obligations (as defined in the Pledge and Security Agreement) purported to be secured thereby, enforceable against (a) a consensual lien on and security interest in the Collateral Account subsequently created by the Borrower in favor of another Person, and (b) a judgment lien subsequently obtained against the Borrower.

Our opinions above are subject to the following qualifications:

(a) Our opinions in paragraphs 1, 2, 3 and 4 above are subject to the effect of any applicable bankruptcy, insolvency (including, without limitation, all laws relating to preferences and fraudulent transfers), reorganization, moratorium or similar laws affecting creditors' rights generally.

(b) Our opinions in paragraphs 1, 2, 3 and 4 above are also subject to the effect of general principles of equity, including without limitation concepts of materiality, reasonableness, good faith and fair dealing (regardless of whether considered in a proceeding in equity or at law). Our opinion in paragraph 1 above is also subject to the qualification that certain provisions of the Pledge and Security Agreement may be further limited or rendered unenforceable by the applicable law of the State of New York, but in our opinion such applicable law does not make the remedies afforded by the Pledge and Security Agreement inadequate for the practical realization of the principal benefits intended to be conferred by the Pledge and Security Agreement.

(c) In connection with our opinion in paragraph 5 above, we note that under the New York substantive common law, to the extent the rights of a secured party in a deposit account are evidenced by an "indispensable instrument" (such as a passbook), the creation, validity and priority of a security interest in such deposit account would be governed by the law of pledges. In the absence of an indispensable instrument, the rights of a secured party in a deposit account would normally constitute a "chose in action" and be governed by the law of assignments.

The common law of pledges ordinarily requires the delivery to the secured party of an "indispensable instrument" (embodying the rights in the object pledged) so as to put third parties on notice of the encumbered status of such object. Thus, the valid pledge of a deposit account would require the identification, and the delivery to the secured party, of an indispensable instrument evidencing the deposit account. In the absence of such an instrument, courts are divided as to whether a pledge can be effected. Although the grant of the lien on and security interest in the Collateral Account does not entail the delivery of an indispensable instrument, the fact that the Collateral Account is established and maintained under the control and dominion of the Bank could permit a court to view the Collateral Account, by analogy, as being in the Bank's possession.

The common law of assignments provides an alternative approach for the creation, validity and priority of a lien on and security interest in a deposit account. Originally under the New York common law, the creation and priority of a written present assignment of a chose in action did not require, in order to be effective, any additional action. However, Benedict v. Ratner, 268 U.S. 353 (1925) (applying New York law), and subsequent cases made even a present assignment void unless the secured party had control and dominion over the subject property. Thus, following Benedict, a common law assignment typically requires the transfer of control and dominion over the subject property. Although Section 9-205 of the New York UCC repeals the Benedict rule, such rule may still govern the creation, validity and priority of security interests in choses in action (such as the Original Funds in the Collateral Account) to the extent they are excluded from the purview of Article 9 of the New York UCC pursuant to Section 9-104(l) thereof.

A finding by a New York court that the Bank has control and dominion over the Collateral Account and the Original Funds would be consistent, under the Benedict analysis, with the facts that the Pledge and Security Agreement provides that the Collateral Account is subject to the sole control and dominion of the Bank; that certain Original Funds in the Collateral Account are to be applied solely, or in priority, to the Secured Obligations; that the Borrower's ability to invest or obtain the release of Pledged Collateral from the Collateral Account for its benefit (which, in and of itself would be inconsistent with a finding of control and dominion) is regulated by the Security and Pledge Agreement and the Account Control Agreement and is conditioned on the absence of a Default or an Event of Default; and that the Pledge and Security Agreement and the Account Control Agreement provide for the policing by the Bank and the Collateral Securities Intermediary of the Collateral Account, the Original Funds and the other Pledged Collateral and permit the Bank to take remedial action against the Borrower and the Pledged Collateral.

(d) Our opinions in paragraphs 2, 3, 4 and 5 above are subject to the qualification that the security interest, and perfection of the security interest, of the Bank in proceeds of the Pledged Collateral (including funds on deposit in the Collateral Account, but excluding the Original Funds) are limited to the extent set forth in Section 9-306 of the New York UCC.

(e) We express no opinion as to the enforceability of the indemnification provisions set forth in Section 9.01 of the Credit Agreement to the extent the enforcement thereof is contrary to public policy regarding the exculpation of criminal violations, intentional harm and acts of gross negligence or recklessness.

(f) Our opinions expressed above are limited to the laws of the State of New York and the Federal law of the United States, and we do not express any opinion herein concerning any other law. Without limiting the generality of the foregoing, we express no opinion as to the effect of the law of a jurisdiction other than the State of New York wherein the Bank (or any assignee or transferee of any of the Bank's rights under the Credit Agreement and/or the Note) may be located or wherein enforcement of the Credit Agreement or the Note may be sought that limits the rates of interest legally chargeable or collectible.

(g) Further, our opinions in paragraphs 2 and 3 above are limited to Article 9 of the New York UCC, and our opinion in paragraph 4 above is limited to Articles 8 and 9 of the New York UCC and the Federal Book-Entry Regulations, and therefore those opinions do not address (i) laws other than Article 8 or 9, as the case may be, of the New York UCC and the Federal Book-Entry Regulations and (ii) collateral of a type not subject to Article 8 or 9, as the case may be, of the New York UCC or the Federal Book-Entry Regulations.

This opinion letter should be interpreted in accordance with the Legal Opinion Principles of the Committee on Legal Opinions of the Section of Business Law, American Bar Association, 53 Business Lawyer 831 (1998).

This opinion is based upon currently existing statutes, rules, regulations and judicial decisions, and we disclaim any obligation to advise you of any change in any of these sources of law or subsequent legal or factual developments which might affect any matters or opinions set forth herein.

Please note that we are opining only as to the matters expressly set forth herein, and no opinion should be inferred as to any other matters. This opinion is solely for your benefit in connection with the consummation of the transactions contemplated by the Credit Documents and may not be quoted or relied upon by any other person or used for any other purpose without our prior written consent.

Very truly yours,

BLIPS Market Risk Overview

The purpose of this note is to review the Market Risks of the BLIPS program.

The Market Risks are segregated into 3 distinct categories
- FX Risk
- Deposit vs Interest Rate Swap Risk
- Interest Rate Swap vs Loan Risk

All the numbers represented in this note are based on our Model LLC, which has $100mm Stated Loan Amount, a $60mm Premium Amount, and Equity Capital of 7.7% of the $60mm ($4.62mm). The model very closely represents what each LLC will look like. In addition, the ratios of Stated Loan Amount to Premium to Equity Capital will always remain constant.

The Equity Capital in the LLC must cover
- All 3 Market Risks stated above
- All amounts owed to the bank on the Loan+Premium/Swap Transactions
- Peak Exposure of the LLC
- Fees due to Deutsche Bank

Within the Credit Agreement, DB has a right to automatically terminate all transactions in the LLC, when the Collateral Value Ratio breaches the 1.0125 : 1.000 trigger.

The Collateral Value Ratio is Calculated as
- Numerator: Value of All Assets in the LLC Minus the Value at Risk on those Assets (and Minus a "Peak Exposure" of the FX trades)
- Denominator: The Maximum Obligations of the LLC to DB Plus A "Peak Exposure" of those Obligations.

Over the past month, we have been doing daily pricings on the Model LLC, and the Transaction Cost for the first 60 day period have been in the 50 to 75 basis point range. Versus the 7.7% of $60mm Equity Capital number, we are left with a cushion of 5.70% to 5.95% Equity Capital reserve, after accounting for DB's fees of 1.25%. Using a Transaction Cost of 75 bps, the Collateral Value Ratio on Day 1 would equal 1.021, giving DB 2.1% protection over what it is due (1.26 mm usd cushion in our Model LLC example), and giving DB 85 bps cushion over the 1.0125 trigger (510,000 usd in our Model LLC example).

FX Risks Overview
The FX transactions of the LLC are designed with somewhat asymetric payoffs. The LLC will make money if local currencies depreciate versus the USD and the LLC will lose money if the local currencies appreciate or remain the same versus the USD. Each LLC will typically have 3 currency forward trades on with a maturity of 30 to 90 days. The currencies will typically be emerging market currencies that are explicitly or implicitly

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pegged to the USD (HKD, Argentina Peso, Saudi Arabian Riyal, Israel Shekl, Egyptian Pound etc).

There is a Risk of Counterparty Credit Losses if the local currencies appreciate rapidly versus the USD. The below table highlights what level of appreciation would cause the Collateral Value Ratio to reach it's 1.0125 trigger, and what level of appreciation would fully deplete all Equity Capital, after DB fees, 1 currency at a time, ceteris paribus.

Local Currency	Current Spot	Trigger (%)	Equity (%)
HKD 35mm usd	7.75	7.450 (3.98)	7.005 (9.71)
SAR 5mm usd	3.7503	2.880 (23.21)	2.200 (41.3)
ARS 15mm usd	0.9996	0.908 (9.16)	0.815 (18.5)

Deposit versus Interest Rate Swap Risk
The Model LLC will keep the Loan + Premium + Equity Capital in a Euro Currency Deposit for the life of the transaction. The Euro Currency Deposit will be structured as a synthetic USD deposit through a combination of spot and forward FX transactions and a Euro Libor based Deposit rate.

It is presently agreed that for the first period DB will pay a Euro Libor deposit rate of Euro Libor - 18 bps. Using the FX spot and forward point overlay, the synthetic USD deposit rate in today's pricing run is equal to USD Libor - 14 bps (which equates to a 4 bp transaction cost on the 60 mm usd Premium amount). That being said, the pricing runs over the past month have generated synthetic USD deposit rates ranging from USD Libor - 38 to USD Libor - 15. Any USD Libor less amount is a cost to the LLC versus the USD Libor Flat payment they owe on the Interest Rate Swap.

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=63729
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=63729
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPs reps to kpmg
Sent: 2000-03-14 16:33:20.240
Date: 2000-03-14 16:33:20.411
X-Folder: Opinions - BLIPS
X-Attachments: Attachments\kpmgrepl[2].doc; "Attachments\DB Reps to KPMG blacklined final.doc"

Can we discuss this at your convenience?

Thanks,
Jeff

-----Original Message-----
From: Napier, Angie
Sent: Sunday, March 12, 2000 2:43 PM
To: Mangieri, Jeffrey
Subject: FW: BLIPs reps to kpmg

Jeff,

Attached below are the representations that DB has agreed to sign. Please make sure that the DB reps attached below are in agreement to the opinion letter templates. Please change the reps in the opinion letter templates to match the reps below. Call me if you have any questions.

Thanks,
Angie

REDACTED

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Saturday, March 11, 2000 11:36 AM
To: Napier, Angie
Subject: FW: BLIPs reps to kpmg

Did you get this from Randy in a usable format? If not, try the other file.

Thanks, Jeff

-----Original Message-----
From: william.boyle@db.com [mailto:william.boyle@db.com]
Sent: Thursday, March 09, 2000 10:33 AM
To: eischeid@kpmg.com
Cc: michelle.cenis@db.com
Subject: BLIPs reps to kpmg

Jeff,

Attached for your review are our recommended changes to the rep letter. Two major changes from your version. First, we are deleting the reference

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KPMG 0033600

to "industry standards" in (a). We believe this language is overly broad and our meeting DB standards should be sufficient. Second, we prefer to retain the final paragraph, except for the first parenthetical. We prefer to retain control over the use of the reps and as such would prefer to review the use of our reps in your tax opinion prior to our giving approval to use such reps in your tax opinion.
Please give me a call to discuss.

Best regards,

Bill

(See attached file: kpmgrepl.doc)

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=20483
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20483
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS
Sent: 1999-04-09 20:10:20.275
Date: 1999-04-09 20:10:20.876
X-Folder: BLIPS

Jeff Z.

As we discussed, pls coordinate w/ Randy B. and Jeff E. re prep of a "standard" BLIPS engagement letter that we can send to Larry along w/ the opinion letter once Phil's comments have been addressed.

Eve:

I assume we also need to send Larry the "reasonable basis" non-registration memo...are you planning to do that following Mark Ely's final review, or do you want Jeff Z. to send along as part of a BLIPS "product package"?

Jeff E./Randy:

Once the product package is finalized, assume you are planning to control "distribution". Do we want to set up a limited access outlook folder (similar to property distribution)? Your call. Also, do we want to discuss the product (very high level; no details re strategy, just generally who we are targeting, minimum size, etc.) on an upcoming Monday night product call so we can try to CONTROL the message re BLIPS? Again, your call (may not be necessary...I just don't know how widespread (if at all) knowledge of BLIPS is).

Mark
202-467-3807

-----Original Message-----
From: Wiesner, Philip J
Sent: Friday, April 09, 1999 3:50 PM
To: Eischeid, Jeffrey A; Bickham, Randall S
Cc: Smith, Richard H; Lippman, Michael H; Ammerman, Douglas K; Watson, Mark S; Springer, Mark A
Subject: BLIPS

Thanks for forwarding to us the most draft of the BLIPS tax opinion. My initial impression is that it is much changed and substantially improved from the earlier version. The description of the investment strategies presents the business purpose and provides the basis for the profit motive analysis which is thoroughly discussed from a technical point of view later in the opinion. My suggestions for improvement are, I believe, minor and should not present any undue problems:

(1) I would like to see a representation on p. 7 that there is no written or implied agreement that an investor would enter into step one only if certain steps occured, ie, whatever results in the most favorable tax route for the taxpayer. I did not state the concept in its most articulate fashion, but I am concerned about the IRS arguing step transaction doctrine and collapsing the steps. You have answered affirmatively, as far as I can tell, that each step

will occur and has independent business purpose and substance. I am trying to assure that the course of action is not predetermined.

(2)The manner of opinion on p. 9 suggested for business purpose and profit motive bothers me. I would rather say something like: investor more likely than not will have a business purpose and a profit motive for each of the stages and for the transaction overall. Note: we would only want to say this assuming it is correct?!

(3)My only suggestions concerning the discussion/opinion re business purpose concerns the concept found in a number of cases of investor due diligence or did the taxpayer's contemporaneous actions support the contention that he/she approached it as a prudent businessperson or simply looked at the tax benefits and only ran the profit numbers after the IRS audited the transaction. Maybe, it belongs as an investor rep and then a discussion around p. 61 as further indicating business purpose/intent.

(4)In a similar light I am a little troubled by the language from ACM on p. 55 concerning the "rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in light of the taxpayer's situation and intentions." Perhaps, a paragraph discussing how this test is met in the present situation would give further credence to our business purpose rationale.

(5)I thought that the discussion of Estate of Baron et al is quite good and agree with the statement of p. 63 that the courts have not been consistent and that no single, uniform standard exists. Having said that in the rationale, I would rather not opine on p. 65 more than that Investor has a reasonable expectation of profit. I would rather not affirmatively opine that the Estate of Baron test would not apply. I think that the former is enough of an opinion to deal with the profit motive issue, given the thorough discussion of the issue.

Finally, with a little bit of tweaking I am there on my issues. I have not read the entire opinion, but I suspect that we are there on the other issues as well. I leave to Richard Smith to verify this. Of course, thanks for your responses on the matters above.

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=21552
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=21552
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS -- Additional Representations
Sent: 1999-05-09 15:55:54.953
Date: 1999-05-09 16:00:03.843
X-Folder: BLIPS

Randy,

Below are the additional representations that I think are necessary to establish that a bona-fide loan was created. In addition, the question of who is the borrower is still being considered.

Representations by Investment Advisor (Presidio):

* Investment Advisor believes there is a reasonable opportunity for Investor to earn a reasonable pre-tax profit, in excess of all associated fees and costs, and without regard to any tax benefits that may occur, by participating in the Investment Program. Further, Investment Advisor has communicated this belief to Investor.

* [Name of Bank] does not directly or indirectly determine or control the investments and operations of [LLC], including how the loan and premium proceeds are invested, or otherwise participate in the management of [LLC].

Representations by Bank:

* [Name of Bank] will record the loan and premium payment to Investor as a [$100 million], seven-year loan and a [$50 million] premium for financial accounting and regulatory purposes.

* [Name of Bank] expects the loan to be outstanding until its fixed maturity date [i.e., seven years] and will not, without just cause, accelerate any stated principal or interest payment due under the loan agreement.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-467-2433 (phone)
202-822-8887 (fax)

Permanent Subcommittee on Investigations
EXHIBIT #95W

Unknown

From: Watson, Mark T
Sent: Monday, May 10, 1999 1:32 PM
To: Bickham, Randall S; Eischeid, Jeffrey A; DeLap, Larry
Cc: Rosenthal, Steven M; Springer, Mark A; Ammerman, Douglas K; Wiesner, Philip J; Smith, Richard H (WNT)

Randy,

The final representation we feel is necessary from the Bank is as follows: "There is no plan or intention to require the investor to convey the loan proceeds or assign the loan obligation to [LLC]."

Assuming this representation and the representations I sent to you yesterday are made, we are ready to proceed with the transaction.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-467-2433 (phone)
202-822-8887 (fax)

Unknown

From: Watson, Mark T
Sent: Thursday, May 13, 1999 10:49 AM
To: Bickham, Randall S
Cc: Eischeid, Jeffrey A; DeLap, Larry; Springer, Mark A; Wiesner, Philip J; Ammerman, Douglas K
Subject: Representations

Randy, after considering the modified representations you faxed to me yesterday, I would like the representations to read as follows:

Representations by Investment Advisor (Presidio):

- Investment Advisor believes there is a reasonable opportunity for Investor to earn a reasonable pre-tax profit, in excess of all associated fees and costs, and without regard to any tax benefits that may occur, by participating in the Investment Program. Further, Investment Advisor has communicated this belief to Investor.
- [Name of Bank] does not, directly or indirectly, control or participate in the management or operations of [LLC].
- [Name of Bank] does not, directly or indirectly, control or direct the investments of [LLC] apart from its rights under the security/collateral agreement.

Representations by Bank:

- The security/collateral agreement is consistent with industry standards.
- [Name of Bank] will record the loan and premium amounts paid to Investor as a [$100 million], [seven]-year loan and a [$50 million] premium payment for financial accounting and regulatory purposes.
- [Name of Bank] has made a [seven]-year loan to Investor and will not, except as provided in the loan agreement, accelerate any stated principal or interest payment due under the loan agreement.
- There is no plan or intention to require Investor to convey the loan proceeds or assign the loan obligation to [LLC].

Also, as we discussed, every loan agreement and security/collateral agreement should be reviewed by WNT *before* a BLIPS transaction is implemented. If a loan agreement and/or security/collateral agreement reveals facts contrary to those contained in prototype opinion letter WNT was asked to review (e.g., the Bank has the right to preapprove or veto Presidio's investment choices and/or the Bank can call the loan within 60 days without just cause), we may *not* be able to issue a more-likely-than-not opinion letter on such transaction.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-467-2433 (phone)
202-822-8887 (fax)

Unknown

From: Bickham, Randall S
Sent: Monday, May 17, 1999 12:00 PM
To: Eischeid, Jeffrey A
Subject: BLIPS - Bank Representations

Jeff

1. I spoke with both Bob and John today about how they are planning to coordinate DB's sign off on the BLIPS reps. Their plan is to work through David Kelley in light of an expected negative reaction from the Bank. David, in the past, has been real good at getting similar projects through the Bank's bureaucracy.

2. Bob and I are meeting tomorrow on Domestic OPIS. The plan is to have a DPP package put together this week for Larry. Kevin is forwarding me today the work that he has done to date on proposed legislation, etc.

Randy

Unknown

From: Bickham, Randall S
Sent: Monday, May 17, 1999 5:04 PM
To: DeLap, Larry
Cc: Eischeid, Jeffrey A; Watson, Mark T
Subject: FW: Representations for tax opinions

Larry

Attached is the e-mail from Presidio stating that DB and Presidio will provide the representations we requested. The representations agreed to by Presidio and DB are the following that were forwarded to me by Mark Watson:

Representations by Investment Advisor (Presidio):

- Investment Advisor believes there is a reasonable opportunity for Investor to earn a reasonable pre-tax profit, in excess of all associated fees and costs, and without regard to any tax benefits that may occur, by participating in the Investment Program. Further, Investment Advisor has communicated this belief to Investor.
- [Name of Bank] does not, directly or indirectly, control or participate in the management or operations of [LLC].
- [Name of Bank] does not, directly or indirectly, control or direct the investments of [LLC] apart from its rights under the security/collateral agreement.

Representations by Bank:

- The security/collateral agreement is consistent with industry standards.
- [Name of Bank] will record the loan and premium amounts paid to Investor as a [$100 million], [seven]-year loan and a [$50 million] premium payment for financial accounting and regulatory purposes.
- [Name of Bank] has made a [seven]-year loan to Investor and will not, except as provided in the loan agreement, accelerate any stated principal or interest payment due under the loan agreement.
- There is no plan or intention to require Investor to convey the loan proceeds or assign the loan obligation to [LLC].

Randy

-----Original Message-----
From: John Larson [SMTP:jlarson@presidioadv.com] <mailto:[SMTP:jlarson@presidioadv.com]>
Sent: Monday, May 17, 1999 12:36 PM
To: eischeid@kpmg.com
Cc: rbickham@kpmg.com; tkhenderson@kpmg.com
Subject: Representations for tax opinions

I have discussed the requested lender's representations with Deutsche Bank. They forsee no problem providing them. Furthermore, Presidio is comfortable with the Investment Advisor representations.

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DeLap, Larry

From: DeLap, Larry
Sent: Tuesday, May 18, 1999 8:44 PM
To: Ammerman, Douglas K; Eischeid, Jeffrey A; Watson, Mark T; Wiesner, Philip J
Cc: Lanning, John T; Stein, Jeff; Lippman, Michael H; Springer, Mark A; Smith, Richard H (WNT); Rosenthal, Steven M; Sams, James K; Elgin, Evelyn; Bickham, Randall S
Subject: FW: BLIPS Representations

Randy Bickham has forwarded to me a memorandum from Bob Pfaff of Presidio Advisors confirming that the below named representations can be made by Presidio and by the participating banks in connection with "BLIPS".

The draft opinion letter on a hypothetical BLIPS transaction includes a discussion of financial statement accounting for a loan premium. I asked Mark Bielstein of DPP-Assurance to comment on the accuracy of that discussion, but have not heard back from him. Provided that Phil Wiesner confirms that he believes a more-likely-than-not opinion on each of the technical issues delineated therein could be reached in subject draft opinion letter even if the financial statement accounting treatment discussion were determined to be inaccurate, marketing of BLIPS is approved, subject to the conditions listed below. However, if Phil indicates that a revision to the existing financial statement accounting treatment in the draft opinion letter could affect the determination of the appropriateness of a more-likely-than-not opinion on any of the technical issues, approval of marketing of BLIPS needs to be deferred until we hear back from Mark Bielstein.

The following are the conditions under which marketing of BLIPS is approved:

1. BLIPS is to be marketed only to individuals. This includes a pass-through entity in which all the persons to whom attributes are passed through are individuals.

2. BLIPS is not to be marketed to corporations, nor to any pass-through entity that includes a corporation (other than an S corporation not subject to corporate tax on recognized built in gains or excess net passive income) as a member, partner, etc.

3. A member of the PFP Innovative Strategies group, or another person specifically designated by Doug Ammerman, is to be present at all presentations to prospective BLIPS clients.

4. A determination is to be made that a prospective BLIPS client has a high tolerance for investment risk and tax risk before presenting an engagement letter to the prospective client.

5. The attached memorandum on penalty issues is to be provided to a prospective BLIPS client prior to providing the prospective client an engagement letter.

6. The attached standard engagement letter is to be used on all BLIPS engagements. Minor revisions to the standard letter may be approved by the applicable Professional Practice Partner - Tax. Significant revisions require the approval of DPP-Tax.

7. Our prospective client evaluation process is to be followed for each BLIPS client who is not an existing KPMG client. Where a pass through entity is involved, this includes each member, partner, etc,. of the pass through entity.

8. Before the first BLIPS engagement letter is issued, Mark Watson and other relevant Washington National Tax personnel are to receive, review, and approve the intended language of the documents to be used.

9. Mark Watson, or his designee, is to be involved in each BLIPS transaction to the extent

necessary to determine that the underlying documentation and transactions are such that the contemplated opinion letter(s) can later be issued.

10. Mark Watson, or his designee, is to review and approve each opinion letter issued to a BLIPS client.

11. There will be an overall limit on the number of BLIPS engagements that can be sold. That overall limit is not being established at this time, but will be the subject of periodic discussions among Doug Ammerman, Jeff Eischeid, Mark Watson, and me.

REDACTED

12. Third parties (e.g., . are not to be used a referral source or otherwise in connection with marketing of BLIPS without express advance permission of DPP-Tax.

13. If there is an intention to use Business Development Managers in connection with the marketing of BLIPS, the intended script and other aspects of the BDMs participation are to be approved in advance by DPP-Tax.

If there are other conditions that we have agreed to, or should agree to, that are not included in the above list, please let me know.

Larry

-----Original Message-----
From: Watson, Mark T
Sent: Thursday, May 13, 1999 1:49 PM
To: Bickham, Randall S
Cc: Eischeid, Jeffrey A; DeLap, Larry; Springer, Mark A; Wiesner, Philip J; Ammerman, Douglas K
Subject: Representations

Randy, after considering the modified representations you faxed to me yesterday, I would like the representations to read as follows:

Representations by Investment Advisor (Presidio):

- Investment Advisor believes there is a reasonable opportunity for Investor to earn a reasonable pre-tax profit, in excess of all associated fees and costs, and without regard to any tax benefits that may occur, by participating in the Investment Program. Further, Investment Advisor has communicated this belief to Investor.
- [Name of Bank] does not, directly or indirectly, control or participate in the management or operations of [LLC].
- [Name of Bank] does not, directly or indirectly, control or direct the investments of [LLC] apart from its rights under the security/collateral agreement.

Representations by Bank:

- The security/collateral agreement is consistent with industry standards.

- [Name of Bank] will record the loan and premium amounts paid to Investor as a [$100 million], [seven]-year loan and a [$50 million] premium payment for financial accounting and regulatory purposes.

- [Name of Bank] has made a [seven]-year loan to Investor and will not, except as provided in the loan agreement, accelerate any stated principal or interest payment due under the loan agreement.

- There is no plan or intention to require Investor to convey the loan proceeds or assign the loan obligation to [LLC].

Also, as we discussed, every loan agreement and security/collateral agreement should be reviewed by WNT *before* a BLIPS transaction is implemented. If a loan agreement and/or security/collateral agreement reveals facts contrary to those contained in prototype opinion letter WNT was asked to review (e.g., the Bank has the right to preapprove or veto Presidio's investment choices and/or the Bank can call the loan within 60 days without just cause), we may *not* be able to issue a more-likely-than-not opinion letter on such transaction.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-467-2433 (phone)
202-822-8887 (fax)

Segel, Karen B
From: Springer, Mark A
Sent: Wednesday, May 19, 1999 11:22 AM
To: Segel, Karen B
Subject: FW: BLIPS Representations

-----Original Message-----
From: DeLap, Larry
Sent: Wednesday, May 19, 1999 10:01 AM
To: Ammerman, Douglas K; Eischeid, Jeffrey A; Watson, Mark T; Wiesner, Philip J
Cc: Lanning, John T; Stein, Jeff; Lippman, Michael H; Springer, Mark A; Smith, Richard H (WNT); Rosenthal, Steven M; Sams, James K; Elgin, Evelyn; Bickham, Randall S
Subject: RE: BLIPS Representations

Mark Bielstein has confirmed that the financial statement accounting treatment discussion in subject draft opinion letter is okay, so marketing of BLIPS is approved, subject to the below listed conditions.

Larry

-----Original Message-----
From: DeLap, Larry
Sent: Tuesday, May 18, 1999 8:44 PM
To: Ammerman, Douglas K; Eischeid, Jeffrey A; Watson, Mark T; Wiesner, Philip J
Cc: Lanning, John T; Stein, Jeff; Lippman, Michael H; Springer, Mark A; Smith, Richard H (WNT); Rosenthal, Steven M; Sams, James K; Elgin, Evelyn; Bickham, Randall S
Subject: FW: BLIPS Representations

Randy Bickham has forwarded to me a memorandum from Bob Pfaff of Presidio Advisors confirming that the below named representations can be made by Presidio and by the participating banks in connection with "BLIPS".

The draft opinion letter on a hypothetical BLIPS transaction includes a discussion of financial statement accounting for a loan premium. I asked Mark Bielstein of DPP-Assurance to comment on the accuracy of that discussion, but have not heard back from him. Provided that Phil Wiesner confirms that he believes a more-likely-than-not opinion on each of the technical issues delineated therein could be reached in subject draft opinion letter even if the financial statement accounting treatment discussion were determined to be inaccurate, marketing of BLIPS is approved, subject to the conditions listed below. However, if Phil indicates that a revision to the existing financial statement accounting treatment in the draft opinion letter could affect the determination of the appropriateness of a more-likely-than-not opinion on any of the technical issues, approval of marketing of BLIPS needs to be deferred until we hear back from Mark Bielstein.

The following are the conditions under which marketing of BLIPS is approved:

1. BLIPS is to be marketed only to individuals. This includes a pass-through entity in which all the persons to whom attributes are passed through are individuals.

2. BLIPS is not to be marketed to corporations, nor to any pass-through entity that includes a corporation (other than an S corporation not subject to corporate tax on recognized built in gains or excess net passive income) as a member, partner, etc.

3. A member of the PFP Innovative Strategies group, or another person specifically designated by Doug Ammerman, is to be present at all presentations to prospective BLIPS clients.

4. A determination is to be made that a prospective BLIPS client has a high tolerance for investment risk and tax risk before presenting an engagement letter to the prospective client.

5. The attached memorandum on penalty issues is to be provided to a prospective BLIPS client prior to providing the prospective client an engagement letter.

6. The attached standard engagement letter is to be used on all BLIPS engagements. Minor revisions to the standard letter may be approved by the applicable Professional Practice Partner - Tax. Significant revisions require the approval of DPP-Tax.

7. Our prospective client evaluation process is to be followed for each BLIPS client who is not an existing KPMG client. Where a pass through entity is involved, this includes each member, partner, etc,. of the pass through entity.

8. Before the first BLIPS engagement letter is issued, Mark Watson and other relevant Washington National Tax personnel are to receive, review, and approve the intended language of the documents to be used.

9. Mark Watson, or his designee, is to be involved in each BLIPS transaction to the extent necessary to determine that the underlying documentation and transactions are such that the contemplated opinion letter(s) can later be issued.

10. Mark Watson, or his designee, is to review and approve each opinion letter issued to a BLIPS client.

11. There will be an overall limit on the number of BLIPS engagements that can be sold. That overall limit is not being established at this time, but will be the subject of periodic discussions among Doug Ammerman, Jeff Eischeid, Mark Watson, and me.

12. Third parties (e.g., First Union) are not to be used a referral source or otherwise in connection with marketing of BLIPS without express advance permission of DPP-Tax.

13. If there is an intention to use Business Development Managers in connection with the marketing of BLIPS, the intended script and other aspects of the BDMs participation are to be approved in advance by DPP-Tax.

If there are other conditions that we have agreed to, or should agree to, that are not included in the above list, please let me know.

Larry

<< File: BLIPSel2.doc >> << File: INDPEN.DOC >>

-----Original Message-----
From: Watson, Mark T
Sent: Thursday, May 13, 1999 1:49 PM
To: Bickham, Randall S
Cc: Eischeid, Jeffrey A; DeLap, Larry; Springer, Mark A; Wiesner, Philip J; Ammerman, Douglas K
Subject: Representations

Randy, after considering the modified representations you faxed to me yesterday, I would like the representations to read as follows:

Representations by Investment Advisor (Presidio):

- Investment Advisor believes there is a reasonable opportunity for Investor to earn a reasonable pre-tax profit, in excess of all associated fees and costs, and without regard to any tax benefits that may occur, by participating in the Investment Program. Further, Investment Advisor has communicated this belief to Investor.

- [Name of Bank] does not, directly or indirectly, control or participate in the management or operations of [LLC].
- [Name of Bank] does not, directly or indirectly, control or direct the investments of [LLC] apart from its rights under the security/collateral agreement.

Representations by Bank:

- The security/collateral agreement is consistent with industry standards.
- [Name of Bank] will record the loan and premium amounts paid to Investor as a [$100 million], [seven]-year loan and a [$50 million] premium payment for financial accounting and regulatory purposes.
- [Name of Bank] has made a [seven]-year loan to Investor and will not, except as provided in the loan agreement, accelerate any stated principal or interest payment due under the loan agreement.
- There is no plan or intention to require Investor to convey the loan proceeds or assign the loan obligation to [LLC].

Also, as we discussed, every loan agreement and security/collateral agreement should be reviewed by WNT *before* a BLIPS transaction is implemented. If a loan agreement and/or security/collateral agreement reveals facts contrary to those contained in prototype opinion letter WNT was asked to review (e.g., the Bank has the right to preapprove or veto Presidio's investment choices and/or the Bank can call the loan within 60 days without just cause), we may *not* be able to issue a more-likely-than-not opinion letter on such transaction.

Mark T. Watson
Partner
KPMG - Washington National Tax
202-467-2433 (phone)
202-822-8887 (fax)

Unknown

From:	Bickham, Randall S
Sent:	Monday, July 19, 1999 6:04 PM
To:	Eischeid, Jeffrey A
Subject:	KPMG Reps
Importance:	High

Jeff

I spoke with Bill Boyle and the attached is the compromise, subject to DPP review. He thinks he needs the 6707 language in some form to substantiate that the Service should look to KPMG and Presidio first as to payment of the penalty, if any. What you think?

KPMG Reps to DB.doc

Randy

KPMG 0007657

Permanent Subcommittee on Investigations
EXHIBIT #95DD

KPMG LLP

Ladies and Gentlemen:

We understand that you may be engaged to provide tax consulting services to individuals (each, an "Individual" and collectively "Individuals") with respect to their participation in an investment program involving investments in foreign currency positions (the "Investment Program"). We understand that Individuals intend to engage Presidio Growth LLC ("Presidio"), a registered investment advisor, to provide Individuals with investment advisory services and trading strategies with respect to the foreign currency positions entered into pursuant to the Investment Program. Individuals may use a high degree of leverage to finance participation in the Investment Program and may borrow funds from Deutsche Bank A.G., Cayman Islands Branch and execute certain transactions with or through Deutsche Bank.

With respect to our execution of transactions relating to the Investment Program, you hereby represent and acknowledge to us and to our affiliates (collectively, "Deutsche Bank") that:

a) KPMG LLP ("KPMG") has either registered the Investment Program with the Internal Revenue Service pursuant to Code Section 6111 of the Internal Revenue Code or has concluded that it is not required to register the Investment Program. We have been advised by Shearman & Sterling that we do not have an obligation to register the Investment Program with the Internal Revenue Service pursuant to Code Section 6111. In the event that the Internal Revenue Service asserts an application of Code Section 6111, KPMG and/or Presidio shall be responsible for defending and satisfying any liability arising under Code Section 6707;

b) Deutsche Bank did not approach KPMG concerning lending into or executing transactions with respect to the Investment Program;

c) KPMG will provide Individuals that participate in the Investment Program with an opinion letter which addresses the U.S. federal income tax consequences associated with participation in the Investment Program based upon their unique facts and circumstances.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter, which shall be governed by the internal laws of the State of New York.

Unknown

From: Bickham, Randall S
Sent: Monday, July 26, 1999 12:45 PM
To: Eischeid, Jeffrey A
Subject: KPMG Reps

Importance: High

Jeff-

Bill forwarded to me the attached additional changes coming out of S&S. Let me know what you think;

KPMG Reps to DB.doc

Randy

KPMG LLP

Ladies and Gentlemen:

We understand that you may be engaged to provide tax consulting services to individuals (each, an "Individual" and collectively "Individuals") with respect to their participation in an investment program involving investments in foreign currency positions. We understand that Individuals intend to engage Presidio Growth LLC ("Presidio"), a registered investment advisor, to provide Individuals with investment advisory services and trading strategies with respect to such foreign currency positions. Individuals may use a high degree of leverage to finance participation in such strategies and may borrow funds from Deutsche Bank AG, Cayman Islands Branch and execute certain transactions with or through Deutsche Bank (any such borrowing, together with such transactions, the "Investment Program").

With respect to our execution of transactions relating to the Investment Program, you hereby represent and acknowledge to us and to our affiliates (collectively, "Deutsche Bank") that:

a) KPMG LLP ("KPMG") has either registered the Investment Program with the Internal Revenue Service pursuant to Code Section 6111 of the Internal Revenue Code or has concluded that it is not required to register the Investment Program;

b) Deutsche Bank did not approach KPMG concerning lending into or executing transactions with respect to the Investment Program; and

c) KPMG will provide Individuals that participate in the Investment Program with an opinion letter which addresses the U.S. federal income tax consequences associated with participation in the Investment Program based upon their unique facts and circumstances.

We have been advised by Shearman & Sterling that we do not have an obligation to register the Investment Program with the Internal Revenue Service pursuant to Code Section 6111. We have also been advised that in the event the Internal Revenue Service asserts an application of Code Section 6111, Deutsche Bank should not be responsible for defending and satisfying any liability arising under Code Section 6707. As between us, Deutsche Bank should not be responsible for defending and satisfying any liability arising under Code Section 6707.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter, which shall be governed by the internal laws of the State of New York.

Unknown

From:	Watson, Mark T [mwatson@KPMG.com]
Sent:	Monday, July 26, 1999 12:16 PM
To:	DeLap, Larry
Cc:	Springer, Mark A; Rosenthal, Steven M
Subject:	FW: Comments on BLIPS Documents

Larry, I meant to copy you on the following message.

-----Original Message-----
From: Watson, Mark T
Sent: Friday, July 23, 1999 4:04 PM
To: Bickham, Randall S; Eischeid, Jeffrey A
Cc: Ammerman, Douglas K; Wiesner, Philip J; Smith, Richard H (WNT); Springer, Mark A; Brockway, David H
Subject: Comments on BLIPS Documents

Gentlemen, we have completed our review of the following BLIPS documents that you sent to us on Thursday, July 15:

* Credit Agreement
* Form of Note
* Form of Notice of Borrowing
* Form of Pledge and Security Agreement
* Form of Account Control Agreement
* Form of Borrower's Certificate
* Form of Investor Representation letter
* Assignment and Assumption Agreement
* Form of Assignee's Certificate

In summary, our primary concern is that these documents do not give the client (the "Borrower") meaningful use or control of the loan proceeds (i.e., the bank ("DB") will not allow the Borrower access to the proceeds nor allow the Borrower to effectively determine how the proceeds will be invested). As a result, we are concerned that (1) a bona fide loan may not exist, (2) if a loan does exist, that the Borrower may not be considered the true borrower, and (3) a modification of a debt instrument under Reg. Section 1.1001-3 may occur which could result in a large amount of cancellation of debt income being generated. Further, because DB effectively controls how the loan proceeds will be invested and because it seems to have no economic incentive to allow such proceeds to be invested in anything other than very safe investments (e.g., money market accounts), we are concerned as to whether there could be a reasonable expectation of making a profit on the loan transaction given that the cost of borrowing may far exceed the expected rate of return generated by the investments purchased with the loan proceeds. Perhaps Presidio can provide us with an economic analysis that will alleviate our fears on this matter. Such an analysis will also be important if a BLIPS transaction is ever challenged by the IRS.

The provisions contained in the documents that we are particularly concerned about are as follows:

Pledge and Security Agreement

* Preliminary statement (2) - This statement provides that the account in which the loan proceeds are to be deposited by DB is "under the sole dominion and control of [DB]." As a result, it appears that DB can effectively control how and when the loan proceeds will be invested.

* Section 5 - The last sentence of paragraph (c) of this section states that DB "shall have the right at any time to direct the Account Bank (which is also DB) to exchange such Permitted Investments for similar Permitted Investments of smaller or larger determinatións [denominations?], or for other Permitted Investments, credited to the Collateral Account." As a result, it appears that DB can effectively control how and when the loan proceeds will be invested.

* Section 8 - This section states in part that the Borrower will "not (a) sell or otherwise dispose of . . . the Pledged Collateral." Since the "Pledged Collateral" consists of any assets purchased with the loan proceeds, it appears that the Borrower has no discretion to sell any investments purchased with such proceeds.

* Section 18 - Paragraph (d) of this section states that DB "will, at the request of the [Borrower] . . . permit the [Borrower] to substitute at any time for any asset included in the Pledged Collateral cash or any other asset which would constitute a Permitted Investment with a Value at least equal to the Value of the asset to be released; provided that such cash or other asset is pledged hereunder upon terms satisfactory to" DB. Because the Borrower does not have a unilateral right to substitute collateral, we are concerned that a modification of a debt instrument may occur under Reg. Section 1.1001-3. See Reg. Section 1.1001-3(c)(2)(iii).

Account Control Agreement - Section 2 effectively states that the Collateral Securities Intermediary (which is also DB) "shall not comply with entitlement orders or other directions concerning the [investment of the loan proceeds] delivered or originated by the Borrower or any other Person." Again, DB appears to control how and when the loan proceeds will be invested and, thus, it questionable as to whether a bona fide loan would be considered to have been made to Borrower.

Assignment and Assumption Agreement - One of the representations we asked that DB make is that there "is no plan or intention to require investor to convey the loan proceeds or assign the loan obligation to LLC." The fact that an Assignment and Assumption Agreement has already been prepared seems to conflict with this representation. Assuming the Borrower really does not have to assign the loan, I suggest that this agreement not be presented to clients until after they decide to assign the loan.

Credit Agreement - We are missing page 16 of this agreement. Also, according to the Credit Agreement the client's equity investment is required to be deposited into the Collateral Account, and the Collateral Account appears to be effectively controlled by DB. Theoretically, then, DB could prevent any funds from being invested in foreign currencies. In such a case, the tax benefits expected by the client may not be realized. It would seem that the loan documents should contain a provision or provisions that would prevent this result.

Master Agreement - We have not received a copy of this agreement.

I have also reviewed the Strategic Investment Fund, LLC agreement and have the following comments thereon:

* First paragraph - The first paragraph indicates that the agreement is amended and restated. Does this LLC already exist?

* Article II, section 2.04 - The paragraphs under this section imply that the LLC was created in conjunction with the loan transaction and, thus, seem inconsistent with some of the representations we asked Presidio and DB to make (e.g., DB does not directly or indirectly control or direct the investments of LLC; there is no plan or intention to require the Borrower to convey the loan proceeds or assign the loan obligation to LLC, etc.).

* Article III, paragraph 3.02(c) - The single sentence of this paragraph appears to be incomplete or a merger of two separate sentences.

* Article III, section 3.07 - The heading to this sentence - No Withdrawal of or Interest on Capital - does not seem consistent with the sentence that follows.

* Article IV, paragraph 4.02(b) - A sentence in this paragraph states "The amount of the Capital Account balance withdrawn shall be payable in cash within fifteen (15) days of the Withdrawal Date." Don't we need foreign currency to be distributed to the withdrawing partner in order to generate the desired tax benefits?

* Article V, paragraph 5.06(a) - Can Presidio actually waive its fiduciary duty?

KPMG 0018005

Please note that I have not yet received Richard Smith's (or his designee's) comments on the LLC agreement. Thus, there may be additional comments on this agreement. As soon as I receive those comments I will forward them to you.

Finally, we also have not received anything from Deutsche Bank indicating that they are in fact willing to make the representations we have requested them to make.

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=22426
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=22426
To: jlarson@presidioadv.com
Subject: FW: BLIPS Document
Sent: 1999-08-05 16:01:41.000
Date: 1999-08-05 16:03:35.000
X-Folder: BLIPS

John

Attached are the final comments from WNT. I will give you a call to discuss.

Randy

-----Original Message-----
From: Watson, Mark T
Sent: Wednesday, August 04, 1999 3:25 PM
To: Bickham, Randall S; Eischeid, Jeffrey A
Cc: Springer, Mark A; Ammerman, Douglas K; Wiesner, Philip J; Smith, Richard H (WNT); Brockway, David H; Goldberg, William J; Ito, Dennis A; Branan, Carolyn B; Duty, James V; Pedersen, Robert A; Tendler, Neil J
Subject: BLIPS Document

We have completed our review of the revised BLIPS documents and have the following comments thereon:

1. The definition of "Permitted Investments" in the Credit Agreement provides for the addition of different types of collateral by the Borrower subject to the Bank's approval. See Paragraphs (d)(iii) and (e). We recommend that Paragraphs (d)(iii) and (e) be eliminated.

2. In addition, all of the Permitted Investments must either be purchased through or entered into with the Bank. This could be viewed as providing the Bank with veto authority over the Borrower's investment choices. We recommend that the Credit Agreement and other loan documents reflect that the Bank will not exercise its discretion whether or not to enter into a Permitted Investment with the Borrower or purchase or sell such Investment with a view toward limiting the Borrower's discretion to invest freely within the range of Permitted Investments.

3. Sections 18(c) and (d) of the Pledge and Security Agreement provide for the release or substitution of collateral by the Borrower subject to the Bank's approval. We recommend that these provisions be eliminated.

4. Section 2(a) of the Account Control Agreement appears to continue to give the Bank broad authority over the operation of the Collateral Account. This authority could be read to override the Borrower's ability to direct the investments of the assets in the Collateral Account provided by section 2(b). We recommend that section 2(a) be eliminated.

5. The first sentence of section 8 of the Pledge and Security Agreement appears to contain a typo - I think "expect"

should be "except".

6. Paragraph 4.02(b) of the Strategic Investment Fund, LLC agreement contains a typo - "kinf" should be "kind".

As we have discussed, in order to avoid a significant modification of the nonrecourse loan used in a BLIPS transaction, any modification that releases, substitutes, adds, or otherwise alters a substantial amount of the collateral for the loan must occur automatically or as a result of a unilateral option. Comments 1 - 4 are intended to prevent the occurrence of a significant modification and the associated negative tax results.

Assuming the above-listed changes are made to the subject documents, we are ready to proceed.

Unknown

From:	Smith, Richard H (WNT)
Sent:	Monday, August 09, 1999 4:02 PM
To:	Bickham, Randall S
Cc:	Ammerman, Douglas K; Brockway, David H; Eischeid, Jeffrey A; Springer, Mark A; Wiesner, Philip J; Watson, Mark T
Subject:	RE: BLIPS Documents - Acceptance of Recommended Language

Randy,

With regard to the LLC agreement (item 6), should I assume that the other comments made will not be incorporated? For example, even though meeting the section 704(b) safe-harbor does not appear to impact the opinions rendered, it seems odd that we would not amend section 1.02 to eliminate red flags (i.e., non-sanctioned events that would call for capital account restatements) that drew the attention of the gov't in the ACM case. Or have all the comments been incorporated?

On item 2, to the extent that (1) we are not making changes based on representations, observations, etc. of Presidio, its counsel, or others, and (2) the representations etc. are relevant to the resolution of the issue which provoked the suggested change, perhaps it is best that we get it in writing from the persons making these representations to assure that we do not have a misunderstanding in the future.

Richard

-----Original Message-----

From:	Bickham, Randall S
Sent:	Monday, August 09, 1999 6:01 PM
To:	Watson, Mark T
Cc:	Ammerman, Douglas K; Brockway, David H; Eischeid, Jeffrey A; Smith, Richard H (WNT); Springer, Mark A; Wiesner, Philip J
Subject:	BLIPS Documents - Acceptance of Recommended Language
Importance:	High

Mark-

All your recommended language changes to the BLIPS documents have been discussed with Deutsche Bank and Presidio. Consistent with your recommendations, the following specific changes to the documents will be incorporated:

1. Paragraphs (d)(iii) and (e) currently in the Credit Agreement will be eliminated.

2. To avoid the scenario whereby "all of the Permitted Investments must either be purchased through or entered into with the Bank", the following changes will be made to the definitions of Permitted Investments as defined in the Credit Agreement:

   - Paragraph (b) relating to fixed income securities will be changed to delete the requirement that such securities be purchased "through Deutsche Bank (or any of its Affiliates)."

   - Paragraph (c) relating to interest rate swap transactions and interest rate options will be changed to allow such contracts to be entered into with "Deutsche Bank, BT Corporation, or any affiliates."

   In our discussions of the above changes, Presidio made the observation that they have been informed by their counsel that the remaining "restrictions" being imposed by Deutsche Bank are typical of those that are applied to highly leveraged hedge fund investments. Furthermore, Presidio's counsel has advised them that if Deutsche Bank was unreasonable in its interpretation of the terms of the Credit Agreement, the Investment Fund would have a significant cause of action for breach of contract against Deutsche Bank. Finally, Presidio made the observation that from a pragmatic perspective, since the investment strategy assumes immediate entry into foreign currency contracts, they would know at once if there is a problem with Deutsche Bank's compliance with the terms and intent of the Credit Agreement.

3. The language in Section 18(c), "The Bank may, in its sole discretion, at the request of the Pledgor, release to the

Pledgor any asset included in the Pledged Collateral if, immediately after giving effect to such release, such ratio would be less than 1.015 to 1.00 but equal to or greater than the ratio required to be maintained under Section 8 (k) of the Credit Agreement (1.0125 to 1.00)," and Section 18(d) currently in the Pledge and Security Agreement will be eliminated.

4. Deutsche Bank has advised us that the language contained in Section 2(a) of the Account Control Agreement is necessary under the UCC to perfect the Bank's security interest in the collateral account in the event of the borrower's default under the terms of the loan agreement. Section 2(a) must be read together with Section 2(b) of the Account Control Agreement (which allows the Borrower to direct investments) and Section 12 of the Pledge and Security Agreement (the Remedies upon Default section) in order to understand how and when Section 2(a) applies. Accordingly, the language is integral to the construct of the document.

   To confirm the meaning and intent of Section 2(a), Deutsche Bank has agreed to add the following to Section 12 of the Pledge and Security Agreement, *Remedies upon Default*: The provisions contained in Section 2(a) of the Account Control Agreement apply only in the event of default by the Borrower.

5. The noted change in Section 8 of the Pledge and Security Agreement will be made.

6. The noted change in Paragraph 4.02(b) of the Strategic Investment Fund, LLC Agreement will be made.

Thanks for all your kind help and assistance in finalizing the BLIPS documentation.

Randy

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=22426
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=22426
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPS Documents -- Acceptance of Recommended Language
Sent: 1999-08-10 16:18:19.250
Date: 1999-08-10 16:18:22.632
X-Folder: BLIPS

John,

The request below is the final from WNT. I will give you a call after a conference call I am on this morning to discuss your thoughts on the feasibility of making the rep below.

Randy

-----Original Message-----
From: Watson, Mark T
Sent: Tuesday, August 10, 1999 8:45 AM
To: Bickham, Randall S; Eischeid, Jeffrey A
Cc: Ammerman, Douglas K
Subject: FW: BLIPS Documents -- Acceptance of Recommended Language

Randy/Jeff, will Presidio's and Presidio's counsel make the representations requested below?

-----Original Message-----
From: Larkins, Richard G
Sent: Tuesday, August 10, 1999 11:30 AM
To: Watson, Mark T
Cc: Schwartz, Carol A; Rosenthal, Steven M
Subject: BLIPS Documents -- Acceptance of Recommended Language

Mark:

If counsel/Presidio can represent (i) that all of the restrictions contained in the definition of Permitted Investments are commercial, customary, arm's length provisions for nonrecourse loans with highly-leveraged borrowers, and (ii) that, based on the Credit Agreement, the Bank is obligated to enter into any of the Permitted Investments if requested by the Borrower and that should the Bank exercise any discretion in this regard, the Borrower would have a significant cause of action against the Bank for breach of contract, then we could conclude that the Borrower more likely than not has a unilateral option as defined in Reg. sec. 1.1001-3(c)(3).

Richard

Unknown

From: John Larson [jlarson@presidioadv.com]
Sent: Tuesday, August 10, 1999 2:20 PM
To: rbickham@kpmg.com
Cc: eischeid@kpmg.com
Subject: Today's rep

Per your request, Presidio is prepared to make the following representations:

"To: Presidio Growth, LLC

We understand that you will present an investment strategy (the "Strategy") to a number of individuals (the "Individuals") in connection with which each individual will invest, through a single-member limited liability company (the "Investor Vehicle"), in a multi-member limited liability company of which you will be the managing member. Each Investor Vehicle will borrow funds from Deutsche Bank pursuant to Credit Agreements, substantially in the form of the draft dated July 29, 1999.

We may be requested to provide the Individuals with opinion letters addressing the US federal income tax consequences associated with their participation in the Strategy including the borrowings to be made under the Credit Agreements. In this connection, you hearby represent and warrant to us that:

(i) the restrictions included in the definition of Permitted Investments in the Credit Agreement are, to the best of our knowlege, commercial, customary, arms-length provisions for nonrecourse loans with highly leveraged borrowers;
(ii) consistent with the terms of the Credit Agreement, Deutsche Bank is obliged to permit Borrower to enter into any of the Permitted Investments, and that should the Bank not allow such Permitted Investments while there is no Event of Default, the Borrower would have a cause of action against the Bank for breach of contract."

Unknown

From: Bickham, Randall S
Sent: Wednesday, August 11, 1999 8:58 AM
To: Springer, Mark A; Eischeid, Jeffrey A
Cc: Ammerman, Douglas K
Subject: RE: BLIPS Documents - Acceptance of Recommended Language

Mark,

We could not have done it without all your help and behind the scenes work.

Randy

-----Original Message-----
From: **Springer, Mark A**
Sent: Wednesday, August 11, 1999 8:28 AM
To: Eischeid, Jeffrey A
Cc: Bickham, Randall S
Subject: RE: BLIPS Documents - Acceptance of Recommended Language

You be welcome! I think we are FINALLY there!

Mark
Tax Innovation Center
202-467-3807

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Wednesday, August 11, 1999 10:25 AM
To: Springer, Mark A
Subject: RE: BLIPS Documents - Acceptance of Recommended Language

Thanks

-----Original Message-----
From: Springer, Mark A
Sent: Tuesday, August 10, 1999 8:50 PM
To: Watson, Mark T
Cc: Eischeid, Jeffrey A; Smith, Richard H (WNT); Wiesner, Philip J; Bickham, Randall S
Subject: RE: BLIPS Documents - Acceptance of Recommended Language

Mark:

Have you now formally approved the BLIPS generic documents, or are you waiting to see another draft?

Mark
Tax Innovation Center
202-467-3807

-----Original Message-----
From: Bickham, Randall S
Sent: Monday, August 09, 1999 6:01 PM
To: Watson, Mark T
Cc: Ammerman, Douglas K; Brockway, David H; Eischeid, Jeffrey A; Smith, Richard H (WNT); Springer, Mark A; Wiesner, Philip J
Subject: BLIPS Documents - Acceptance of Recommended Language
Importance: High

Mark-

All your recommended language changes to the BLIPS documents have been discussed with Deutsche Bank and Presidio. Consistent with your recommendations, the following specific changes to the documents will be incorporated:

1. Paragraphs (d)(iii) and (e) currently in the Credit Agreement will be eliminated.

2. To avoid the scenario whereby "all of the Permitted Investments must either be purchased through or entered into with the Bank", the following changes will be made to the definitions of Permitted Investments as defined in the Credit Agreement:

   - Paragraph (b) relating to fixed income securities will be changed to delete the requirement that such securities be purchased "through Deutsche Bank (or any of its Affiliates)."

   - Paragraph (c) relating to interest rate swap transactions and interest rate options will be changed to allow such contracts to be entered into with "Deutsche Bank, BT Corporation, or any affiliates."

   In our discussions of the above changes, Presidio made the observation that they have been informed by their counsel that the remaining "restrictions" being imposed by Deutsche Bank are typical of those that are applied to highly leveraged hedge fund investments. Furthermore, Presidio's counsel has advised them that if Deutsche Bank was unreasonable in its interpretation of the terms of the Credit Agreement, the Investment Fund would have a significant cause of action for breach of contract against Deutsche Bank. Finally, Presidio made the observation that from a pragmatic perspective, since the investment strategy assumes immediate entry into foreign currency contracts, they would know at once if there is a problem with Deutsche Bank's compliance with the terms and intent of the Credit Agreement.

3. The language in Section 18(c), "The Bank may, in its sole discretion, at the request of the Pledgor, release to the Pledgor any asset included in the Pledged Collateral if, immediately after giving effect to such release, such ratio would be less than 1.015 to 1.00 but equal to or greater than the ratio required to be maintained under Section 8(k) of the Credit Agreement (1.0125 to 1.00)," and Section 18(d) currently in the Pledge and Security Agreement will be eliminated.

4. Deutsche Bank has advised us that the language contained in Section 2(a) of the Account Control Agreement is necessary under the UCC to perfect the Bank's security interest in the collateral account in the event of the borrower's default under the terms of the loan agreement. Section 2(a) must be read together with Section 2(b) of the Account Control Agreement (which allows the Borrower to direct investments) and Section 12 of the Pledge and Security Agreement (the Remedies upon Default section) in order to understand how and when Section 2(a) applies. Accordingly, the language is integral to the construct of the document.

   To confirm the meaning and intent of Section 2(a), Deutsche Bank has agreed to add the following to Section 12 of the Pledge and Security Agreement, *Remedies upon Default*: The provisions contained in Section 2(a) of the Account Control Agreement apply only in the event of default by the Borrower.

5. The noted change in Section 8 of the Pledge and Security Agreement will be made.

6. The noted change in Paragraph 4.02(b) of the Strategic Investment Fund, LLC Agreement will be made.

Thanks for all your kind help and assistance in finalizing the BLIPS documentation.

Randy

S&S DRAFT
8/17/99

FORM OF DEUTSCHE BANK AG REPRESENTATION LETTER

[Letterhead of KPMG LLP]

We understand that Deutsche Bank AG ("Deutsche Bank") or branches or affiliates of Deutsche Bank may lend funds to limited liability companies established by individuals ("Individuals") and enter into other transactions with such companies with respect to the participation by such Individuals in an investment program (the "Investment Program") sponsored by Presidio Growth LLC ("Presidio"). Such loans will be made pursuant to credit agreements (the "Credit Agreements") substantially in the form of the draft thereof dated August __, 1999. Unless otherwise defined herein, capitalized terms used herein are used as defined therein.

We may be requested to provide the Individuals with opinion letters addressing the United States federal income tax consequences associated with their participation in the Investment Program including the borrowings to be made under the Credit Agreements. In this connection you hereby represent and acknowledge to us that:

(a) The loans to be made pursuant to the Credit Agreements will have been approved by the competent authorities within Deutsche Bank as consistent, in the light of all the circumstances such authorities consider relevant, with Deutsche Bank credit and documentation standards.

(b) Deutsche Bank intends to record for U.S. GAAP accounting purposes and U.S. regulatory purposes the Stated Principal Amount and the Initial Unamortized Premium Amount of the loans to be made pursuant to the Credit Agreements as follows: a $_________, seven year loan and a $__________ unamortized premium amount, respectively.

(c) Each Credit Agreement will provide that the Maturity Date of the loan to be made thereunder will be the seventh anniversary of the applicable Borrowing Date. Furthermore, Section 8 of each Credit Agreement will set forth the conditions upon which the principal of and any accrued interest in respect of the applicable Note, the applicable Prepayment Amount, if any, the applicable Breakage Fee, if any, and all other obligations owing under such Credit Agreement and the applicable Note may be declared to be, or become, due and payable prior to the applicable Maturity Date.

While as part of the negotiation of the form of the Credit Agreement a form of Assignment and Assumption Agreement has been negotiated and it is the expectation of

Deutsche Bank that the Bank (as defined in the Credit Agreements) will be requested to give its consent to an assignment of the applicable Borrower's rights and obligations under each Credit Agreement pursuant thereto to the Presidio limited liability company used to effectuate the Investment Program, the Credit Agreements will not require the Borrowers to assign the loans to be made thereunder to any Person.

Your representations and acknowledgments herein are being furnished to us for our use solely as one of the bases for our delivering the tax opinions mentioned above (for which we confirm and acknowledge to you that you have no responsibility whatsoever) and may not be furnished by us to any other Person for any purpose whatsoever or expressly referred to by us in any communication to any other Person (including such tax opinions) without your prior written consent.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter which shall be governed by the internal laws of the State of New York.

Very truly yours,

KPMG LLP

By:____________________
Name:
Title:

Agreed to and accepted:

DEUTSCHE BANK AG

By:____________________
Name:
Title:

By:____________________
Name:
Title:

Unknown

From: Watson, Mark T
Sent: Wednesday, August 25, 1999 4:42 AM
To: Eischeid, Jeffrey A
Subject: RE: BLIPS

OK. Thanks.

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Wednesday, August 25, 1999 7:45 AM
To: Watson, Mark T; Bickham, Randall S
Subject: RE: BLIPS

When I talked to Larson last week, he said no problem. Mark, please ask Richard to draft the language he'd like to see. Randy, what happened to the DB reps?

Jeff

-----Original Message-----
From: Watson, Mark T
Sent: Wednesday, August 25, 1999 7:29 AM
To: Bickham, Randall S; Eischeid, Jeffrey A
Subject: FW: BLIPS

Gentlemen, will Presidio make these representations? Also, when will we receive the required representations from DB?

-----Original Message-----
From: Larkins, Richard G
Sent: Tuesday, August 24, 1999 12:09 PM
To: Watson, Mark T; Bickham, Randall S; Eischeid, Jeffrey A
Cc: Rosenthal, Steven M
Subject: BLIPS

All:

As Steve may have explained to you yesterday, it is very important that we receive a representation from Presidio that there will not exist at the time the Borrower exercises its option to trade within the range of Permitted Investments an Event of Default (which would give the Bank the right to terminate the instrument). In addition, we need a representation from Presidio that the Borrower will not exercise its option to trade within the range of Permitted Investments in a manner that results in an Event of Default. These representations are necessary to ensure that the Borrower's trading activities will always be consistent with the definition of a unilateral option (see Reg. sec. 1.1001-3(c)(3)).

Finally, it is our view that the parties to any BLIPS transaction should be aware that they should not release, substitute, add or otherwise alter a substantial amount of the collateral for the loan (in any manner other than by changing a Permitted Investment, as limited above) without consulting a tax advisor. Again, the danger is that a significant modification may occur as a result of the foregoing.

,ou have any questions or concerns regarding any of the foregoing, please do not hesitate to call me.

Richard

Proprietary Material
Confidentiality Requested

KPMG 0007827

Permanent Subcommittee on Investigations
EXHIBIT #95MM

Unknown

From: Watson, Mark T
Sent: Friday, August 27, 1999 11:32 AM
To: Eischeid, Jeffrey A; Bickham, Randall S
Subject: FW: BLIPS

Gentlemen, the language for the additional Presidio representations is set forth below.

-----Original Message-----
From: Larkins, Richard G
Sent: Friday, August 27, 1999 11:41 AM
To: Rosenthal, Steven M; Watson, Mark T
Subject: RE: BLIPS

All:

I think what we are missing in the second representation is the word "neither" between "represents that" and "the Borrower." Steve agrees.

Richard

-----Original Message-----
From: Rosenthal, Steven M
Sent: Friday, August 27, 1999 11:04 AM
To: Larkins, Richard G; Watson, Mark T
Subject: RE: BLIPS

Looks fine to me, although the word "not" is missing from the second representation.

-----Original Message-----
From: Larkins, Richard G
Sent: Thursday, August 26, 1999 7:38 PM
To: Watson, Mark T
Cc: Rosenthal, Steven M
Subject: RE: BLIPS

Mark:

The following strikes me as suitable language:

Presidio, as Investment Advisor with respect to the Investment Program, hereby represents that there will not ever exist at the time the Borrower or any Assignee exercises its option to trade within the range of Permitted Investments an Event of Default.

Presidio, as Investment Advisor with respect to the Investment Program, hereby represents that the Borrower nor any Assignee will ever exercise its option to trade within the range of Permitted Investments in a manner that results in or causes an Event of Default.

Steve, how does this sound to you?

Richard

-----Original Message-----
From: Watson, Mark T
Sent: Wednesday, August 25, 1999 7:41 AM
To: Larkins, Richard G
Subject: FW: BLIPS

Richard, can you put together some sample language for the Presidio reps?

-----Original Message-----

From: Eischeid, Jeffrey A
Sent: Wednesday, August 25, 1999 7:45 AM
To: Watson, Mark T; Bickham, Randall S
Subject: RE: BLIPS

When I talked to Larson last week, he said no problem. Mark, please ask Richard to draft the language he'd like to see. Randy, what happened to the DB reps?

Jeff

-----Original Message-----
From: Watson, Mark T
Sent: Wednesday, August 25, 1999 7:29 AM
To: Bickham, Randall S; Eischeid, Jeffrey A
Subject: FW: BLIPS

Gentlemen, will Presidio make these representations? Also, when will we receive the required representations from DB?

-----Original Message-----
From: Larkins, Richard G
Sent: Tuesday, August 24, 1999 12:09 PM
To: Watson, Mark T; Bickham, Randall S; Eischeid, Jeffrey A
Cc: Rosenthal, Steven M
Subject: BLIPS

All:

As Steve may have explained to you yesterday, it is very important that we receive a representation from Presidio that there will not exist at the time the Borrower exercises its option to trade within the range of Permitted Investments an Event of Default (which would give the Bank the right to terminate the instrument). In addition, we need a representation from Presidio that the Borrower will not exercise its option to trade within the range of Permitted Investments in a manner that results in an Event of Default. These representations are necessary to ensure that the Borrower's trading activities will always be consistent with the definition of a unilateral option (see Reg. sec. 1.1001-3(c)(3)).

Finally, it is our view that the parties to any BLIPS transaction should be aware that they should not release, substitute, add or otherwise alter a substantial amount of the collateral for the loan (in any manner other than by changing a Permitted Investment, as limited above) without consulting a tax advisor. Again, the danger is that a significant modification may occur as a result of the foregoing.

If you have any questions or concerns regarding any of the foregoing, please do not hesitate to call me.

Richard

Unknown

From:	Bickham, Randall S
Sent:	Friday, August 27, 1999 11:51 AM
To:	Eischeid, Jeffrey A
Subject:	KPMG Reps
Importance:	High

KPMG Reps to DB.doc

Attached is the rep letter requested.

KPMG LLP

Ladies and Gentlemen:

We understand that you may be engaged to provide tax consulting services to individuals (each, an "Individual" and collectively "Individuals") with respect to their participation in an investment program involving investments in foreign currency positions. We understand that Individuals intend to engage Presidio Growth LLC ("Presidio"), a registered investment advisor, to provide Individuals with investment advisory services and trading strategies with respect to such foreign currency positions. Individuals may use a high degree of leverage to finance participation in such strategies and may borrow funds from Deutsche Bank AG, Cayman Islands Branch and execute certain transactions with or through Deutsche Bank (any such borrowing, together with such transactions, the "Investment Program").

With respect to our execution of transactions relating to the Investment Program, you hereby represent and acknowledge to us and to our affiliates (collectively, "Deutsche Bank") that:

a) KPMG LLP ("KPMG") has either registered the Investment Program with the Internal Revenue Service pursuant to Code Section 6111 of the Internal Revenue Code or has concluded that it is not required to register the Investment Program;

b) Deutsche Bank did not approach KPMG concerning lending into or executing transactions with respect to the Investment Program; and

c) KPMG will provide Individuals that participate in the Investment Program with an opinion letter which addresses the U.S. federal income tax consequences associated with participation in the Investment Program based upon their unique facts and circumstances.

We have been advised by Shearman & Sterling that we do not have an obligation to register the Investment Program with the Internal Revenue Service pursuant to Code Section 6111. We have also been advised that in the event the Internal Revenue Service asserts an application of Code Section 6111, Deutsche Bank should not be responsible for defending and satisfying any liability arising under Code Section 6707. As between us, Deutsche Bank should not be responsible for defending and satisfying any liability arising under Code Section 6707.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter, which shall be governed by the internal laws of the State of New York.

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=22426
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=22426
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: Amended Sample Language
Sent: 1999-09-24 14:29:00.398
Date: 1999-09-24 14:29:03.768
X-Folder: BLIPS

The amended language has been agreed to by Presidio.

Randy

-----Original Message-----
From: Rosenthal, Steven M
Sent: Friday, September 24, 1999 5:16 AM
To: Larkins, Richard G
Cc: Bickham, Randall S; Eischeid, Jeffrey A; Watson, Mark T
Subject: RE: Amended Sample Language

Looks fine to me.

-----Original Message-----
From: Larkins, Richard G
Sent: Thursday, September 23, 1999 10:09 AM
To: Rosenthal, Steven M
Cc: Bickham, Randall S; Eischeid, Jeffrey A; Watson, Mark T
Subject: Amended Sample Language

Steve:

Randy Bickham called me last night and suggested an amendment to our sample representation language regarding the prepayment amount. The attached document shows Randy's suggested change in italics. It seems fine by me and I told Randy so. I also told him that I would run by you to ensure that we are all on the same page in this regard. What do you think?

Richard

<< File: Presidio Growth LLC.doc >>

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLPS Implementation Issues
Sent: 2000-01-27 15:28:04.420
Date: 2000-01-27 15:28:05.201
X-Folder: Opinions - BLIPS

ok. I will update if necessary once Mark finalizes the BLIPS opinion letter. Attached letter included community property rep- will include if Investor lived in community property state.

Angie

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Thursday, January 27, 2000 10:19 AM
To: Napier, Angie
Subject: FW: BLIPS Implementation Issues
Importance: High

I think these are fine if they comport with our "final" opinion. We can't have them signed until the fact section is complete (sorry).

-----Original Message-----
From: Napier, Angie
Sent: Friday, October 15, 1999 3:00 PM
To: Eischeid, Jeffrey A
Subject: RE: BLPS Implementation Issues
Importance: High

Jeff,

I hope this is what you were looking for. I created a generic form representation letter for Investors to sign. I started with the opinion letter representation section and added the draft separate property representation.

On the OPIS transaction, we sent out a representation letter after the opinion was reviewed and approved by Randy. It included the facts and the representations. On BLIPS, it would be helpful if we could send the representation letter out earlier so the release of the opinion letters are not delayed while we wait on investors to return the rep letters. What do you think about having the investors sign the rep letter without having them sign-off on the facts?

If so, we could have the rep letters go out in Jan. 2000. I don't believe we can have them signed before Jan. 2000 because Rep 6 relates to the liquidating distribution from the Partnership.

Angie

<< File: INVESTOR REPRESENTATION LETTER.DOC >>

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Thursday, October 14, 1999 4:53 PM

To: Napier, Angie
Cc: Mangieri, Jeffrey
Subject: FW: BLPS Implementation Issues

Will you provide me a "form" investor rep letter to circulate? We'll need optional language that addresses the community property/separate property issue. Let me know if I didn't send you Carol's first draft that I sent to Mark Watson for review.

Thanks, Jeff

-----Original Message-----
From: Warley, Carol G
Sent: Thursday, October 14, 1999 4:02 PM
To: Eischeid, Jeffrey A
Cc: Carbo, Deke G
Subject: RE: BLPS Implementation Issues

Do you have a copy of the first draft of the investor rep on this issue? I think it needs to be revised to cover the LLC being separate as well as the capital contribution.

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Thursday, October 14, 1999 9:27 AM
To: Warley, Carol G
Cc: Napier, Angie; Mangieri, Jeffrey
Subject: RE: BLPS Implementation Issues

We will add this rep.

-----Original Message-----
From: Warley, Carol G
Sent: Thursday, October 14, 1999 10:25 AM
To: Eischeid, Jeffrey A
Cc: Carbo, Deke G
Subject: RE: BLPS Implementation Issues

Jeff, has a final decision been made as to whether we are going to change the investor rep letter to add this subject matter?

Jeff and Deke, we also need to make sure that we have properly documented that the Borrower LLC is separate. I sent an e mail on this subject earlier.

-----Original Message-----
From: Carbo, Deke G
Sent: Thursday, October 14, 1999 8:37 AM
To: Poreba, Edward W; Slattery, Daniel M; Lipschultz, Brent S; Rivkin, David; Heil, Matthew C; Monahan, Jean C; Nuckolls, John M; Quock, Erika L; Zaudtke, David P; Deutz, Dean G; Hasting, Carl D; Paule, Robin M; Warley, Carol G; Henderson II, Cornelius R; Sabedra, Claudia M
Cc: Eischeid, Jeffrey A; Bloom, Todd; Liston, Shannon L
Subject: BLPS Implementation Issues

Importance: High

There are several BLIPS implementation issues to remember so that you keep your client informed of upcoming steps in the process and insure you have proper documentation for your client. I will be sending out reminders on these issues. The first reminder is as follows:

Make sure you have properly documented that the capital contribution to the Borrower LLC is the separate property of the LLC member.

Deke

To: Jeff Eischeid
From: Jeff Mangieri
Re: BLIPS Deutsche Bank Representation Letter
Sent: February 3, 2000

Jeff,

I understand that Bill Boyle of Deutsche Bank believes that there are significant differences between two drafts of a representation letter that, ultimately, will be used to substantiate the BLIPS opinion letter we issue to our clients. We mailed Bill one draft, dated 10/14/99 ("Our Draft"), for Deutsche Bank approval. Bill internally circulated another draft, dated 8/17/99 ("Their Draft"), for Deutsche Bank approval. Although Our Draft bears a later date than Their Draft, Bill maintains that Our Draft is the original, and that it is missing several important revisions found in Their Draft. This memo compares and contrasts the content of both drafts.

Differences Found in Introductory Paragraphs

Our Draft	Their Draft
KPMG understands that *Deutsche Bank* loans funds and executes transactions...	*Deutsche Bank or branches or affiliates*
...to *individuals and/or their limited liability companies*	*limited liability companies established by individuals*
Bank executes transactions with respect to Individual's participation in *an investment program involving investments in foreign currently [sic] positions*	(does not reference foreign currency investments)
Individuals intend to engage Presidio for *investment advisory services and trading strategies with respect to foreign currency positions*	(acknowledges Presidio as sponsor of program, but does reference Presidio's services)

Comprehensive List of Representations in Opinion Letter and Both Drafts

BLIPS Opinion Letter	Our Draft	Their Draft
The Credit Agreement was *consistent with industry standards*	(identical)	*consistent, in light of all the circumstances (competent authorities within Deutsche Bank) consider relevant, with Deutsche Bank credit and documentation standards*

Proprietary Material
Confidentiality Requested

KPMG 0029784

Permanent Subcommittee on Investigations
EXHIBIT #95RR

Deutsche Bank acted independently of, and at arm's length from, Managing Member, the Class B Member and Investor	(no comparable language)	(no comparable language)
Deutsche Bank recorded the loan and premium amounts paid to Investor as a [$x], seven-year loan and a [$x] premium payment for accounting and regulatory purposes	(nearly identical language)	(nearly identical language)
Deutsche Bank made a seven-year loan to Investor and would not, except as provided in Credit Agreement, accelerate any stated principal or interest payment due under the Credit Agreement	(nearly identical language)	(substantially identical language)
There was no plan or intention to require Investor to convey the loan proceeds or assign the loan obligation to Partnership	(nearly identical language)	*While...it is the expectation of Deutsche Bank that the Bank will be requested to give its consent to an assignment of the applicable Borrower's rights and obligations under each Credit Agreement...the Credit Agreements will not require the Borrowers to assign the loans...to any Person*

Nondisclosure Provision

Their Draft includes a nondisclosure provision as a condition for KPMG's ("our," below) use of Deutsche Bank's ("your," below) representations. In relevant part, it states:

> Your representations and acknowledgments herein are being furnished to us for our use solely as one of the bases for our delivering the tax opinions mentioned above (for which we confirm and acknowledge to you that you have no responsibility whatsoever) and may not be furnished by us to any other Person for any purpose whatsoever or *expressly referred to by us in*

any communication to any other Person (including such tax opinions) without your prior written consent. [italics mine]

This nondisclosure provision is incompatible with the BLIPS opinion letter as presently drafted. As you are aware, we expressly refer to Deutsche Bank's representations in Part II of the BLIPS opinion letter. Such references are prohibited by the italicized clause above. Thus, we should remove, or redraft, this provision before we submit a letter to Deutsche Bank for their approval.

February 21, 2000

PRIVATE AND CONFIDENTIAL
Mr. John Larson
Presidio Growth, LLC
333 Hayes Street, Suite 200
San Francisco, California 94102

Dear John:

We understand that Presidio Growth LLC ("Presidio"), a registered investment advisor, provides clients, which include single-member limited liability companies (each, an "Investor" and collectively "Investors"), with investment advisory services and trading strategies which may involve investments in foreign currency positions. We understand that Investors may participate in an investment program ("Investment Fund"), designed by Presidio, to implement such strategies with respect to foreign currency positions. Investors may use a high degree of leverage to finance participation in such strategies, and may receive loans from a bank ("Bank"), and may execute certain transactions with or through Bank. In turn, Investor and Presidio may execute certain transactions with respect to their participation in the Investment Fund through a Delaware limited liability company ("Partnership"), that was treated as a partnership for United States federal income tax purposes.

If engaged by Investors, KPMG LLP ("KPMG") will provide Investors that participate in the Investment Fund with an opinion letter which addresses the U.S. federal income tax consequences associated with participation in the Investment Fund based upon their unique facts and circumstances. With respect to such opinion letter, you hereby represent and acknowledge to us the following:

- Presidio believed there was a reasonable opportunity for Investor to earn a reasonable pre-tax profit, in excess of all associated fees and costs, and without regard to any tax benefits that may occur, by participating in the Investment Fund. Presidio communicated this belief to Investor. (Exhibit I).

- Presidio acted independently of, and at arm's length from, Investor and Bank with respect to the transactions described therein.

- Bank did not, directly or indirectly, control or participate in the management or operations of Partnership.
- Bank did not, directly or indirectly, control or direct the investments of Partnership apart from its rights under a Pledge and Security Agreement, Credit Agreement, and Account Control Agreement.
- All transactions undertaken by Partnership were executed on foreign exchanges not designated as "qualified boards of exchange" under Code Section 1256(g)(7).
- There will not exist at the time Investor or any assignee enters into trading strategies, within the range of Permitted Investments, an Event of Default under the terms of the Credit Agreement.
- Neither the Investor nor any assignee will enter into trading strategies, within the range of Permitted Investments in a manner that results in or causes an Event of Default under the terms of the Credit Agreement.
- The loan collateral and covenants under a Pledge and Security Agreement were not altered or amended upon assumption of the loan by Partnership.
- The descriptions of the Investment Fund and the economics of the financing arrangement used by Investor, as set forth in Exhibit I attached hereto, are accurate.

My signature indicates that I have read and agree that the stated representations made to KPMG are accurate.

Presidio Growth, LLC

Name: ______________________ Title: ______________________

Very truly yours,

KPMG LLP

Jeffrey A. Eischeid
Partner

KPMG 0026300

Exhibit 1: Description of Investment Transactions

The following describes the investment program entered into by Investor and the investment structure utilized based upon information represented by Presidio:

> Since inception of floating exchange rates in 1973, all currencies have been subject to wide swings in value. The general consensus by the international financial community is that exchange rate volatility is undesirable because of the adverse impact these swings have on international capital flows. Consequently, many governments influence the level of their currency by intervening in foreign exchange markets. Emerging market governments are typically more active participants in their respective currency markets because emerging market currency levels are more easily controlled and the benefits to the emerging market nations are more significant. By controlling the level of their currency, emerging market nations encouraged capital inflows by mitigating the risk of currency devaluation. In addition, by entering into a managed currency regime, the emerging market nation can curb hyperinflation, a problem faced by many emerging market nations due to a combination of rapid growth and imprudent fiscal management common to many of these countries.
>
> The Investment Fund entered into by Investor was established by Presidio as an investment that sought to provide investors with a high total return. To obtain this objective, the Investment Fund invested in U.S. dollar and foreign currency denominated debt securities of corporate and governmental issuers and entered into forward foreign currency contracts, options on currencies and securities and other investments selected by Presidio, as Managing Member of the Investment Fund.[1]
>
> It was Presidio's belief that successful implementation of its investment strategy could best be achieved through a relatively long-term investment horizon. Accordingly, the Investment Fund was structured as a three stage,

[1] An investment in the Investment Fund increased or declined in value as a result of changes in the value of the securities in which the Investment Fund invested and the currencies and securities underlying the forward foreign currency contracts and options.

seven year investment program. The core investment strategy underlying all three stages was to maintain long or short positions in debt securities and currency exchange contracts. Through such investments, the Investment Fund sought to profit from changes that Presidio anticipated would occur in the value of the currencies in which such securities were denominated or quoted or to which the forward currency exchange contracts related.[2]

The three investment stages were differentiated by the degree of risk assumed by the Investment Fund. In each successive stage, Presidio allocated a greater percentage of the Investment Fund's assets to securities and currency positions that allowed a greater opportunity for profit but also correspondingly greater risk. Reflecting the greater degree of risk, Presidio could require investors to make additional capital contributions. However, the aggregate contributions of an investor could not exceed the amount to which such investor agreed at the time of subscription to the Investment Fund. The obligation to make additional capital contributions terminated if the investor notified Presidio of its election to withdraw its entire capital account balance from the Investment Fund.

The anticipated time horizons and associated investment strategies for the three stages at the time Investor entered into the Investment Fund were as follows:

- ***Stage I:*** The first stage was expected to last 60 days, during which time the Investment Fund would engage in strategies that the Managing Member believed entailed relatively low levels of risk compared to later investment stages. An example of a strategy that could be used during this stage was for the Investment Fund to sell short currencies under managed currency regimes ("pegged currencies") that the Managing Member believed were likely to depreciate in the short term.

[2] These profit opportunities were primarily based upon selectively selling ("shorting") overvalued emerging market currencies and selectively buying ("going long") undervalued emerging market currencies. The investment strategy effectively sought to obtain high risk-adjusted returns for its investors by exploiting opportunities to short currencies under unsustainable managed currency regimes and going long currencies previously subject to managed currency regimes that were considered fundamentally undervalued by Presidio due to political or economic upheaval. By monitoring the economic conditions in emerging market countries and the direction of the currency markets, Presidio sought to identify, and profit from, those currency devaluations which were most likely to occur over the life of the Investment Fund.

- ***Stage II:*** The second stage of the investment strategy was expected to last approximately 120 days. During stage two, the Investment Fund would pursue similar investment strategies as during stage one. However, the degree of risk taken by the Investment Fund would increase. More of the Investment Fund's capital was to be allocated to riskier positions, resulting in higher potential profit but also higher potential losses and volatility. Due to the increase in risk during investment stage two, the members could be required to increase their capital contributions to the Investment Fund.

- ***Stage III:*** The third stage of the investment strategy was expected to last approximately 6.5 years. During the third investment stage, the Investment Fund would pursue investment strategies that had the potential for greater rewards but also would entail substantially greater risk. For example, in addition to maintaining short positions in pegged currencies which the Managing Member believed to be overvalued, the Investment Fund could establish long positions in emerging market currencies that have recently been devalued. By buying debt securities denominated in recently devalued currencies or entering into forward currency exchange contracts after a devaluation, the risk profile of the Investment Fund would be higher than during the first two stages; however, the potential returns were expected to be commensurately higher.[3]

The minimum investment for an investor in the Investment Fund was $10 million in return for a Class A interest. Contributions to the Investment Fund had to be in cash. At the discretion of Presidio, as the Managing Member, the Investment Fund allowed a Class A Member to contribute cash subject to indebtedness at the time of subscription. If an investor funded its investment capital through a loan, the Managing Member required investors to arrange at least seven-year financing in order to cover the expected term of the program.[4] In addition to one or more Class A Members and the Managing Member, the Investment Fund allowed for one or more holders of Class B interests. The Class B Member(s) were affiliates of the Managing Member.

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[3] Presidio believed that currencies which had recently been devalued typically were undervalued due to economic upheaval and abnormally high interest rates. The value of these currencies may, however, be particularly volatile.

[4] Presidio effectively allowed an investor a choice of funding its participation in the Investment Fund on either a non-leveraged basis or a leveraged basis by contributing cash subject to an outstanding loan to the Investment Fund.

Class A Members had the right to withdraw all (but not part) of their capital account balances upon written request to the Managing Member beginning on the 60th day following the Class A Member's initial investment and each 60 day anniversary thereafter provided that the Managing Member received the written request at least 10 business days prior to such date. Unless the Managing Member otherwise agreed, Class B Members could only withdraw their capital account balances following the withdrawal by all of the Class A Members. In lieu of accepting a Class A Member's withdrawal request, the Managing Member could have elected either to liquidate the Investment Fund or to arrange for the purchase of the Class A Member's interest at a price equal to the withdrawal proceeds that the Class A Member would otherwise have received.

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: Additional Opinion Letter Representation
Sent: 2000-02-25 13:42:54.417
Date: 2000-02-25 13:42:55.370
X-Folder: Opinions - BLIPS

Jeff,

We have already asked John Larson to sign the representation letter. Do we need to add this representation?

Angie

-----Original Message-----
From: Watson, Mark T
Sent: Thursday, February 24, 2000 7:16 PM
To: Napier, Angie; McGrath, Kevin J
Cc: Rosenthal, Steven M
Subject: Additional Opinion Letter Representation

Please add the following Presidio representation to the opinion letter templates:

"Any amount due under the loan other than the aggregate outstanding principal amount, any accrued but unpaid interest, and the unamortized premium is expected to be incidental (i.e., under all reasonably expected market conditions on the date of issuance of the loan, the potential amount of any such payment would be insignificant relative to the total expected amount of the remaining payments on the loan)."

Mark T. Watson
Partner
KPMG - Washington National Tax
202-533-3092 (phone)
202-533-8451 (fax)

KPMG 0025740

Permanent Subcommittee on Investigations
EXHIBIT #95TT

From /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
From: /O=KPMG/OU=US/CN=RECIPIENTS/CN=41900
To: /O=KPMG/OU=US/CN=RECIPIENTS/CN=20499
Subject: BLIPs reps to kpmg
Sent: 2000-03-09 20:40:25.409
Date: 2000-03-09 20:40:25.581
X-Folder: Opinions - BLIPS

Randy,

I can not open the attached file.

Angie

-----Original Message-----
From: Bickham, Randall S
Sent: Thursday, March 09, 2000 3:26 PM
To: Napier, Angie
Cc: Eischeid, Jeffrey A
Subject: FW: BLIPs reps to kpmg

Angie,

Jeff asked me to forward you the attached e-mail for incorporation into the opinion letters.

Randy

-----Original Message-----
From: Eischeid, Jeffrey A
Sent: Thursday, March 09, 2000 11:46 AM
To: Bickham, Randall S
Subject: FW: BLIPs reps to kpmg

As discussed.

-----Original Message-----
From: william.boyle@db.com [mailto:william.boyle@db.com]
Sent: Thursday, March 09, 2000 10:33 AM
To: eischeid@kpmg.com
Cc: cdwyer@shearman.com; michelle.cenis@db.com
Subject: BLIPs reps to kpmg

Jeff,
Attached for your review are our recommended changes to the rep letter. Two major changes from your version. First, we are deleting the reference to "industry standards" in (a). We believe this language is overly broad and our meeting DB standards should be sufficient. Second, we prefer to retain the final paragraph, except for the first parenthetical. We prefer to retain control over the use of the reps and as such would prefer to review the use of our reps in your tax opinion prior to our giving approval to use such reps in your tax opinion.

KPMG 0033604

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95UU

Please give me a call to discuss.
Best regards,

Bill

(See attached file: kpmgrepl.doc)

APR-03-2000 17:05 KPMG Peat Marwick 404 222 3435 P.02/23

KPMG

303 Peachtree Street, N.E.
Suite 2000
Atlanta, GA 30308

Telephone 404 222 3000
Fax 404 222 3060

PRIVATE AND CONFIDENTIAL
Mr. Richard Pankuch
Bayerishche Hypo-und Vereinsbank AG, New York Branch
150 East 42nd Street
New York, NY 10017-4679

Gentlemen:

We understand that Bayerishche HYPO-und Vereinsbank AG, New York Branch or its affiliates ("HypoVereinsbank") may lend funds to limited liability companies established by investors ("Investors") and enter into other transactions with such companies with respect to the participation by such Investors in an investment program (the "Investment Program") sponsored by Presidio Growth LLC ("Presidio"). Such loans will be made pursuant to credit agreements (the "Credit Agreements") substantially in the form of the draft thereof dated August 1999. Unless otherwise defined herein, capitalized terms used herein are used as defined therein.

We may be requested to provide the Investors with opinion letters addressing the United States federal income tax consequences associated with their participation in the Investment Program including the borrowings to be made under the Credit Agreements. In this connection you hereby represent and acknowledge to us that:

(a) The Credit Agreement and associated exhibits contained therein (i.e., the Pledge and Security Agreement and the Account Control Agreement) and the Assignment and Assumption Agreement entered into between Investors and HypoVereinsbank will have been approved in the ordinary course of business by the competent authorities within HypoVereinsbank as consistent, in the light of all the circumstances such authorities consider relevant, with HypoVereinsbank credit and documentation standards which HypoVereinsbank believes are consistent with industry standards.

(b) HypoVereinsbank will act independently of, and at arm's length from, Investors and the other participants in the Investment Program.

(c) HypoVereinsbank intends to record for U.S. GAAP accounting purposes and U.S. regulatory purposes a seven year premium loan whose premium is recorded separately and is amortized over the life of the loan.

Proprietary Material
Confidentiality Requested

KPMG 0046310

Permanent Subcommittee on Investigations
EXHIBIT #95VV

APR-03-2000 17:05 KPMG Peat Marwick 404 222 3435 P.03/03

Page 2
Mr. Richard Pankuch
Bayerishche Hypo-und Vereinsbank AG, New York Branch

(d) Each Credit Agreement will provide that the Maturity Date of the loan to be made thereunder will be the seventh anniversary of the applicable Borrowing Date. Furthermore, Section 8 of each Credit Agreement will set forth the conditions upon which the principal of and any accrued interest in respect of the applicable Note, the applicable Prepayment Amount, if any, the applicable Breakage Fee, if any, and all other obligations owing under such Credit Agreement and the applicable Note may be declared to be, or become, due and payable prior to the applicable Maturity Date. Except as provided in such Credit Agreement, HypoVereinsbank will not accelerate any stated principal or interest payment due under the Credit Agreement.

While as part of the negotiation of the form of the Credit Agreement, a form of Assignment and Assumption Agreement has been negotiated and it is the expectation of HypoVereinsbank that the Bank (as defined in the Credit Agreements) will be requested to give its consent to an assignment of the applicable Borrower's rights and obligations under each Credit Agreement pursuant thereto to the Presidio limited liability company used to effectuate the Investment Program. The Credit Agreements will not require the Borrowers to assign the loans to be made thereunder to any Person and HypoVereinsbank has no plan or intention to require such assignment.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter which shall be governed by the internal laws of the State of New York.

Very truly yours,

KPMG LLP

By: ______

Name: Jeffrey A. Eischeid
Title: Partner

Agreed to and accepted:

Richard Pankuch

By: ______

Name: RICHARD G. PANKUCH
Title: AUTHORIZED SIGNATORY

By: ______

Name:
Title:

TOTAL P.03

TOTAL P.03

MAR-02-2000 19:10 KPMG Peat Marwick 404 222 3425 P.02/03

KPMG

303 Peachtree Street, N.E.
Suite 2000
Atlanta, GA 30308

Telephone 404 222 3000
Fax 404 222 3050

PRIVATE AND CONFIDENTIAL
Mr. Martin Rushton-Turner
National Westminster Bank plc
135 Bishopsgate
London EC2M 3UR

Gentlemen:

We understand that National Westminster Bank plc ("NatWest") or branches or affiliates of NatWest may lend funds to limited liability companies established by investors ("Investors") and enter into other transactions with such companies with respect to the participation by such Investors in an investment program (the "Investment Program") sponsored by Presidio Growth LLC ("Presidio"). Such loans will be made pursuant to credit agreements (the "Credit Agreements") substantially in the form of the draft thereof dated August 1999. Unless otherwise defined herein, capitalized terms used herein are used as defined therein.

We may be requested to provide the Investors with opinion letters addressing the United States federal income tax consequences associated with their participation in the Investment Program including the borrowings to be made under the Credit Agreements. In this connection you hereby represent and acknowledge to us that:

a) The Credit Agreement and associated exhibits contained therein (i.e., the Pledge and Security Agreement and the Account Control Agreement) and the Assignment and Assumption Agreement entered into between Investors and NatWest have been approved in the ordinary course of business by the competent authorities within NatWest as consistent, in the light of all the circumstances such authorities consider relevant, with NatWest credit and documentation standards which NatWest believes are consistent with industry standards.

b) NatWest acted independently of, and at arm's length from, Investor and the other participants in the Investment Program.

c) NatWest intends to record for accounting purposes and regulatory purposes the Stated Principal Amount and the Initial Unamortized Premium Amount of the loans to be made pursuant to the Credit Agreements as follows: a $______, seven year loan and a $__________ unamortized premium amount, respectively.

KPMG

Page 2
Mr. Martin Rushton-Turner
National Westminster Bank plc

d) Each Credit Agreement will provide that the Maturity Date of the loan to be made thereunder will be the seventh anniversary of the applicable Borrowing Date. Furthermore, Section 8 of each Credit Agreement will set forth the conditions upon which the principal of and any accrued interest in respect of the applicable Note, the applicable Prepayment Amount, if any, the applicable Breakage Fee, if any, and all other obligations owing under such Credit Agreement and the applicable Note may be declared to be, or become, due and payable prior to the applicable Maturity Date. Except as provided in such Credit Agreement, NatWest will not accelerate any stated principal or interest payment due under the Credit Agreement.

While as part of the negotiation of the form of the Credit Agreement, a form of Assignment and Assumption Agreement has been negotiated and it is the expectation of NatWest that the Bank (as defined in the Credit Agreements) will be requested to give its consent to an assignment of the applicable Borrower's rights and obligations under each Credit Agreement pursuant thereto to the Presidio limited liability company used to effectuate the Investment Program. The Credit Agreements will not require the Borrowers to assign the loans to be made thereunder to any Person and NatWest has no plan or intention to require such assignment.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter.

Very truly yours,

KPMG LLP

By: Jeff Eischeid / [illegible]
Name:
Title:

Agreed to and accepted:

Mr. Martin Rushton-Turner

By: [signature]
Name: John Martin Rushton-Turner
Title: Managing

By:____________
Name:
Title:

TOTAL P.03

TOTAL P.03

KPMG 0046313

FORM OF KPMG REPRESENTATION LETTER

[Letterhead of Deutsche Bank Securities, Inc.]

KPMG LLC
~~[Address]~~
Attention: Jeffrey A. Eischeid
303 Peachtree Street, N.E.
Suite 2000
Atlanta, Georgia 30308

Gentlemen:

You hereby acknowledge to us (a) that neither we nor any of our affiliates have or has played any role whatsoever in the marketing to the Investor identified in the Credit Agreement of even date herewith between [Borrower Name2] and Deutsche Bank A.G., Cayman Islands Branch, of the transactions contemplated thereby or any similar transactions and (b) that while affiliates of ours are participating as lender or as counterparty in certain of the transactions contemplated by such Credit Agreement, neither we nor any of our affiliates are or is committed to participate in any transactions. ~~which you may arrange.~~

You also represent to us that, except as we may have specifically consented to in writing, you have not referred to us or to any of our affiliates in any written materials furnished to the Investor in connection with the marketing of the transactions contemplated by such Credit Agreement or any other transactions.

Very truly yours,

DEUTSCHE BANK SECURITIES, INC.

By:______________
Name:
Title:

By:______________
Name:
Title:

Agreed to and accepted:

KPMG LLC

KPMG 0005585

Proprietary Material
Confidentiality Requested

Permanent Subcommittee on Investigations
EXHIBIT #95WW

By:____________________
Name:
Title:

Bickham, Randall S
To: Watson, Mark T
Cc: Ammerman, Douglas K; Brockway, David H; Eischeid, Jeffrey A; Smith, Richard H (WNT); Springer, Mark A; Wiesner, Philip J
Subject: BLIPS Documents-Acceptance of Recommended Language

Mark-

All your recommended language changes to the BLIPS documents have been discussed with Deutsche Bank and Presidio. Consistent with your recommendations, the following specific changes to the documents will be incorporated:

1. Paragraphs (d)(iii) and (e) currently in the Credit Agreement will be eliminated.

2. To avoid the scenario whereby "all of the Permitted Investments must either be purchased through of entered into with Bank", the following changed will be made to the definitions of Permitted Investments as defined in the Credit Agreement:

    - Paragraph (b) relating to fixed income securities will be changed to delete the requirement that such securities be purchased "through Deutsche Bank (or any of its Affiliates)."

    - Paragraph © relating to interest rate swap transactions and interest rate options will be changed to allow such contracts to be entered into with "Deutsche Bank, BT Corporation, or any affiliates."

    In addition to the changes made, Presidio made the observation that if Deutsche Bank was unreasonable in its interpretation of the terms of the Credit Agreement, the Investment Fund would have cause of action for breach of contract against Deutsche Bank. Presidio made the further observation that from a pragmatic perspective, since the investment strategy assumes immediate entry into foreign currency contracts, they would know at once if there is a problem with Deutsche Bank's reading of the Credit Agreement.

3. The language in Section 18(c), "The Bank may, in its sole discretion, at the request of the Pledgor, release to the Pledgor any asset included in the Pledged Collateral if, immediately after giving effect to such release, such ratio would be less than 1.015 to 1.00 but equal to or greater than the ratio required to be maintained under Section 8(k) of the Credit Agreement (1.0125 to 1.00)," and Section 18(d) currently in the Pledge and Security Agreement will be eliminated.

4. Deutsche Bank requires the language contained in Section 2(a) to perfect the Bank's security interest in the collateral. Accordingly, since the language is integral to the construct of the document, it can not be eliminated. To clarify the intent of provision, (i.e., that Section 2(a) only applies in the event of default on the terms of the loan by the Borrower), the following language is being added to Section 12 of the Pledge and Security Agreement, *Remedies upon Default*: Section 12(e) – "The provisions contained in Section 2(a) of the Account Control Agreement apply solely in the event of default by the Borrower."

5. The noted change in Section 8 of the Pledge and Security Agreement will be made.

6. The noted change in Paragraph 4.02(b) of the Strategic Investment Fund, LLC Agreement will be made.

Thanks for all your kind help and assistance in finalizing the BLIPS documentation.

Randy

Bickham, Randall S
To: Watson, Mark T
Cc: Ammerman, Douglas K; Brockway, David H; Eischeid, Jeffrey A; Smith, Richard H (WNT); Springer, Mark A; Wiesner, Philip J
Subject: BLIPS Documents-Acceptance of Recommended Language

Mark-

All your recommended language changes to the BLIPS documents have been discussed with Deutsche Bank and Presidio. Consistent with your recommendations, the following specific changes to the documents will be incorporated:

1. Paragraphs (d)(iii) and (e) currently in the Credit Agreement will be eliminated.

2. To avoid the scenario whereby "all of the Permitted Investments must either be purchased through or entered into with the Bank", the following changes will be made to the definitions of Permitted Investments as defined in the Credit Agreement:

   - Paragraph (b) relating to fixed income securities will be changed to delete the requirement that such securities be purchased "through Deutsche Bank (or any of its Affiliates)."

   - Paragraph (c) relating to interest rate swap transactions and interest rate options will be changed to allow such contracts to be entered into with "Deutsche Bank, BT Corporation, or any affiliates."

   In our discussions of the above changes, Presidio made the observation that they have been informed by their counsel that the remaining "restrictions" being imposed by Deutsche Bank are typical of those that are applied to highly leveraged hedge fund investments. Furthermore, Presidio's counsel has advised them that if Deutsche Bank was unreasonable in its interpretation of the terms of the Credit Agreement, the Investment Fund would have a significant cause of action for breach of contract against Deutsche Bank. Finally, Presidio made the observation that from a pragmatic perspective, since the investment strategy assumes immediate entry into foreign currency contracts, they would know at once if there is a problem with Deutsche Bank's compliance with the terms and intent of the Credit Agreement.

3. The language in Section 18(c), "The Bank may, in its sole discretion, at the request of the Pledgor, release to the Pledgor any asset included in the Pledged Collateral if, immediately after giving effect to such release, such ratio would be less than 1.015 to 1.00 but equal to or greater than the ratio required to be maintained under Section 8(k) of the Credit Agreement (1.0125 to 1.00)," and Section 18(d) currently in the Pledge and Security Agreement will be eliminated.

4. Deutsche Bank has advised us that the language contained in Section 2(a) of the Account Control Agreement is necessary under Section 8 of the UCC to perfect the Bank's security interest in the collateral account in the event of the borrower's default under the terms of the loan agreement. Section 2(a) must be read together with Section 2(b) of the Account Control Agreement (which allows the Borrower to direct investments) and Section 12 of the Pledge and Security Agreement (the Remedies upon Default section) in order to understand how and when Section 2(a) applies. Accordingly, the language is integral to the construct of the document.

   To confirm the meaning and intent of Section 2(a), Deutsche Bank has agreed to add the following to Section 12 of the Pledge and Security Agreement, *Remedies upon Default*: The provisions contained in Section 2(a) of the Account Control Agreement apply only in the event of default by the Borrower.

5. The noted change in Section 8 of the Pledge and Security Agreement will be made.

6. The noted change in Paragraph 4.02(b) of the Strategic Investment Fund, LLC Agreement will be made.

Thanks for all your kind help and assistance in finalizing the BLIPS documentation.

Randy

[Date]

PRIVATE AND CONFIDENTIAL
[Investor, Sole Member (e.g. Mr. Bill Smith or XYZ Trust)]
[c/o Name, Trustee (only applicable if Trust is Sole Member)]
[Borrower LLC]
[Address]

Dear [Investor]:

The following are representations which will be relied upon by KPMG, LLP ("KPMG") to issue an opinion regarding the foreign currency investment strategy involving [Deutsche Bank or HypoVereinsBank]. Please sign and return in the enclosed envelope.

In connection with the foreign currency investment strategy, Investor has represented to KPMG the following:

- Investor's single member invests directly in marketable securities and other financial instruments on its own account.

- Investor, the Managing Member, the Class B Member and [Deutsche Bank or HypoVereinsBank] each acted independently and at arm's length with respect to the transactions described herein.

- There was no legally binding agreement, written or otherwise, that compelled Investor to complete the transactions in the way described herein. The duration of Investor's participation in the Investment Fund was dependent upon the performance of the program relative to alternative investments.

- There were no written agency agreements or arrangements (apart from Presidio's role as Managing Member of Partnership) consummated with respect to the transactions undertaken pursuant to the Investment Fund and none of the parties involved held itself out to a third party as an agent of any of the others with respect to these transactions.

- Investor independently reviewed the economics underlying the Investment Fund before entering into the program and believed there was a reasonable opportunity to earn a reasonable pre-tax profit from the transactions described herein (not including any tax benefits that may occur), in excess of all associated fees and costs.

In connection with the transactions described above, Investor has represented to KPMG LLP ("KPMG") the following:

- Investor's single member invests directly in marketable securities and other financial instruments on its own account.

- Investor, Investment Advisor and [Deutsche Bank] each acted independently and at arm's length with respect to the transactions described herein.

- There was no legally binding agreement, written or otherwise, the compelled Investor to complete the transactions in the way described herein. The duration of Investor's participation in the Investment Program was dependent upon the performance of the program relative to alternative investments.

- There were no written agency agreements (apart from a standard investment advisory agreement) consummated with respect to the transactions undertaken pursuant to the Investment Program and none of the parties involved held itself out to a third party as an agent of any of the others with respect to these transactions.

- Investor independently reviewed the economics underlying the Investment Program before entering into the program and believed there was a reasonable opportunity to earn a reasonable pre-tax profit from the transactions described herein (not including any tax benefits that may occur), in excess of all associated fees and costs.

- The [Deutsche Bank AG] loan collateral and covenants were not altered or amended upon assumption f the loan by Partnership.

- Investor was liquidated subsequent to receiving the liquidating distributions from Partnership. The foreign currency and financial instruments received as Partnership liquidating distributions were sold by Investor's single member.

- Investor has provided KPMG with all facts and circumstances that Investor knows, or has reason to know, are pertinent to this opinion letter and believes that all assumptions and representations on which this opinion relies are reasonable.

[Borrower LLC]
[Date]

- Investor was liquidated subsequent to receiving the liquidating distributions from Partnership. The foreign currency and financial instruments received as Partnership liquidating distributions were sold by Investor's single member.
- Investor has provided KPMG with all facts and circumstances that Investor knows, or has reason to know, are pertinent to this opinion letter and believes that all its representations on which this opinion relies are reasonable.
- [Add this representation if Investor resides in a community property state - If Investor is an individual, Investor's capital contribution to the single member LLC was Investor's separate property.]

****

I have read the representations which KPMG will rely upon regarding the foreign currency investment strategy. My signature indicates I agree that the representations made to KPMG are accurate.

_________________________________ Date: ____________________
[Investor Name]
["Trustee" only applicable if Investor is a Trust]

PRIVATE AND CONFIDENTIAL
Mr. William Boyle
Deutsche Bank Securities, Inc.
31 West 52nd Street, 13th Floor
New York, New York 10019

Dear Bill:

We understand that Deutsche Bank AG ("Deutsche Bank") or branches or affiliates of Deutsche Bank may lend funds to limited liability companies established by investors ("Investors") and enter into other transactions with such companies with respect to the participation by such Investors in an investment program (the "Investment Program") sponsored by Presidio Growth LLC ("Presidio"). Such loans will be made pursuant to credit agreements (the "Credit Agreements") substantially in the form of the draft thereof dated August 1999. Unless otherwise defined herein, capitalized terms used herein are used as defined therein.

We may be requested to provide the Investors with opinion letters addressing the United States federal income tax consequences associated with their participation in the Investment Program including the borrowings to be made under the Credit Agreements. In this connection you hereby represent and acknowledge to us that:

a) The Credit Agreement and associated exhibits contained therein (i.e., the Pledge and Security Agreement and the Account Control Agreement) and the Assignment and Assumption Agreement entered into between Investors and Deutsche Bank have been approved in the ordinary course of business by the competent authorities within Deutsche Bank as consistent, in the light of all the circumstances such authorities consider relevant, with Deutsche Bank credit and documentation standards which Deutsche Bank believes are consistent with industry standards.

b) Deutsche Bank acted independently of, and at arm's length from, Investor and the other participants in the Investment Program.

KPMG 0029776

Permanent Subcommittee on Investigations
EXHIBIT #95ZZ

c) Deutsche Bank intends to record for U.S. GAAP accounting purposes and U.S. regulatory purposes the Stated Principal Amount and the Initial Unamortized Premium Amount of the loans to be made pursuant to the Credit Agreements as follows: a $________, seven year loan and a $__________ unamortized premium amount, respectively.

d) Each Credit Agreement will provide that the Maturity Date of the loan to be made thereunder will be the seventh anniversary of the applicable Borrowing Date. Furthermore, Section 8 of each Credit Agreement will set forth the conditions upon which the principal of and any accrued interest in respect of the applicable Note, the applicable Prepayment Amount, if any, the applicable Breakage Fee, if any, and all other obligations owing under such Credit Agreement and the applicable Note may be declared to be, or become, due and payable prior to the applicable Maturity Date. Except as provided in such Credit Agreement, Deutsche Bank will not accelerate any stated principal or interest payment due under the Credit Agreement.

While as part of the negotiation of the form of the Credit Agreement a form of Assignment and Assumption Agreement has been negotiated and it is the expectation of Deutsche Bank that the Bank (as defined in the Credit Agreements) will be requested to give its consent to an assignment of the applicable Borrower's rights and obligations under each Credit Agreement pursuant thereto to the Presidio limited liability company used to effectuate the Investment Program, the Credit Agreements will not require the Borrowers to assign the loans to be made thereunder to any Person and Deutsche Bank has no plan or intention to require such assignment.

Your representations and acknowledgements herein are being furnished to us for our use solely as one of the bases for our delivering the tax opinions mentioned above and may not be furnished by us to any other Person for any purpose whatsoever or expressly referred to by us in any communication to any other Person (including such tax opinions) without your prior consent.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter which shall be governed by the internal laws of the State of New York.

Very truly yours,

KPMG LLP

By:________________________
Name: Jeffrey A. Eischeid
Title: Partner

Agreed to and accepted:

DEUTSCHE BANK AG

By:________________________
Name:
Title:

By:________________________
Name:
Title:

KPMG LLP
Attention: Jeffrey A. Eischeid
303 Peachtree Street, N.E.
Suite 2000
Atlanta, Georgia 30308

Ladies and Gentlemen:

We understand that you may be engaged to provide tax consulting services to individuals (each, an "Individual" and collectively "Individuals") with respect to their participation in an investment program involving investments in foreign currency positions. We understand that Individuals intend to engage Presidio Growth LLC ("Presidio"), a registered investment advisor, to provide Individuals with investment advisory services and trading strategies with respect to such foreign currency positions. Individuals may use a high degree of leverage to finance participation in such strategies and may borrow funds from Deutsche Bank AG, Cayman Islands Branch and execute certain transactions with or through Deutsche Bank (any such borrowing, together with such transactions, the "Investment Program").

With respect to our execution of transactions relating to the Investment Program, you hereby represent and acknowledge to us and to our affiliates (collectively, "Deutsche Bank") that:

a) KPMG LLP ("KPMG") has either registered the Investment Program with the Internal Revenue Service pursuant to Code Section 6111 of the Internal Revenue Code or KPMG has made a reasonable determination based upon its understanding of the facts and current tax law not to register the Investment Program with the Internal Revenue Service;

b) Deutsche Bank did not approach KPMG concerning lending into or executing transactions with respect to the Investment Program;

c) Except for the representations regarding the Investment Program that Deutsche Bank makes in a separate letter to KPMG, ~~Deutsche Bank has not made any representations regarding the Investment Program. In addition,~~ Deutsche Bank has not made any guarantee or representation whatsoever as to the expected performance or results of the Investment Program (including the legal, tax, financial or accounting consequences thereof to any Individual), and any income tax consulting advice you render with respect thereto was not and will not be rendered in reliance upon any such guarantee or representation regarding the expected performance or results of the Investment Program; and

d) KPMG will provide Individuals that participate in the Investment Program with an opinion letter which addresses the U.S. federal income tax consequences associated

Proprietary Material
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KPMG 0046035

Permanent Subcommittee on Investigations
EXHIBIT #95AAA

with participation in the Investment Program based upon their unique facts and circumstances.

We have been advised by Shearman & Sterling that, as a lender and a counterparty in the transactions referred to in the last sentence of the first paragraph of this letter, we do not have an obligation to register the Investment Program with the Internal Revenue Service pursuant to Code Section 6111. We have also been advised that in the event the Internal Revenue Service asserts an application of Code Section 6111, Deutsche Bank should not be responsible for defending and satisfying any liability arising under Code Section 6707. As between us, Deutsche Bank should not be responsible for defending and satisfying any liability arising under Code Section 6707.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter, which shall be governed by the internal laws of the State of New York.

Richard G. Pankuch
Managing Director
150 East 42nd Street
New York, New York 10017

Phone (212) 672-5696
FAX: (212) 672-5591
E-mail Richard_Pankuch@america.hypovereinsbank.com

HVB STRUCTURED FINANCE INC.

Fax

To:	Jeff Eischeid	**From:**	Dick Pankuch
Fax:	404-222 3435	**Pages:**	3 including cover
Phone:	404-222-3180	**Date:**	April 4, 2000
Re:	Presidio Rep Letter	**CC:**	

Urgent **For Review** ☐ **Please Comment** ☐ **Please Reply** ☐ **Please Recycle**

Jeff:

Attached is the rep letter with my signature alone. As I indicated, our system requires 2. I will get Dom's signature later this week when he returns from Europe.

Let me know if you need anything else.

Dick Pankuch

Note: The attached letter was reviewed with Shearman & Sterling (Cornelius Dwyer of Shearman & Sterling) Thomas Sima of HVB NY and J. Sensel of Accounting before it was signed and returned.

Richard [signature]
4/4/2000

Permanent Subcommittee on Investigations
EXHIBIT #95BBB

KPMG

303 Peachtree Street, N.E.
Suite 2000
Atlanta, GA 30308

Telephone 404 222 3000
Fax 404 222 3050

PRIVATE AND CONFIDENTIAL
Mr. Richard Pankuch
Bayerishche Hypo-und Vereinsbank AG, New York Branch
150 East 42nd Street
New York, NY 10017-4679

Gentlemen:

We understand that Bayerishche HYPO-und Vereinsbank AG, New York Branch or its affiliates ("HypoVereinsbank") may lend funds to limited liability companies established by investors ("Investors") and enter into other transactions with such companies with respect to the participation by such Investors in an investment program (the "Investment Program") sponsored by Presidio Growth LLC ("Presidio"). Such loans will be made pursuant to credit agreements (the "Credit Agreements") substantially in the form of the draft thereof dated August 1999. Unless otherwise defined herein, capitalized terms used herein are used as defined therein.

We may be requested to provide the Investors with opinion letters addressing the United States federal income tax consequences associated with their participation in the Investment Program including the borrowings to be made under the Credit Agreements. In this connection you hereby represent and acknowledge to us that:

(a) The Credit Agreement and associated exhibits contained therein (i.e., the Pledge and Security Agreement and the Account Control Agreement) and the Assignment and Assumption Agreement entered into between Investors and HypoVereinsbank will have been approved in the ordinary course of business by the competent authorities within HypoVereinsbank as consistent, in the light of all the circumstances such authorities consider relevant, with HypoVereinsbank credit and documentation standards which HypoVereinsbank believes are consistent with industry standards.

(b) HypoVereinsbank will act independently of, and at arm's length from, Investors and the other participants in the Investment Program.

(c) HypoVereinsbank intends to record for U.S. GAAP accounting purposes and U.S. regulatory purposes a seven year premium loan whose premium is recorded separately and is amortized over the life of the loan.

KPMG

Page 2
Mr. Richard Pankuch
Bayerishche Hypo-und Vereinsbank AG, New York Branch

(d) Each Credit Agreement will provide that the Maturity Date of the loan to be made thereunder will be the seventh anniversary of the applicable Borrowing Date. Furthermore, Section 8 of each Credit Agreement will set forth the conditions upon which the principal of and any accrued interest in respect of the applicable Note, the applicable Prepayment Amount, if any, the applicable Breakage Fee, if any, and all other obligations owing under such Credit Agreement and the applicable Note may be declared to be, or become, due and payable prior to the applicable Maturity Date. Except as provided in such Credit Agreement, HypoVereinsbank will not accelerate any stated principal or interest payment due under the Credit Agreement.

While as part of the negotiation of the form of the Credit Agreement, a form of Assignment and Assumption Agreement has been negotiated and it is the expectation of HypoVereinsbank that the Bank (as defined in the Credit Agreements) will be requested to give its consent to an assignment of the applicable Borrower's rights and obligations under each Credit Agreement pursuant thereto to the Presidio limited liability company used to effectuate the Investment Program. The Credit Agreements will not require the Borrowers to assign the loans to be made thereunder to any Person and HypoVereinsbank has no plan or intention to require such assignment.

Please indicate your agreement to the above by countersigning and returning to us a copy of this letter which shall be governed by the internal laws of the State of New York.

Very truly yours,

KPMG LLP

By: ____________________
Name: Jeffrey A. Eischeid
Title: Partner

Agreed to and accepted:

Richard Pankuch

By: ____________________
Name: RICHARD G. PANKUCH
Title: AUTHORIZED SIGNATORY

TOTAL P.03

By: ____________________
Name:
Title:

KPMG

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Atlanta, GA 30308

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KPMG

Page 2
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Bayerishche Hypo-und Vereinsbank AG, New York Branch

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Please indicate your agreement to the above by countersigning and returning to us a copy of this letter which shall be governed by the internal laws of the State of New York.

Very truly yours,

KPMG LLP

By: [signature]
Name: Jeffrey A. Eischeid
Title: Partner

Agreed to and accepted:

Richard Pankuch

By:______________________
Name:
Title:

By: [signature]
Name: DOMENICK DEGIORGIO
Title: VICE PRESIDENT

Unknown

From: DeLap, Larry [ldelap@KPMG.COM]
Sent: Friday, March 03, 2000 1:43 PM
To: Manth, Larry E
Subject: RE: S corp Strategy

Larry -

It is my view that, where a valuation is an integral element of an aggressive tax strategy promoted by us, the client should have it performed by an independent valuation firm.

Larry

```
> -----Original Message-----
> From:     Manth, Larry E
> Sent:     Friday, March 03, 2000 10:34 AM
> To: DeLap, Larry
> Subject:  S corp Strategy
>
> Larry, in regards to the valuation work necessary to implement the
> strategy, is there any way that we can use our own valuation group
> (maybe have a different office?  separate engagement letter and separate fee?).
> It would make the implementation much more smoother for us.
>
> Thanks, Larry
>
>
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KPMG 0016839

Permanent Subcommittee on Investigations
EXHIBIT #96a

KPMG

SC² OUTLINE

PLEASE READ ATTACHED WHITE PAPER FIRST

SC2_Whitepaper.doc

KPMG

To: Tax Innovation Center (Washington National Tax)

From: Larry E. Manth, Andrew S. Atkin, Douglas Duncan, Robert Huber (Los Angeles)

Date: March 31, 2000

Re: S-Corporation Charitable Contribution Strategy ("SC^2")

FACTS

Shareholder is the sole individual shareholder of S Corp (hereinafter "S Corp"), a subchapter S corporation that is engaged in an active trade or business and that is not an investment company. Shareholder desires to contribute stock to a qualified tax-exempt entity as a philanthropic gesture. Shareholder also desires greater flexibility regarding estate planning with respect to his ownership interest in S Corp.

The facts are as follows:

- The fair market value ("FMV") of S Corp is $10 million.
- There are 100 shares of common stock outstanding (all owned by Shareholder).
- Shareholder has zero basis in his stock.
- S Corp has zero balance in its Accumulated Adjustments Account ("AAA") and also has no Accumulated Earnings and Profits ("AEP").
- S Corp has no Section 751 property.[1]
- S Corp is an accrual basis taxpayer and is on the calendar year for tax reporting purposes.
- In tax years 2000 and 2001, the taxable income of S Corp is expected to be $4 million per year. This income is normal operating income and is not the result of significant one-time gains or income from extraordinary transactions.
- No distributions are expected in tax years 2000 and 2001.
- Exempt-Org (hereinafter "Exempt-Org") has represented (and has received a determination letter) that it is a governmental pension plan that meets the requirements of Section 401(a) and the related rulings and regulations, both in form and operation. Exempt-Org is not related to or controlled by Shareholder. In addition, Shareholder is not a direct beneficiary of Exempt-Org, i.e. Shareholder is not a member of the pension plan.
- Exempt-Org is desirous of accepting contributions in the form of subchapter S corporation stock because it is not concerned about unrelated business income tax ("UBIT").

[1] All references to Sections herein are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.

The following proposed transaction is being considered by Shareholder:

Step One:

(a) Distribution of nonvoting shares. On 12/30/99, S Corp amends its Articles of Incorporation and By Laws to permit it to issue nonvoting stock. On that same date, S Corp distributes 900 shares of nonvoting common stock to Shareholder. Under the articles of incorporation and corporate by-laws, the nonvoting stock has the same distribution and liquidation rights as the voting stock.

(b) Distribution of warrants. On 12/30/99, S Corp also makes a distribution of warrants to acquire 7000 shares of nonvoting S Corp stock to Shareholder, with an exercise period of ten years. These warrants represent the right to purchase 87.5 percent of the equity value of S Corp (7000 / 8000[2]). The total exercise price is $7.875 million, or 90 percent of the FMV of the equity that can be purchased by the warrants.[3]

Fair market value of nonvoting stock. The fair market value of the nonvoting stock will be determined by a qualified independent valuation firm meeting the requirements of a "qualified appraiser" under Regulation Section. 1.170A-13(c)(6).[4]

Step Two:

(a) Donation of the stock. On 12/31/99, Shareholder donates the 900 shares of nonvoting common stock to Exempt-Org.

(b) Formation of the redemption agreement. Simultaneous with the donation, Exempt-Org and S Corp enter into a redemption agreement (the "Redemption Agreement"). Under the terms of the Redemption Agreement, Exempt-Org has the power to demand that S Corp redeem its shares for the FMV at the time of the redemption (as determined by a qualified independent valuation firm). The power is not exercisable until two years from the date of the signing of the agreement. It is explicitly stated in the Redemption Agreement that neither Shareholder nor S Corp has the power to force a redemption on Exempt-Org. Furthermore, the Redemption Agreement provides that Exempt-Org may not revoke the subchapter S election of S Corp and that Exempt-Org may not make any

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[2] The 8000 total shares is calculated as follows: 7000 warrants plus the 100 voting shares and 900 nonvoting shares.

[3] The exercise price is determined as follows: 90 percent * ($10 million total equity value * 87.5 percent)).

[4] A third party independent valuation group ("VG") has determined the value of nonvoting stock in similar situations by determining what the total equity value of S Corp would be after the exercise of the warrants ($17.875 million ($10 million initial value plus the $7.875 million additional input of capital from an exercise of the warrants). The VG would then multiply the $17.875 million total value by the percentage equity interest the nonvoting stock would represent after the warrants were exercised (11.25% (900 shares / 8000 total shares), for an initial equity value of the nonvoting stock of approximately $2 million (11.25% * $17.875 million total value). Lastly, the VG would apply a discount for lack of control and marketability (35%), for a fair market value of approximately $1.3 million.

transfer of the nonvoting stock that would cause the subchapter S status of S Corp to be revoked.

(c) Pledge. Shareholder enters into a pledge with Exempt-Org, providing that Shareholder will make an additional contribution to Exempt-Org, should the value of the nonvoting stock decrease from the time it is contributed until the time that Exempt-Org first has the right to present the stock for redemption. The amount due under the pledge will be the difference between the FMV of the stock on the date that it was contributed and the FMV on the date that Exempt-Org first had the right to present the stock for redemption. The pledge will become due six months from the date that Exempt-Org actually presents the stock for redemption. In addition, the pledge will be payable over one year, in monthly installments, with a market rate of interest. S Corp will not be a party to this pledge and will not guarantee the payment.

ANALYSIS

Step One:

(a) The distribution of the nonvoting stock. S Corp will be able to make a tax-free distribution of the nonvoting common stock without Shareholder recognizing any gain from the distribution. Section 305(a) provides that gross income does not include a corporation's distribution of stock or stock rights to its shareholders. Likewise, S Corp will not recognize gain on the distribution of the nonvoting stock under Section 311(a).

The distribution of the nonvoting stock will not trigger a second class of stock. As mentioned above, the nonvoting stock contains identical distribution and liquidation rights as the voting stock, as required by Section 1361(b)(1)(D) and Regulation Section 1.1361-1(l)(1). In addition, the differences in voting rights will be ignored in determining whether there is more than one class of stock.[5]

(b) The distribution of the warrants. S Corp will also be able to make a tax-free distribution of the warrants under Section 305(a).[6] Under Regulation Section 1.305-1(d) the term "stock" is defined to include warrants to acquire stock. Therefore, the distribution of the warrants will not trigger any gain to Shareholder. As with the nonvoting stock discussed above, S Corp will also not recognize gain on the distribution under Section 311(a).

The distribution of warrants will not create a second class of stock if it qualifies under Regulation Section 1.1361-1(l)(4)(iii). This regulation provides that a corporation's call option, warrant, or similar instrument is treated as a second class of stock only if the option is substantially certain to be exercised by the holder or a potential transferee and the option has a strike price substantially below the FMV of the underlying stock. More precisely, there is a safe harbor under Regulation Section 1.1361-1(l)(4)(iii)(C) which provides that if the strike price is at least 90 percent of the FMV of the underlying stock

[5] I.R.C. Sec. 1361(c)(4) and Reg. Sec. 1.1361-1(l)(1).
[6] *See* I.R.C. Sec. 305(d), which includes "stock rights" in the term "stock."

on the date it is issued, it is not considered a second class of stock. In the case of the warrants S Corp issues to Shareholder, the exercise price is equal to the 90 percent of the FMV of the underlying stock, thus satisfying this safe harbor test.

Basis issues. The basis in the warrants and the nonvoting common stock will be determined under Section 307(a). Under this provision, the basis in the voting stock will be allocated among all of the warrants, non-voting common stock and voting common stock based on their respective fair market values.[7] However, since Shareholder had no basis in the voting common stock, Shareholder will be allocated no basis in the warrants or the nonvoting common stock.[8]

Alternative characterization. The Service could argue that the distributions of the nonvoting stock and warrants were a recapitalization under Section 368(a)(1)(E), as opposed to tax-free distributions under Section 305(a). However, if the Service were to recharacterize the distributions as a recapitalization, the issuance of the nonvoting stock and warrants would still be tax-free. Under Section 354(a), no gain or loss is recognized if stock or securities in a corporation which is a party to a reorganization[9] are exchanged solely for stock and securities in that corporation. Under Regulation Section 1.354-1(e), the term "securities" includes rights issued by a party to a reorganization to acquire stock in the corporation. Therefore, even if the issuances of the nonvoting stock and warrants are considered a recapitalization, the issuances should still be tax-free under Section 354(a).[10]

Step Two

(a) The donation of the stock. Section 170(a) provides that, "[t]here shall be allowed as a deduction any charitable contribution . . . payment of which is made within the taxable year."

Shareholder will be entitled to a charitable contribution deduction under Section 170(c)(1), which provides that the term "charitable contribution" includes:

> a contribution or gift to or for the use of a state, a possession of the United States, or any political subdivision of any of the foregoing or the United

[7] Reg. Sec. 1.307-1(a).
[8] The basis allocation requirements under I.R.C. Sec. 307 may be a trap for the unwary in an S corporation context. Assume a shareholder has basis in his S corporation stock of $1 million at 12/31/1999 and the corporation has paid a dividend of $1 million on 2/1/00. Also assume the corporation will break-even for the 2000 tax year. If a distribution of warrants were to occur prior to the end of the year, basis would be allocated pursuant to I.R.C. Sec. 307. Since the shareholder's basis in his stock is not adjusted for distributions until the end of the year (Reg. Sec. 1.1367-1(d)), and I.R.C. Sec. 307 requires a basis allocation on the date the warrants are received by the shareholder, the distribution received by the shareholder in February will be partially taxed as capital gain or ordinary income.
[9] Under I.R.C. Sec. 368(a)(1)(E), a recapitalization is considered a type of reorganization.
[10] It should also be noted that under Reg. Sec. 1.354-1(e), rights to acquire stock have no principal amount for purposes of determining whether there is any boot under I.R.C. Sec. 356. Therefore, even if the warrants did not meet the statutory definition of a security, they would still not be considered boot under I.R.C. Sec. 356.

> States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.[11]

The Service has specifically ruled that contributions to pension funds established for the benefit of municipal employees, municipal policemen or municipal firemen constitute charitable contributions. Specifically, the Service has held that:

> contributions made by third parties to pension funds established under a state law for the benefit of municipal employees, municipal policemen, or municipal firemen, which are deposited by the administering pension board to the credit of the particular fund for the use and benefit of the respective pension system, are deductible by the donors in computing their taxable income in the manner and to the extent provided by section 170 of the Code.[12]

Accordingly, Shareholder should be entitled to a charitable contribution deduction.

However, the amount of the deduction may be limited under Section 170(e)(1). Specifically, "in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply" to reduce the amount of the deduction by the amount of any ordinary income that would have been realized had the assets of the corporation been sold.[13] Thus, the charitable contribution deduction will be reduced by the portion of the FMV of the donated stock that is attributable to such ordinary income items. Here, there are none.[14]

The amount of Shareholder's deduction for the contribution of the stock will also be limited to 30 percent of Shareholder's adjusted gross income (AGI).[15] In addition, Shareholder's overall contributions for the year (including this stock contribution) may not exceed 50 percent of AGI.[16]

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[11] I.R.C. Sec. 170(c)(1).
[12] Rev. Rul. 58-154, 1958-1 C.B. 125. Subsequently, in PLR 6603315320A, the Service ruled that contributions to a pension trust were not deductible, reasoning that the contributions benefited the employees of the trust and not the trust itself. In PLR 6610145320A, the Service again refused to allow deductions for these contributions and stated that it was, "reconsidering the rationale of our published revenue ruling." The Service however relied on Rev. Rul. 58-154 in Rev. Rul. 71-270, ruling that contributions made to the pension trust of a Section 501(c)(3) organization were deductible because, "the contributions to the pension plan trust relieve the organization of its obligation to make such payments." Therefore, it appears that Rev. Rul. 58-154 is still valid.
[13] I.R.C. Sec. 170(e)(1).
[14] As mentioned in the facts, S Corp does not have any I.R.C. Sec. 751 property. If this were not the case, an analysis would need to be performed to determine the amount of I.R.C. Sec. 751 property. One key issue would be whether there was any unrealized accounts receivable. Unrealized accounts receivable would be applicable where the S corporation is on the cash basis of accounting and, therefore, would not have previously included these amounts in its income. Since S Corp is on the accrual method, the adjustment relating to unrealized accounts receivable is not required.
[15] *See* I.R.C. Sec. 170(b)(1)(C).
[16] *See* I.R.C. Sec. 170(b).

Gift Tax. In computing the amount of Shareholder's taxable gifts for the year, the charitable contribution will be allowed as a deduction. Under Section 2522(a), the taxpayer is allowed a deduction for all gifts made to an entity that can receive deductible charitable contributions. Shareholder will not be required to file a gift tax return for the charitable donation. Under Section 6019(3), an individual is not required to file a gift tax return for a gift which was allowed as a deduction under Section 2522, so long as the transfer was of the donor's entire interest in the property transferred and no other interest in such property is transferred for less than full consideration to a person for a use not described in Section 2522. Since Shareholder is donating his entire interest in the nonvoting stock, there should be no need to file a gift tax return.

Exempt-Org is a permitted shareholder. Under Section 1361(c)(6), organizations that are described in Section 401(a) and that are exempt from tax under Section 501(a), are permissible S Corporation shareholders.

As stated in the facts, Exempt-Org is an organization described Section 401(a) that is a governmental plan. Under Section 501(a), Section 401(a) organizations are exempted from tax. Therefore, Exempt-Org meets all shareholder eligibility criteria specified in Section 1361(c)(6).[17]

(b) Formation of redemption agreement. Under the Section 1361 regulations, redemption agreements are generally disregarded in determining whether there is more than one class of stock.[18] Specifically, a redemption agreement does not trigger a second class of stock unless: 1) a principal purpose is to circumvent the one class of stock requirement; and 2) the agreement establishes a purchase price that, at the time of the agreement, is significantly in excess of or below FMV.[19]

1) Principal purpose test. In determining generally whether there is more than one class of stock, the Section 1361 regulations focus on whether there are different distribution rights or rights to liquidation proceeds.[20] The purpose of the Redemption Agreement is to give Exempt-Org a market to sell its stock, not to give it additional or different rights from other shareholders. The Redemption Agreement does not change distribution rights. Moreover, if there was a liquidation of S Corp, Exempt-Org would have full liquidation rights. Based on these facts, it is not a principal purpose of the Redemption Agreement to circumvent the one class of stock requirement.

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[17] The organization described in I.R.C. Sec. 401(a) is technically the trust, not the plan itself. Commentators have noted that for many governmental plans, "there is no formal trust document." *See* Karen B. Kotner and Leslye G. Laderman, Defined Benefit Plans of Churches and State and Local Governments, 372 Tax Management. (BNA) (1990) at §III(e). However, "the Section 401(a) trust requirement would apparently be satisfied if the statutory language imposes duties on the plan administrator equivalent to those imposed on a private sector trustee." *Id.*

[18] *See* Reg. Sec. 1.1361-1(l)(2)(iii).

[19] *Id.*

[20] *See* Reg. Sec. 1.1361-1(l)(1) ("[A] corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.").

2) FMV test. Under the Redemption Agreement, the price for the redemption is the FMV at the time of the redemption. Therefore, the second test for avoiding a second class of stock should also be met.

(c) The Pledge. The fact that Shareholder has entered into a pledge with Exempt-Org should not create a second class of stock because the pledge is an agreement between Exempt-Org and Shareholder, individually. Since S Corp is not a party to this pledge and does not guarantee the payment, the pledge should not create a second class of stock. If Shareholder should pay any amount under the pledge, he should be entitled to a charitable contribution deduction for the amount paid under Section 170(c).

Outstanding Stock. The warrants will not count as outstanding stock for purposes of determining the allocation of the taxable income of S Corp provided that their strike price can be shown to be not substantially below the fair market value of the stock on the date the options are issued or on any date that they may be materially modified.[21]

Section 269 Issues. Section 269 allows the Internal Revenue Service (the "Service") to disallow "benefit of a deduction, credit, or other allowance," through acquisitions made for the principal purpose of avoiding income tax. Specifically, this section applies when a corporation directly or indirectly acquires control of another corporation. For purposes of Section 269, control is defined as owning at least 50 percent of the voting power of all classes of stock or at least 50 percent of the total value of shares of all classes of stock. In the proposed transaction, this control requirement will not be met and there will be no acquisition, because Exempt-Org will never own 50 percent of the total value or 50 percent of the total voting power of the stock. However, even if the control requirement is met, Exempt-Org does not "secure a deduction, credit or other allowance" from S Corp. Income will be attributed to Exempt-Org, not deductions, credits or other allowances. Therefore, Exempt-Org receives no tax benefit from the acquisition of control. In addition, S Corp obtains no tax benefit from the acquisition of control as subchapter S corporations are generally not subject to a corporate level income tax under Section 1361. Thus, the acquisition of control is not material to any tax benefit and Section 269 should not apply to the proposed transaction.

Additionally, the Service has conceded that Section 269 does not apply in the case of an S corporation formed for the purpose of allowing corporate income to be offset by shareholders' NOL carryovers,[22] or to secure the benefit of exemption from the corporate income tax.[23]

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[21] *See* Reg. Sec. 1.1361-1(l)(4)(iii)(A); *Hume v. Commissioner*, T.C. Memo 1988-485 (an option to acquire S stock held by an ineligible shareholder did not disqualify the S election because the option was not exercised); *see also Tax Planning for S Corporations*, §4.05 (Matthew Bender 1998) ("Stock warrants and restricted stock allow for special allocations in S corporations because before the exercise of the warrants or the vesting of the restricted stock, the option holder or restricted shareholder is not treated as a shareholder of the corporation. Therefore, all items of income and deduction that would otherwise be attributable to the stock are allocated to the other shareholders."); *see also* Eustice & Kuntz, *Federal Income Taxation of S Corporations*, §6.04 (Warren, Gorham & Lamont 3rd ed. 1993).

[22] *See Modern Home Fire & Casualty v. Commissioner*, 54 T.C. 839 (1970).

[23] *See* Rev. Rul. 76-363, 1976-2 C.B. 90.

Section 384 Issues. For Section 384 to apply and thereby place a limit on pre-acquisition losses to offset built-in gains, a corporation must obtain "control" of another corporation. "Control" for purposes of Section 384 is defined in Section 384(c)(5) by reference to Section 1504(a)(2), which requires ownership of at least 80 percent of the total voting power of the stock and ownership of at least 80 percent of the total value of the stock of such corporation. In the proposed transaction, this control requirement will not be met, because Exempt-Org will never own 80 percent of the total voting power or 80 percent of the total value of the stock, let alone both. Therefore, Section 384 does not apply to the proposed transaction

Possible Redemption of Exempt-Org's stock

If Exempt-Org presents the nonvoting stock for redemption, under Section 1368(e)(1)(B), S Corp's AAA will be decreased by the ratable share of S Corp's AAA attributable to the redeemed stock. In this case, AAA will be reduced by 90 percent. S Corp's beginning AAA was zero. The AAA was increased for the $4 million of taxable income per year, $8 million in total. Due to the redemption, the AAA will be reduced by Exempt-Org's share of that income, $3.6 million per year, $7.2 million in total. The ending AAA balance thus will be $800,000.[24]

SUMMARY OF TAX BENEFITS

We believe that if the above transaction is carried out, Shareholder will be entitled to a charitable contribution deduction in tax year 1999 for approximately the FMV of the stock donated to Exempt-Org. Moreover, in tax years 2000 and 2001, 90 percent of S Corp's taxable income should be allocated to Exempt-Org.

FINANCIAL STATEMENT IMPACT

For KPMG audit clients, the SC² strategy should be discussed with the assurance engagement team to address specific accounting implications to the client. Specifically, there may be disclosure issues for S-Corp associated with the issuance of nonvoting stock and warrants. S Corp should also disclose the terms of the redemption agreement within the financial statements of S Corp. Where the client is not a KPMG audit client, the client should be advised to consult its own auditors to address the financial accounting implications of the SC² strategy.

[24] Although AAA does not matter in the case of an S corporation without C corporation AEP, it should be noted that there are ordering rules with respect to the AAA in the case of a S corporation that has both distributions and redemptions in the same tax year. If an S corporation has both AAA and AEP, the timing of distributions is extremely important. *See generally* Reg. Sec. 1.1368.

POTENTIAL IRS ARGUMENTS

In order to prevent Shareholder from recognizing the tax benefits associated with the charitable contribution of the nonvoting stock, the Service may wish to advance several, somewhat overlapping arguments.

1) <u>The Non-Voting Stock is a Second Class of Stock.</u>

The Service could argue that the nonvoting stock is a second class of stock. For example, if Exempt-Org were to present the stock for redemption, the Service could argue that the payment of the redemption amount caused the nonvoting stock to be a second class of stock. The Service could argue that the redemption amount was in excess of the fair market value of the nonvoting stock. Specifically, the Service could argue that the nonvoting stock has no value due to the fact that the potential tax liability from owning the stock exceeds the value of the stock before the tax liability is taken into account. Therefore, when the nonvoting stock was redeemed, Exempt-Org received more than the true value of the nonvoting stock. Accordingly, the Service could assert that under Regulation Section 1.1361-1(l)(2)(iii), there is a second class of stock because the redemption amount was significantly in excess of fair market value.

While it is true that the potential tax liability associated with the nonvoting stock may exceed the stock's fair market value, this does not mean that the stock has a zero value. With respect to Exempt-Org, the value of the nonvoting stock is in fact greater than zero because Exempt-Org will not have to pay tax on its allocable share of S Corp's taxable income. Therefore, with respect to Exempt-Org, the value of the nonvoting stock is greater than zero. However, even if a court were to find that the value of the nonvoting stock was in fact zero, that would not automatically lead to a conclusion that the nonvoting stock is a second class of stock.

Under Regulation Section 1.1361-1(l)(2)(iii)(A)(2), "a good faith determination of fair market value will be respected unless it can be shown that the value was substantially in error and the determination of the value was not performed with reasonable diligence." Therefore, in order for there to be a second class of stock, the Service would need to prove that reasonable steps were not taken to value the nonvoting stock. Here, the nonvoting stock has been valued by a qualified appraiser. Accordingly, Shareholder should be able to rely upon the independent valuation per Regulation Section 1.1361-1(l)(2)(iii), even if a court were to alter the valuation of the nonvoting stock.

The Service could also argue that the creation and potential exercise of the warrants cause the nonvoting stock to be a second class of stock because: 1) the creation of the warrants dilutes the value of the nonvoting stock; and 2) a potential exercise of the warrants would dilute the distribution amounts and distribution rights associated with the nonvoting stock.

Even though the warrants do in fact dilute the value of the nonvoting stock, the nonvoting stock is still not a second class of stock. In determining whether there is more than one class of stock, the Section 1361 regulations focus on whether there are different distribution rights or rights to liquidation proceeds.[25] The value of the stock is simply not a factor in determining whether there is more than one class of stock.[26] Moreover, it is irrelevant that if the warrants were to be exercised, it would affect the amount of distributions associated with the nonvoting stock. Under Regulation Section 1.1361-1(l)(1), the key issue is whether distribution <u>rights</u> (as opposed to amounts), are altered. Even after any potential exercise of the warrants, the nonvoting stock would still possess the same rights to distributions. The distribution rights associated with the nonvoting stock are set by the by-laws and articles of incorporation of the company; any exercise of the warrants would not alter these rights.

An exercise of the warrants would not cause the nonvoting stock to be a second class of stock because all of the stock of the company (i.e. both voting and nonvoting stock) would be diluted. Thus, an exercise of the warrants would not cause the nonvoting stock to have distribution or liquidation rights that differ from the voting stock. Since both the voting and nonvoting stock would be similarly affected by any exercise of the warrants, the warrants should not cause the nonvoting stock to be a second class of stock.[27] In fact, whenever a company has warrants, the outstanding stock of the company is potentially diluted. If the Service's argument was accepted, it would mean that a second class of stock would exist any time that a company has warrants. Naturally, such a result would be contrary to the Code and Regulations, which specifically permit subchapter S corporations to issue warrants.

<u>2) The Warrants are a Second Class of Stock.</u>

The Service could also contend that the warrants are a second class of stock. In particular, the Service could argue that: 1) the warrants are a second class of stock because the warrants give Shareholder an additional ownership interest in the corporation; and 2) the exercise price of the warrants is substantially below fair market value and therefore the warrants fall outside the safe harbor provided by the regulations.

In regards to the first argument, as explained previously, the Service has issued regulations that specifically allow for warrants to be issued without causing them to be classified as a second class of stock if certain requirements are met. These requirements have been met by S Corp.[28]

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[25] *See* Reg. Sec. 1.1361-1(l)(1) ("[A] corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.").

[26] It should also be noted that when the nonvoting stock was valued, the existence of the warrants was accounted for in determining value. Therefore, the existence of the warrants does not alter the nonvoting stock because the nonvoting stock, from its inception, was diluted by the warrants.

[27] Even though an exercise of the warrants would have the effect of diluting the nonvoting stock and thus limiting the holder's profit potential, Exempt-Org still enjoys economic benefits from owning the stock. Regardless of whether the warrants are exercised, Exempt-Org will still share in a portion of the appreciation of the company. In addition, it should also be noted that if the warrants are exercised prior to Exempt-Org having its stock redeemed, Exempt-Org will share in some of the capital contribution from the warrant exercise.

[28] *See supra*, ANALYSIS, Step One, Section (b).

With respect to the second argument, the Regulations state that "a good faith determination of fair market value by the corporation will be respected unless it can be shown that the value was substantially in error and the determination of the value was not performed with reasonable due diligence to obtain a fair value."[29] Since S Corp engaged qualified valuation professionals and relied upon their expertise, it cannot be said that the valuation was performed without reasonable due diligence.

Even if the Service were to prevail regarding the safe harbor, the Regulations state that the "failure of an option to meet this safe harbor will not necessarily result in the option being treated as a second class of stock."[30]

__3) The Warrants are Outstanding Stock.__

Another attack the Service could assert is to re-characterize the warrants as outstanding stock under a constructive ownership theory. In Revenue Ruling 82-150,[31] the Service looked beyond the form of an option grant and recharacterized the grant of the option as a current sale of the underlying property. Specifically, the Service held that the purchase of an option to acquire stock was in substance a purchase of the stock because exercise of the option was considered to be a virtual certainty.[32]

It appears that under this Ruling, the key issue in determining whether the warrants should be recharacterized as stock is whether the warrants are substantially certain to be exercised. As discussed above, this same issue is critical in determining whether there are two classes of stock. Under Regulation Section 1.1361-1(l)(4)(iii)(A), a warrant is considered a second class of stock if, "taking into account all the facts and circumstances, the call option is substantially certain to be exercised. . . ." In addition, as discussed above, there is a safe harbor in Regulation Section 1.1361-1(l)(4)(iii)(C), which provides that if the strike price is at least 90 percent of the fair market value at the time of issuance, a second class of stock is not created. Since the warrants issued by S Corp meet this safe harbor provision, it would be unlikely that the Service could argue that the warrants are substantially certain to be exercised. Accordingly, the Service should not be able to re-characterize the warrants as stock under Revenue Ruling 82-150.

Additionally, the courts have been reluctant to re-characterize warrants as stock. For example, in *Graney v. United States,*[33] a corporation granted its president an option to

[29] Reg. Sec. 1.1361-1(l)(4)(iii).
[30] *Id.*
[31] 1982-2 C.B. 10.
[32] In Rev. Rul. 82-150, an individual contributed $ 100,000x to a foreign corporation in exchange for all the stock of the foreign corporation. A U.S. citizen paid the individual $ 70,000x for the option to purchase all of the stock for an exercise price of $ 30,000x. Reflecting the fact that it appeared extraordinarily unlikely that the market value of the stock would fall below $ 30,000x before the option expired; the Service concluded the option purchaser had assumed the risks of an equity investor because, in substance, it had or would furnish 100% of the funds used to capitalize the corporation that were at risk. Therefore, the Service concluded the benefits and burdens of stock ownership had been shifted to the option purchaser.
[33] 258 F. Supp. 383 (S.D. W.Va. 1996), *aff'd.*, 377 F.2d 992 (4th Cir. 1967), *cert. denied*, 389 U.S. 1022 (1967).

purchase the corporation's stock at a price substantially below the market value of such stock, exercisable over a five-year period, to encourage him to remain with the company after a merger. The option agreement specified that the stook would be placed in an escrow account for the five-year period and that he would have the right to vote the stock and exercise stockholder's rights with respect to the stock during the life of the option. The president exercised the option in stages, 100 shares in each of the first three years following the merger and the last 200 shares in the fourth year, at which point he sold his stock. He asserted that he became vested with ownership of all 500 shares of stock upon entering into the option contract, and upon his sale of the stock he was entitled to treat the excess of the sale proceeds over the fair market value of the stock at the time the warrants were granted as long-term capital gain. The Service asserted the arrangement was an option and the excess of the fair market value of the stock over the option premium was ordinary income to the president in each of the years that a portion of the option was exercised. The court agreed with the Service noting that although the contract vested a number of ownership rights in the president, those rights were extended by the terms of the agreement and not by virtue of ownership of the stock itself, and that the option did not impose an obligation upon the president to buy the stock.

The present situation is less extreme than *Graney*. In *Graney*, the underlying stock was actually placed in escrow. Moreover, the option holder had the right to exercise all shareholder rights associated with the stock. Here, the underlying stock has not been placed in escrow and the warrant holder has no right to exercise shareholder rights associated with the underlying stock. Accordingly, under *Graney*, the warrants should not be recharacterized as stock.

4) There is no Economic Substance to the Proposed Transaction.

Another issue the Service may raise is economic substance, and attack the proposed transaction based on the recent cases of *Compaq*,[34] *Winn-Dixie*[35] and *ACM Partnership*.[36]

The economic substance analysis, as applied in the above cases, is both an objective and a subjective analysis, but focuses mainly on pre-tax profit motive. The key issue is whether the taxpayer reasonably expects to generate a pre-tax profit. The proposed transaction is entirely distinguishable from this line of analysis because the shareholder is making a philanthropic gesture through his charitable contribution. Charitable contributions have never been questioned for their pre-tax profit motive because there is not a pre-tax profit motive and there could never be one. The gift is considered charitable because the taxpayer is giving something of value to a charitable organization, without receiving anything in return. By its very nature a charitable donation could not require pre-tax profit motive, otherwise all charitable gifts would fail the economic substance test.

[34] *Compaq Computer v. Commissioner*, 113 T.C. 17 (1999).
[35] *Winn-Dixie Stores v. Commissioner*, 113 T.C. 21 (1999).
[36] *ACM Partnership v. Commissioner*, 157 F.3d 231 (3rd Cir. 1998).

The Service however, could rely on *Mount Mercy Associates v. Commissioner*,[37] where the Tax Court disallowed a charitable contribution deduction, holding that the transaction lacked economic substance. In *Mount Mercy*, a partnership purchased property from a convent. The partnership immediately donated some of the land back to the convent. The Tax Court concluded that the donation lacked economic substance because the convent never lost possession, control, or ownership of the property. Although this case applied an economic substance analysis, it appears that the Tax Court's conclusion was driven by the substance of the gift, i.e. whether the convent had actually given up possession, control or ownership of the property.

Based on *Mount Mercy*, the Service could argue that Shareholder never gave up possession or control of the nonvoting stock and therefore the substance of the transaction was a cash contribution to Exempt-Org as opposed to a true stock contribution. The Service could maintain that the donation of the nonvoting stock and the redemption agreement simply represented a pledge to make a future gift. If this argument were successful, it would mean that no income should have been allocated to Exempt-Org and that this income should be re-allocated to the shareholders.

For the purpose of determining federal income tax, "command over property or enjoyment of its economic benefits marks the real owners."[38] That is, it is the beneficial owner of the stock that is considered the owner for federal income tax purposes. The issue of whether a holder of legal title to S corporation stock should be considered as the beneficial owner has been addressed with respect to transfers between family members. In these cases, the courts have focused on the following factors to determine beneficial ownership:

(1) Are the transferees within the family able to effectively exercise ownership rights of their shares;
(2) Did the transferor continue to exercise complete dominion and control over the transferred stock;
(3) Did the transferor continue to enjoy economic benefits of ownership after conveyance of the stock; and
(4) Did the transferor deal at arm's length with the corporation involved?[39]

Variations of the above four factors have also been listed in several private letter rulings. In PLR 9022029, the Service considered the following factors:

(1) Whether the transferee has full, independently exercisable voting rights in the stock.
(2) Whether the transferee has the right to receive all of the dividends payable on the stock.
(3) Whether the transferee is entitled to sell, dispose of or encumber the stock at its sole discretion, without approval of the transferor or the other shareholders.

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[37] T.C. Memo 1994-83.
[38] *Anderson v. Commissioner*, 164 F.2d 870, 873 (7th Cir. 1947), *cert. den.*, 334 U.S. 819 (1948).
[39] *Speca v. Commissioner*, 630 F.2d 554 (7th Cir. 1980); *Duarte v. Commissioner*, 44 TC 193 (1965); *Bierne v. Commissioner*, 61 TC 268 (1973); *Kirkpatrick v. Commissioner, TC Memo 1977-281.*

(4) Whether the transferee has the right to receive the proceeds of any liquidating distribution.

PLR 8536017 looked to:

(1) Whether the transferee had the right to receive distributions.
(2) Whether the transferee had the right to participate in management.
(3) Whether the transferee would economically participate in future business activities of the corporation.
(4) Whether the transferee had the right to share in assets in the event of the corporation's dissolution.

Although these factors were developed in the context of family transfers, the Service could attempt to apply them to a donation to a tax-exempt entity as well. However, although the fact patterns differ, nothing suggests that the issue and analysis apply only to intra-family stock transfers. Instead, the case law supports the position that they are applicable to any situation in which the facts indicate a purported transfer of ownership of corporate stock may lack economic substance.

The Service could argue that because the strategy purports to shift 90% of S Corp's income to Exempt-Org, while using the warrants to cap the economic value of that 90% interest at 11.25% of the economic value of the corporation (ignoring any discount for lack of control and lack of marketability), the strategy lacks economic substance. The Service could contend that, although legal ownership of 90% of the stock was transferred to Exempt-Org, only an 11.25% beneficial ownership interest was transferred. In that event, the Service could then argue that the beneficial ownership interest governs and, therefore, only 11.25% of S Corp's income is allocable to Exempt-Org.

The Service may contend that in this strategy, (i) the transitory nature of the shift of taxable income from a taxable shareholder to an exempt organization, (ii) the intent not to pay any dividends during the period of time the exempt organization owns the stock, (iii) the use of non-voting stock, (iv) the use of the warrants to cap the economic value of Exempt-Org's stock and (v) the ratio of the transferor's tax benefits to economic cost create a *prima facie* case that the economic substance of the transaction is that Exempt-Org is the beneficial owner of only 11.25% of the stock of S Corp and Shareholder remained the beneficial owner of the remaining 89.75%. If the Service were to prevail in such a contention, the shift in taxable income from Shareholder to Exempt-Org would be only 11.25%.

To overcome the Service's argument that there Exempt-Org does not have beneficial ownership, it is necessary to show that (i) the transaction has economic substance and (ii) that the donation by Shareholder satisfies the above tests for beneficial ownership of the full 90% of the stock, based on the facts and circumstances of the specific transaction.

i. The transaction has economic substance.

It appears that the transaction has economic substance. There are several responses to the IRS' possible contention that the transfer of 90% of the stock of S Corp to Exempt-Org lacks economic substance because the effect of the warrants is to ensure that no more than 11.25% of the economic value of the equity of S Corp is shifted to Exempt-Org.

First, it is common for closely-held corporations that issue stock to key employees who are not the "founders" of the corporation to require that those "non-founding" shareholders enter into buy-sell or redemption agreements that does not apply to the stock of the "founding" shareholders. For example, such agreements commonly provide that if a "non-founding" shareholder leaves the employ of the corporation or otherwise wishes to dispose of his/her stock, the corporation will redeem it at a fixed price, such as book value. As a practical matter, book value may be substantially less than fair market value. In such situations, if the corporation is an S corporation, the per-share flow-through of S corporation income, gain, loss, deductions and credits to the "non-founder" shareholders is the same as it is to the "founding" shareholders who are not subject to the buy-sell or redemption agreement.

In such situations, there is no authority to support treating the "non-founding" shareholders as beneficially owning less than their actual amount of stock simply because their stock could be redeemed at a lower price per share than that of the "founding shareholders. Nor has the Service ever argued that such treatment would be appropriate. In fact, Regulation Section 1.1361-1(l)(2)(v), Example 9, contains exactly such a fact pattern. The example concludes that the terms of the redemption agreement are disregarded in determining whether the S corporation has a second class of stock unless a principal purpose of the redemption agreement is to circumvent the Section 1361(b)(1)(D) one-class-of-stock requirement. The "principal purpose" issue has already been addressed above and we have concluded that no principal purpose of avoidance exists.[40]

The Redemption Agreement here is analogous to the "non-founder" buy-sell or redemption agreement approved in Regulation Section 1.1361-1(l)(2)(v), Example 9. As a result, the fact that the Redemption Agreement applies only to Exempt-Org and results in capping the economic value of Exempt-Org's stock should not cause the Service to characterize the stock donation as lacking in economic substance.

It is also important to note that the transfer of 90% of S Corp's stock to Exempt-Org not only means that 90% of income and gains are allocable to Exempt-Org, it also means that, in the event that S Corp incurs losses, the tax benefit of 90% of those losses would be allocated to Exempt-Org. Accordingly, the 90% allocation has the potential for tax detriment, as well as tax benefit, to Shareholder.

Moreover, any income or gains of S Corp allocable to Exempt-Org while it is a shareholder will increase the tax basis of Exempt-Org's S corporation stock. The

[40] *See Supra*, text accompanying note 19.

Shareholder will obtain no stock basis increase for the income or gain allocable to Exempt-Org. To the extent that dividend distributions to Exempt-Org during the period of time that it is a shareholder of S Corp are less than Exempt-Org's allocable share of income or gain, those undistributed earnings would subsequently be available for distribution to Shareholder. However, Shareholder will have no stock basis to enable the distribution(s) to be received as a tax-free recovery of basis under Section 1368(b)(1). If the earnings that were allocated to Exempt-Org are subsequently distributed to Shareholder, they will be taxable to Shareholder under Section 1368(b)(2) or (c)(2). Accordingly, when all of the tax consequences of the overall transaction are taken into consideration, there is not an excessive tax benefit to Shareholder when compared to the economic costs of the transaction.

It is also important to note that the Small Business Job Protection Act of 1996, by adding Section 1361(c)(6) and amending Section 1361(b)(1)(B), specifically authorized and approved the transfer of stock of an S corporation to an exempt charitable organization in taxable years beginning after December 31, 1996. An automatic consequence of such a transfer is a shift of flow-through income, gain or loss allocable to the transferred shares from the transferor to the exempt organization. Typically, when stock of a closely-held corporation is donated to a charitable organization, the expectation of the parties is that, although the charity may hold the stock for a period of time, it will ultimately be tendered for redemption. Therefore, this transaction does nothing more than what is contemplated by the statute.

ii. Shareholder transferred beneficial ownership, as well as legal title, of 90% of the outstanding stock to Exempt-Org.

Based on an analysis of the factors cited by the courts and the Service above, it appears that Shareholder has transferred beneficial ownership of the full 90% of the outstanding stock of S Corp and that the transfer should be respected for federal income tax purposes. An analysis of those factors in the context of this transaction follows:

1. Whether Exempt-Org is able to effectively exercise ownership rights of its shares. Under the facts, Exempt-Org is an independent party not under the control of Shareholder and is able to fully exercise all of its rights as a shareholder.

2. Whether Shareholder continued to exercise complete dominion and control over the transferred stock. Under the facts, Exempt-Org has not waived any of its rights as a shareholder. It is entitled to notice of shareholder meetings and has the right to attend those meetings. It has the same rights as other shareholders to inspect corporate books and records. There is no retention by Shareholder of any dominion or control over the transferred stock.

3. Whether Shareholder continued to enjoy economic benefits of ownership after conveyance of the stock. This is a potential weak point if no dividends are paid during the period of time that Exempt-Org owns the stock. As noted above, the absence of any

dividend payments while the corporation enjoyed substantial earnings has been viewed as evidence of the transferor's retention of economic benefits.

However, Exempt-Org knew when it accepted the gift that it was for nonvoting stock which did not have the power to force the corporation to make distributions. Therefore, it should not be relevant whether distributions were actually made because Exempt-Org knew when it accepted the stock that it did not have the power to force a distribution.

It should also be noted that a corporation is not required under the tax law or state corporate law to pay dividends or make distributions to its shareholders. If anything, state corporate law limits a corporation's ability to make distributions to its shareholders; the laws of each state generally determine how and to what extent corporations can make distributions to their shareholders.[41] The right of a stockholder to the declaration of a dividend rests in the discretion of the directors, so long as such discretion is fairly exercised.[42] The decision, whether or not to make a distribution is one of business judgment, not law. The courts will not interfere in the legitimate business decisions of a private corporation just to resolve a dispute between majority and minority shareholders.[43] Stockholders have no individual or property interest in the profits of a corporation and are not entitled to any portion of the accumulated earnings until declaration of a dividend or its equivalent.[44]

In *Lawton v. Commissioner*,[45] the Sixth Circuit Court of Appeals analyzed whether a transfer of stock from a father to his children should be respected. The Service pointed to the fact that distributions were never made. However, the Sixth Circuit ruled that the reinvestment of non-excessive profits by a corporation was not unwarranted or even unusual. Therefore, to the extent that S Corp needs the funds for business reasons, the failure to make distributions should not be relevant to the analysis of whether Exempt-Org is the beneficial owner of the nonvoting stock.

With respect to S corporations specifically, at least one court has held that where the individual shareholders are taxed on the retained earnings of the corporation, it is not necessarily oppressive of the corporation to fail to distribute earnings.[46] There is no oppression because state laws protect the rights and interests of all shareholders. If a shareholder believes that the corporation is improperly withholding legitimate distributions, it has the right to file suit and compel the corporation to make a distribution.[47] Exempt-Org, in the proposed transaction, has this right.

Moreover, the lack of a distribution does not diminish the value of the nonvoting stock. The value of the nonvoting stock will appreciate based on the accumulation of profits in the corporation as well as the growth on investing the profits. The appreciation of the

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[41] *See, e.g.* California Corporations Code §§ 114, 500-510.
[42] 18B Am. Jur. 2d, Corporations, §1224.
[43] *Zidell v. Zidell, Inc.*, 560 P.2d 1086 (Or. 1977).
[44] *Id.*
[45] 164 F.2d 380 (6th Cir. 1947).
[46] *Iwasaki v. Iwasaki Bros., Inc.*, 649 P.2d 598 (Or. Ct. App. 1982).
[47] 18B Am Jur. 2d, Corporations, §1277.

nonvoting stock through the growth in the equity of a corporation is a benefit of ownership. In addition, if there were to be an initial public offering at a premium price, Exempt-Org would share in that upside as well.

4. Whether Shareholder dealt at arm's-length with S Corp. In order to meet this factor, any post-transfer transactions between Shareholder and S Corp that could confer an economic benefit on Shareholder should be avoided.

5. Whether Exempt-Org has full, independently exercisable voting rights in the stock. Since the stock to be transferred to Exempt-Org is non-voting stock, this factor does not appear to be relevant.

6. Whether Exempt-Org will have the right to receive all of the dividends payable on the stock. Exempt-Org has exactly the same rights to dividends, to the extent that any are declared, that Shareholder has.

7. Whether Exempt Org is entitled to sell, dispose of, or encumber such stock at its sole discretion without the approval of Shareholder. Except for the restriction against any transfer of its stock that would cause the corporation's S election to be terminated, Exempt-Org's stock is freely alienable without the approval of any other party.

With respect to charitable donations, courts have focused on whether there is any potential whatsoever, that the charity will sell the stock:

> [T]he Commissioner of Internal Revenue and the courts have been at odds in gift-and-repurchase situations such as confronts us here. While the Commissioner has emphasized the "prearrangement," "understanding" of the parties and "common identity" of donor and repurchaser aspects relative to gifts of stock, the courts have tended to focus on the narrow circumstances surrounding actual delivery of the stock to the donee – which, without more, implies relinquishment of dominion and control by the donor over such stock .... These decisions disclose that courts will attach conclusive substance to the form chosen by the parties unless one can demonstrate rather clearly that the form chosen is not an accurate reflection of its substance. Further, they reveal that courts are generally not concerned with what a donee does with the gift thereafter, even if the gift is repurchased shortly after it is given by the donor's controlled corporation, providing there is no agreement between the donor and donee such as to render the gift a sham, and **the donor risks the possibility, however small, that the donee may sell the gift elsewhere.**[48]

8. Whether Exempt-Org has the right to receive the proceeds of any liquidating distribution. In the event of the liquidation of S Corp while Exempt-Org is a shareholder, its stock has the same per-share right to liquidations proceeds as the stock of Shareholder.

[48] *DeWitt v. United States*, 204 Ct. Cl. 274 (1974) (emphasis added).

9. Whether Exempt-Org has the right to participate in management. Under applicable state business corporation statutes, shareholders generally have no right to participate directly in the management of the activities of the S corporation solely by virtue of their stock ownership. Absent any contrary provisions in an S corporation's by-laws, a shareholder's only direct right with respect to management is that owners of shares of voting stock are permitted to vote for members of the S corporation's board of directors, who generally have the authority to appoint management. Here, Exempt-Org will hold only non-voting stock. However, as a shareholder, Exempt-Org will have full rights to attend and participate (except for voting) in shareholder meetings and will have access to S Corp's books and records.

10. Whether Exempt-Org's stock will economically participate in future business activities of S Corp. There is no arrangement in effect, nor is any contemplated, that would have the effect of preventing the shares of stock owned by Exempt-Org from participating in any future business activities of S Corp.

Based on the above analysis, it appears that Shareholder would be found to have transferred beneficial ownership of 90% of the outstanding stock to Exempt-Org. Therefore, such transfer should be respected for federal income tax purposes.

5) The Shareholder is Assigning Income to Exempt-Org.

The Service could also assert that Shareholder is assigning income to Exempt-Org and that therefore, Shareholder should be taxed on this income. Under the assignment of income doctrine, where a taxpayer attempts to "shift" income to another party, the taxpayer does not escape taxation on the shifted income. The assignment of income doctrine is not codified in the Internal Revenue Code but created out of judicial precedence. The purpose of the assignment of income doctrine is not to determine whether an item of income should be includible in gross income, but rather which taxpayer must include such item in its taxable income. Most cases in this area relate to the transfer of either appreciated property or an ordinary income stream, i.e. personal service income, dividend income or interest income.[49]

The Service could argue that Shareholder's built-in gain in the donated nonvoting stock should be taxed to Shareholder. In the past, the Service has recharacterized certain stock contributions followed by a redemption. Specifically, where there was a prearranged plan to have the corporation redeem stock previously donated to a tax-exempt entity, the Service would treat the transaction as a redemption of the stock by the donor followed by a contribution of the cash to the tax-exempt entity. Therefore, the donor would be taxed on the gain from the redemption. However, the Service has subsequently stated in a Revenue Ruling that it will treat the proceeds of a redemption of donated stock as income

[49] *Bagley v. Commissioner*, 85 T.C. 663 (1985); *Culver v. Commissioner*, T.C. Memo 1983-614.

to the donor only if the tax-exempt organization is legally bound, or can be compelled by the corporation, to surrender the shares.[50]

In the proposed transaction, the redemption agreement specifically states that neither Shareholder nor S Corp has the power to compel Exempt-Org to surrender its shares. Exempt-Org will of course desire to surrender its shares since it will likely have no market in which to sell the stock. However, we do not believe this fact proves that S Corp can compel a redemption. Rather, this fact simply makes it more desirable for Exempt-Org to redeem the stock. Therefore, the built-in gain in the donated nonvoting stock should not be taxed to Shareholder.

The assignment of income doctrine however, is not limited to redemption proceeds. The doctrine also applies to, "[i]ncome from a business assigned by the taxpayer to others . . . to the extent it [the income] is attributable to the taxpayer's personal skill."[51] For example, in the 1953 Tax Court decision of *Stokby v. Commissioner*,[52] the Tax Court held that income a wife reported on her tax return from a proprietorship was instead taxable to the husband because, "the business depended upon the personal services of petitioner [the husband], and . . . petitioner was the moving factor, motivating source, and the true earner of this income."[53]

Similar results were reached in the 1952 Tax Court decision in *Leonard v. Commissioner*[54] and the Tenth Circuit Court of Appeal's 1942 decision in *Hogle v. Commissioner*.[55] In *Leonard*, the Tax Court held that income earned by a partnership owned by the petitioners' wives was taxable to the petitioners because the income was the result of, "the husbands' wide experience, knowledge, contacts, and long association with the trucking and automobile business. . . ."[56] In contract, "the wives contributed little, if anything, other than to sign the agreements, open the bank accounts, and through their designated representative, sign checks for the expenses."[57]

In *Hogle*, parent (a successful stockbroker) set up irrevocable trusts for the benefit of his three children.[58] The declarations of trust provided that parent would maintain a trading account on margin for the benefit of the trusts.[59] Profits from parent's trading activities

[50] Rev. Rul. 78-197, 1978-1 C.B. 83. The Service relied upon *Palmer v. Commissioner*, 62 T.C. 684 (1974), where the taxpayer had voting control of both a corporation and a tax-exempt private foundation. The Tax Court treated the transaction according to its form because the foundation was not a sham, the transfer of stock to the foundation was a valid gift, and the foundation was not bound to go through with the redemption at the time they received title to the shares.
[51] Maule, 502-1st T.M., *Gross Income: Tax Benefit, Claim of Right and Assignment of Income*, at Sec. IV-B.
[52] 12 T.C.M. 761 (1953).
[53] *Id.*
[54] 11 T.C.M. 12 (1952).
[55] 132 F.2d 66 (10th Cir. 1942).
[56] *Leonard, supra*, at 15.
[57] *Id.* at 18.
[58] *Hogle, supra*, at 69.
[59] *Id.*

would be divided among the three children in set percentages.[60] The Tax Court ruled that parent was taxable on the income of the trust because:

> [t]he income thus created and the profits thus realized were not merely income accruing from the corpus of the trust or from capital gains realized from disposition of the corpus, but were profits earned through trading on margins involving the exercise of personal skill and judgment of Hogle [parent], and were in substance personal earnings of Hogle. The amount of trading on margins which Hogle was to carry on for the trust was wholly in his discretion. He could trade little or much or not at all for the benefit of the trust as he saw fit. Thus, he exercised practical control over what portion of income from his personal efforts in trading on margins should accrue to the trust.[61]

If the income of S Corp is primarily attributable to Shareholder's personal skills, the Service could argue, based on the above cases, that the gift of stock to Exempt-Org is an assignment of income of Shareholder to Exempt-Org. It should be noted though that the assignment of income doctrine and other judicially imposed doctrines "have been criticized as 'blunt tools' and, in the wake of contemporary decisions, now appear to have fallen into judicial disfavor."[62]

Notwithstanding the fact that the assignment of income doctrine has fallen into judicial disfavor, even if the Service were to make such an argument it does not appear that the gift of stock should be considered an assignment of Shareholder's income to Exempt-Org. As discussed below, even if the income of S Corp is entirely due to the personal services of Shareholder, the income would still be considered to be income of S Corp and not Shareholder, unless S Corp is found to be a sham. Therefore, the assignment of income analysis should focus on whether Shareholder has assigned income of S Corp to Exempt-Org, not whether Shareholder has assigned his own income to Exempt-Org. For

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[60] *Id.*

[61] *Id.* at 71. It should be noted that in a subsequent related decision, the Tenth Circuit addressed the gift tax consequences of the transaction. *See Hogle v. Commissioner*, 165 F.2d 352 (10th Cir. 1947). In that case, the court ruled that there was no gift tax due because parent had no legal right to the profits. In so ruling, the court "recast[ed] the Tenth Circuit's opinion in the prior case and distinguish[ed] the control necessary for treating the trading profits as Parent's gifts." Caron, *Taxing Opportunity*, 14 Va. Tax Rev. 347 (Fall 1994). The Tenth Circuit explained its first ruling, commenting that:

> [d]espite certain statements contained in the opinion on which the Commissioner relies, the basis of the holding that Hogle was liable for income tax on the net income resulting from trading on margin was his power to control the extent of such trading and therefore the extent of the income therefrom. It was predicated on his power to dominate the amount of income that would accrue from trading. That was the essence of our holding. We did not hold that such income accrued first to Hogle and was by him transferred by anticipatory gift to the trusts.

Hogle, 165 F.2d. at 354. The court went on to state the first decision was, "an extreme application . . . ." *Id.*

[62] Lewis, *Attribution of Income in Personal Services Corporations*, 1 Va. Tax. Rev. 327, 328 (Fall 1981).

the reasons stated below, there is no assignment by Shareholder of S Corp's income to Exempt-Org.

Under court decisions more recent than the assignment of income cases cited above, it has been held that the assignment of income doctrine should not be applied to reallocate income from a personal services corporation to the owner unless the corporation is a sham.[63] In *Fogleson v. Commissioner*,[64] the Service argued that the bulk of the commission income of a personal service corporation was taxable to the shareholder and not to the corporation under the assignment of income doctrine.[65] The Seventh Circuit Court of Appeals ruled that the income of the corporation should not be assigned to the shareholder unless the corporation was a sham:

> We believe that, where the issue is application of the assignment of income doctrine to effectively set aside the corporation, under the particular circumstances of this case (which we have carefully delineated), an attempt to strike a balance between tax avoidance motives and "legitimate" business purposes is an unproductive and inappropriate exercise. Such an approach places too low a value on the policy of the law to recognize corporations as economic actors except in exceptional circumstances. This is true whether the analysis used to dismantle the corporation pursues the rubric of assignment of income or substance over form.

The Tax Court had ruled that there was an assignment of income. The Seventh Circuit reversed because, "the Tax Court did not find that the Corporation was organized as a pure tax avoidance vehicle," and there was no evidence of, "any flouting of the corporate form in the way business has been conducted."[66]

With respect to S corporations specifically, the courts have ruled that the income of the S corporation is to be considered income earned by the corporation and not the shareholder. In *Ding v. Commissioner*,[67] the Ninth Circuit Court of Appeals stated that it is, "improper to treat income earned by a corporation through its trade or business as though it were earned directly by its shareholders, even when, as here, the shareholders' services help to produce that income."[68] The Ninth Circuit therefore ruled that shareholders can not include S corporation losses in determining their self-employment tax.[69]

It is also important to note that S corporations in which the shareholders provide services are required to pay a "reasonable compensation" to the shareholders for these services so that employment taxes can be properly determined.[70] Therefore, in the S corporation

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[63] *See e.g., Foglesong v. Commissioner*, 621 F.2d 865 (7th Cir. 1980).
[64] *Id.*
[65] *Id.* at 865-866.
[66] *Id.* at 873.
[67] 200 F.3d 587 (9th Cir. 2000)
[68] *Id.* at 589 (quoting *Durando v. U.S.*, 70 F.3d 548, 550 (9th Cir. 1995)).
[69] *Id.* at 589.
[70] Rev. Rul. 74-44, 1974-1 C.B. 287.

context, it is possible to determine what amount of income should be considered to be directly earned by the shareholders.

Based on the *Fogleson* and *Ding* decisions, the income of S Corp should not be considered to be income earned by Shareholder, even if the income is solely the result of Shareholder's personal services, unless it is found that S Corp is a sham. Therefore, the income at issue here should be considered to be income of S Corp. Accordingly, the assignment of income analysis not should focus on whether income of Shareholder is being assigned, but rather, whether Shareholder has assigned income of S Corp.

The test for whether Shareholder has assigned income of S Corp will be whether there has been a valid transfer of the nonvoting stock to Exempt-Org.[71] If it is determined that there was an unsuccessful transfer, the income would be included in Shareholder's gross income, not Exempt-Org's gross income. For example, an invalid gift may fail to shift the income to Exempt-Org.[72]

To be a valid transfer of property, there must be a significant change in the economic relationship of the taxpayer to the property.[73] There is no significant change in the taxpayer's economic relationship to the property if the taxpayer retains rights in and control over the transferred assets.[74] Retention by the taxpayer of risk of loss and full control of the property obviates any effective transfer.[75] If the transfer is a bona fide transfer of property, without retention of control by the transferor, the assignment of income doctrine does not apply.[76] Nor does it apply if the transferor retains rights that are insignificant.[77]

The test for whether there has been an assignment of income with respect to income producing property is thus essentially the same as the test for whether there was an actual transfer of stock, i.e. was there a transfer of beneficial ownership of the stock? This issue is discussed and analyzed in full in Section Four of this Memorandum,[78] relating to whether the transaction has economic substance. For the reasons stated in that section, it appears that beneficial ownership is transferred in this transaction. Therefore, in addition to the transaction having economic substance, it should also be found that there is no assignment of S Corp's income by Shareholder.

It should also be noted that there is a special provision in the Code allowing for the Service to reallocate income of an S corporation, but only with respect to certain family

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[71] *Moore v. Thomas*, 145 F.2d 813 (5th Cir. 1944).
[72] *Urbanovsky v. Commissioner*, T.C. Memo 1965-276.
[73] *Zmuda v. Commissioner*, 731 F.2d 1417 (9th Cir. 1984).
[74] *Yeoham Est. v. Commissioner*, T.C. Memo 1986-431, *aff'd*, 826 F.2d 11 (5th Cir. 1987).
[75] *Applestein Est. v. Commissioner*, 80 T.C. 331(1983).
[76] *See R & T Developers, Inc. v. Commissioner*, T.C. Memo 1973-128; *Burns v. U.S.*, 65-1 U.S.T.C. Para. 9385 (N.D. Tex. 1965); *U.S. v. Leuschner*, 63-1 U.S.T.C. Para. 9155 (S.D. Cal. 1962), *aff'd in part and rev'd in part on other issues*, 336 F.2d 246 (9th Cir. 1964). *See also* PLR 9315008 (agreement between husband and wife to share sweepstakes entry addressed solely to wife transferred an ownership interest in the property rather than merely assigning the income from it).
[77] *Ideal Tool and Die Co. v. Commissioner*, T.C. Memo 1960-96.
[78] The Section entitled, "[t]here is no economic substance to the proposed transaction."

members described in Section 704(e)(3).[79] That situation is not present here. Therefore, the Service should not be permitted to reallocate the income of S Corp from Exempt-Org to Shareholder.

6) There is No Business Purpose for the Distribution of Non-Voting Stock and Warrants.

Another argument the Service could assert is that there is no business purpose for the distribution of nonvoting stock and warrants. For example, the Service could argue that Shareholder could have achieved the same economic result by distributing one share of nonvoting stock as opposed to distributing 900 shares, diluted by warrants.

Section 301, which governs the tax treatment of corporate distributions, is very broad in specifying the types of permissible corporate distributions. By its terms, the statute does not contain any business purpose requirement. It also does not appear that there is any case law imposing a business purpose for corporate distributions, except when the distributions form a part of a corporate organization or reorganization.[80] With regard to distributions of stock specifically, the applicable provision, Section 305, also does not contain any business purpose requirement. As such, it appears that corporations are permitted to structure distributions in any manner they see fit.

Although there does not appear to be any case law requiring a business purpose for distributions that do not form a part of a corporate organization or reorganization, courts have on occasion, invoked a business purpose where none has been required before.[81] However, tax-free corporate distributions of stock have been permitted for over 80 years without a business purpose.[82] If the courts or Congress was of the view that a business purpose was required for stock distributions, the issue clearly would have been settled by now.

In other areas of tax law, a business purpose doctrine has been specifically imposed. For example, there must be a valid business purpose for corporate organizations and reorganizations (Sections 351 though 368), including those that contain a corporate distribution as a necessary element.[83] The fact that no court has yet to specifically delineate a business purpose requirement for corporate distributions that fall outside of the organization and reorganizations provisions is telling.

In private letter rulings, the Service has given corporations a great deal of discretion with respect to stock distributions. For example, in Private Letter Ruling 7908044, the Service

[79] I.R.C. Sec. 1366(e).
[80] *See* Reg. Sec. 1.355-2(b) and *Gregory v. Helvering*, 293 U.S. 465 (1934).
[81] *See, e.g. US v. Wexler*, 31 F3d 117 (3rd Cir., 1994).
[82] Distributions of stock with respect to a corporation's stock have not been included in gross income since Congress exempted stock dividends from tax in the Revenue Act of 1921, enacted in response to the Supreme Court decision of *Eisner v. Macomber*, 252 U.S. 189 (1920). *See* Shiff, 765 T.M., *Stock Rights and Stock Dividends: Sections 305 and 306*, at A-4.
[83] *See* Reg. Sec. 1.355-2(b) and *Gregory v. Helvering, supra.*

permitted a tax-free distribution of 99 shares of common stock for each share of common stock outstanding under Section 305(a).[84]

It should also be noted that with regard to the number of shares involved in a distribution or other transaction, the Service stated in GCM 390888 that: "[a]s Congress noted when it stated that a common stock on common stock dividend would not be taxable because it did not change the proportionate interests of the shareholders, **the actual numbers of shares involved are relevant only insofar as they determine the proportionate interests of the shareholders.**"[85]

In the unlikely event that the Service is successful in imposing a business purpose requirement for the distributions, there are several business purposes for the issuance of nonvoting common stock and warrants. For example, the warrants could be used for estate planning and gifting such as a contribution to a Family Limited Partnership ("FLP"), a contribution to a charitable remainder unitrust, and other charitable bailouts, such as pooled income funds to allow for future diversification. Additionally, the warrants could also be used for financing or obtaining liquidity with ineligible S corporation shareholders such as public companies, venture/private equity funds, and capital for transactions with other companies, e.g. mergers or acquisitions. The warrants could also be sold to an ineligible shareholder (by existing shareholders) who could then exercise them if desired. To the extent that the issuance of the warrants accomplishes family financial planning objectives, the likelihood of the warrant issuance being attacked for lack of business purpose diminishes.

7) There is no Charitable Intent.

The Service may also attempt to argue that there is no valid charitable contribution because the shareholder obtains an ancillary tax benefit from the contribution and that the gift is motivated by the receipt of this tax benefit.

There has been some confusion in the tax law as to the proper test for determining whether a charitable contribution is valid. Some courts in the past have applied the test used to determine whether a gift should be excluded from gross income in determining whether a charitable contribution deduction should be allowed.[86] The Supreme Court articulated the income exclusion test in *Commissioner v. Duberstein.*[87] Under this test, a

[84] Similarly, in General Counsel Memorandum ("GCM") 37197 (July 15, 1977), the corporation made a distribution of ten shares of nonvoting, nonconvertible preferred stock for each share of common stock outstanding as part of a Section 303(a) redemption in order to maintain the remaining shareholders proportionate voting control. A portion of the distributed stock was redeemed before the expiration of time in Section 303(b)(1)(A), for cash and the amount received by the estate equaled the maximum amount permitted under Section 303(a). The corporation distributed the appropriate vote and value to achieve its shareholders' objectives, specifically to retain voting control and shift the appropriate value to the estate. The GCM held that Section 305(a) applied to the distributed stock.

[85] GCM 39088 (December 7, 1983) (citing H.R. Rep. No. 91-413, 1969-3 C.B. at 217) (emphasis added).

[86] *See* Merten's Law of Federal Income Tax §31.04.

[87] *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960).

transfer is not a valid gift unless it was made with "detached and disinterested generosity."[88]

However, since the *Duberstein* decision, the Supreme Court has specifically addressed the test for determining whether a charitable contribution is valid. In *U.S. v. American Bar Endowment*,[89] the Supreme Court stated that

> The *sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return.[90]

The Supreme Court also discussed charitable contributions in *Hernandez v. Commissioner*.[91] In *Hernandez*, the Supreme Court analyzed the legislative history of the charitable contribution deduction:

> The legislative history of the "contribution or gift" limitation, though sparse, reveals that Congress intended to differentiate between unrequited payments to qualified recipients and payments made to such recipients in return for goods or services. Only the former were deemed deductible. The House and Senate Reports on the 1954 tax bill, for example, both define "gifts" as payments "made with no expectation of a financial return commensurate with the amount of the gift." Using payments to hospitals as an example, both Reports state that the gift characterization should not apply to "a payment by an individual to a hospital *in consideration of* a binding obligation to provide medical treatment for the individual's employees. It would apply only if there were no expectation of any quid pro quo from the hospital."[92]

The Court in *Hernandez* stated that the external features of the transaction, and not the motivations of individual taxpayers, need to be examined to determine whether such an expectation existed.[93] Therefore, it appears that the "detached and disinterested generosity" test set forth in *Duberstein* is no longer the most appropriate test for

[88] *Id.*
[89] 477 U.S. 105 (1986).
[90] *Id.* at 118.
[91] 490 U.S. 680 (1989).
[92] *Id.* at 690 (citations omitted).
[93] *Id.*

determining whether a charitable contribution deduction should be allowed for a particular contribution.[94]

Under *American Bar Endowment* and *Hernandez*, it appears that the test for determining whether a charitable contribution is valid is whether there is an expectation of a *quid pro quo* to be received from the donee. In *Hernandez*, for example, the taxpayers' deductions were disallowed because the contributions were in reality payments to a church for certain hourly training services. With regard to the proposed transaction however, there is no expectation of receiving a benefit from Exempt-Org. Exempt-Org does not exchange goods or services for the nonvoting stock and Shareholder is not a member of the pension plan.

It does not appear that the tax benefits Shareholder may receive from making the contribution should be considered to be a *quid pro quo* for the contribution. First, it is not Exempt-Org which provides these benefits to Shareholder. All Exempt-Org does is accept the gift of stock and sign the Redemption Agreement. Moreover, Exempt-Org is free to sell or transfer the stock at any time, so long as the transfer will not invalidate S Corp's S election. Shareholder obtains the tax benefits of the transaction due to the Subchapter S income allocation rules in the Internal Revenue Code.[95] Moreover, it is S Corp which determines and reports the income allocation of S Corp to the Service, not Exempt-Org. If Shareholder does not receive the anticipated tax benefits, either because they are disallowed by the Service or there is a law change, Shareholder has no right to ask for any remuneration from Exempt-Org or to rescind the contribution. Therefore, it does not appear that there is any *quid pro quo* exchange here, as articulated by the Supreme Court in *American Bar Endowment* and *Hernandez*.

In fact, in at least one case, a taxpayer's deduction was allowed even though the charitable contribution was solely motivated by a tax benefit. In *Weitz v. Commissioner*,[96] the Tax Court stated, "[a] charitable contribution may be motivated by the basest and the most selfish of purposes as long as the donor does not reasonably anticipate benefit from the donee in return." In *Weitz*, the donee's agent bought medical equipment and supplies chosen by the donee hospital for the donor to later contribute to the hospital. The supplies were purchased at a bankruptcy auction for below fair market value and a deduction was claimed for the full fair market of the equipment and supplies upon contribution to the hospital.

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[94] *See* Merten's Law of Federal Income Tax §31.04:

> To qualify for the exclusion from income for amounts received as a gift, the transfer must be based on "detached and disinterested generosity." While the same formulation is often repeated in cases regarding the charitable deduction, it must be remembered that a generous and altruistic donative intent is not required.

See also, 521-2nd T.M., *Charitable Contributions: Income Tax Aspects*, at II (E):

> Although the Duberstein test has been applied by the Tax Court in the context of charitable contribution issues, other courts have declined to apply Duberstein in § 170 cases.

[95] *See* I.R.C. Sec. 1366.

[96] T.C. Memo 1989-99.

Although the deduction amount was reduced to reflect the price of the equipment and supplies, the Tax Court allowed a deduction for the charitable contribution to the hospital stating, "[p]etitioners' actions have been planned and executed to assure that their donation of medical equipment to West Hudson would come within the definition of a deductible charitable contribution and all of the steps necessary to accomplish that goal have been effectuated. Petitioners cannot be penalized for being too careful."[97] The Tax Court went so far as to state that a charitable contribution may be accomplished through the efforts of an agent acting for the donee.[98]

In addition, the courts have stated that when the "primary motivation for conveying the property was to secure a tax deduction . . . it does not result in the disallowance of the deduction."[99] Also, in *Waller v. Commissioner,*[100] the taxpayers were allowed deductions for contributions of appreciated securities with unrealized appreciation which thereby avoided payment of capital gains tax on such appreciation while claiming a charitable contribution deduction for such appreciation. In *Waller*, although the taxpayers were the creators and trustees of the donee-trust, the Tax Court held that avoiding the tax on the gain by selling to this particular trust, does not negate the tax-exempt status of the trust or the deductibility of the contributions made.

8) The Proposed Transaction is an excess benefit transaction under Section 4958.

Section 4958, enacted by the Taxpayer Bill of Rights, provides for intermediate sanctions on the "disqualified persons" and managers of certain tax-exempt organizations that engage in an "excess benefit transaction." The intermediate sanctions are enforced by a 25% excise tax on any "disqualified person" which benefited from the "excess benefit transaction,"[101] and by a 10% tax on the "organization manager."[102] The intermediate sanction rules in Section 4958 are applicable to Section 501(c)(3) public charities and Section 501(c)(4) social welfare organizations (hereinafter referred to as "applicable organizations").[103]

The Service has warned that it may treat a "charitable split-dollar insurance" transaction as an excess benefit transaction under Section 4958, assessing taxes against a disqualified person who benefits from the transaction as well as the charity's managers.[104] The rationale for treating the arrangement as an excess benefit transaction appears to be that in a charitable split-dollar insurance transaction, the economic benefits of the insurance policy are primarily realized by the person contributing funds to the charity (or by a

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[97] *Id.*
[98] *Id.* (citing *Greer v. Commissioner*, 70 T.C. 294, 304 (1978)).
[99] *Mount Mercy, supra* (citing *Weitz, supra*).
[100] 39 T.C. 665 (1963).
[101] I.R.C. Sec. 4958(a)(1).
[102] I.R.C. Sec. 4958(a)(2).
[103] I.R.C. Sec. 4958(e)(1).
[104] Notice 99-36, 1999-26 I.R.B. 3

related person), as opposed to the charity.[105]

It does not appear that the transaction will constitute an excess benefit transaction under Section 4958. Since Exempt-Org is a Section 401(a) public pension plan, Section 4958 is not applicable because in order for a transaction to be an excess benefit transaction, one of the parties to the transaction must be an applicable organization.[106] Section 401(a) pension plans are not included in the statutory definition of applicable organizations.[107] Therefore, the transaction should not be considered an excess benefit transaction.

Moreover, the transaction differs from charitable split-dollar life insurance transactions. In the split-dollar insurance transactions, the charity purchases a life insurance policy for the benefit of the donor (or a related person). The act of purchasing the life insurance policy arguably is the providing of an economic benefit. In the transaction, all Exempt-Org does is accept the donation of the stock and sign the redemption agreement. Neither of these actions should be considering the providing of an economic benefit to Shareholder. First, with respect to the acceptance of stock, the acceptance of the stock clearly provides a benefit to Exempt-Org, which obtains a valuable asset. With respect to the Redemption Agreement, it also provides an economic benefit to Exempt-Org because it gives Exempt-Org a market in which to sell its stock. Moreover, Exempt-Org is not mandated to redeem. If Exempt-Org does not believe the redemption price is fair, it can sell the stock elsewhere. In marked contrast to the split-dollar insurance transactions, Exempt-Org does not provide an economic benefit to Shareholder.

As demonstrated by Notice 99-36, if the transaction is found to be an excess benefit transaction and that Shareholder is a disqualified person, the Service could potentially: (1) disallow the income and/or gift tax charitable contribution deduction for the contribution of the stock to Exempt-Org (and, thus, create a substantial gift tax liability for Shareholder); and (2) reallocate all or most of the S Corp's taxable income to Shareholder.

It appears unlikely however that the Service would disallow the charitable contribution deduction in this transaction. In Notice 99-36, the Service disallowed the charitable contribution deduction because it recharacterized the transaction from a gift of cash to a transaction, "in which the taxpayer obtains an insurance policy, pays premiums with respect to that policy, and transfers some of the rights under that policy to the trust and the remaining rights to charity."[108] The Service thus ruled that the charitable contribution deduction should be disallowed because charitable contribution deductions are not allowed for transfers of partial interests in property.[109]

In our transaction, if the Service were to recharacterize the transaction, it would most likely determine that the substance of the transaction was a transfer of cash, as opposed to

[105] *See* Simpson, *Tax Exempt Organizations: Organization, Operating and Reporting Requirements*, 870-1st T.M. Sec. 3-XV-D
[106] I.R.C. Sec. 4958(c)(1).
[107] *See* I.R.C. Sec. 4958(e).
[108] Notice 99-36, 1999-26 I.R.B. 3.
[109] I.R.C. Sec. 170(f)(3).

a valid stock transfer. While this recharacterization would mean that all of S Corp's income would be reallocated back to Shareholder, it would still appear that Shareholder should be entitled to a charitable contribution deduction.

CONCLUSION

Based on the above analysis and discussion, we believe that it is more likely than not that, Shareholder will be entitled to a charitable contribution deduction in tax year 1999 for approximately the FMV of the stock donated to Exempt-Org. Moreover, in tax years 2000 and 2001, 90 percent of S Corp's taxable income should be allocated to Exempt-Org.

KPMG 0013427

I) Targeting

a) Characteristics of a good target

i) The company is closely held (generally less than six shareholders).

ii) The company can be either an S corporation or any other type of entity willing and able to convert to S Status. If the company is a C Corporation, see attached outline of C to S conversion issues.

"C to S corp.doc"

Not Yet Reviewed by WNT

iii) The company generates at least $2.5M taxable income annually. Per WNT, the income that the company expects to receive during the anticipated period of the transaction should be normal operating income.

iv) The company should not be planning a public offering in the near future (next three years). However, the strategy could be used to bring in ineligible S corporation shareholders (e.g. non-resident aliens, corporations or investment partnerships), through the warrant distribution.

v) Per WNT, companies with significant one-time gains or income from extraordinary transactions are not suitable for this transaction.

KPMG 0013428

vi) Initial marketing: primarily to KPMG clients. If they are not clients, we should also request to prepare the tax return to ensure proper allocation.

b) Tools for targeting

i) Internal PowerPoint presentation (us. in redacted pile ht call)

SC_Presentation.ppt

ii) Internal Awareness Elevation Presentation

SC_2_Powerpoint_Presentation.ppt

with: mts redaction pile

Pending DPP review

iii) Executive Summary that can be supplied to ‑ ‑d outside counsel

execsummary.doc

Pending DPP review

II) Implementation of Strategy

a) Engagement Letter and Risk Analysis memo

ENGAGE.DOC SC2_Risk_Analysis.doc

Reviewed by Delap

KPMG 0013429

b) Due Diligence.

i) Information Request letter

Info_Request.doc

Not yet reviewed by WNT

ii) Corporate Issues. The following discussion is to be used strictly as guidance to outside counsel. All decisions with respect to legal documents should be made by the company's legal counsel (i.e. nonKPMG personnel)

(1) Distribution requirements. Are there any provisions in the by-laws, articles of incorporation, shareholders' agreements or elsewhere that mandates that the company make a distribution to pay the shareholders' taxes? If so, these provisions should be deleted prior to implementation.

(2) Redemption Rights. Are there any provisions in the by-laws, articles of incorporation, shareholders' agreements or elsewhere that gives the company the right to force any shareholders to present their stock for redemption? If so, these provisions should be deleted prior to implementation.

(3) Indemnification Rights. Are there any provisions in the by-laws, articles of incorporation, shareholders' agreements or elsewhere that give any shareholders indemnification rights from the

company? If so, these provisions should be deleted prior to implementation.

(4) Revocation/termination of S Election. Under §1361(d)(1)(B), if more than one half of the shareholders agree, the S election can be revoked. It appears that nonvoting stockholders would be entitled to revoke under this provision. Since the tax-exempt will most likely hold a majority of the outstanding shares, it theoretically could revoke the election. Although the redemption agreement provides that it may not revoke the election, for added comfort, the company should have language in the by-laws which gives only the voting stockholders the right to revoke the S election. A model form is attached below.

iii) State Law Issues

(1) Copy of Annual Report and other corporate information. Under California law, shareholders must be sent a copy of the annual report unless the by-laws specifically waive this requirement. *See* Ca. Corporations Code §1501. If prior to the implementation of this strategy, the by-laws already waive this requirement, there is no need to send the Exempt Organization a copy of the annual report. However, if the by-laws have not already waived this requirement, we would prefer that it not be waived and that the Exempt Organization be sent a copy of the annual report. We need to monitor to make sure that the company complies with this

requirement. If the strategy is being implemented in another state, we should have counsel check if there are similar requirements in that state and make sure they are being complied with.

(a) Shareholder record. Under California law, only a shareholder or combined shareholders holding more than 5% of the voting stock can demand a record of shareholders of the corporation. *See* Ca. Corporations Code §1600. If the strategy is being implemented in another state, we should have counsel research whether there any similar type rights the Exempt Organization may have.

(2) Restrictions on Distributions. Are there any state law restrictions on corporate distributions? Under many state laws, corporations must meet certain tests before they may make distributions to shareholders. We should consult with local counsel to be certain that the planned distributions of nonvoting stock and warrants in the strategy are proper under the applicable state's law.

(3) Shareholder Restrictions. Are there any state law restrictions on who may be a shareholder of the corporation? For example, under many state laws, there are restrictions on who may be a shareholder in a professional services corporation.

iv) Shareholder issues

(1) How many shareholders are there and what are their respective ownership percentages? All distributions in the strategy should be

made pro rata, based on the shareholders' respective ownership interests. Otherwise, the transaction could trigger a second class of stock.

(2) Did any of the shareholders acquire their stock in multiple transactions? If yes, basis must be tracked separately for each acquisition.

(3) Which shareholders, if any, are active in the business and in what capacitities?

(4) How do the shareholders hold the stock, e.g. in a trust?

(5) What are the shareholders' cash flow needs for the next three years? That is, do the shareholders depend upon corporate distributions as their primary source of income?

(6) Do any shareholders already make substantial contributions to charities? If yes, the shareholders may be limited in their use of the charitable deduction generated by this strategy, due to the percentage limitation in Section 170.

(7) Do any shareholders have NOL carryforwards or passive losses? If yes, the benefit from strategy may be significantly reduced.

(8) Will any shareholders be in an AMT position? If yes, the benefit from strategy may be significantly reduced.

v) Federal Tax issues.

(1) What is each shareholders' basis in stock as of the beginning of the current taxable year?

(a) Is there shareholder debt? What type of debt?

(2) What is the AAA balance as of the beginning current taxable year?

(3) Does the corporation have accumulated earnings and profits (AEP) from being a C Corporation? This strategy could be used to bail-out the AEP through an election under Section 1368(e)(3), if the corporation makes any distributions to the tax-exempt.

(4) If the corporation was ever a C corporation, determine whether there are any passive income issues under Section 1375 which could cause a corporate level tax.

(a) Excess passive investment income for three consecutive years can result in termination of the S election. Passive investment income includes royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

(5) Have there already been any distributions during the taxable year or are distributions being contemplated for the duration of the taxable year?

(a) If yes, extreme caution is necessary in implementing the strategy, because when the warrants and nonvoting stock are distributed in the strategy, the shareholders' basis in their voting common stock will be reallocated mostly to these other securities.

"307 and 1367 Memo(final).doc"

Reviewed and approved by Rich Manfreda

Therefore, if the strategy is implemented in situations where the distributions during the taxable year are in excess of the reduced basis in the voting common stock, taxable gain may result.

(b) If this is an issue, one possible cure could be to issue compensatory options under Section 83 as an alternative to a distribution under Section 305. In addition, a closing of the books election would also probably be necessary.

(6) Does the company have any Section 751 assets? Under Section 170(e), the amount of the charitable contribution deduction is reduced if the company has any Section 751 assets. Memo is forthcoming.

Significant Section 751 assets include:

(a) unrealized accounts receivable. If the corporation is on the cash basis of accounting and has an accounts receivable balance, that may reduce the charitable contribution deduction.

(b) Sections 1245 and 1250 recapture property

(c) Inventory.

(7) Does the company have a Net Unrealized Built-in Loss (NUBIL) at the time of the transaction? The implementation of this strategy will most likely cause an ownership change under §382. Therefore, if the company has a NUBIL that exceeds $10 Million or 15% of the variable assets (the threshold for the NUBIL rules in §382 to apply), there could be limitations on the amount of depreciation deductions that the company may claim during the five years following the implementation of the transaction. Care should be taken in implementing the strategy where the company may have a NUBIL.

vi) State Tax Issues

(1) Certain states do not recognize S corporations. In addition, certain states impose a corporate level tax on S corporations. In these states, the benefit from the strategy will be reduced.

(2) Checklist of states with S-corporation election and also corporate level tax.

states1.JPG states2.JPG states3.JPG states4.jpg

(3) In what states does the corporation do business?

(4) If the company owns other corporations, does the state allow for combined or consolidated returns?

(5) Make sure the tax-exempt entity is a permissible shareholder under state law, i.e. does the state follow the federal rules on who may be a shareholder in an S Corp.?

vii) Tax-Exempt Issues

(1) There should be written documentation that the tax-exempt entity is a qualified plan under Section 401(a).

(a) If it has a determination letter from the I.R.S., we should obtain a copy of that. In addition, we should have the plan sign a representation that it is a qualified plan (see below).

(2) The tax-exempt entity should not be related to or controlled by any of the Shareholders and none of the Shareholders or their relatives should be beneficiaries under the pension plan.

c) Preliminary Benefit Analysis

i) The shareholders should contemplate donating stock worth approximately 12.5% of the projected first year taxable income. This percentage may change if the company expects high growth.

ii) Spreadsheets for determining benefit of transaction. When using the spreadsheets, please note that the constants built-in to the spreadsheet may need to be altered if the facts are not in line with the spreadsheets. (see assumptions in the spreadsheets)

"Model Cash Flow 2 YEAR.xls" "Model Cash Flow 3 YEAR.xls" "Model Cash Flow 5 YEAR.xls" *d) Transaction*

i) Pre-transaction Planning – Possible Note Issuance (NOT YET DISCUSSED WITH WNT)

(1) Prior to the transaction, it may be beneficial for the corporation to distribute notes to the shareholders. The issuance of notes would be particularly beneficial where the shareholders have high basis in their stock.

(2) By issuing notes prior to the transaction, the shareholders can utilize this basis before it gets reallocated to the nonvoting stock and warrants.

(3) The issuance of notes may also be beneficial where the shareholders are dependant on distributions for their primary source of income. During the transaction period, distributions normally are not made. Therefore, if the shareholders will need cash from the corporation during the transaction period, a note should be distributed prior to the transaction.

(4) To the extent that notes are not necessary to either reduce basis or provide necessary income to the shareholders, they should not be issued, because the issuance of notes arguably weakens the economic substance of the donation of stock.

(5) Care should be taken in issuing notes, to make sure that the amount of the note distribution does not trigger any tax due to lack

of basis, i.e. the note amount should not exceed the shareholders' basis in their stock.

ii) Standard Transaction (Section 305 distributions). The standard transaction should be used wherever possible. The alternative transaction (compensatory options under Section 83), should only be used where there are basis issues that preclude using the standard transaction.

(1) Redacted legal documents THESE DOCUMENTS ARE INTENDED FOR THE SOLE PURPOSE OF SUGGESTING APPROPRIATE LANGUAGE TO THE CLIENT'S OUTSIDE LEGAL COUNSEL WITH RESPECT TO LEGAL DOCUMENTS THAT LEGAL COUNSEL IS RESPONSIBLE FOR DRAFTING. WHEN PROVIDED TO LEGAL COUNSEL, THE TRANSMITTAL LETTER BELOW IS TO BE USED. UNDER NO CIRCUMSTANCES ARE COPIES OF THESE DOCUMENTS TO BE PROVIDED DIRECTLY TO THE CLIENT.

redacted_forms.doc

Prior version sent to Delap, but modified since then to change redemption amount and to add a pledge agreement

(2) Additional restrictions to protect against S election being terminated

S_Corp_restrictions.doc

Not yet reviewed by WNT

(3) Transmittal letter

"transmittal letter.doc"

Incorporates Delap language to be sent with legal documents to outside counsel, but complete letter not yet reviewed by WNT

(4) Sample Valuation Report

"Redacted Valuation Report.doc"

Prepared by KPMG Valuation Group for beta test client

(a) The valuation report should meet all requirements under Section 170, for charitable contributions of stock.

(b) Approved independent valuation groups: A separate list will be forthcoming.

(c) WNT would prefer that valuation discounts (e.g. lack of marketability, control, etc.) not exceed 35%.

(d) The valuation group needs to value all of the securities: the voting stock, the warrants and the nonvoting stock, in order to enable us to determine the basis in each under Section 307.

(e) We may also need the valuation group to value certain other assets in order to help us with the Section 751 calculations. For example, it may be necessary to value the receivables if the company is on a cash basis. It may also be necessary to have the inventory valued and Section 1245 or Section 1250 assets.

(5) The plan must make written representation that it is a qualified plan.

401_representations.doc

reviewed by Kelliher

(6) Procedures on Gifting Stock.

(a) Shareholder needs to sign an assignment of the nonvoting stock to the Exempt Organization. The certificates should then be presented to the Exempt Organization. Concurrently with the stock transfer, S Corporation and Exempt Organization should both sign the Redemption Agreement and Shareholder should sign the Pledge.

(b) Exempt Organization needs to send the certificates to the S corporation or its legal counsel requesting reissuance in the Exempt Organization's name. Counsel and the S corporation should be apprised of this ahead of time and should reissue shares which state that they are redeemable. See attached form letter for Exempt Organization's use:

new_certif_request.
doc

Net yet reviewed by WNT

(c) Exempt Organization will eventually need to sign Form 8283, prior to the filing of the Shareholder's tax return (see below).

(7) Filings and Disclosures

(a) If the articles of incorporation are amended to permit the company to issue nonvoting stock, it may be necessary to file the amendments with the Secretary of State. This should be done by the company's counsel.

(b) In certain states, there may be necessary securities law filings to issue the new nonvoting stock or the warrants. This should be done by the company's counsel.

(c) Form 8283 needs to be completed by us and signed by the Exempt Organization. It needs to be attached to the shareholders' returns for the year of the contribution.

(d) Check the appropriate state law for any required state tax return filings

(e) Financial Statement disclosure. For KPMG audit clients, the SC² strategy should be discussed with the assurance engagement team to address specific accounting implications to the client.

Specifically, there may be disclosure issues for S-Corp associated with the issuance of nonvoting stock and warrants. S Corp should also disclose the terms of the redemption agreement within the financial statements of S Corp. Where the client is not a KPMG audit client, the client should be advised to consult its own auditors to address the financial accounting implications of the SC² strategy.

(8) Calculate benefit of contribution.

(a) Determine whether the corporation has any Section 751 property. See Section 170(e). See Technical Discussion memo above.

(b) Determine whether the percentage limitations in Section 170 are applicable.

(9) Calculate basis in voting stock, warrants and nonvoting stock under Section 307 regulations. The basis needs to be allocated based on the respective fair market value of each security.

iii) Post-transaction

(1) Opinion letters. There are three opinion letters issued.

(a) Opinion letter re: distribution and contribution of stock. This letter should be issued concurrently with the valuation report.

Opinion_ltr_redacted.doc

(b) Opinion letter re: warrant distribution. This letter should be issued prior to the filing of the shareholders' tax returns.

Opion_ltr_warrants_redacted.doc

Not yet reviewed by WNT

(c) Opinion letter re: income allocation. This letter should be issued prior to the filing of the shareholders' tax returns.

Opinion_ltr_allocation_redacted.doc

Not yet reviewed by WNT

(2) Distributions. WNT believes that the shareholders' positions would be strenghtened if the S corp were to pay a dividend each year, rather than paying no dividends. Failing to pay dividends would not adversely affect our ability to issue a "more likely than not" opinion on the strategy; nor would the payment of dividends enable us to issue a higher level of opinion. However, WNT thinks payment of dividends would reduce the taxpayers' level of risk by making it more difficult for the IRS to successfully argue that the taxpayer has retained beneficial ownership of the stock contributed to the exempt pension fund. WNT thinks it would also bolster the taxpayers' "economic substance" argument. Although the payment of any dividends to the exempt pension fund would be an additional cost to the taxpayer, that cost would provide a corresponding benefit in the event of an examination challenge.

(3) Effect of possible redemption.

(a) AAA and E&P is reduced.

"AAA and EP Memo(final).doc"

Reviewed by Manfreda

(4) If the Exempt Organization presents the stock for redemption, S Corp must write a check to the tax-exempt for the redemption amount. (A subsequent valuation will be necessary for this). In addition, if the stock has depreciated in value, the Shareholder may need to pay some amount under the pledge.

(5) Estate / Gift Tax Opportunities.

(a) Appreciation Transfer Trust. By using this strategy, the shareholders may be able to avoid transfer taxes on a significant portion of the appreciation of the company by transfering the warrants to a grantor trust. See attached link: http://taxkm.us.kworld.kpmg.com/TSI/Ideas/tsi99-33.htm

(b) Family limited partnership. See attached link: http://taxkm.us.kworld.kpmg.com/TSI/Ideas/tsi00-01.htm

(6) Possible Audit issues.

(a) Statute of limitations.

Stat_of_lim_.doc

Reviewed by Norlyn Miller & Manfreda

(b) Penalties. See DPP memo:

"Indv'l penalties.doc"

iv) Alternative transaction structures.

(3) If basis in the voting stock needs to be saved due to prior distributions during the tax year, the warrants could be issued as compensation under Section 83. If this is done, a closing of the books election may also be necessary.

III) Frequently asked questions

a) Tax

i) Does Section 269 apply to the transaction? No, see white paper for discussion.

ii) Does Section 384 apply to the transation? No, see white paper for discussion.

iii) Do the new Corporate Tax Shelter Regs apply? No, see attached

Tax_shelter_memo.doc

Currently under review by WNT

iv) Do the Intermediate Sanctions Rules under Section 4958 (excess benefit transactions) apply? No, because the rules do not apply to Section 401(a) pension plans.

b) General questions

i) What are the downsides to the transaction?

(1) The strategy restricts ability to make distributions during the time that charity owns the stock, without paying most of the distribution to the charity.

(2) limits ability to go public while strategy is in place

(3) shareholders lose basis in stock that is reallocated to nonvoting

(4) The shareholders do not obtain basis increases for income that is allocated to the Exempt-Organization.

ii) What if the tax-exempt won't redeem?

(1) The tax-exempt has no reason to hold on to the stock after the redemption period. First, it has no vote to authorize a distribution. Secondly, the market for it to sell the stock is severely limited because most holders of this stock would incur more in tax liability than the stock is worth. In addition, the stock has limited appreciation potential. Therefore, the tax-exempt has nothing to gain by holding the stock beyond the redemption period.

(2) Still, if tax-exempt won't redeem, exercising the warrants will immediately dilute the tax-exempt's interest.

iii) How long is the implementation process?

(1) If tax information and corporate documents are readily available, the implementation process could take as few as two weeks.

Message0202	
Subject:	RE: S corporation Charitable Contribution Strategy
From:	Manth, Larry E
Date:	4/10/2000 6:44:55 AM
To:	Terracina, Michael P

Message Body

Mike, see attached, hopefully this will help. Since DeLap has not reviewed this, please make sure it does not go to clients.

Thanks,

Larry

-----Original Message-----
From: Terracina, Michael P
Sent: Sunday, April 09, 2000 9:31 AM
To: Manth, Larry E
Subject: FW: S corporation Charitable Contribution Strategy

Larry - this is typical of a lot of TSP's responses. I felt that my explanation to George was more than I should have. Is there an executive summary that we may want to give these guys that is not as comprehensive as the white paper. I'm uncomfortable with that, but wanted your thoughts. I'm out of the office Monday am and will hook up with Jorge Monday pm. I can probably overcome his objections with another conversation, but wanted to see what you thought.

Mike
-----Original Message-----
From: Del Alamo Jr, Jorge A
Sent: Saturday, April 08, 2000 6:22 AM
To: Terracina, Michael P
Cc: Slattery, Daniel M; Beakley, William D
Subject: RE: S corporation Charitable Contribution Strategy

Mike:
As I mentioned to you in our initial conversation there are several opportunities that I think could work.I am very uncomfortable about approaching people that I have worked very hard to establish a relationship with about a strategy that I have no idea how it works.
I would like to review a white paper before calling prospects. The info I received is a

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Confidentiality Requested

KPMG 0048332

Permanent Subcommittee on Investigations
EXHIBIT #96c

sales presentation that does not tell me anything.
I will be in Houston Monday and Tuesday so maybe you can give something
thanks
Jorge

-----Original Message-----
From: Terracina, Michael P
Sent: Thursday, April 06, 2000 8:26 PM
To: Moore, Michael D; Del Alamo Jr, Jorge A; Jeandron Jr, Raymond J; Fowler Jr, Hardy B; Pitts, Martin W; Leblanc Jr, Donald H
Cc: Jolly, J. G; Johnston, Michael L
Subject: S corporation Charitable Contribution Strategy

Last week I spoke to each of you about the initial targets that came up on the target list for a new S corp. strategy (SC2). The strategy was approved by DPP yesterday so we are ready to take to clients.

Listed below are the clients and the respective TSP. Several of you indicated that for various reasons some of the targets were not viable candidates. The basic criteria is S corporations with less than 6 shareholders, taxable income of $2.5 million or more, and shareholders with some charitable intent.

I would appreciate if you could definitively conclude which ones we should not take this to and the explanation. For the ones that are viable candidates, I would like to discuss when we can meet with them and the approach you think we should take.

We can also take this to C corporations that meet the other criteria and would consider converting to S status. Also, we can consider taking this to former clients and targets that you have a good relationship with. If other partners in your office have viable targets, please pass this info on to them and let me know.

I will do whatever you need to get more comfortable with the strategy before presenting to your client including getting Larry Manth, the National Solution Champion, involved. He has implemented the strategy several times.

One issue that many of you raised is who are the eligible charitable organizations. I now understand that although we have not approached organizations in each city, we have a database that can be searched that includes eligible charities in each state. The best approach is to address this after the client gets comfortable with the economic arrangement and the technical aspects of the strategy.

The minimum fee is $250,000. The fee is generally 10% of the average taxable income over two years. (e.g. $2.5 million average per year x 10% = $250K)

This is a high profile strategy from which Bill Beakley is expecting significant revenue.

Redacted
by
Permanent Subcommittee
on Investigations

Attachment
SC2_Internal_Awareness_Presentation.ppt

Content Header Information
Conversation Topic: S corporation Charitable Contribution Strategy
Subject: RE: S corporation Charitable Contribution Strategy
From: Manth, Larry E.
Sender Name: Manth, Larry E.
To: Terracina, Michael P.
Received By: Terracina, Michael P.
Delivery Time: 4/10/2000 6:44:55 AM
Creation Time: 4/10/2000 6:38:15 AM
Modification Time: 10/23/2000 11:26:28 AM
Submit Time: 4/10/2000 6:44:43 AM
Importance: 4/1
Priority: 4/0
Sensitivity: 4/0
Flags: 4/1
Size: 4/894134

Message0008	
Subject:	**RE: Valuation Firms**
From:	Terracina, Michael P
Date:	4/20/2000 10:37:43 AM
To:	Beakley, William D
Message Body	

Great -let me know when you've spoken to him. I remember him well.

-----Original Message-----
From: Beakley, William D
Sent: Thursday, April 20, 2000 11:21 AM
To: Terracina, Michael P
Subject: RE: Valuation Firms

I know Ernest HunDahl very well. I hired him & he used to work in the Houston office. If it's ok by you I'll call him, set the hook, and tell you'l be contacting him.

-----Original Message-----
From: Terracina, Michael P
Sent: Thursday, April 20, 2000 10:17 AM
To: Choate, Gary M; Johnston, Michael L
Cc: Engel, Greg A; Beakley, William D
Subject: FW: Valuation Firms

As we discussed, for the SC2 strategy there will need to be an independent valuation of the S corp. stock. These are some names I have gotten as possibilities for us to refer the client to.

We need to have them lined up now. Any additions, deletions before we start contacting?

Mike

-----Original Message-----
From: Morse, Gloria K
Sent: Thursday, April 20, 2000 9:32 AM
To: Terracina, Michael P
Subject: Valuation Firms

Howard Frazier Barker Elliott, Inc.
Contact: Don Barker, Alex Howard, Will Frazier
(713) 225-2580

Houlihan Lokey Howard & Zukin (Dallas)
Contact: Jim Massey
(214) 220-8470

Southwest Financial Analytics, Inc.
Contact: Ernest Hundahl
[713] 278-2500

Outlook Header Information
Conversation Topic: Valuation Firms Subject: RE: Valuation Firms From: Terracina, Michael P Sender Name: Terracina, Michael P To: Beakley, William D Delivery Time: 4/20/2000 10:37:43 AM Creation Time: 4/20/2000 10:37:43 AM Modification Time: 4/20/2000 10:37:44 AM Submit Time: 4/20/2000 10:37:44 AM Importance: 4/1 Priority: 4/0 Sensitivity: 4/0 Flags: 4/1 Size: 4/4650

KPMG 0048197

Message0011	
Subject:	**FW: Rough draft of sc2 presentation--FINAL REVISIONS?**
From:	Manth, Larry E
Date:	4/27/2000 7:35:23 AM
To:	Atkin, Andrew S; Bogos, Nicholas G; Choate, Gary M; Duncan, Douglas P; Engel, Greg A; Huber, Robert; Hutchison, Mark-Warner Cntr; Johnston, Michael L; Leak, Councill; Lipschultz, Brent S; Peterson, Kurt; Pichette, Craig L; Schrier, John V; Speiss, Timothy P; Terracina, Michael P

Message Body

This is e-mail 1 of 2 with respect to SC2 being rolled out to the BDMs. We are keeping the presentation at an extremely high level so they don't give it away. The call is scheduled today. Please make sure that you contact the BDMs in your area to make sure you are internally coordinated. They should be contacting you, but we obviously need to make sure we are not crossing paths. They will help to identify other KPMG clients (perhaps audit clients but not tax clients) as well as identify non-clients of the firm, in which they will have specific instructions on coordinating first with the regional champions and also keeping any communication at an extremely high level. All regional champions can join the call, the number is forthcoming in the next e-mail.

-----Original Message-----
From: Sparkman, James
Sent: Wednesday, April 26, 2000 3:33 PM
To: Coughlin, Sean S; Brauneis, Lawrence J; Kellar, Jeff; Roth, Robert J; Melick, Molly; Manth, Larry E
Cc: Gilman, Tobin M; Hagenhoff, Michael J; Krumholz, Andrew; Parker, Paul C; Stile, Richard; Harrison, C. Ian (NEW YORK)
Subject: FW: Rough draft of sc2 presentation--FINAL REVISIONS?

Team,
Here is the presentation for tomorrow for your review. If you have any suggestions or revisions, please have them done and back before 9am(PST). Molly, if you don't receive an update from me by noon(CST), then send this to all BDM's for the call. We have our dry run at 2pm(PST), and the call-in went out earlier. Thanks to the team for your contributions, and let's treat this like it's a strategy that can have a significant impact on our year-end, because that's exactly what it can do for the firm, not to mention providing alot of BDM's an opportunity to join us at Aviara in August at PERFORMERS CLUB. The goal has to be for each BDM to find and close one in the next 60 days. That's how good this presentation needs to be, and I know each of you are up to the task.

James D. Sparkman
Area Sales Director-West
KPMG
Los Angeles, Ca.
213-430-2157

-----Original Message-----
From: Coughlin, Sean S
Sent: Tuesday, April 25, 2000 2:12 PM
To: Manth, Larry E; Sparkman, James
Cc: Kellar, Jeff
Subject: RE: Rough draft of sc2 presentation

Changes as per Larry's request

Sean S. Coughlin
206-292-4277

Proprietary Materia
Confidentiality Reques

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KPMG 0049214

206-292-4233(fax)

-----Original Message-----
From: Manth, Larry E
Sent: Tuesday, April 25, 2000 1:14 PM
To: Sparkman, James; Coughlin, Sean S
Cc: Kellar, Jeff
Subject: RE: Rough draft of sc2 presentation

suggested changes:

page 2 -- ...and has > then $2.5 million, should be > "than"

page 2 -- ...for the next two year to;, should be ... "years to:"

page 3 -- add the following:

Homebuilder -- $3 million fee
Construction Company -- $1 million fee
Computer Company -- $2 million fee

Larry

-----Original Message-----
From: Sparkman, James
Sent: Tuesday, April 25, 2000 12:53 PM
To: Manth, Larry E
Cc: Kellar, Jeff
Subject: FW: Rough draft of sc2 presentation

Please review and provide feedback/ suggestions for improvement. Thanks

James D. Sparkman
Area Sales Director-West
KPMG
Los Angeles, Ca.
213-430-2157

-----Original Message-----
From: Coughlin, Sean S
Sent: Tuesday, April 25, 2000 10:54 AM
To: Sparkman, James
Subject: FW: Conference Call--Tuesday, 4/25--9am(PST)--12pm(EST)

How is this for a presentaion?

<< File: scorp.ppt >>

Sean S. Coughlin
206-292-4277
206-292-4233(fax)

Proprietary Material
Confidentiality Requested

KPMG 0049215

-----Original Message---

From: Brauneis, Lawrence J
Sent: Tuesday, April 25, 2000 10:17 AM
To: Sparkman, James; Manth, Larry E; Coughlin, Sean S; Roth, Robert J; Kellar, Jeff
Subject: RE: Conference Call--Tuesday, 4/25--9am(PST)--12pm(EST)

Here is my understanding of the Outline from Mike Hagenhoff:

* Product Description
* Target Profile
* ______ Proposition (first word blank either value or KPMG?)
* Competition
* Opinion Level
* Contact Point
* Why KPMG
* Pricing Structure
* Success Stories
* Key's to closing the sale
* Sales Cycle
* Qualifying Questions
* Overcoming Client objections
* Delivery team
* Next Steps

Larry Brauneis
Business Development Manager - Tax
Phone: 312-665-2566
Fax: 312-665-2486
email: lbrauneis@kpmg.com
kpmg

-----Original Message-----
From: Sparkman, James
Sent: Monday, April 24, 2000 11:30 AM
To: Manth, Larry E; Coughlin, Sean S; Roth, Robert J; Brauneis, Lawrence J; Kellar, Jeff
Subject: FW: Conference Call--Tuesday, 4/25--9am(PST)--12pm(EST)

Below is the call-in for our rehearsal tomorrow. Thank you.

James D. Sparkman
Area Sales Director-West
KPMG
Los Angeles, Ca.
213-430-2157

-----Original Message-----
From: Lilyea, Francine
Sent: Monday, April 24, 2000 8:42 AM
To: Sparkman, James
Subject: Conference Call

Jim:

The conference call has been set up for Tuesday, April 25th at 9:00 a.m. PST. for 1 hour and 8 in attendance. The

dial-in number is:
1-888-594-8171 - passcode 15891#

Fran Lilyea
Telephone: 213-955-8991
FAX: 213-955-8504
flilyea@kpmg.com

Attachment
scorp.ppt

Outlook Header Information
Conversation Topic: Conference Call Subject: FW: Rough draft of sc2 presentation--FINAL REVISIONS? From: Manth, Larry E Sender Name: Manth, Larry E To: Atkin, Andrew S; Bogos, Nicholas G; Choate, Gary M; Duncan, Douglas P; Engel, Greg A; Huber, Robert; Hutchison, Mark-Warner Cntr; Johnston, Michael L; Leak, Councill; Lipschultz, Brent S; Peterson, Kurt; Pichette, Craig L; Schrier, John V; Speiss, Timothy P; Terracina, Michael P Received By: Schrier, John V Delivery Time: 4/27/2000 7:35:23 AM Creation Time: 4/27/2000 7:35:14 AM Modification Time: 4/27/2000 8:32:36 AM Submit Time: 4/27/2000 7:35:15 AM Importance: 4/1 Priority: 4/0 Sensitivity: 4/0 Flags: 4/17 Size: 4/161583

Unknown

From: DeLap, Larry [ldelap@KPMG.COM]
Sent: Thursday, May 11, 2000 7:36 AM
To: Smith, Richard H (WNT)
Cc: Culbertson, Teri A; Elgin, Evelyn; Ely, Mark H; Galib, Nancy M; Miller Jr, Norlyn D
Subject: RE: SC 2 solution

Richard -

The obvious answer to your question is "no", but I think the "proviso" developed the other way around. I believe the solution champion, Larry Manth, decided not to market to C corporations in view of the corporate tax shelter regulations. I doubt that anyone told him he could not so market if he so chose to.

Larry

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>  -----Original Message-----
> From:     Smith, Richard H (WNT)
> Sent:     Wednesday, May 10, 2000 9:00 PM
> To:-Culbertson, Teri A; DeLap, Larry; Elgin, Evelyn; Ely, Mark H; Galib,
> Nancy M; Miller Jr, Norlyn D
> Subject:  FW: SC 2 solution
>
> Teri et al.
>
> This string of messages suggests that we should not market SC2 to C
> corporations that might convert to S status. The reason for not so
> marketing appears to be some concern with the corp tax shelter regs.
>
> Why is it that we would not market this solution to a C corporation
> that is contemplating conversion to S status? Why is that we would not
> present this strategy to certain C corps that might be thereby
> encouraged to convert to S status because of this strategy? As an
> aside, I suspect that C corps in the latter category will be rare as
> compared to the population of S corporations in the former category.
>
> In either event, clients may have tougher disclosure issues or we may
> have a tougher listing decision but should we, on the basis of these
> issues, dictate that we screen C crops from our target market?
>
> Thanks,
>
> Richard
>  -----Original Message-----
> From:     Miller Jr, Norlyn D
> Sent:     Wednesday, May 10, 2000 6:59 PM
> To: Smith, Richard H (WNT)
> Subject:  FW: SC 2 solution
>
> FYI
>
>  -----Original Message-----
> From:     Ely, Mark H
> Sent:     Wednesday, May 10, 2000 1:44 PM
> To: Miller Jr, Norlyn D
> Subject:  FW: SC 2 solution
>
> this is what i was talking about
>
> Mark H. Ely
> National Partner-in-Charge
> Tax Controversy Technical Services
> Washington National Tax
```

Proprietary Material
Confidentiality Requested

KPMG 0015060

Permanent Subcommittee on Investigations
EXHIBIT #96f

```
> KPMG LLP
> p-(202)533-3042; f-(202)533-8546; mhely@kpmg.com
>
>     -----Original Message-----
>     From: DeLap, Larry
>     Sent: Friday, May 05, 2000 8:21 PM
>     To:   Galib, Nancy M
>     Cc:   Culbertson, Teri A; Ely, Mark H; Elgin, Evelyn
>     Subject:    FW: SC 2 solution
>
>     The Tax Solution Alert states:
>     An optimal target for S-Corporation Charitable Contribution Strategy
> has the following characteristics:
> *   S Corporation or entity willing and able to convert to S status;
>
>     Given that, I think there should be a presumption it will be marketed
> to some C corporations that intend to convert to S corporation status.
>
>     -----Original Message-----
>     From:       Culbertson, Teri A
>     Sent: Friday, May 05, 2000 4:59 PM
>     To:   DeLap, Larry; Elgin, Evelyn
>     Cc:   Ely, Mark H; Galib, Nancy M
>     Subject:    SC 2 solution
>
>     TCS proposes the following results on the SC 2 solution.  (Checklist
> sent to shelter reg. mailbox 4/25/00).
>
>     Disclosure - No
>     Registration - No
>     List - No
>
>     This solution is only marketed to individual shareholders of S Corps.
> It converts ordinary income to capital gains.  There are no corporate
> participants, within the meaning of the regulations.
>
>     One proviso applies:  The solution should not be marketed to "C"
> corporations that intend to convert to "S" corp status.  The National
> Product Champion is aware of this proviso.
>
>     Please send Nancy your views.  Thanks.
>
```

KPMG 0015061

Proprietary Material
Confidentiality Requested

From: Speiss, Timothy P
Sent: Friday, May 19, 2000 6:39 PM
To: Farnsworth, Susan H; Krumholz, Andrew; Foody, David; King, James M; Rice, Jeffrey S; Silver, Lawrence G
Cc: Chopack, John J; Manth, Larry E; Hannum, Earl W; Duty, James V; Farnesi, Frank A
Subject: SC2 - Process Reminders and Other Topics

It is imperative that we observe and remember the following process and issues in our SC2 activities:

1. Telephone pre-screening should be focused exclusively on fact gathering (confirm S corp, 6 or fewer shareholders, forecasted ordinary income amounts, basis structure data regarding single or multiple entities). Should an entity representative want to know why we need this data, we should posture that we have a tax planning strategy that can attain income tax benefits based upon certain facts. We are asking for a meeting to describe the strategy in more detail should certain entity attributes exist.

We can discuss this on 5/22 to address your questions and comments. We should be very guarded in our description of the strategy before a meeting has occurred.

2. Until further notice, effective immediately all prospects contacted after 5/19/2000 must meet a minimum S corp ordinary income amount of $ 5 million, increased from $ 2.5 million. To amplify, what this means is that prospects contacted after 5/19/2000 (clients or otherwise) will not meet pre-qualification requirements unless they have a $ 5 million ordinary income amount in each year the strategy would be in place. We should expect a formal announcement wrt this topic the week of 5/22. The reason for this policy revision is to increase the overall quality of SC2 candidates and assist KPMG in the management of the total number of SC2 transactions that will be closed. To ensure the quality of the strategy, there will be a finite period of time the strategy will be offered as well as a finite number of solutions completed.

3. To date our area has no signed engagement letters, however there has been a significant amount of ICVs and Pre-ICV qualification activity. There are four additional ICVs that will take place between 5/22 and 6/2; I expect more to be scheduled over the next three weeks. Therefore, as we approach 6/30, we should focus on best opportunities that have the highest likelihood of closing (evidenced by signed engagement letters) within the next three weeks. Accordingly, please send me a list of all your prospects (use a code name) and fees (first year ordinary income multiplied by 10%), coded as follows:

A - Engagement letter delivered and letter negotiation in process, signature expected by 6/9/2000; client genuinely interested in implementing transaction

B - Engagement letter issued, feasibility/benefit analysis delivered, more than 50% likelihood client will proceed (describe what you are doing or what needs to be done to close/obtain signed engagement letter)

C - 50%/50% non-engagement/opportunity for closing (describe what you are doing or what needs to be done to close/obtain signed engagement letter)

D - ICV held, client only moderately interested

4. If we encounter scenarios where S corp voting stock is owned by a grantor trust, we can consider a structure where post-recap, the grantor would purchase non-voting stock from the trust, with the grantor then completing the transaction with the tax-exempt using the non-voting stock. We should obtain and review copies of trust documents ASAP for clients contemplating the strategy. Similarly, we can suggest structures to assist S corp shareholders to attain their estate planning objectives using grantor trusts (ATT structures) with trust provisions that can allow trust asset substitution or non-voting stock migration to tax-exempts, considering also trustee issues. Again, this should not be discussed with candidates unless we are in a meeting setting.

I would like to schedule a teleconference on 5/24 at 11 am to discuss our activities, and debrief you regarding today's national teleconference. Should anyone desire to speak with me or Larry Silver prior to 5/24 on any SC2 matters, please contact us at 215-299-5053 or 215-299-3119, respectively.

Permanent Subcommittee on Investigations
EXHIBIT #96g

Message0059	
Subject:	**Ian Harrison**
From:	Stein, Jeff (US/Vice Chairman)
Date:	6/2/2000 5:33:58 AM
To:	James Brasher; John Chopack; Peter Colley; Richard Rosenthal; Thomas Crawford; William Beakley; Johnny Gutierrez; Ken-WASH-DC Jones; Peter Elinsky; Stanley Wiseberg; Walter Duer; Douglas Ammerman; Jeffrey LeSage; Robert Peters; Ronald Harvey; Thomas Rotelli; William Hibbitt
CC:	Harrison, C. Ian (NEW YORK); Lippman, Michael H; Lanning, John T; Springer, Mark A; Peters, Marsha F; Klein, Wendy (NSS-Tax)

Message Body

By now I am sure many of you have heard that we've asked Ian to move back into the SALT practice and really help drive their results. These guys had a pretty difficult year and it is in no small part due to the fact that we've pulled senior level resources every year out of that practice to help us drive new initiatives in the tax practice and/or to assume various leadership roles. Having said that, this cannot be a cold turkey break from his old role to his new role but rather I hope a more carefully orchestrated transition. Ian has led the way in a number of areas these past 18 months including the development and delivery of sales training, serving in the role of sales coach on a myriad of large opportunites as well as developing and leading our sales force. We do not intend to slow any of these initiatives or lessen our commitment to continuously building on what has been created. Frankly, I believe Ian deserves a fair amount of credit for driving the teamwork I think we're seeing across the board between our partners in all of our product groups. SC2, RIPPS, IHCO, OPCO, and 401k are just some of the great successes of this past year and Ian was and continues to be involved with all of these as are our partners from Fed tax and our various product groups. That success is not attributable to any one person but rather to our 500 tax partners pulling together to share leads, brainstorm on the right pricing models and work together to close those opportunities. For your info, although this is off the subject of this email, we have $7.2 million in signed engagment letters on SC2 with another $12 million in a close to signed stage. That's pretty incredible given that we've only been hitting the marketplace for about 2 1/2 months and really only in earnest everywhere other than the West for about the last 30 days. Talk about a change in culture!

The real reason for this message is leadership within the BDM organization. With Ian transitioning back into SALT, we've decided to ask Toby Gilman, the Area Sales Director in the Southwest to assume Ian's lead role. Toby will continue to lead the Southwest in addition to overseeing the BDM organization. That responsibility will include assisting us in developing a new compensation model for the BDM's as well as ASD's, working with us to finalize the cost allocation model for the BDM's for '01, driving the performance of the entire organization, overseeing the training of the BDM's, dealing with the commission accounting, etc. Before Ian has a conversation with the ASD's on Monday, I wanted to be sure none of you had a problem with Toby as the leader or foresaw major issues arising as a result of his appointment. This has already been discussed with Bill Beakley who is supportive of the idea. Obviously, the SW is one of the areas where we've had our greatest success.

If you have any issues, please send me an email with a copy to Ian. There is no need to respond if you're OK with this.

Thanks

Proprietary Material
Confidentiality Requested

KPMG 0050391

Permanent Subcommittee on Investigations
EXHIBIT #96h

Outlook Header Information
Conversation Topic: Ian Harrison Subject: Ian Harrison From: Stein, Jeff (US/Vice Chairman) Sender Name: Stein, Jeff (US/Vice Chairman) To: James Brasher; John Chopack; Peter Colley; Richard Rosenthal; Thomas Crawford; William Beakley; Johnny Gutierrez; Ken-WASH-DC Jones; Peter Elinsky; Stanley Wiseberg; Walter Duer; Douglas Ammerman; Jeffrey LeSage; Robert Peters; Ronald Harvey; Thomas Rotelli; William Hibbitt CC: Harrison, C. Ian (NEW YORK); Lippman, Michael H; Lanning, John T; Springer, Mark A; Peters, Marsha F; Klein, Wendy (NSS-Tax) Received By: Klein, Wendy (NSS-Tax) Delivery Time: 6/2/2000 5:33:58 AM Creation Time: 6/2/2000 5:33:57 AM Modification Time: 6/2/2000 5:33:59 AM Submit Time: 6/2/2000 5:33:58 AM Importance: 6/1 Priority: 6/0 Sensitivity: 6/0 Flags: 6/1 Size: 6/14482

KPMG 0050392

From: Kelliher, William B
Sent: Wednesday, June 07, 2000 12:13 PM
To: Johnston, Michael L
Cc: Manth, Larry E; Terracina, Michael P; Manfreda, Richard H
Subject: RE: SC2 - Limitations on Sale of Stock

I think that the restrictions you describe would be acceptable. Generally, we recommend that multi-shareholder S corps adopt shareholder agreements prohibiting any transfer of stock that would result in a termination of the corporation's S election. Reg. sec. 1.1361-1(l)(2)(iii) of the "one-class-of-stock" regulations states that "[b]uy-sell agreements among shareholders restricting the transferability of stock, and redemption agreements are disregarded in determining whether [an S corporation has one class of stock] ...". That provision would also apply to a right of first refusal for the current shareholders and a prohibition against the sale of stock to any current or potential competitor. It would be necessary to specify a procedure for determining whether a prospective purchaser is a current or potential competitor. One way might be for the agreement to specify that the determination would be made by the corporation's board of directors, in its sole discretion, which must be reasonably applied.

Bill

-----Original Message-----
From: Johnston, Michael L
Sent: Wednesday, June 07, 2000 10:44 AM
To: Kelliher, William B
Cc: Manth, Larry E; Terracina, Michael P
Subject: SC2 - Limitations on Sale of Stock

Bill

We have had an ICV with an SC2 target that is very concerned about limiting the potential of the charitable shareholder to sell its stock. We wanted to see if we can expand the limitations on sale of the stock to include both the previously approved limitations and one additional limitation.

Can we limit the sale to:

- Only transferable to qualified S Corp shareholders
- A right of first refusal for the current stockholders to purchase the shares
- A limitation on the transfer of the stock to any current or potential competitor in the same or similar line of business as the client. If we could not get an absolute prohibition on such transfer could we get a limitation of the price paid by the potential competitor to an appraised FMV so that the right of first refusal could be utilized?

The company's fear is that a corporate raider who could afford to absorb the taxable income generated by the non voting would be willing to pay a substantial premium over appraised FMV to acquire the interest. Once he had the interest they are concerned he would utilize shareholder rights to discover information regarding the client's business process which would take away their competitive advantage.

Michael L. Johnston
FCS/TTM
phone (713) 319-2366
fax (713) 319-2290
e-mail mjohnsto@kpmg.com

Permanent Subcommittee on Investigations
EXHIBIT #96i

XX-001946

Message0004	
Subject:	**RE: Revised SC2 Script**
From:	Rosenthal, Richard P
Date:	6/9/2000 1:24:18 PM
To:	Klein, Wendy (NSS-Tax)
Message Body	

Sounds great!

Rick

-----Original Message-----
From: Klein, Wendy (NSS-Tax)
Sent: Thursday, June 08, 2000 11:19 AM
To: Rosenthal, Richard P
Subject: FW: Revised SC2 Script

Thanks, actually some of the targets on the list are from CREW-P "rejects" and we know that they are "S" corps from an earlier effort. We have questions for CREW-P since we are doing a PDC effort on those so we will add here but I am doubtful that we will find too many "C" corps since we purchased a D&B list which ostensibly includes "S" corps only.

Finally I will show to Manth -- I want to confirm a few things with him such as:

- net income level: I have seen $2.5 Million in net income or more annually, and expect to for the next 2-4 years?
- number of principle owners: I have seen are there fewer than 6 principle owners, or, if more, do 5 owners have more than a 90% interest?

-----Original Message-----
From: Stein, Jeff (US/Vice Chairman)
Sent: Thursday, June 08, 2000 2:09 PM
To: Klein, Wendy (NSS-Tax)
Subject: FW: Revised SC2 Script

-----Original Message-----
From: Rosenthal, Richard P
Sent: Thursday, June 08, 2000 12:10 PM
To: Stein, Jeff (US/Vice Chairman)
Subject: RE: Revised SC2 Script

This looks good as it relates to SC2. However, with a few additional questions, we can get information to determine if CREWP applies. I don't know what those questions should be, other than if they answer that they are a C Corp, we should ask a set of CREWP questions. If they answer that they are an S Corp. then we ask the SC2 questions.

Manth and Wisehere should sign off on the questions....

Proprietary Material
Confidentiality Requested

Rick

KPMG 0049111

-----Original Message-----
From: Stein, Jeff (US/Vice Chairman)

Permanent Subcommittee on Investigations
EXHIBIT #96j

Sent: Thursday, June 08, 2000 4:57 AM
To: Rosenthal, Richard P
Subject: FW: Revised SC2 Script
Importance: High

Thoughts?

-----Original Message-----
From: Klein, Wendy (NSS-Tax)
Sent: Thursday, June 08, 2000 7:40 AM
To: Stein, Jeff (US/Vice Chairman)
Subject: Revised SC2 Script
Importance: High

I understand that Larry Manth, National Champion for SC2, believes that the PDCs may help qualify prospects for SC2. Given the current environment I wanted to be sure that there were no pitfalls in following the line of questioning included below. I have inserted an excerpt from the talk points the PDCs would use below (however the full conversation guide is included in the word file). Can we discuss?

Owner/CFO Opening:

Hello, ___________? This is ___________ with KPMG's Tax Practice. We have an innovative tax strategy that could potentially benefit closely-held companies like ___________, but I have a couple of questions to make sure we have a good fit with your company's situation. Could you answer a few/handful of questions for me?

1.) Are you an "S," or a "C" corporation?

2.) How many stockholders do you have?

3.) Do you anticipate that your corporation will have net income of at least $3.3 million annually for the next 2-4 years? "Yes," go to Appointment Close. "No," go to Non-appointment Close.

<< File: SC2Script.doc >>

Outlook Header Information

Conversation Topic: Revised SC2 Script
Subject: RE: Revised SC2 Script
From: Rosenthal, Richard P
Sender Name: Rosenthal, Richard P
To: Klein, Wendy (NSS-Tax)
Received By: Klein, Wendy (NSS-Tax)
Delivery Time: 6/9/2000 1:24:18 PM
Creation Time: 6/9/2000 1:24:14 PM
Modification Time: 6/9/2000 1:24:18 PM
Submit Time: 6/9/2000 1:24:14 PM
Importance: 6/1
Priority: 6/0
Sensitivity: 6/0
Flags: 6/1
Size: 6/7569

Message0021	
Subject:	SC2 Coordination and revenue sharing
From:	Manth, Larry E
Date:	6/9/2000 8:15:42 AM
To:	Atkin, Andrew S; Bogos, Nicholas G; Choate, Gary M; Cohen, David-CHI; Duncan, Douglas P; Duty, James V; Engel, Greg A; Gray, Mike - RALEIGH; Huber, Robert; Hutchison, Mark-Warner Cntr; Johnston, Michael L; Leak, Councill; Lipschultz, Brent S; Peterson, Kurt; Pichette, Craig L; Schrier, John V; Silver, Lawrence G; Speiss, Timothy P; Terracina, Michael P; Warley, Carol G; Wise, Richard
CC:	Rosenthal, Richard P; Ammerman, Douglas K

Message Body

Hello everybody. Please find attached a memo describing marketing coordination and revenue sharing. Please call me with any questions.

Thanks,

Larry

213-630-8101

Attachment

SC2_coordination.doc

Outlook Header Information

Conversation Topic: SC2 Coordination and revenue sharing
Subject: SC2 Coordination and revenue sharing
From: Manth, Larry E
Sender Name: Manth, Larry E
To: Atkin, Andrew S; Bogos, Nicholas G; Choate, Gary M; Cohen, David-CHI; Duncan, Douglas P; Duty, James V; Engel, Greg A; Gray, Mike - RALEIGH; Huber, Robert; Hutchison, Mark-Warner Cntr; Johnston, Michael L; Leak, Councill; Lipschultz, Brent S; Peterson, Kurt; Pichette, Craig L; Schrier, John V; Silver, Lawrence G; Speiss, Timothy P; Terracina, Michael P; Warley, Carol G; Wise, Richard
CC: Rosenthal, Richard P; Ammerman, Douglas K
Received By: Schrier, John V
Delivery Time: 6/9/2000 8:15:42 AM
Creation Time: 6/9/2000 8:15:34 AM
Modification Time: 6/9/2000 8:21:09 AM
Submit Time: 6/9/2000 8:15:35 AM
Importance: 6/1
Priority: 6/0
Sensitivity: 6/0
Flags: 6/17
Size: 6/32047

Message0021	
Subject:	**FW: SC2 and private foundations**
From:	Bogos, Nicholas G
Date:	4/3/2000 10:19:09 AM
To:	Schrier, John V; Lipschultz, Brent S

Message Body

Just got off the phone with Rich Manfreda. He thinks this may work. He even had a 9th Circuit case (either Palmer or Ferguson) that supports us. A private foundation can't be a shareholder of an S corp, but these case and the step transaction/conduit doctrine may allow us to claim that the private foundation never owned the stock and thus was never a shareholder. Even if it was a shareholder, we might have strong grounds for arguing inadvertent termination.

Nick Bogos
(212) 954-6118
(212) 954-7431 (fax)

-----Original Message-----
From: Bogos, Nicholas G
Sent: Monday, April 03, 2000 11:46 AM
To: Manfreda, Richard H
Subject: SC2 and private foundations

I was wondering if it's possible to run SC2 through a private foundation as a conduit. We have a potential SC2 opportunity in Boston, but the tax partner on the account thinks the client won't be interested. The client insists on using his own private foundation for all his charitable gifts. The tax partner says the client won't be interested in anything that doesn't go through the private foundation. I get the feeling that the client likes the publicity attached to his private foundation.

Could we use the private foundation as a conduit for the transfer to the § 115 entity? If so, the client gets the publicity he seeks, as well the charitable benefits that SC2 offers. I was thinking along the lines of a binding contract between the private foundation and the S corp requiring the private foundation to pass the stock on to the § 115 entity. The stock would go from the S corp to the private foundation and then to the § 115 entity. Could we rely on authorities like the § 7701(l) regs, Aiken Industries, Rev. Ruls. 84-152 and 84-153, as well as similar cases and rulings in the M&A area, to ignore the private foundation as a mere conduit? If so, we could take a position that the stock really went to the § 115 entity. The client determines his § 170 deduction as if the stock went directly to the § 115 entity, but can publicize it as if it came from the private foundation.

Nick Bogos
(212) 954-6118
(212) 954-7431 (fax)

Outlook Header Information

Conversation Topic: SC2 and private foundations
Subject: FW: SC2 and private foundations
From: Bogos, Nicholas G
Sender Name: Bogos, Nicholas G
To: Schrier, John V; Lipschultz, Brent S
Received By: Schrier, John V
Delivery Time: 4/3/2000 10:19:09 AM
Creation Time: 4/3/2000 10:19:08 AM

Modification Time: 4/3/2000 10:37:41 AM
Submit Time: 4/3/2000 10:19:08 AM
Importance: 4/1
Priority: 4/0
Sensitivity: 4/0
Flags: 4/1
Size: 4/7505

Message0022	
Subject:	**FW: SC2 and private foundations**
From:	Schrier, John V
Date:	4/3/2000 11:03:05 AM
To:	Manth, Larry E

Message Body

-----Original Message-----
From: Schrier, John V
Sent: Monday, April 03, 2000 12:56 PM
To: Bogos, Nicholas G
Subject: RE: SC2 and private foundations

Be the octopus! You can draw on David Kohn if needed.

Thanks,

John

-----Original Message-----
From: Bogos, Nicholas G
Sent: Monday, April 03, 2000 12:40 PM
To: Schrier, John V
Subject: RE: SC2 and private foundations

Before or after I talk with Mark on SLEEK?

PS: Larry who-DeLap?

Nick Bogos
(212) 954-6118
(212) 954-7431 (fax)

-----Original Message-----
From: Schrier, John V
Sent: Monday, April 03, 2000 12:38 PM
To: Bogos, Nicholas G; Lipschultz, Brent S
Subject: RE: SC2 and private foundations

REDACTED

Okay, I'm duly impressed! This is a strong idea and adds appeal, not to mention that it would address the concern raised by Do you think that you could put together a brief memorandum supporting characterization of conduit treatment that we could send up to Kozik? I'm copying Larry as he probably will want to be aware of this possibility of structuring.

Thanks,

John

Proprietary Material
Confidentiality Requested

-----Original Message-----
From: Bogos, Nicholas G
Sent: Monday, April 03, 2000 12:19 PM

To: Schrier, John V; Lipschultz, Brent S
Subject: FW: SC2 and private foundations

Just got off the phone with Rich Manfreda. He thinks this may work. He even had a 9th Circuit case (either Palmer or Ferguson) that supports us. A private foundation can't be a shareholder of an S corp, but these case and the step transaction/conduit doctrine may allow us to claim that the private foundation never owned the stock and thus was never a shareholder. Even if it was a shareholder, we might have strong grounds for arguing inadvertent termination.

Nick Bogos
(212) 954-6118
(212) 954-7431 (fax)

-----Original Message-----
From: Bogos, Nicholas G
Sent: Monday, April 03, 2000 11:46 AM
To: Manfreda, Richard H
Subject: SC2 and private foundations

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Could we use the private foundation as a conduit for the transfer to the § 115 entity? If so, the client gets the publicity he seeks, as well the charitable benefits that SC2 offers. I was thinking along the lines of a binding contract between the private foundation and the S corp requiring the private foundation to pass the stock on to the § 115 entity. The stock would go from the S corp to the private foundation and then to the § 115 entity. Could we rely on authorities like the § 7701(l) regs, Aiken Industries, Rev. Ruls. 84-152 and 84-153, as well as similar cases and rulings in the M&A area, to ignore the private foundation as a mere conduit? If so, we could take a position that the stock really went to the § 115 entity. The client determines his § 170 deduction as if the stock went directly to the § 115 entity, but can publicize it as if it came from the private foundation.

Nick Bogos
(212) 954-6118
(212) 954-7431 (fax)

Outlook Header Information

Conversation Topic: SC2 and private foundations
Subject: FW: SC2 and private foundations
From: Schrier, John V
Sender Name: Schrier, John V
To: Manth, Larry E
Delivery Time: 4/3/2000 11:03:05 AM
Creation Time: 4/3/2000 11:03:05 AM
Modification Time: 4/3/2000 11:03:05 AM
Submit Time: 4/3/2000 12:03:05 PM
Importance: 4/1
Priority: 4/0
Sensitivity: 4/0
Flags: 4/1

Size: 4/7602

THESE DOCUMENTS ARE INTENDED FOR THE SOLE PURPOSE OF SUGGESTING APPROPRIATE LANGUAGE TO THE CLIENT'S OUTSIDE LEGAL COUNSEL WITH RESPECT TO LEGAL DOCUMENTS THAT LEGAL COUNSEL IS RESPONSIBLE FOR DRAFTING. WHEN PROVIDED TO LEGAL COUNSEL, THE TRANSMITTAL LETTER INCLUDED HERE IS TO BE USED. UNDER NO CIRCUMSTANCES ARE COPIES OF THESE DOCUMENTS TO BE PROVIDED DIRECTLY TO THE CLIENT.

INDEX

[Date]

Privileged and Confidential

[Name
Attorney at Law
Address]

Re: [Name of Client]

Dear [Name]:

Pursuant to your request, we have enclosed copies of sample documents for your consideration when preparing the legal documents and agreements necessary to implement the S Corporation Charitable Contribution and Estate Planning Strategy for [Name of client].

The sample documents and agreements enclosed are:

Action of the Board of Directors without a meeting[1]
Action of the Shareholders without a meeting
Action of the Board of Directors without a meeting[2]
Warrant
Warrant Exercise Form
Warrant Transfer or Assignment Form
Action of the Board of Directors without a meeting[3]
Redemption Agreement
Nonvoting Common Stock Certificate (Front)
Restrictions (Attachment to Share Certificate)
Assignment Separate from Certificate
Additional restriction on newly issued share to Tax-Exempt

A diskette containing the sample documents and agreements is also enclosed.

KPMG cannot provide legal advice. The enclosed documents and agreements, which were drafted by other legal counsel in connection with similar engagements for other clients are merely samples. If you should choose to take the sample documents and agreements into consideration, modifications may be necessary to satisfy [Name of client's] specific facts and legal issues as a result of your legal review and conclusions.
If you have any questions, please call me at ( ) __________ or ________________at ( ) __________________________.

Sincerely,

KPMG LLP

Manager, Senior Manager, Partner or Principal

Enclosures

cc:

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

ACTION OF THE BOARD OF DIRECTORS WITHOUT A MEETING[1]

The undersigned, constituting all of the Directors of [Company Name], a California corporation (hereinafter "Corporation"), hereby consider the following:

WHEREAS, [Shareholder] intends to make a charitable contribution to [Tax-Exempt]; and

WHEREAS, [Shareholder] desires to make this charitable contribution in the form of nonvoting common stock of the Corporation; and

WHEREAS, the Articles of Incorporation do not presently authorize the issuance of nonvoting common stock; and

WHEREAS, in anticipation of the contribution of stock to [Tax-Exempt], [Shareholder] no longer desires the Corporation to be obligated to make a distribution of cash to pay income taxes due with respect to the stock held.

THEREFORE, the undersigned Directors hereby consent in writing pursuant to §307(b) of the California Corporations Code and the By Laws of the Corporation, to the following action;

> RESOLVED, that the Board of Directors recommend to the shareholder(s) that they amend the Articles of Incorporation to provide for the authorization to issue nonvoting common stock; and
>
> RESOLVED, that the Board of Directors recommend to the shareholder(s) that they amend the Shareholders' Agreement to provide that the Corporation will no longer be obligated to distribute cash to the shareholder(s) to pay income taxes due with respect to their stock.

The undersigned Directors further direct that this writing be filed with the minutes of the proceedings of the Board of Directors.

IN WITNESS THEREOF, the undersigned, constituting all of the Directors of the Corporation, hereby execute this Action on this ___ day of ______, ______.

[Directors' signatures]

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

ACTION OF THE SHAREHOLDERS WITHOUT A MEETING

[Shareholder] (hereinafter "Shareholder"), being the sole shareholder of [Company Name], a California Corporation (hereinafter "Corporation"), hereby considers the following:

WHEREAS, the Board of Directors of the corporation has proposed that the Articles of Incorporation be amended to provide for the authorization to issue nonvoting stock; and

WHEREAS, the Board of Directors of the corporation has proposed that the Shareholders' Agreement be amended to provide that the Corporation will no longer be obligated to distribute cash to the shareholder(s) to pay income taxes due with respect to their stock; and

WHEREAS, Section 903 of the California Corporations Code provides that an amendment to the articles of incorporation of a corporation governed by California law is adopted when it is approved by the affirmative vote of the holders of a majority of the voting power of the shares of stock of the corporation present and entitled to vote; and

WHEREAS, the corporation's shareholders deem it desirable and in the best interests of the corporation to amend its articles of incorporation to provide for the authorization to issue nonvoting stock; and

WHEREAS, the corporation's shareholders deem it desirable and in the best interests of the corporation to amend the Shareholders' Agreement to provide that the Corporation will no longer be obligated to distribute cash to the shareholder(s) to pay income taxes due with respect to their stock.

THEREFORE, Shareholder hereby consents in writing pursuant to §603(a) of the California Corporations Code and the By Laws of the Corporation to the following action;

> RESOLVED, that Article ___ of the corporation's Articles of Incorporation, filed ________, is amended to read in its entirety as follows:
>
> Article ____
>
> (a) Authorized Shares. The corporation is authorized to issue two classes of shares, no par value, to be designated "voting common" and "nonvoting common," herein referred to "voting common shares" and "nonvoting common shares" respectively and as the "common stock" collectively.

The total number of voting common shares authorized is [number] shares. The total number of nonvoting common shares authorized is [number] shares.

(b) Authority of Board of Directors. Except as otherwise provided in these Articles of Incorporation, the Board of Directors is hereby authorized to alter the rights, preferences, privileges, and restrictions granted to or imposed on any class of shares.

(c) Voting Rights--Election of Directors. Except as otherwise provided by law, or by the Board of Directors pursuant to the provisions of paragraph (b), the holders of the voting common shares shall have and possess the exclusive voting rights and powers and the holders of the nonvoting common shares shall not have such rights and powers.

RESOLVED, that paragraph _ of the Shareholders' Agreement, filed ________, is amended to read in its entirety as follows:

(_) Distributions to Pay Federal and State Income Taxes- So long as the Corporation is an S corporation for federal income tax purposes, its Directors may, but are not obligated to, declare and pay cash distributions to the Shareholders, on or before the 15th day after the close of each calendar quarter of the Corporation, in an amount equal to the estimated tax payments due by each Shareholder with respect to the S corporation's net income for federal and state income tax purposes for the immediately preceding calendar quarter as determined by the certified public accountants for the Corporation. In addition, the Directors may, but are not obligated to, declare and pay cash distributions on or before two and one-half months after the close of each fiscal year in an amount necessary to pay each Shareholder's federal and state income tax liability for the Corporation's net income for the immediately preceding fiscal year as determined by the certified public accountants for the Corporation; provided, however, that in determining the amount of such distributions, there shall be taken into account all prior distributions made to pay estimated taxes during the preceding taxable year. For purposes of these computations, each Shareholder shall be presumed to be subject to a federal income tax rate on his share of the Corporation's net income for the quarter or year, respectively, equal to the highest federal income tax rate imposed for individual Shareholders who are not married.

Shareholder directs that this writing be filed with the minutes of the proceedings of the Shareholders.

IN WITNESS WHEREOF, the undersigned, being the sole shareholder of the Corporation, hereby signs this Action on this ___ day of _______, ______.

[Shareholder signature]

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

ACTION OF THE BOARD OF DIRECTORS WITHOUT A MEETING[2]

The undersigned, constituting all of the Directors of [Company Name], a California corporation (hereinafter "Corporation"), hereby consider the following:

WHEREAS, [Shareholder] (hereinafter "Shareholder") desires an option to purchase nonvoting stock of the Corporation in the future;

WHEREAS, the balance sheet furnished by the chief financial officer of Corporation to the Board of Directors is believed by the Directors to be an accurate statement of the financial condition of the Corporation as of [Date]; and

WHEREAS, on examining such balance sheet, the Board of Directors is of the opinion that this Corporation is authorized to pay the dividend set forth below, and that, after payment of such dividend the corporation will be able to pay its debts as they become due in the ordinary course of business;

THEREFORE, the undersigned Directors hereby consent in writing pursuant to §307(b) of the California Corporations Code and the By Laws of the Corporation, to the following action:

> RESOLVED, that [number] of [term] year warrants to purchase nonvoting common stock at an exercise price of $[price] per share are to be issued as a tax-free dividend under Internal Revenue Code Section 305(a), such dividend payable to the Shareholders of record of the Corporation on [record date], with [pro rata amount] warrants to be distributed to the order of each outstanding share of stock of the Corporation, such dividend is to be in addition to any cash dividend now or subsequently declared.

The undersigned Directors further direct that this writing be filed with the minutes of the proceedings of the Board of Directors.

IN WITNESS THEREOF, the undersigned, constituting all of the Directors of the Corporation, hereby execute this Action on this ___ day of ______, ______.

[Directors' signatures]

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

Warrant

Warrant No. _

Right to purchase
[number] shares

[Company Name]

Warrant to purchase Nonvoting Common Stock

Registered Owner: [Shareholder]

For value received, [Company Name], a California corporation (the "Corporation") grants the following rights to the registered owner of this Warrant:

(a) Issue. Upon tender to the Corporation (as defined in paragraph (e) hereof), the Corporation shall issue to the registered owner hereof the number of shares specified in paragraph (b) hereof of fully paid and nonassessable shares of nonvoting common stock of the Corporation that the registered owner is otherwise entitled to purchase.

(b) Number of shares. The number of shares of nonvoting common stock of the Corporation that the registered owner of this Warrant is entitled to receive upon exercise of this Warrant is [number] shares. The Corporation shall at all times reserve and hold available sufficient shares of nonvoting common stock to satisfy all options and warrants, including this Warrant. The Corporation covenants and agrees that all shares of nonvoting common stock that may be issued upon the exercise of this Warrant shall, upon issuance, be duly and validly issued, fully paid and nonassessable, and free from all taxes, liens and charges with respect to the purchase and the issuance of the shares.

(c) Exercise price. The exercise price of this Warrant, the price at which the shares of stock purchasable upon exercise of this Warrant may be purchased is $[price] per share, the amount determined by an independent appraisal, dated [Date], to represent 90% of the fair market value of each share of nonvoting common stock on [Date].

(d) Exercise period. This Warrant may only be exercised on or after [beginning date] and or before a day that is [end time] years after that date (the "Exercise Period"). If not exercised during this period, this Warrant and all rights granted under this Warrant shall expire and lapse.

(e) Tender. The exercise of this Warrant must be accomplished by actual delivery of the Exercise Price in cash, certified check, or official bank draft in lawful money of the United States of America, and by actual delivery of a duly executed exercised form, a copy of which is attached to this Warrant as Exhibit "A," properly executed by the registered owner of this Warrant, and by surrender of this Warrant. The payment and exercise form must be delivered, personally or by mail, to the principal office of the Corporation. Documents sent by mail shall be deemed to be delivered when they are received by the Corporation.

IN WITNESS WHEREOF, the Corporation has signed this Warrant by its duly authorized officers this ____ day of _____, 1999.

[Company Name]
By: ________________
President
Corporate Seal or Facsimile

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

Exercise Form

Exhibit "A"

The undersigned hereby: (1) irrevocably subscribes for and offers to purchase ____ shares of nonvoting common stock of [Company Name], pursuant to the warrant to which this exhibit is attached; (2) encloses payment of $_____ for these shares at a price of $___ per share; and (3) requests that a certificate for the shares be issued in the name of the undersigned and delivered to the undersigned at the address specified below.

Date:________

____
(Please sign exactly as your name appears on the warrant)

____

____
(Address of warrant holder)

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

Transfer or Assignment Form

Exhibit "B"

For value received, the undersigned hereby sells, assigns and transfers to

Name:__________________________________

Address:________________________________

this warrant and irrevocably appoints _________ attorney (with full power of substitution) to transfer this warrant on the books of [Company Name].

Date:________

____
(Please sign exactly as your name appears on the warrant)

KPMG 0015580

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

ACTION OF THE BOARD OF DIRECTORS WITHOUT A MEETING[3]

The undersigned, constituting all of the Directors of [Company Name], a California corporation (hereinafter "Corporation"), hereby consider the following:

WHEREAS, the balance sheet furnished by the chief financial officer of [Company Name] to the Board of Directors is believed by the directors to be an accurate statement of the financial condition of the corporation on the last day of the fiscal year ending ______, 19__; and

WHEREAS, on examining such balance sheet the Board of Directors is of the opinion that this corporation is authorized to pay the dividend set forth below and that, after payment of such dividend, the corporation will be able to pay its debts as they become due in the ordinary course of business; and

WHEREAS, [Shareholder] desires to make a charitable contribution to [Tax-Exempt] in the form of nonvoting common stock;

THEREFORE, the undersigned Directors hereby consent in writing pursuant to §305(b) of the California Corporations Code and the By Laws of the Corporation, to the following action:

> RESOLVED, that [number] shares of nonvoting common stock of the corporation be issued, as a tax-free stock dividend under Internal Revenue Code section 305(a), payable to the shareholders of record of the corporation on [record date], [Number] shares of stock to be distributed as a stock dividend to the order of each outstanding share of stock of the corporation; such dividend is to be in addition to any cash dividend now or subsequently declared; and
>
> RESOLVED, that the proposed Redemption Agreement, a copy of which is attached to these minutes as Exhibit "A," is approved and the President is directed to execute such agreement, substantially in the form submitted to this meeting.

The undersigned Directors further direct that this writing be filed with the minutes of the proceedings of the Board of Directors.

IN WITNESS THEREOF, the undersigned, constituting all of the Directors of the Corporation, hereby execute this Action on this ___ day of ______, ______.

[Directors' signatures]

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Redemption Agreement

THIS REDEMPTION AGREEMENT is entered into this ___ day of ____, ______, at [place], by [Company Name], a California corporation, hereinafter referred to as "Corporation," and [Tax-Exempt] hereinafter referred as "Retirement Plan"

WHEREAS, [Shareholder] presently owns all of the issued and outstanding nonvoting common stock of the Corporation; and

WHEREAS, [Shareholder] desires to contribute all its nonvoting common stock of the Corporation to Retirement Plan; and

WHEREAS, without a redemption agreement, Retirement Plan will have no ready market in which to sell any nonvoting stock in Corporation contributed to it; and

WHEREAS, the parties hereto desire to promote their mutual interests by imposing certain restrictions and/or obligations on themselves;

NOW, THEREFORE, in consideration of the mutual promises herein contained, the parties hereto agree as follows:

1. Purchase and sale. Commencing on, but no earlier than [date], Retirement Plan shall have the right to present for redemption, all of the nonvoting common stock of Corporation owned by it, and upon such presentation, the Corporation shall purchase, all of the nonvoting common stock of Corporation owned by Retirement Plan at the price provided in Paragraph 2 herein below. Upon presentation of the nonvoting common stock for redemption, Retirement Plan shall endorse and deliver to the Corporation the stock certificate or certificates representing the shares of stock required to be purchased and sold under this Agreement, and the purchase price shall be paid in accordance with Paragraph 3 herein below. In order for Retirement Plan to be entitled to redemption under this agreement, it must tender, at the same time, all of the nonvoting common stock of Corporation owned by it.

2. Purchase Price. The purchase price of the stock required to be purchased hereunder shall be the fair market value on the date that Retirement Plan presents the stock for redemption. Said fair market value shall be determined by [Valuation Company] and shall be made in accordance with the accounting principles and practices applied and used to value the stock for purposes of determining the amount of [Shareholder's] charitable contribution deduction for contribution of the stock to Retirement Plan;

3. Manner of payment. Concurrently with the delivery of the stock certificate or certificates to the Corporation, the Corporation shall pay the purchase price to Retirement Plan in cash or other mutually agreed upon consideration.

4. Maintenance of S election. The Corporation and Retirement Plan agree that the Corporation shall maintain its federal income tax status as an S corporation. Retirement Plan shall not revoke Corporation's S election or otherwise cause a termination. In addition, should Retirement Plan become an ineligible holder of subchapter S corporation stock, due to the loss of its Internal Revenue Code section 401(a) status, law change or otherwise, Retirement Plan will immediately present all stock it holds in Corporation for redemption under the terms of this agreement.

5. Endorsement. Upon the execution of this Agreement or the receipt of stock by Retirement Plan, whichever is later, the certificates of stock subject hereto shall be surrendered to the Corporation and endorsed as follows:

"The shares of stock represented by this certificate are redeemable in accordance with and pursuant to a Redemption Agreement, dated ______, a copy of which is on file at the main corporate office of the Corporation."

After endorsement, the certificates shall be returned to Retirement Plan who shall, subject to the terms of this Agreement, be entitled to exercise all rights of ownership of such stock. The Corporation agrees that it will cause a similar endorsement to be placed on all certificates hereafter issued by it and which are subject to the provisions of this Agreement.

6. Necessary acts. Each of the parties hereto agrees that it will do any act or thing and will execute any and all instruments necessary and/or proper to make effective the provisions of this Agreement.

7. Definitions. References to "stock owned" by Retirement Plan shall include any nonvoting common stock in Corporation hereafter acquired by Retirement Plan, whether by way of gift, stock dividend, purchase, recapitalization, reorganization, or otherwise.

8. Agreement binding. This Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective next of kin, legatees, administrators, executors, legal representatives, successors, and assigns (including remote, as well as immediate, successors to and assignees of said parties).

IN WITNESS WHEREOF, the parties hereto have executed this Redemption Agreement on the day and year first above written.

[Company Name]
By: ________________
President

[Tax-Exempt]
By:_______________
[Title]

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

PLEDGE

[Date]

WHEREAS, on [Date], I contributed to [Tax-Exempt], [#] shares of nonvoting stock of [Company Name]; therefore

With the desire to further aid the cause of the [Tax-Exempt], in the event that [Tax-Exempt] should present the donated stock for redemption and the fair market value of the donated stock on the date that [Tax-Exempt] first had the right to present the stock for redemption (the "redemption amount"), is less than the fair market value of the stock on the date that it was contributed by me (the "contribution amount"), I promise to pay to [Tax-Exempt] the amount by which the contribution amount exceeds the redemption amount.

The amount due under this pledge shall first become due six months from the date [Tax-Exempt] presented the stock for redemption. The amount shall be payable in twelve monthly installments, bearing interest at the rate of six percent per annum.

For purposes of determining fair market values under this Pledge, fair market values shall be determined by [Valuation Company] and shall be made in accordance with the accounting principles and practices applied and used to value the stock for purposes of determining the amount of my charitable contribution deduction for contribution of the stock to [Tax-Exempt].

[Shareholder signature]

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Nonvoting Common Stock Certificate (Front)
(before restriction on redemption added)

Number ____ __________ Shares

Nonvoting Common Stock [Company Name]

Incorporated Under the Laws of the State of California

This certifies that [Shareholder] is the owner of [#] shares of fully paid and nonassessable nonvoting common stock, without par value, of [Company Name], transferable only on the books of the Corporation by the holder in person or by duly authorized attorney upon surrender of this Certificate properly endorsed.

In Witness Whereof, the Corporation has caused this Certificate to be signed by its duly authorized officers and sealed with the seal of the Corporation this _____ day of ______, 19___.

____
President

____
Secretary

This corporation is a close corporation. The number of holders of record of its shares of all classes cannot exceed 35. Any attempted voluntary inter vivos transfer which would violate this requirement is void. Refer to the articles, bylaws and any agreements on file with the secretary of the corporation for further restrictions.

Additional Restrictions Attached

Corporate Seal or Facsimile

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Restrictions
(Attachment to Share Certificate)

1. The shares of stock represented by this agreement are subject to the terms and conditions of a Shareholders' Agreement dated ____________, 19___, as from time to time may be amended, between the Corporation and the registered owner hereof; and neither this Certificate nor the shares evidenced hereby may be transferred, sold, pledged, encumbered, assigned, or otherwise disposed of except in strict compliance with the provisions of said Agreement, a copy of which is on file at the principal office of the Company.

2. The shares of stock represented by this certificate cannot be transferred if such transfer would void the election of the Corporation to be taxed under Subchapter S of the Internal Revenue Code of 1986.

3. The shares of stock represented by this certificate have no voting rights due to restrictions contractually imposed by the Corporation.

4. Shareholders may obtain from the principal office of the corporation, on request and without charge, a copy of the statement of the rights, preferences, privileges, and restrictions granted to or imposed on each class or series of shares authorized to be issued and on the holders thereof.

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Assignment Separate from Certificate

FOR VALUE RECEIVED, the undersigned, [Shareholder], hereby sells, assigns and transfers to [Tax-Exempt], [Number] shares of the nonvoting common stock of [Company Name], standing in their name on the books of said Corporation, represented by Certificate Number ___ herewith, and does hereby irrevocably constitute and appoint [Attorney], attorney to transfer said stock on the books of the within named corporation, with full powers of substitution in the premises.

DATED: _______________

[Shareholder signature]

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Additional restriction on newly issued share to Tax-Exempt

The following additional restriction should be added to the shares issued to [Tax-Exempt]:

5. The shares of stock represented by this certificate are redeemable in accordance with and pursuant to a Redemption Agreement, dated ______, a copy of which is on file at the principal office of the Corporation.

From: Atkin, Andrew S
Sent: Thursday, July 06, 2000 1:39 PM
To: Segel, Karen B
Cc: Douglas Duncan; Larry Manth; Robert Huber
Subject: correction

Contacts: SC2 Team

Karen:

I sent you the wrong version of the forms replacement. Please use this one:

Forms_June_updates_with_transm...

Thanks

Andrew

Permanent Subcommittee on Investigations
EXHIBIT #96m

THESE DOCUMENTS ARE INTENDED FOR THE SOLE PURPOSE OF SUGGESTING APPROPRIATE LANGUAGE TO THE CLIENT'S OUTSIDE LEGAL COUNSEL WITH RESPECT TO LEGAL DOCUMENTS THAT LEGAL COUNSEL IS RESPONSIBLE FOR DRAFTING. WHEN PROVIDED TO LEGAL COUNSEL, THE TRANSMITTAL LETTER INCLUDED HERE IS TO BE USED. UNDER NO CIRCUMSTANCES ARE COPIES OF THESE DOCUMENTS TO BE PROVIDED DIRECTLY TO THE CLIENT.

INDEX

[Date]

Privileged and Confidential

[Name
Attorney at Law
Address]

Re: [Name of Client]

Dear [Name]:

Pursuant to your request, we have enclosed copies of sample documents for your consideration when preparing the legal documents and agreements necessary to implement the S Corporation Charitable Contribution and Estate Planning Strategy for [Name of client].

The sample documents and agreements enclosed are:

Action of the Board of Directors without a meeting[1]
Action of the Shareholders without a meeting
Certificate of Amendment to the Articles of Incorporation
Action of the Board of Directors without a meeting[2]
Action of the Board of Directors without a meeting[3]
Warrant
Warrant Exercise Form
Shareholder Consent to Redemption Agreement without a Meeting
Action of the Board of Directors without a meeting[4]
Redemption Agreement
Pledge
Nonvoting Common Stock Certificate (Front)
Restrictions (Attachment to Share Certificate)
Assignment Separate from Certificate
Additional restriction on newly issued share to Tax-Exempt
Donee Acknowledgment
Representation Concerning Qualified Plan Status

A diskette containing the sample documents and agreements is also enclosed.

KPMG cannot provide legal advice. The enclosed documents and agreements, which were drafted by other legal counsel in connection with similar engagements for other clients are merely samples. If you should choose to take the sample documents and agreements into consideration, modifications may be necessary to satisfy [Name of client's] specific facts and legal issues as a result of your legal review and conclusions.
If you have any questions, please call me at ( )__________ or ________________at ( )
__________________________.

Sincerely,

KPMG LLP

Manager, Senior Manager, Partner or Principal

Enclosures

cc:

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ACTION OF THE BOARD OF DIRECTORS WITHOUT A MEETING[1]

The undersigned, constituting all of the Directors of [Company Name], a California corporation (hereinafter "Corporation"), hereby consider the following:

WHEREAS, [Shareholder] intends to make a charitable contribution to [Tax-Exempt]; and

WHEREAS, [Shareholder] desires to make this charitable contribution in the form of nonvoting common stock of the Corporation; and

WHEREAS, the Articles of Incorporation do not presently authorize the issuance of nonvoting common stock; and

WHEREAS, the Board believes it is in the best interests of the Corporation to restrict the transferability of any nonvoting stock of the Corporation and intends to restrict such transferability by the addition of a new Section to the bylaws establishing a Right of First Refusal; and

WHEREAS, the Board desires clarification that it is not obligated to make distributions to shareholders to pay federal or state income taxes, but if so, under what circumstances it is so obliged; and

WHEREAS, the Board and Shareholder want to protect the Corporation's status as a subchapter S corporation;

THEREFORE, the undersigned Directors hereby consent in writing pursuant to §307(b) of the California Corporations Code and the bylaws of the Corporation, to the following action;

> RESOLVED, that the Board of Directors recommend to Shareholder that he amend the Articles of Incorporation to provide for the authorization to issue nonvoting common stock; and
>
> RESOLVED, that the Board of Directors amend the bylaws of the Corporation to establish a Right of First Refusal restricting the transferability of any nonvoting common stock of the Corporation by requiring that no holder of nonvoting common stock of the Corporation may sell or otherwise dispose of the nonvoting common stock of the Corporation or any right or interest in such stock without offering to sell

such stock to the Corporation and the shareholder(s) holding voting common stock; and

RESOLVED, that the Board of Directors recommend that Shareholder clarify that the Corporation is not currently, and shall not be obligated under any circumstances, absent a vote and an amendment to the bylaws, to distribute cash to shareholders to pay income taxes due on account of their stock ownership in Corporation; and

RESOLVED, that the Board of Directors amend the bylaws of the Corporation to provide that the Corporation's status as a subchapter S corporation shall not be revoked unless a majority of shareholders holding voting common stock agree.

The undersigned Directors further direct that this writing be filed with the minutes of the proceedings of the Board of Directors.

IN WITNESS THEREOF, the undersigned, constituting all of the Directors of the Corporation, hereby execute this Action on this ___ day of ______, ______.

[Signatures]

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

ACTION OF THE SHAREHOLDERS WITHOUT A MEETING

[Shareholder] (hereinafter "Shareholder"), being the sole shareholder of [Company Name], a California Corporation (hereinafter "Corporation"), hereby considers the following:

WHEREAS, the Board of Directors of the Corporation has proposed that the Articles of Incorporation be amended to provide for the authorization to issue nonvoting stock; and

WHEREAS, the Board of Directors of the Corporation has proposed that the bylaws of the Corporation be amended to establish a Right of First Refusal to restrict the transferability of any nonvoting common stock of the Corporation and has provided Shareholder with a copy of the proposed amendment on this date; and

WHEREAS, the Board of Directors of the Corporation has proposed that Shareholder clarify whether the Corporation is obligated, or whether the Corporation is obligated under specific circumstances, to distribute cash to shareholders to pay income taxes due with respect to their ownership of stock in the Corporation; and

WHEREAS, the Board of Directors of the Corporation has proposed that the Board of Directors amend the bylaws of the Corporation to provide that the Corporation's status as a subchapter S corporation shall not be revoked unless a majority of shareholders holding voting common stock agree and has provided Shareholder with a copy of the proposed amendment on this date; and

WHEREAS, Section 903 of the California Corporations Code provides that an amendment to the articles of incorporation of a corporation governed by California law is adopted when it is approved by the affirmative vote of the holders of a majority of the voting power of the shares of stock of the corporation present and entitled to vote; and

WHEREAS, Shareholder deems it desirable and in the best interests of the corporation to amend its articles of incorporation to provide for the authorization to issue nonvoting stock;

THEREFORE, Shareholder hereby consents in writing pursuant to §603(a) of the California Corporations Code and the bylaws of the Corporation to the following action;

> RESOLVED, that Article ___ of the corporation's Articles of Incorporation, filed ________, is amended to read in its entirety as follows:

XX-001961

Article ____

(a) Authorized Shares. The corporation is authorized to issue two classes of shares, no par value, to be designated "voting common" and "nonvoting common," herein referred to "voting common shares" and "nonvoting common shares" respectively and as the "common stock" collectively. The total number of voting common shares authorized is [number] shares. The total number of nonvoting common shares authorized is [number] shares.

(b) Voting Rights--Election of Directors. Except as otherwise provided bylaw, the holders of the voting common shares shall have and possess the exclusive voting rights and powers and the holders of the nonvoting common shares shall not have such rights and powers.

RESOLVED, that the bylaws of the Corporation be amended by the addition of Section ____, RIGHT OF FIRST REFUSAL, in the form proposed by the Board on this date, which section shall prohibit any holder of nonvoting common stock in the Corporation from selling or otherwise disposing of nonvoting common stock of the Corporation without first offering to sell such stock to the Corporation and the shareholders holding voting common stock in the manner set forth therein.

RESOLVED, that the Board of Directors and the Corporation are not currently, and shall not be obligated under any circumstances, absent a vote by the shareholders entitled to vote and an amendment to the bylaws, to distribute cash to the shareholders to pay income taxes due on account of their ownership in the Corporation; and

RESOLVED, that the bylaws of the Corporation be amended by the addition of Section ____, SUBCHAPTER S STATUS, in the form proposed by the Board on this date, which section shall provide that the Corporation's status as a subchapter S corporation shall not be revoked unless a majority of shareholders holding voting common stock agree.

Shareholder directs that this writing be filed with the minutes of the proceedings of the Shareholders.

IN WITNESS WHEREOF, the undersigned, being the sole shareholder of the Corporation, hereby signs this Action on this ___ day of _______, ______.

[Shareholder signature]

XX-001962

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF [COMPANY NAME] (a California Corporation)

To The Secretary of State
State Of California

Pursuant to the provisions of the General Corporation Law of the State of California, the undersigned officers of [Company Name] do hereby certify as follows:

1. The name of the corporation is [Company Name]. The corporate number of this corporation is ______. The date of incorporation is ______.

2. Article ____ of the corporation's Articles of Incorporation, which relates to the authorized shares of the corporation, is hereby amended in its entirety to state as follows:

Article ____

(a) Authorized Shares. The corporation is authorized to issue two classes of shares, no par value, to be designated "voting common" and "nonvoting common," herein referred to "voting common shares" and "nonvoting common shares" respectively and as the "common stock" collectively. The total number of voting common shares authorized is [number] shares. The total number of nonvoting common shares authorized is [number] shares.

(c) Voting Rights--Election of Directors. Except as otherwise provided bylaw, the holders of the voting common shares shall have and possess the exclusive voting rights and powers and the holders of the nonvoting common shares shall not have such rights and powers.

3. As of the date of the adoption of this Amendment, the corporation has issued ___ shares of voting common stock Common stock, which stock remains issued and outstanding. All such issued stock shall retain its current status as voting common stock.

4. The foregoing Amendment of the Articles of Incorporation has been duly

approved by the corporation's Board of Directors.

5. The foregoing Amendment of the Articles of Incorporation has been duly approved by the required vote of shareholders in accordance with Section 902 of the Corporations Code. The total number of outstanding shares of the corporation is ___ voting common shares. The number of shares voting in favor of the Amendment equaled or exceeded the vote required. The percentage vote required of each class of stock issued was more than 50%.

6. The undersigned are officers and/or directors of the corporation and are authorized to execute and file this Certificate of Amendment on behalf of the corporation.

[Signatures]

On June ____, 2000, in the City of ______ ______ County, California, each of the undersigned does hereby declare under penalty of perjury that he signed the foregoing Certificate of Amendment of Articles of Incorporation in the official capacity set forth beneath his signature, and that the statements set forth in said certificate are true of his own personal knowledge.

[Signatures]

XX-001964

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

ACTION OF THE BOARD OF DIRECTORS WITHOUT A MEETING[2]

The undersigned, constituting all of the Directors [Company Name], a California corporation (hereinafter "Corporation"), hereby consider the following:

WHEREAS, the Corporation desires to restrict the transferability of the nonvoting common stock of the Corporation; and

WHEREAS, the Corporation desires to protect the Corporation's status as a subchapter S corporation.

THEREFORE, the undersigned Directors hereby consent in writing pursuant to §211 of the California Corporations Code and the bylaws of the Corporation, to the following action;

RESOLVED, that a new Section ___ of the bylaws of the Corporation is added to read in its entirety as follows:

__. RIGHT OF FIRST REFUSAL

(a) Void Transfers. No holder of nonvoting common stock of the Corporation shall sell or otherwise dispose of the nonvoting common stock of the Corporation or any right or interest in nonvoting common stock of the Corporation without first offering to sell them to the Corporation and the shareholders holding voting common stock in the manner set forth in this Section. Any sale or other disposition of the shares in violation of these provisions shall be null and void.

(b) Notice of Intent to Sell . In the event that a shareholder shall desire to sell or otherwise dispose of all or any part of nonvoting common stock in the Corporation, or of an interest in the nonvoting common stock, and in the event that the shareholder has received a firm written offer from a bona fide purchaser financially able to satisfy terms of the written offer to purchase such stock (a "qualified offer to purchase"), the shareholder shall give written notice of the offer to the Corporation. The notice must be given by registered or certified mail, return receipt requested, addressed to the Secretary of the Corporation at the Corporation's principal executive office or delivered in person to the Secretary of the Corporation. The notice must designate the number of shares to be sold, the name of the proposed purchaser, the price per share agreed on in good faith between the shareholder and the proposed purchaser, the terms of payment of the sales price and the total amount of the sales price.

(c) Offer by Corporation . Within 30 days after receipt by the Corporation of the notice to the Secretary, if the Corporation desires to purchase all or some of the shares, it must mail or deliver to the offering shareholder a written offer to purchase the shares at the price and on the terms stated in the notice to the Secretary.

(d) Notification to Shareholders. In the event that the Corporation is unable to purchase some or all of the shares or if the Corporation elects within the 30-day period mentioned above to purchase none or less than all of the shares so offered, the Secretary shall, at the termination of that 30-day period, mail or deliver to each of the shareholders of record holding voting common stock, a notification specifying the number of shares remaining to be sold, the price per share, the terms on which the offering shareholder intends to make the sale, and the name of the proposed purchaser, if any, or, if none, a statement of that fact. This notification may be delivered to the shareholders personally or may be mailed to the last known addresses of the shareholders, as the same may appear on the books of the corporation.

(e) Offer by Shareholders. Within 20 days after the mailing or delivering of the notification to the shareholders holding voting common stock, any such shareholder or shareholders desiring to purchase any part or all of the shares referred to in the notification shall deliver by mail or otherwise to the Secretary of the Corporation a written offer or offers to purchase a specified number of the shares at the price and on the terms stated in the notification.

(f) Pro Rata Allocation of Shares. If the total number of shares specified in the offers from the shareholders holding voting common stock exceeds the number of shares referred to in the notification, the shares to be sold shall be allocated among the offering shareholders pro rata to the number of shares owned by each shareholder.

(g) Purchase in Excess of Pro Rata Amount. If all the shares referred to in the notification are not disposed of under apportionment provided in paragraph (f), each shareholder desiring to purchase shares in a number in excess of his or her pro rata share, as provided above, shall be entitled to purchase the proportion of the shares that remain undisposed of as the total number of shares that he or she holds bears to the total number of shares held by all the shareholders desiring to purchase shares in excess of those to which they are entitled under the apportionment, or all of the shares if there is no other shareholder desiring to purchase shares in excess of those to which he or she is entitled under the apportionment provided for above.

(h) Release of Restriction. Unless all of the offered shares have been purchased by the Corporation or by the shareholders or by both within a period of 60 days after the mailing or delivery of the notice to the Secretary required by paragraph (b), all the offered shares shall be released from the restrictions on sale or other disposition, provided, however, that the shares shall be released solely for the purpose of the proposed sale or other disposition in the total amount specified and at the price specified in the notice to the Secretary, or at a greater price than that specified, and provided further that the sale or other disposition be completed within 30 days after the 60-day period referred to above. After completion of the sale or other disposition, or after the expiration of the 30 days within which the sale or disposition must be completed, whichever first occurs, the shares shall again be and remain subject to the restrictions on sale or other disposition imposed by this Section.

(i) Transfer Restrictions Endorsed on Share Certificates. There shall appear on all nonvoting common stock share certificates a statement of the fact that the shares are subject to restrictions on transfer.

(j) Restrictions Binding on Heirs, Successors, and Permitted Assigns. All the terms, conditions, and provisions restricting the sale or other disposition of nonvoting common stock of the corporation or of an interest in them shall apply to and bind the heirs, successors, or assigns of each of the owners or holders of any of the shares.

(k) Sale or Transfer of Shares With Shareholders' Written Assent. Notwithstanding anything in these bylaws to the contrary, any or all of the shares of the Corporation may be sold, transferred, or otherwise disposed of, or hypothecated without restriction, provided written assent or approval to the proposed sale, transfer, other disposition, or hypothecation is obtained and signed by the holders of not less than all of the shares of this corporation entitled to vote. All consents or approvals shall be filed with the Secretary of the corporation.

RESOLVED, that a new Section ___ of the Bylaws, is added to read in its entirety as follows:

___. SUBCHAPTER S STATUS

(a) Maintenance of S Election. Corporation shall maintain its federal income tax status as an S corporation until the Stockholders holding a majority of the voting common shares agree to terminate such status. Therefore, until the Stockholders owning at least a majority of the voting common shares of the Corporation otherwise agree, each Stockholder shall take all and any actions necessary to maintain such S status.

XX-001967

(b) Revocation of Election, etc. Stockholders owning a majority of the voting common shares of the Corporation may at any time and from time to time agree in writing:

(1) to authorize or ratify any transfer of stock that would otherwise not be permitted by this Agreement, in which event the transfer shall be deemed for all purposes to comply with this Agreement;

(2) to direct all Stockholders to consent to a revocation of the Corporation's S election, in which event every Stockholder shall within 30 days thereafter execute and deliver to the Corporation a consent to a revocation of the election in a form meeting the requirements of the Internal Revenue Code; and

(3) to authorize the Corporation to act (or to refrain from acting) in a manner that would otherwise violate the provisions of this Section, in which event the action (or failure to act) shall be deemed for all purposes to comply with this Agreement.

(c) Inadvertent Termination. If any Stockholder makes any transfer or takes any other action that causes termination of the Corporation's S election, the Board of Directors may direct the appropriate officers of the Corporation to attempt to obtain a waiver from the Internal Revenue Service of the terminating event on grounds of inadvertency or to commence the appropriate procedure to obtain approval from the Internal Revenue Service to file a new election to be treated as an S corporation before the five-year waiting period after termination of an S election has expired.

(d) Termination of Election. Nothing in this Agreement shall be construed to prevent the Corporation or persons holding a majority of the Corporation's voting common shares from terminating the Corporation's S election, if the Corporation's directors or such persons determine that such termination is desirable.

(e) Allocation of Income. Upon the transfer or redemption of any shares or termination of the Corporation's S election, each of the Stockholders agrees to consent, upon the request of the Corporation's Board of Directors, and to the extent allowed by the Code and the Regulations thereunder, to determine the Stockholder's share of any item for federal income tax purposes as if the taxable year of the Corporation consisted of two taxable years, as permitted under IRC Section 1362(e) and 1377(a) of the Internal Revenue Code of 1986, and Treasury Regulation 1.1368-1(g) as amended.

The undersigned Directors further direct that this writing be filed with the minutes of the proceedings of the Board of Directors.

1802

IN WITNESS THEREOF, the undersigned, constituting all of the Directors of the Corporation, hereby execute this Action on this ___ day of ______, ______.

[Signatures]

XX-001969

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

ACTION OF THE BOARD OF DIRECTORS WITHOUT A MEETING[3]

The undersigned, constituting all of the Directors of [Company Name], a California corporation (hereinafter "Corporation"), hereby consider the following:

WHEREAS, [Shareholder] (hereinafter "Shareholder") desires an option to purchase nonvoting stock of the Corporation in the future;

WHEREAS, the balance sheet furnished by the chief financial officer of Corporation to the Board of Directors is believed by the Directors to be an accurate statement of the financial condition of the Corporation as of [Date]; and

WHEREAS, on examining such balance sheet, the Board of Directors is of the opinion that this Corporation is authorized to pay the dividend set forth below, and that, after payment of such dividend the corporation will be able to pay its debts as they become due in the ordinary course of business;

THEREFORE, the undersigned Directors hereby consent in writing pursuant to §307(b) of the California Corporations Code and the bylaws of the Corporation, to the following action:

> RESOLVED, that on [Date], [number] warrants to purchase nonvoting common stock at an exercise price of $[price] per share are to be issued as a tax-free dividend under Internal Revenue Code Section 305(a), such dividend payable to the Shareholders of record of the Corporation on [record date], with [pro rata amount] warrants to be distributed to the order of each outstanding share of stock of the Corporation, such dividend is to be in addition to any cash dividend now or subsequently declared. The exercise period of said warrants shall commence immediately upon issuance and shall terminate [term] years from the date of issuance.
>
> RESOLVED, that the proposed warrant form, a copy of which is attached to these minutes as Exhibit "A," is approved and the President is directed to issue warrants substantially in the form submitted to this meeting.

The undersigned Directors further direct that this writing be filed with the minutes of the proceedings of the Board of Directors.

IN WITNESS THEREOF, the undersigned, constituting all of the Directors of the Corporation, hereby execute this Action on this ___ day of ______, ______.

[Signatures]

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Warrant

Warrant No. _

Right to purchase
[number] shares

[Company Name]

Warrant to purchase Nonvoting Common Stock

Registered Owner: [Shareholder]

For value received, [Company Name], a California corporation (the "Corporation") grants the following rights to the registered owner of this Warrant:

(a) Issue. Upon tender to the Corporation (as defined in paragraph (e) hereof), the Corporation shall issue to the registered owner hereof the number of shares specified in paragraph (b) hereof of fully paid and nonassessable shares of nonvoting common stock of the Corporation that the registered owner is otherwise entitled to purchase.

(b) Number of shares. The number of shares of nonvoting common stock of the Corporation that the registered owner of this Warrant is entitled to receive upon exercise of this Warrant is [number] shares. The Corporation shall at all times reserve and hold available sufficient shares of nonvoting common stock to satisfy all options and warrants, including this Warrant. The Corporation covenants and agrees that all shares of nonvoting common stock that may be issued upon the exercise of this Warrant shall, upon issuance, be duly and validly issued, fully paid and nonassessable, and free from all taxes, liens and charges with respect to the purchase and the issuance of the shares. This warrant shall not require the registered owner to exercise the purchase as to all of the shares, but the registered owner at his/her option may make a partial exercise.

(c) Exercise price. The exercise price of this Warrant, the price at which the shares of stock purchasable upon exercise of this Warrant may be purchased is $[price] per share, the amount determined by an independent appraisal applying a valuation methodology that is consistent with the objective standards of the valuation industry, to represent an amount greater than 90% of the fair market value of each share of nonvoting common stock on the date the warrants were issued.

(d) Exercise period. This Warrant may be exercised commencing immediately on the date of issuance and or before a day that is [end time] years after that date (the "Exercise Period"). If not exercised during this period, this Warrant and all rights granted under this Warrant shall expire and lapse.

(e) Tender. The exercise of this Warrant must be accomplished by actual delivery of twenty-five percent (25%) of the Exercise Price in cash, certified check, or official bank draft in lawful money of the United States of America, or if acceptable to the Board, assets with an appraised equivalent value, and by actual delivery of a duly executed exercise form, a copy of which is attached to this Warrant as Exhibit "A," properly executed by the registered owner of this Warrant, and by surrender of this Warrant. The balance of the purchase price shall be payable in like manner no later than one hundred eighty (180) days after such exercise, and shall be evidenced by an interest free promissory note payable to the Corporation. Failure to pay the balance of the purchase price shall cause an immediate forfeiture of the proportionate number of shares represented by the promissory note, or unpaid portion thereof. The payment and exercise form must be delivered, personally or by mail, to the principal office of the Corporation. Documents sent by mail shall be deemed to be delivered when they are received by the Corporation.

IN WITNESS WHEREOF, the Corporation has signed this Warrant by its duly authorized officers this ____ day of _____, 1999.

[Company Name]
By: _______________
President
Corporate Seal or Facsimile

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

Exercise Form

Exhibit "A"

The undersigned hereby: (1) irrevocably subscribes for and offers to purchase ____ shares of nonvoting common stock of [Company Name], pursuant to the warrant to which this exhibit is attached; (2) encloses payment of $_____ for these shares at a price of $___ per share; and (3) requests that a certificate for the shares be issued in the name of the undersigned and delivered to the undersigned at the address specified below.

Date:_________

____
(Please sign exactly as your name appears on the warrant)

____

____
(Address of warrant holder)

XX-001973

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

Shareholder Consent to Redemption Agreement Without a Meeting

[Shareholder] being the sole shareholders of [Company Name], a California Corporation (hereinafter "Corporation"), hereby considers the following:

WHEREAS, the Board of Directors of the Corporation has proposed that the Corporation enter into a Redemption Agreement with [Tax-Exempt] in conjunction with an anticipated charitable contributions nonvoting common stock of the Corporation; and

WHEREAS, the Board of Directors of the Corporation has proposed that the Shareholder consent to the form of the Redemption Agreement contemplated for use in the transaction, consent to entry into the Redemption Agreement by the Corporation, and agree that the Board may approve the Redemption Agreement and that the President may execute the Redemption Agreement on behalf of the Corporation;

THEREFORE, Shareholder hereby consents and mutually agrees in writing that:

1. The Redemption Agreement, a copy of which is attached hereto as Exhibit A, is approved; and

2. The Corporation may enter into the Redemption Agreement with Tax-Exempt in conjunction with an anticipated charitable contributions of nonvoting common stock of the Corporation; and,

3. The Board of Directors is authorized to approve the Redemption Agreement; and,

4. The President is specifically authorized to execute the Redemption Agreement on behalf of the Corporation.

IN WITNESS WHEREOF, the undersigned shareholder hereby approves and consents to the action described above effective _______, 2000.

[Shareholder signature]

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ACTION OF THE BOARD OF DIRECTORS WITHOUT A MEETING[4]

The undersigned, constituting all of the Directors of [Company Name], a California corporation (hereinafter "Corporation"), hereby consider the following:

WHEREAS, the balance sheet furnished by the chief financial officer of [Company Name] to the Board of Directors is believed by the directors to be an accurate statement of the financial condition of the corporation on the last day of the fiscal year ending _____, 19__; and

WHEREAS, on examining such balance sheet the Board of Directors is of the opinion that this corporation is authorized to pay the dividend set forth below and that, after payment of such dividend, the corporation will be able to pay its debts as they become due in the ordinary course of business; and

WHEREAS, Shareholder desires to make a charitable contribution to [Tax-Exempt] in the form of nonvoting common stock of the corporation.

THEREFORE, the undersigned Directors hereby consent in writing pursuant to §305(b) of the California Corporations Code and the bylaws of the Corporation, to the following action:

> RESOLVED, that [number] shares of nonvoting common stock of the corporation be issued, as a tax-free stock dividend under Internal Revenue Code section 305(a), payable to the shareholders of record of the corporation on [record date], [Number] shares of stock to be distributed as a stock dividend to the order of each outstanding share of stock of the corporation; such dividend is to be in addition to any cash dividend now or subsequently declared; and
>
> RESOLVED, that the proposed Redemption Agreement, a copy of which is attached to these minutes as Exhibit "A," is approved and the President is directed to execute such agreement, substantially in the form submitted to this meeting.

The undersigned Directors further direct that this writing be filed with the minutes of the proceedings of the Board of Directors.

IN WITNESS THEREOF, the undersigned, constituting all of the Directors of the Corporation, hereby execute this Action on this ___ day of ______, ______.

[Signatures]

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Redemption Agreement

THIS REDEMPTION AGREEMENT is entered into this ___ day of ____, ______, at [place], by [Company Name], a California corporation, hereinafter referred to as "Corporation," and [Tax-Exempt] hereinafter referred as "Tax-Exempt."

WHEREAS, [Shareholder] presently owns all of the issued and outstanding nonvoting common stock of the Corporation; and

WHEREAS, [Shareholder] desires to contribute all its nonvoting common stock of the Corporation to Tax-Exempt; and

WHEREAS, without a redemption agreement, Tax-Exempt will have no ready market in which to sell any nonvoting stock in Corporation contributed to it; and

WHEREAS, the parties hereto desire to promote their mutual interests by imposing certain restrictions and/or obligations on themselves;

NOW, THEREFORE, in consideration of the mutual promises herein contained, the parties hereto agree as follows:

1. Purchase and sale. Commencing on, but no earlier than [date], Tax-Exempt shall have the right to present for redemption, all of the nonvoting common stock of Corporation owned by it, and upon such presentation, the Corporation shall purchase, all of the nonvoting common stock of Corporation owned by Tax-Exempt at the price provided in Paragraph 2 herein below. Upon presentation of the nonvoting common stock for redemption, Tax-Exempt shall endorse and deliver to the Corporation the stock certificate or certificates representing the shares of stock required to be purchased and sold under this Agreement, and the purchase price shall be paid in accordance with Paragraph 3 herein below. In order for Tax-Exempt to be entitled to redemption under this agreement, it must tender, at the same time, all of the nonvoting common stock of Corporation owned by it. Tax-Exempt's right to present the stock it owns for redemption shall end as of the close of business on [end date].

2. Purchase Price. The purchase price of the stock required to be purchased hereunder shall be the fair market value on the date that Tax-Exempt presents the stock for redemption under the assumptions and methodologies applied to determine the value of the shareholders' charitable contribution of the stock, specifically that, the stock is nonvoting stock, the stock does not represent a controlling interest in Corporation, there is a lack of marketability of the stock, any outstanding warrants of the Corporation should be accounted for in the determination of the value of the stock, and that the Corporation is not obligated to pay dividends. Said fair market value shall be determined by

[Valuation Company], or, at the Corporation's option, by another appraiser regularly engaged in valuing businesses and qualified to make appraisals of businesses engaged in enterprises similar to the Corporation's business.

3. Manner of Payment. Concurrently with the delivery of the stock certificate, or certificates to the Corporation, the Corporation shall pay twenty five percent (25%) of the purchase price to Tax-Exempt in cash or other mutually agreed upon consideration. The Corporation shall pay the balance of the purchase price to Tax-Exempt in cash or other mutually agreed upon consideration within forty-five (45) days after the initial installment payment. No interest or other charges shall accrue on the balance due Tax-Exempt pending the final payment forty-five (45) days after the initial installment.

4. Maintenance of S election. The Corporation and Tax-Exempt agree that the Corporation shall maintain its federal income tax status as an S corporation. Tax-Exempt shall not revoke Corporation's S election or otherwise cause a termination. In addition, should Tax-Exempt become an ineligible holder of subchapter S corporation stock, due to the loss of its Internal Revenue Code section 401(a) status, law change or otherwise, or should there be a law change whereby an excise tax will be imposed on any of the shareholders of the Corporation or the Corporation due to Tax-Exempt's ownership of stock in S Corporation, Tax-Exempt will immediately present all stock it holds in Corporation for redemption under the terms of this agreement.

5. Closing of the Books Election. The Corporation and Tax-Exempt agree that the Corporation may determine Tax-Exempt's share of any item for federal income tax purposes as if any taxable year of the Corporation consisted of two taxable years, as permitted under IRC §§ 1362(e) and 1377(a) of the Internal Revenue Code of 1986, as amended, and Treasury Regulation § 1.1368-1(g).

6. Compliance with Chapter 5 of Corporations Code. This Redemption Agreement is subject to the solvency requirements of Corporations Code Chapter 5 (Sections 500 et seq.) and the Corporation shall therefore: (a) maintain adequate retained earnings to pay the amount of the redemption, or (b) accumulate sufficient assets at the time of the redemption such that after the redemption the sum of the assets of the Corporation will be at least equal to 1.25 times its liabilities, and the current assets of the Corporation will be at least equal to its current liabilities (or, if the average of the earnings of the Corporation before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the interest expense of the Corporation for such fiscal years, at least equal to 1.25 times its current liabilities). Additionally, the Corporation shall maintain sufficient working capital and credit facilities to assure that at such time as it is required to redeem Tax-Exempt's shares that its ability to meet its liabilities as they mature will not be impaired by such redemption.

7. Endorsement. Upon the execution of this Agreement or the receipt of stock by Tax-Exempt, whichever is later, the certificates of stock subject hereto shall be surrendered to the Corporation and endorsed as follows:

"The shares of stock represented by this certificate are redeemable in accordance with and pursuant to a Redemption Agreement, dated ______, a copy of which is on file at the main corporate office of the Corporation."

After endorsement, the certificates shall be returned to Tax-Exempt who shall, subject to the terms of this Agreement, be entitled to exercise all rights of ownership of such stock. The Corporation agrees that it will cause a similar endorsement to be placed on all certificates hereafter issued by it and which are subject to the provisions of this Agreement.

8. Necessary acts. Each of the parties hereto agrees that it will do any act or thing and will execute any and all instruments necessary and/or proper to make effective the provisions of this Agreement.

9. Right of First Refusal. Tax-Exempt shall not sell or otherwise dispose of any nonvoting common stock of the Corporation or any right or interest in nonvoting common stock of the Corporation without first offering to sell them to the Corporation and the shareholders holding voting common stock of the Corporation in accordance with the procedures of Section ___, RIGHT OF FIRST REFUSAL, of the bylaws of the Corporation. Any sale or other disposition of the shares in violation of this paragraph shall be null and void.

10. Definitions. References to "stock owned" by Tax-Exempt shall include any nonvoting common stock in Corporation hereafter acquired by Tax-Exempt, whether by way of gift, stock dividend, purchase, recapitalization, reorganization, or otherwise.

11. Agreement binding. This Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective next of kin, legatees, administrators, executors, legal representatives, successors, and assigns (including remote, as well as immediate, successors to and assignees of said parties).

IN WITNESS WHEREOF, the parties hereto have executed this Redemption Agreement on the day and year first above written.

[Company Name]
By: ________________
President

[Tax-Exempt]
By: ________________
[Title]

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

PLEDGE

[Date]

WHEREAS, on [Date], I contributed to [Tax-Exempt], [#] shares of nonvoting stock of [Company Name]; therefore

With the desire to further aid the cause of the [Tax-Exempt], in the event that [Tax-Exempt] should present the donated stock for redemption and the fair market value of the donated stock on the date that [Tax-Exempt] first had the right to present the stock for redemption, as determined under the Redemption Agreement dated _____ (the "redemption amount"), is less than the fair market value of the stock on the date that it was contributed by me (the "contribution amount"), I promise to pay to [Tax-Exempt] the amount by which the contribution amount exceeds the redemption amount.

The amount due under this pledge shall first become due six months from the date [Tax-Exempt] presented the stock for redemption. The amount shall be payable in twelve monthly installments, bearing interest at the rate of six percent per annum.

The redemption amount and the contribution amount shall be determined under the assumptions and methodologies applied to determine the value of the shareholders' charitable contribution of the stock, specifically that, the stock is nonvoting stock, the stock does not represent a controlling interest in Corporation, there is a lack of marketability of the stock, any outstanding warrants of the Corporation should be accounted for in the determination of the value of the stock, and that the Corporation is not obligated to pay dividends. Said fair market value shall be determined by [Valuation Company], or, at the Corporation's option, by another appraiser regularly engaged in valuing businesses and qualified to make appraisals of businesses engaged in enterprises similar to the Corporation's business.

[Shareholder signature]

XX-001979

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

Nonvoting Common Stock Certificate (Front)
(before restriction on redemption added)

Number ____ __________ Shares

Nonvoting Common Stock [Company Name]

Incorporated Under the Laws of the State of California

This certifies that [Shareholder] is the owner of [#] shares of fully paid and nonassessable nonvoting common stock, without par value, of [Company Name], transferable only on the books of the Corporation by the holder in person or by duly authorized attorney upon surrender of this Certificate properly endorsed.

In Witness Whereof, the Corporation has caused this Certificate to be signed by its duly authorized officers and sealed with the seal of the Corporation this _____ day of ______, 19___.

____
President

____
Secretary

This corporation is a close corporation. The number of holders of record of its shares of all classes cannot exceed 35. Any attempted voluntary inter vivos transfer which would violate this requirement is void. Refer to the articles, bylaws and any agreements on file with the secretary of the corporation for further restrictions.

Additional Restrictions Attached

Corporate Seal or Facsimile

XX-001980

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Restrictions
(Attachment to Share Certificate)

1. The shares of stock represented by this certificate cannot be transferred if such transfer would void the election of the Corporation to be taxed under Subchapter S of the Internal Revenue Code of 1986.

2. The shares of stock represented by this certificate have no voting rights due to restrictions contractually imposed by the Corporation.

3. The shares of stock represented by this certificate are subject to certain rights of first refusal entitling the corporation and voting shareholders to purchase the stock in the event the holder of such stock intends to sell such stock to a bona fide purchaser. Said rights are stated in the bylaws of the Corporation, on filed at the principal office of the Corporation.

4. Shareholders may obtain from the principal office of the corporation, on request and without charge, a copy of the statement of the rights, preferences, privileges, and restrictions granted to or imposed on each class or series of shares authorized to be issued and on the holders thereof.

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Assignment Separate from Certificate

FOR VALUE RECEIVED, the undersigned, [Shareholder], hereby gifts, assigns and transfers to [Tax-Exempt], [Number] shares of the nonvoting common stock of [Company Name], standing in their name on the books of said Corporation, represented by Certificate Number ___ herewith, and does hereby irrevocably constitute and appoint [Attorney], attorney to transfer said stock on the books of the within named corporation, with full powers of substitution in the premises.

DATED: _____________

[Shareholder signature]

XX-001982

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

Additional restriction on newly issued share to Tax-Exempt

The following additional restriction should be added to the shares issued to [Tax-Exempt]:

5. The shares of stock represented by this certificate are redeemable in accordance with and pursuant to a Redemption Agreement, dated ______, a copy of which is on file at the principal office of the Corporation.

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Acknowledgement of Receipt of Certificates and Disclosures

Tax-Exempt (hereinafter referred to as "Tax-Exempt") acknowledges and consents to the following:

1. Tax-Exempt acknowledges receipt of a charitable contribution of ______ shares of nonvoting common stock of [Company Name], a California corporation (hereinafter referred to as the "Corporation") from the shareholder of said corporation.

2. Tax-Exempt acknowledges that the nonvoting common shares that are the subject of the aforesaid charitable contribution have not been registered under the Federal Securities Act of 1933 or qualified under the California Corporate Securities Law of 1968, that any disposition of the shares may be subject to restrictions imposed by federal and state law. Tax-Exempt further acknowledges that the shares cannot be sold, transferred or disposed of absent registration and qualification, or an available exemption from registration and qualification, and that no undertaking has been made with regard to registering or qualifying the shares in the future.

3. Tax-Exempt acknowledges that no public market exists with respect to the nonvoting common shares that are the subject of the aforesaid charitable contribution, and that no representation has been made by the shareholders, directors, officers or agents of the Corporation that such a public market will exist at a future date.

4. Tax-Exempt acknowledges that, other than payments that may be made pursuant the Redemption Agreement entered into concurrently with the charitable contribution, the Corporation is not required to make distributions of income to shareholders, for tax or other purposes, and absent specific action by the Directors of the Corporation, will not be required to make distributions in the foreseeable future.

5. Tax-Exempt acknowledges that prior to the charitable contribution of the nonvoting common stock to Tax-Exempt, the Corporation has issued tax-free dividends of [term] year warrants to purchase additional nonvoting common stock in the Corporation to the shareholders (which shareholders do not include Tax-Exempt). If the warrants are exercised by the holders thereof, the exercise will have the effect of diluting the ownership interest in the Corporation represented by the charitable contribution of shares referenced above. However, it is not anticipated that the actual exercise of warrants will have a negative impact on the valuation of the redemption purchase price established by [valuation firm] or an alternative qualified appraiser retained to establish the fair market value of the Tax-Exempt shares pursuant to the Redemption Agreement, in that a potential exercise of the warrants will be, and has already been, factored into the value of the nonvoting common stock.

Dated: ____________________

By:____________________________

This document contains suggested draft language for consideration by client's legal counsel. The document may not be valid in certain jurisdictions and may be inappropriate for client's circumstances.

Representation Concerning Qualified Plan Status

THIS REPRESENTATION CONCERNING QUALIFIED PLAN STATUS is entered into this ___ day of ____, ______, at [place], by [Company Name], a California corporation, hereinafter referred to as "Corporation," [Shareholder] (hereinafter referred to as "Shareholder") and [Tax-Exempt] (hereinafter referred as "Tax-Exempt").

WHEREAS, Shareholder desires to make a charitable contribution to Tax-Exempt in the form of stock in Corporation; and

WHEREAS, Corporation is an S corporation under the Internal Revenue Code; and

WHEREAS, Internal Revenue Code Section 1361(c)(6) provides that an organization which is described in Internal Revenue Code Section 401(a) and that is exempt from tax under Internal Revenue Code Section 501(a) may be a shareholder in an S corporation; and

WHEREAS, if Shareholder donates stock in Corporation to Tax-Exempt and it is subsequently determined that Tax-Exempt is not an organization described in Internal Revenue Code Section 401(a) and/or that Tax-Exempt is not exempt from tax under Internal Revenue Code Section 501(a), Corporation's status as an S Corporation may terminate.

THEREFORE, Tax-Exempt hereby represents to Shareholder and Corporation that Tax-Exempt is a qualified plan under Internal Revenue Code Section 401(a) and that its associated trust is exempt from tax under Internal Revenue Code Section 501(a). Tax-Exempt further represents that it knows of no reason why the plan should not be considered qualified under Internal Revenue Code Section 401(a) and its associated trust tax-exempt under Internal Revenue Code Section 501(a); and

THEREFORE, in consideration for making this representation, Shareholder and Corporation agree and acknowledge that Tax-Exempt, its officers, employees or agents shall not be liable for any claim, demand or cause of action of any kind whatsoever for or on account of any determination that Tax-Exempt is not a qualified plan under Internal Revenue Code Section 401(a) or that its associated trust is not exempt from tax under Internal Revenue Code Section 501(a), including, but not limited to, any damages suffered or additional tax imposed as a result of any termination of Corporation's S corporation status.

IN WITNESS WHEREOF, the parties hereto have executed this REPRESENTATION CONCERNING QUALIFIED PLAN STATUS on the day and year first above written.

[Company Name]

By: ____________________
President

____
[Shareholder]

[Tax-Exempt]
By:____________________
[Title]

REDACTED

STOCKHOLDER AGREEMENT

THIS STOCKHOLDER AGREEMENT (the "**Agreement**") is entered into this ___ day of February, 2002, by · (the "**Corporation**") and (the "**Charitable Organization**").

WHEREAS, the Stockholders of the Corporation as of January 31, 2002 (the "**Stockholders**") presently own all of the issued and outstanding Class C nonvoting common stock of the Corporation; and

WHEREAS, the Stockholders desire to contribute all of the Class C nonvoting common stock of the Corporation to the Charitable Organization, provided that such shares are subject to the rights and restrictions set forth in this Agreement; and

WHEREAS, without an agreement by the Corporation to purchase such Class C nonvoting common stock, the Charitable Organization will have no ready market in which to sell the Class C nonvoting common stock contributed to it by the Stockholders; and

WHEREAS, the Corporation and the Charitable Organization desire to promote their mutual interests by imposing certain restrictions and obligations regarding the Class C nonvoting common stock of the Corporation contributed to the Charitable Organization by the Stockholders;

NOW, THEREFORE, in consideration of the mutual premises herein contained, the parties hereto agree as follows:

ARTICLE I
CHARITABLE ORGANIZATION'S PUT OPTION

1.1 Purchase and Sale. Commencing on, but no earlier than the Commencement Date (as defined in Paragraph 1.2), the Charitable Organization shall have the right, on ten (10) days written notice, to present for purchase by the Corporation, all of the Class C nonvoting common stock of Corporation owned by it, and upon such presentation, the Corporation shall purchase, all of the Class C nonvoting common stock of Corporation owned by the Charitable Organization at the price provided in Paragraph 1.3 herein below. Notice of intent to redeem pursuant to this Agreement shall be given by registered or certified mail, return receipt requested, addressed to the Secretary of the Corporation at the Corporation's principal executive office or delivered in person to the Secretary of the Corporation. Upon presentation of the Class C nonvoting common stock for purchase by the Corporation, the Charitable Organization shall endorse and deliver to the Corporation the stock certificate or certificates representing the shares of stock to be purchased and sold under this Agreement, and the purchase price shall be paid in accordance with Paragraph 1.3 herein below. In order for the Corporation to be obligated to purchase such stock under this Agreement, the Charitable Organization must tender, at the same time, all of the Class C nonvoting common stock of Corporation owned by it. The Charitable Organization's right to present the stock it owns for purchase by the Corporation shall expire 180 days after the Commencement Date, after which the Charitable Organization shall have no rights whatsoever to exercise the option set forth in this Article I with respect to the Class C nonvoting common stock held by the Charitable Organization.

1.2 Commencement Date. If prior to February 2, 2004, the Corporation declares and pays cash dividends of more than $45,000 in the aggregate to the Charitable Organization, the Commencement Date for purposes of Paragraph 1.1 shall be February 2, 2005. Otherwise, the Commencement Date for purposes of Paragraph 1.1 shall be February 2, 2004.

1.3 Purchase Price. The purchase price of the stock required to be purchased hereunder shall be the fair market value on the date that the Charitable Organization presents the stock for purchase by the Corporation. Such fair market value shall be calculated based on the assumptions and methodologies applied to determine the value of Stockholder's charitable contribution of the stock, including factors such as the following: (i) the stock is nonvoting stock, (ii) the stock does not represent a controlling interest in Corporation, (iii) there is a lack of marketability of the stock, (iv) any outstanding warrants of the Corporation should be accounted for in the determination of the value of the stock, and (v) the Corporation is not obligated to pay dividends. Said fair market value shall be determined by Southwest Financial Analytics, Inc., or, at the Corporation's option, by another appraiser regularly engaged in valuing businesses and qualified to make appraisals of businesses engaged in enterprises similar to the Corporation's business.

1.4 Manner of Payment. Concurrently with the delivery of the stock certificate(s) to the Corporation, the Corporation shall pay twenty five percent (25%) of the purchase price to the Charitable Organization in cash or other mutually agreed upon consideration. The Corporation shall pay the balance of the purchase price to the Charitable Organization in cash or other mutually agreed upon consideration within forty-five (45) days after the initial installment payment. No interest or other charges shall accrue on the balance due the Charitable Organization pending the final payment forty-five (45) days after the initial installment.

1.5 Put Option Not Transferable. Notwithstanding any statement to the contrary contained in this Agreement, the Charitable Organization's put option set forth in this Article I is non-transferable and may be exercised only by the Charitable Organization, and such put option will not inure to the benefit of any transferee, assignee or successor to any interest in any of the Class C nonvoting common stock formerly held by the Charitable Organization.

ARTICLE II
SUBCHAPTER S ELECTION

2.1 Maintenance of S Election.

(a) The Corporation and the Charitable Organization agree that the Corporation shall maintain its federal income tax status as a corporation taxed under subchapter S of the Internal Revenue Code of 1986, as amended (the "**Code**") until a majority of the Stockholders holding the Class A voting common shares agrees to terminate such status. Therefore, until Stockholders owning a majority of the Class A voting common shares of the Corporation otherwise agree, the Charitable Organization shall take all and any actions necessary to maintain such subchapter S status. The Charitable Organization shall not revoke or otherwise cause a termination of such S election. Specifically, no transfer may be made to, and no acquisition may be made by, any person who would cause the Corporation to have more than the maximum permitted number of stockholders under subchapter S of the Code as then in effect, or to any person that is not eligible to be a stockholder of a subchapter S corporation under the provisions of the Code as in effect at the time of the purported transfer (presently including non-resident aliens and any person other than an individual, an estate, or certain trusts). In addition, should the Charitable Organization become an ineligible holder of subchapter S corporation stock due to the loss of its Code section 401(a) status, law change or otherwise, the Charitable Organization will immediately present all stock it holds in Corporation for purchase for the price and on the terms set forth in Paragraphs 1.3 and 1.4 of this Agreement.

(b) Any purported transfer or acquisition of shares of the Corporation by the Charitable Organization in violation of this Paragraph 2.1 shall be null and void. The purported transferee shall have no interest in any of the shares of the Corporation purported to be transferred. The Charitable Organization agrees that any such transfer or acquisition may and should be enjoined. Any purported transfer in violation of this Paragraph 2.1 will not affect the beneficial ownership of shares of the Corporation. Thus, in such a situation the Charitable Organization will retain the right to receive dividends and liquidation proceeds. Additionally, in such a situation the Charitable Organization shall continue to report the portion of income or loss allocated by the Corporation in accordance with the provisions of the Code as then in effect.

ARTICLE III
RIGHT OF FIRST REFUSAL

3.1 Right of First Refusal. The Charitable Organization shall not sell or otherwise dispose of any Class C nonvoting common stock of the Corporation without first offering to sell such stock, right or interest to the Corporation and the Stockholders holding the Class A voting common stock and Class B nonvoting common stock of the Corporation in the manner set forth in this Article III. Any sale or other disposition of the Class C nonvoting common stock in violation of this Agreement shall be null and void.

3.2 Notice of Intent to Sell. In the event that the Charitable Organization shall desire to sell or otherwise dispose of all or any part of its Class C nonvoting common stock in the Corporation, and in the event that the Charitable Organization has received a firm written offer from a bona fide purchaser financially able to satisfy terms of the written offer to purchase such stock (a "**qualified offer to purchase**"), the Charitable Organization shall give written notice of the offer to the Corporation. The notice must be given by registered or certified mail, return receipt requested, addressed to the Secretary of the Corporation at the Corporation's principal executive office or delivered in person to the Secretary of the Corporation. The notice must designate the number of shares to be sold, the name of the proposed purchaser, the price per share agreed on in good faith between the Stockholder and the proposed purchaser, the terms of payment of the sales price, the total amount of the sales price and any other terms of the offer.

3.3 Offer by Corporation. Within 30 days after receipt by the Corporation of the notice to the Secretary delivered pursuant to Paragraph 3.2, if the Corporation desires to purchase all or some of the shares, it must mail or deliver to the Charitable Organization a written offer to purchase the shares at the price and on the terms stated in such notice to the Secretary.

3.4 Notification to Stockholder. In the event that the Corporation is unable to purchase some or all of the shares or if the Corporation elects within the 30-day period mentioned above to purchase none or less than all of the shares so offered, the Secretary shall, at the termination of that 30-day period, mail or deliver to each of the Stockholders holding Class A voting common stock or Class B nonvoting common stock, a notification specifying the number of shares remaining to be sold, the price per share, the terms on which the Charitable Organization intends to make the sale, and the name of the proposed purchaser, if any, or, if none, a statement of that fact. This notification may be delivered to the Stockholder personally or may be mailed to the last known addresses of the Stockholder, as the same may appear on the books of the Corporation.

3.5 Offer by Stockholder. Within 20 days after the mailing or delivering of the notification to each of the Stockholders holding Class A voting common stock or Class B nonvoting common stock, such Stockholders desiring to purchase any part or all of the shares referred to in the notification shall deliver by mail or otherwise to the Secretary of the Corporation a written offer or offers to purchase a specified number of the shares at the price and on the terms stated in the notification.

3.6 Pro Rata Allocation of Shares. If the total number of shares specified in the offers from the Stockholders holding Class A voting common stock and Class B nonvoting common stock exceeds the number of shares referred to in the notification, the shares to be sold shall be allocated among the offering Stockholders pro rata based on the number of shares owned by each such Stockholder, provided that no Stockholder shall be required to purchase more than the number of shares that such Stockholder offered to purchase.

3.7 Purchase in Excess of Pro Rata Amount. If all the shares referred to in the notification are not disposed of under the apportionment provided in Paragraph 3.6, each holder of Class A voting common stock or Class B nonvoting common stock desiring to purchase shares in a number in excess of his or her pro rata share, as provided above, shall be entitled to purchase the same proportion of the shares that remain undisposed of as the total number of shares that he or she holds (including any shares allocated to such Stockholder under Paragraph 3.6 above) bears to the total number of shares held by all of such Stockholders (including any shares allocated to such Stockholders under Paragraph 3.6 above) desiring to purchase shares in excess of those to which they are entitled under the apportionment, or all of the shares if there is no other Stockholder desiring to purchase shares in excess of those to which he or she is entitled under the apportionment provided for above.

3.8 Release of Restriction. Unless all of the offered shares of Class C nonvoting common stock have been purchased by the Corporation or by the Stockholders holding Class A voting common stock and Class B nonvoting common stock or by both within a period of 60 days after the mailing or delivery of the notice to the Secretary required by Paragraph 3.2, all of the remaining offered shares of Class C nonvoting common stock shall be released from the restrictions on sale or other disposition set forth in this Article III; *provided, however*, that such shares shall be released solely for the purpose of the proposed sale or other disposition in the total amount specified and at the price specified in the notice to the Secretary, or at a greater price than that specified, and provided further that the sale or other disposition be completed within 30 days after the 60 day period referred to above.

As a prerequisite to any release of restrictions pursuant to this Paragraph 3.8, and as a prerequisite to any shares being transferred of record to a third party offeror, such third party offeror (and, if such third party offeror is married, his spouse) must deliver to the Corporation a written acknowledgement, in a form acceptable to the Corporation, stating that:

(i) such third party offeror, and any shares of the Corporation's Class C nonvoting stock transferred to such third party offeror, are bound by all of the terms and restrictions set forth in this Agreement, including the right of first refusal set forth in this Article III;

(ii) all stock certificates issued to such third party offeror in respect of the Corporation's Class C nonvoting common stock shall bear the legend set forth in Paragraph 4.3 of this Agreement; and

(iii) such third party offeror is eligible to become a qualified stockholder under any state or federal tax statute the Corporation has adopted, including, without limitation, Subchapter S status.

After completion of the sale or other disposition, or after the expiration of the 30 days within which the sale or disposition must be completed, whichever first occurs, the offered shares of Class C nonvoting common stock shall again be and remain subject to the restrictions on sale or other disposition imposed by this Agreement, and the holder of such shares shall hold such shares subject to the right of first refusal set forth in this Article III and the other provisions of this Agreement.

3.9 Termination of Charitable Organization; Bankruptcy; Involuntary Transfer. The Corporation and the holders of the Corporation's Class A voting common stock and Class B nonvoting common stock shall have an irrevocable option to purchase the Class C nonvoting common stock held by the Charitable Organization in the event that (i) the Charitable Organization terminates, is dissolved or otherwise ceases its existence as such, (ii) the Charitable Organization files a petition or otherwise seeks relief under any bankruptcy or similar laws or a charge or petition is filed against the Charitable Organization under such laws, or (iii) any of the Corporation's Class C nonvoting common stock held by the Charitable Organization will be transferred involuntarily (whether by court order, operation of law, or otherwise). The procedures applicable to the exercise of an option under this Paragraph 3.9 shall be identical to those set forth in this Article III with respect to a proposed sale to a third party, and the Charitable Organization shall provide prompt notice of any of the events described in this Paragraph 3.9 in accordance with Paragraph 3.2 above. The purchase price for Class C nonvoting common stock purchased pursuant to this Paragraph 3.9 shall be determined in the manner set forth in Paragraph 1.3 above.

3.10 Failure to Give Notice. If any option period under this Agreement commences with the giving of notice and the person or entity required to give such notice fails for any reason to do so within 30 days of the occurrence of a option to purchase shares hereunder, then the option shall be in effect for the applicable period of time commencing with the later of the end of such 30 day period or the date that the Corporation or the Stockholder, as applicable, receives actual notice from any source of a qualified option to purchase shares.

3.11 Restrictions Binding on Heirs, Successors, and Assigns. All the terms, conditions, and provisions restricting the sale or other disposition of Class C nonvoting common stock of the Corporation shall apply to and bind the heirs, successors, or assigns of each of the owners or holders of any of the shares.

3.12 Sale or Transfer of Shares With Stockholders' Written Assent. Notwithstanding anything in this Agreement to the contrary, any or all of the Class C nonvoting common shares of the Corporation may be sold, transferred, or otherwise disposed of, or hypothecated without restriction, provided written assent or approval to the proposed sale, transfer, other disposition, or hypothecation is obtained and signed by the holders of not less than all of the shares of the Corporation entitled to vote. All consents or approvals shall be filed with the Secretary of the Corporation.

ARTICLE IV
MISCELLANEOUS

4.1 Closing of the Books Election. The Corporation and the Charitable Organization agree that the Corporation, upon the approval of such an action by the

Corporation's Board of Directors, may determine the Charitable Organization's share of any item for federal income tax purposes as if any taxable year of the Corporation consisted of two taxable years, as permitted under Sections 1362(e) and 1377(a) of the Code and Treasury Regulation § 1.1368-1(g).

4.2 Compliance with Kansas General Corporation Code. This Agreement is subject to the requirements of Kansas General Corporation Code Chapter 17, Article 60 (Sections 17-6001 *et seq.*) and the Corporation shall therefore maintain adequate surplus such that the capital of the Corporation is not impaired and such that the Corporation may purchase its stock as required by Article I of this Agreement without impairing the capital of the Corporation.

4.3 Endorsement. Upon the execution of this Agreement or the receipt of stock by the Charitable Organization, whichever is later, the certificates of stock subject hereto shall be surrendered to the Corporation and endorsed as follows:

> THE SECURITIES REPRESENTED BY THIS CERTIFICATE ARE THE SUBJECT OF A CERTAIN STOCKHOLDER AGREEMENT DATED FEBRUARY 1, 2002, A COPY OF WHICH IS FILED WITH THE SECRETARY OF THE CORPORATION, AND CANNOT BE SOLD OR OTHERWISE TRANSFERRED EXCEPT IN ACCORDANCE WITH THE TERMS OF SUCH AGREEMENT, INCLUDING THE RIGHT OF FIRST REFUSAL SET FORTH THEREIN. ANY PERSON WHO ACQUIRES ANY LEGAL OR BENEFICIAL INTEREST IN THE SECURITIES REPRESENTED BY THIS CERTIFICATE SHALL BE BOUND BY SUCH AGREEMENT AS IF AN ORIGINAL PARTY THERETO.

After endorsement, the certificates shall be returned to the Charitable Organization who shall, subject to the terms of this Agreement, be entitled to exercise all rights of ownership of such stock. The Corporation agrees that it will cause a similar endorsement to be placed on all certificates hereafter issued by it which are subject to the provisions of this Agreement.

4.4 Necessary Acts. Each of the parties hereto agrees that it will do any act or thing and will execute any and all instruments necessary and/or proper to make effective the provisions of this Agreement.

4.5 Notice. Any written notice required or permitted by this Agreement may be delivered personally or by deposit in the United States mail, postage prepaid, certified or registered mail, return receipt requested, addressed to the parties at the addresses recorded for such party on the books of the Corporation. Notice given personally will be deemed received upon delivery, and notice given by mail will be deemed received five days following its deposit in the United States mail as set forth above, or ten business days following its deposit in the mail of any foreign country which is the country of residence of the sender.

4.6 Severability. If any provision of this Agreement is held by final judgment of a court of competent jurisdiction to be invalid, illegal or unenforceable, such invalid, illegal or unenforceable provision shall be severed from the remainder of this Agreement, and the remainder of this Agreement shall be enforced. In addition, the invalid, illegal or unenforceable provision shall be deemed to be automatically modified, and, as so modified, to be included in this Agreement, such modification being made to the minimum extent necessary to render the provision valid, legal and enforceable. Notwithstanding the foregoing, however, if the severed or modified provision concerns all or a portion of the essential consideration to be delivered under this Agreement by one party to the other, the remaining provisions of this Agreement shall also be modified to the extent necessary to equitably adjust the parties' respective rights and obligations hereunder.

4.7 Governing Law. This Agreement will be construed pursuant to the laws of the State of Kansas (without regard to conflicts of law principles).

4.8 Terminology. With respect to terminology in this Agreement, each number (singular and plural) will include all numbers and each gender (male, female or neuter) will include all genders. The titles of the Paragraphs in this Agreement will have no effect and will neither limit nor amplify the provisions hereof.

4.9 Specific Performance. Damages at law alone will be an insufficient remedy for a violation of this Agreement and the parties hereto will suffer irreparable injury if the terms of this Agreement are violated. Accordingly, upon application to a court of competent jurisdiction, any party hereto shall be entitled to injunctive relief to enforce the provisions of this Agreement in the event of any breach, or threatened breach, of its terms. Injunctive relief may be sought in addition to any other available rights or remedies at law. The prevailing party shall additionally be entitled to reasonable attorneys' fees incurred in enforcing the provisions of this Agreement.

4.10 Definitions. References to "stock owned" by the Charitable Organization shall include any Class C nonvoting common stock in Corporation hereafter acquired by the Charitable Organization, whether by way of gift, stock dividend, purchase, recapitalization, reorganization, or otherwise.

4.11 Binding Nature of Agreement; Third Party Beneficiaries. This Agreement shall inure to the benefit of and be binding upon the parties hereto, the Stockholders and their respective heirs, next of kin, legatees, administrators, executors, legal and personal representatives, successors and assigns (including remote, as well as immediate, successors to and assignees of said parties) and will run with the ownership of all shares of the Corporation.

4.12 Entire Agreement. This Agreement, including the exhibits and schedules attached hereto (if any), contains the entire agreement of the parties with respect to the subject matter of this Agreement, and supersedes all prior agreements between them, whether oral or written, of any nature whatsoever with respect to the subject matter hereof.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, the parties hereto have executed this Stockholder Agreement on the day and year first above written.

By: ______________________
Name: ______________________
Title: ______________________

By: ______________________
Name: ______________________
Title: ______________________

REDACTED

KPMG 0047977

Proprietary Material
Confidentiality Requested

Message0009	
Subject:	SC2 Initiative -- Action Plan
From:	Schmidt, Michael (US/NSS-MONTVALE)
Date:	7/18/2000 7:12:01 PM
To:	Manth, Larry E
CC:	Klein, Wendy (NSS-Tax); Springer, Mark A; Cockrell, Sandra J; Scheffler, Kenneth J; Moore, Colleen A

Message Body

Larry:

Thanks again for taking the time to go through all the aspects of our go-to-market strategy for SC2 earlier today. I've summarized the action steps from the call below - please review them carefully and let us know if you have changes. We're looking forward to assist you in the pursuit of these targets.

Thank you.

Target list
* You have reviewed the target list of app. 300 companies with $20-$80 Million in revenue that Colleen sent you some weeks ago. Although this revenue threshold sounds a bit low to you, you want us to pursue these targets as companies with larger revenue are likely to have been pursued by KPMG already.

Channel Conflict (4 steps)
* Targets indicating OMS acitivty for SC2 will be removed by Christine Meek before July 21
* You'll share the revised target list (we'll sort by area) with your team July 21 to ensure that the Practice Development Coordinators (PDCs) don't call targets that are already being pursued by your SC2 deployment team. You'll email the target list with comments/edits to me July 28.
* I'll send the target list to the Area Marketing Directors July 28 and will get their feedback August 1
* "Channel Conflict" email containing targets left to pursue will be sent to all US Tax Service Partners August 2
* PDC call activity commence 3rdt week of August (after channel conflict process is complete)

PDC Talk Points (script)
* Attached below is the draft of the PDC talk points that you'll review again (e.g. double-check qualifying questions are still correct). You'll email comments or approval to me by July 21.

* We've agreed to arrange a PDC tutorial Wednesday, August 2 at 11am EDT. As mentioned, you'll lead the tutorial and prepare a presentation for the PDC team (simple overview of the solution and ways to handle objections, questions, etc.)
* A PowerPoint sample is attached directly below. Please send your SC2 presentation draft to me by July 26 so we can assist you in finalizing the presentation.

Proprietary Material
Confidentiality Requested

KPMG 0049119

* We discussed whether to have the PDC schedule a phone appointment with the BDM or your Area Champion (or other tax professional assigned to SC2). We agreed to have the PDCs coordinate schedules so both the BDM and Area Champion are available for a joint call, however default to a BDM for the initial phone call if the PDC is unable to schedule a joint call. You'll send me the names of your deployment team by area so the PDCs can coordinate their calendars. In situations where the BDM places the initial call alone, the BDM will advise the Area Champion or tax professional (via email) after contact has been made to immediately bring in the professional expertise to discuss the solution with the prospect.

Permanent Subcommittee on Investigations
EXHIBIT #96o

Deployment & Training
* As you describe the solution being relatively straightforward, you're confident that the recent BDM training is sufficient at this juncture. You're flexible as to whether to set up phone appointments with one dedicated BDM, or alternatively all BDMs in each area (whatever is more effective). We need to resolve with the ASDs which BDMs we're using in each area, and they must be identified in advance.
* To optimize the lead generation from the PDC calls, you'll lead a training call with your SC2 deployment team. You'll arrange this call the 1st week in August and check calendars for optimal attendance. We'll help you prepare the training materials, and will invite the Area Marketing Directors (AMDs) to ensure local marketing support and understanding of SC2.

Beta Test
* We agreed to have the PDCs beta test the Northeast area before calling the other 5 areas. I'll work directly with the PDC team and contact you when we're ready to share the initial results on a debriefing call

Attachment
PDC_TUTORIAL.PPT

Attachment
SC2TALKPOINTMONT 061913.DOC

Outlook Header Information
Conversation Topic: SC2: Practice Development Coordinators Involvement Subject: SC2 Initiative – Action Plan From: Schmidt, Michael (US/NSS-MONTVALE) Sender Name: Schmidt, Michael (US/NSS-MONTVALE) To: Manth, Larry E CC: Klein, Wendy (NSS-Tax); Springer, Mark A; Cockrell, Sandra J; Scheffler, Kenneth J; Moore, Colleen A Received By: Klein, Wendy (NSS-Tax) Delivery Time: 7/18/2000 7:12:01 PM Creation Time: 7/18/2000 7:12:00 PM Modification Time: 7/18/2000 7:12:01 PM Submit Time: 7/18/2000 7:12:00 PM Importance: 7/1 Priority: 7/0 Sensitivity: 7/0 Flags: 7/17 Size: 7/127415

Message0046	
Subject:	RE: SC2
From:	Jones, David P (NY)
Date:	9/5/2000 7:16:40 PM
To:	Schrier, John V
Message Body	

Agree

-----Original Message-----
From: Schrier, John V
Sent: Thursday, August 31, 2000 10:49 PM
To: Jones, David P (NY)
Subject: FW: SC2

Say the word and I'll back off. But, while I'm all in favor of PFP exploiting all available sources to increase its client base, seems to me that if the objective or result of this effort is to pull all SC2 opportunities under the umbrella of PFP opportunities, we're left with only 1/3 of the managed revenue premium across the board. If that's the case, perhaps we need to re-discuss certain goals, boxes, etc.

Thanks,

John

-----Original Message-----
From: Speiss, Timothy P
Sent: Thursday, August 31, 2000 1:12 PM
To: Duff, John F
Cc: Casten, David B; Connolly, William J; Schrier, John V; Manth, Larry E; Crawford, Thomas W; Prifti, Robert W; Rivotto, Brian
Subject: SC2

John, Brian Rivotto and I are looking at the attached SC2 target list for New England, along with coordinating our PFP/Tax target relationship efforts with STRATECON. We want to keep you updated as we have identified New England opportunities and we want to coordinate with Federal Tax to make sure we know of KPMG (PFP/Fed Tax) relationships with these companies. KPMG Ft. Wayne is contacting the targets via phone, then STRATECON/PFP we follow up to conduct a pre-ICV teleconference with the target to overview the strategy. We are working with target now in Rhode Island (Dave Casten and Bill Connelly) where we are attempting to set up a meeting, as Bill has a relationship with company reps.

When we schedule meetings we will prepare considering KPMG attendees (STRATECON, Federal Tax).

Thanks, TPS
-----Original Message-----
From: Rivotto, Brian
Sent: Thursday, August 31, 2000 12:51 PM
To: Speiss, Timothy P
Subject: FW: How's this look?

FYI
-----Original Message-----
From: Rossini, Elisete G
Sent: Thursday, August 31, 2000 10:06 AM

Proprietary Material
Confidentiality Requested

KPMG 0050044

Permanent Subcommittee on Investigations
EXHIBIT #96p

To: Rivotto, Brian
Subject: How's this look?

<< File: SC2leads.XLS >>

Elisete G. Rossini
PFP/Tax
617-988-5878

Outlook Header Information
Conversation Topic: How's this look? Subject: RE: SC2 From: Jones, David P (NY) Sender Name: Jones, David P (NY) To: Schrier, John V Received By: Schrier, John V Delivery Time: 9/5/2000 7:16:40 PM Creation Time: 9/5/2000 7:16:37 PM Modification Time: 9/5/2000 7:16:40 PM Submit Time: 9/5/2000 7:16:39 PM Importance: 9/1 Priority: 9/0 Sensitivity: 9/0 Flags: 9/1 Size: 9/5847

Message0048	
Subject:	**RE: SC2**
From:	Manth, Larry E
Date:	9/5/2000 8:05:06 AM
To:	Schrier, John V

Message Body

John, see the attached memo. You should agree on some sort of split or mutually agreeable revenue sharing with respect to new leads. But in all cases, SC2 is to be implemented by Fed Tax. Also, the Northeast was designed as a test case for cold calling and therefore other regions have not been involved. For the most part SC2 has been driven by Stratecon in each region, although I'm starting to see increased PFP involvement. Do you want to discuss?

Larry

-----Original Message-----
From: Schrier, John V
Sent: Monday, September 04, 2000 7:04 PM
To: Manth, Larry E
Subject: FW: SC2

Larry,

Outside of NE, to your knowledge is PFP seeking to have all opportunities (particularly those generated from the master dialing-for-dollars list out of IN) jointly coded PFP/Stratecon?

Thanks,

John

-----Original Message-----
From: Schrier, John V
Sent: Thursday, August 31, 2000 10:13 PM
To: Lipschultz, Brent S; Hill, Katherine C
Cc: Bogos, Nicholas G; Speiss, Timothy P; Jones, David P (NY)
Subject: RE:

IMHO, Brent's suggested revisions don't fully resolve the confusion. Issues of revenue splitting notwithstanding, to the best of my awareness SC2 is uniformly coded throughout KPMG as Stratecon. Without expressing any view at the present time, let me suggest that we sit on these changes until I return 9/5, and discuss same at that time.

Thanks,

John

-----Original Message-----
From: Lipschultz, Brent S
Sent: Thursday, August 31, 2000 3:21 PM
To: Hill, Katherine C
Cc: Bogos, Nicholas G; Speiss, Timothy P; Schrier, John V

kpmg

To Client Attorney

Date September 5, 2000

From Larry Manth/ Andrew Atkin/ Stephanie Shen

Ref Warrant Memo.doc

The Issuance of Warrants Pursuant to S Corporation Charitable Contribution Strategy

This memo will address the following issues regarding the issuance of warrants pursuant to KPMG's S Corporation Charitable Contribution Strategy:

1. Why The Existence of The Warrants Dilutes The Value of The Outstanding Stock.
2. How The S Corporation Second Class of Stock Rules May be Applied to The Issuance of The Warrants.

1. **Why The Existence of The Warrants Dilutes The Value of The Outstanding Stock.**

A warrant is essentially a call option issued by a firm. An important distinction between an option traded on an exchange and a warrant is that the existence of a warrant requires the firm to issue new shares of common stock. Thus the total number of shares outstanding increases.

Since the issuance of a warrant creates the potential for an increase in the number of outstanding shares, any per share calculation must be done assuming that all common stock equivalents ("CSEs") are exercised. These figures are called fully diluted earnings per share ("FDEPS"). According to Accounting Principles Board ("APB") Fifteen, the treasury stock method should be used to account for CSEs' impact on the earnings per share calculations of publicly traded companies. In calculating FDEPS, warrants and options are considered dilutive when the market price of the underlying share exceeds the exercise price of the option and or warrant. Since the Strategy calls for the issuance of warrants with an exercise price that is less than 100 percent of the fair market value of the underlying share, the impact is dilutive.

2. **How the S Corporation Second Class of Stock Rules May be Applied to The Issuance of The Warrants.**

Generally, a corporation that has more than one class of stock cannot qualify as an S Corporation. As stated previously, warrants and options are CSE's since their conversion feature is the sole basis for value. Therefore, when looking at the second class of stock requirements, an S Corporation must also take into consideration whether their options and warrants may violate the one class of stock rules.

Regulation Section 1.1361-1(l)(4)(iii) provides rules that describe whether certain call options, warrants or similar instruments issued by a corporation are treated as a second class of stock. Regulation Section 1.1361-l(1)(4)(iii)(C) provides a safe harbor (the "Safe Harbor") whereby such instruments will not be treated as a second class of stock if the terms of the warrants meet certain criteria.

A call option, warrant or similar instrument (collectively referred to in the statute as a "call option") issued by a corporation will be deemed to be a second class of stock if the option is substantially certain to be exercised and has a strike price substantially below the fair market value of the underlying stock (also referred to as being significantly "in-the-money") on the date that the call option is issued.[1] Under the Safe Harbor, a call option is not treated as a second class of stock if, on the date of issuance, the strike price of the call option "is at least 90% of the fair market value of the underlying stock on that date." The Internal Revenue Code and Regulations do not provide much specific guidance on the application of the Safe Harbor. According to the Service, the rationale for including call options in the second class of stock analysis is that call options which are significantly "in-the-money" are akin to equity. Specifically, "[t]he Service and Treasury believe that deep-in-the-money options effectively confer rights to corporate equity and should be taken into account for purposes of the one class of stock requirement." Treasury Decision 8419, 57 F.R. 22646 (May 29, 1992). Based on this statement, we believe that the purpose of the Safe Harbor is to provide a standard as to how "in-the-money" a call option can be without being considered to be an equity instrument. Essentially, the call option can be no more than 10% "in-the-money" under the Safe Harbor.

It is fairly straightforward how to apply the Safe Harbor where the call option is in the form of an option to purchase already existing stock. For example, assume an S corporation whose only asset is $1,000,000 worth of gold. Assume that the corporation has 100 shares outstanding all owned by Shareholder, with each share worth $10,000. If Shareholder wants to sell an option to purchase one of his shares, the minimum exercise price of the option would need to be $9,000 (90% of the value of the share that can be purchased with the option) in order to fall under the Safe Harbor. In other words, the option could not be more than 10% "in-the-money."

What is not so straightforward is how the Safe Harbor is applied to warrants. Under the Safe Harbor, the same test is applied to warrants as to options, even though there are significant differences between these two types of securities. *See* Ross, Westerfield and Jaffe, *Corporate Finance* (5^{th} Ed., Irwin McGraw-Hill), p. 603-607. The most important difference between a call option and a warrant is that a warrant is issued by the company and therefore each time a warrant is exercised, the number of shares outstanding increases. *Id.* at 603.

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[1] Under Regulation Section 1.1361-1(l)(4)(iii)(A), the term call options includes call options, warrants and similar instruments.

Assume in the above example that instead of Shareholder issuing an option, the company desires to issue 900 warrants to purchase additional shares of stock, with a term of 35 years. In order for the warrants to meet the Safe Harbor, it could be argued that the exercise price of each warrant must be at least $9,000 (90% of the value of a share), for a total exercise price of $8,100,000. For the reasons discussed below, we believe that this interpretation of the Safe Harbor is incorrect.

Under the plain language of the Safe Harbor, the exercise price of the warrant must be at least "90 percent of the fair market value of the underlying stock on that date." In our example, the stock underlying each warrant represents 1/1000th of the total outstanding stock. We believe that it is the fair market value of this interest that must be determined in order to apply the Safe Harbor because that is what the "underlying stock" is worth. The $9,000 per share value is not the value of the underlying stock but rather the value of a share before the warrants were issued. This value does not represent the value of the "underlying stock."

However, the more fundamental problem with applying the Safe Harbor by using the value of a share before the warrants are issued is that if this value is used, the permissible percentage by which a warrant may be "in-the-money" will fluctuate depending on how many warrants are issued. As explained in Ross, *Corporate Finance*, the formula for determining the gain from exercise of a warrant is: (value of company plus total exercise price / number of shares plus the number of warrants) minus the total exercise price. *See* Ross, Corporate Finance, at 605-606. As the following chart illustrates, the percentage by which a warrant is "in-the money" will vary from 11% to less than 1% if the number of warrants in the above example is altered:

ASSUMPTIONS:				
FMV of company before warrant exercise	1,000,000	1,000,000	1,000,000	1,000,000
Number of shares before warrant exercise	100	100	100	100
Number of warrants issued	1	900	9,000	10,000
Exercise price per warrant	9,000	9,000	9,000	9,000
CONCLUSIONS:				
FMV of company after warrant exercise	1,009,000	9,100,000	82,000,000	91,000,000
Percentage of company owned by warrant holder	0.990%	90.000%	98.901%	99.010%
FMV of portion of company owned by warrant holder	9,990	8,190,000	81,098,901	90,099,010
Less Exercise price	9,000	8,100,000	81,000,000	90,000,000
Gain from exercise	990	90,000	98,901	99,010
% each warrant is "in-the-money" (gain / total exercise price)	11.001%	1.111%	0.122%	0.110%

We do not see any technical or policy reason why the permissible percentage each warrant may be "in-the-money" should change depending on the total number of warrants issued.

Indeed, as the above table demonstrates, if only one warrant is issued, the Safe Harbor would not be met while if 900 warrants were issued the Safe Harbor would be met.

We believe the more reasonable interpretation of the Safe Harbor is that it permits each warrant to be up to 10% "in-the-money" regardless of how many other warrants are issued. We reach this conclusion based on the fact that when the Safe Harbor is applied to an option to purchase stock, the permissible percentage does not change if more or less options are issued.

The Safe Harbor allows the taxpayer to rely upon an independent valuation as to what the underlying stock is worth. *See* Regulations Section. 1.1361-1(l)(4)(iii)(C) (a good faith determination of value is respected unless the determination of value was not performed with reasonable diligence).

The valuation firms that we have worked with generally first determine the enterprise value of the subject company and subtract all debt to determine the value of the company's equity. For illustration purposes, say that Company A initially has 100 shares of voting stock only. The Company then issues 900 shares of non-voting stock, making the total amount of stock outstanding equal to 1,000 shares. The company desires to issue warrants that, if exercised, would constitute 95% of the total shares outstanding. These transactions are summarized in the following chart:

	Voting	Non-Voting	Warrants	Total
Total Shares Outstanding – Before Recap	100	0	0	100
% of Total Shares Outstanding	100.0%	0.0%	0.0%	100.0%
Total Shares Outstanding- After Recap	100	900	0	1,000
% of Total Shares Outstanding	10.0%	90.0%	0.0%	100.0%
Total Shares Outstanding – After Recap & Warrants	100	900	19,000	20,000
% of Total Shares Outstanding	0.5%	4.5%	95.0%	100.0%

Assume that we issue warrants with a term of 35 years and set the exercise price of each warrant at $2,759.65 per share.

The first step of the valuation firm will be to calculate the present value of the warrant proceeds received by the company, assuming the warrants were exercised. The reason the valuation firm assumes the warrant is exercised at the end of the exercise period is that the warrant holder would not want to exercise early and forego the interest or income that could be earned from investing the funds that would be used to exercise. In addition, not exercising the warrants gives the holder leverage. An option or warrant enables the holder to control large amounts of wealth with very small, or no cash outlays. When exercised early, the benefit of leverage is lost. Another consideration is the fact that one of the elements that contribute to the value of an option or a warrant is the time value. The longer the time to expiration the more valuable the instrument. By exercising early, one loses the value of the option or warrant attributable to its time value.

In our example, if we assume a 6% risk free rate and a present value factor of 0.1296, the proceeds from the exercise of the Warrants will have a present value of approximately $6,800,000. The valuation firm will add this amount to the equity value of the company.

Per Share Warrant Exercise Price	$2,759.65
Times: Total number of New Warrant Shares	19,000
Warrant Proceeds ($000's)	$52,433.00
Warrant Proceeds ($000's)	$52,433
Times: Present Value Factor	0.1296
Present Value of Warrant Proceeds ($000's)	$6,794.88
- Rounded	$6,800.00

The value of the company increases to reflect the proceeds from the warrant exercise. However, the incremental increase per share is quite small because of the long-term nature of the warrants and the dilutive effect of the to be issued shares. Discounts for lack, of control, lack of marketability, and for the lack of voting rights are then applied resulting in a non-marketable, lack of control value.

For example, assume that the value of the company (prior to marketability and minority discounts), without taking into account the warrant proceeds is $95 million. The value of a share of nonvoting stock would be determined as follows:

Controlling Interest Value Conclusion for Nonvoting Shares	$95,000,000
PV of Warrant Proceeds	6,800,000
Controlling Interest Value Conclusion	$101,800,000
Less Discounts	(40,700,000)
Non Voting Non-Marketable Minority Interest Value Conclusion	$61,100,000
Value of Nonvoting Common Share based on 20,000 Shares	$3,055

Per the Safe Harbor, we would compare the value of a nonvoting share to the exercise price of the warrants, to make sure the exercise price is at least 90% of the exercise price of a warrant:

Per-Share Warrant Exercise Price	$2,759.65
Divided By: Per-Share Nonvoting Non-Marketable Minority Interest Value Conclusion	$3,055.00
Percent of Warrant Exercise Price to Fair market Value of Underlying Stock	90.3%

The valuation firms' approach appears reasonable because it is specifically following the test specified in the Safe Harbor. That is, the Safe Harbor provides that we should compare the exercise price to the fair market value of the underlying stock. By comparing the exercise price of the warrants to the value of the stock as determined by the valuation firm, we are doing exactly what the regulation mandates.

Remember also that if the Service were to determine that the Safe Harbor was not met, it does not automatically lead to a conclusion that the warrants are a second class of stock. It must also be shown that the warrants were substantially certain to be exercised and that the fair market value of the warrants was substantially below fair market value. Reg. Sec. 1.1361-1(l)(4)(iii)(A).

CONCLUSION

Since the existence of warrants requires an S corporation to issue more common stock, the issuance of warrants under KPMG's S Corporation Charitable Contribution Strategy increases the total number of shares outstanding, thereby decreasing the value of each share. Based on this diluted price, a valuation firm will determined the price of the non voting stock and the warrants so that the warrants will be worth at least 90% of the underlying stock. By ensuring that the value of the warrants are 90% of the underlying stock, KPMG will be able to abide by the Safe-Harbor rules and a second class of stock will not be created. Therefore, done properly, the issuance of the warrants under KPMG's S Corporation Charitable Contribution Strategy will not affect the S corporation's S status.

Our advice in this document is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the above-stated facts, assumptions and representations. If any of the foregoing facts, assumptions or representations is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. In rendering our advice, we are relying upon the relevant provisions of the Internal Revenue Code of 1986, as amended, [state and local tax statutes,] the regulations thereunder, and the judicial and administrative interpretations thereof. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our conclusions. We will not update our advice for subsequent changes or modifications to the law and regulations or to the judicial and administrative interpretations thereof.

kpmg

To Client Attorney

Date September 5, 2000

From Larry Manth/ Andrew Atkin

Ref Warrant Memo Q&A.doc

Questions and Answers Regarding The Issuance of Warrants Pursuant to S Corporation Charitable Contribution Strategy

1. **What is the difference between a call option and a warrant?**

   A warrant is essentially a call option issued by a firm. An important distinction between an option traded on an exchange and a warrant is that the existence of a warrant requires the firm to issue new shares of common stock. Thus the total number of shares outstanding increases.

2. **Why does the existence of warrants dilute the value of the outstanding stock when used in KPMG's S-Corporation Charitable Contribution Strategy?**

   Since the issuance of a warrant creates the potential for an increase in the number of outstanding shares, any per share calculation must be done assuming that all common stock equivalents ("CSEs") are exercised. These figures are called fully diluted earnings per share ("FDEPS"). According to Accounting Principles Board ("APB") fifteen the treasury stock method should be used to account for CSEs' impact on the earnings per share calculations of publicly traded companies. In calculating FDEPS, warrants and options are considered dilutive when the market price of the underlying share exceeds the exercise price of the option and or warrant. Since the Strategy calls for the issuance of warrants with an exercise price that is less than 100 percent of the fair market value of the underlying share, the impact is dilutive.

3. **In regards to the issuance of warrants, what S-Corp Rules will affect KPMG's Corporation Contribution Strategy?**

   Regulation Section 1.1361-1(l)(4)(iii) provides rules that describe whether certain call options, warrants or similar instruments (collectively referred to in the statute as a "call option") issued by a corporation are treated as a second class of stock. Regulation Section 1.1361-l(1)(4)(iii)(C) provides a safe harbor (the "Safe Harbor") whereby such instruments will not be treated as a second class of stock if the terms of the warrants meet certain criteria. Specifically, the warrants will not be considered a second class of stock if the strike price of the warrant is at least equal to 90% of the value of the underlying stock (discussed more fully below).

4. Why the S-Corporation Second Class of Stock Rules apply to warrants?

Generally, a corporation that has more than one class of stock cannot qualify as an S Corporation. As stated previously, warrants and options are CSEs since their conversion feature is the sole basis for value. Therefore, when looking at the second class of stock requirements, an S Corporation must also take into consideration whether their options and warrants may violate the one class of stock rules.

A call option, warrant or similar instrument issued by a corporation will be deemed to be a second class of stock if the option is substantially certain to be exercised and has a strike price substantially below the fair market value of the underlying stock (also referred to as being significantly "in-the-money") on the date that the call option is issued.[1] According to the Service, the rationale for including call options in the second class of stock analysis is that call options which are significantly "in-the-money" are akin to equity. Specifically, "[t]he Service and Treasury believe that deep-in-the-money options effectively confer rights to corporate equity and should be taken into account for purposes of the one class of stock requirement." Treasury Decision 8419, 57 F.R. 22646 (May 29, 1992).

5. What is the Safe Harbor rule in regards to warrants?

Under the Safe Harbor, a call option is not treated as a second class of stock if, on the date of issuance, the strike price of the call option "is at least 90% of the fair market value of the underlying stock on that date." The Internal Revenue Code and Regulations do not provide much specific guidance on the application of the Safe Harbor. Based on the service's interpretation of the second class of stock rules, we believe that the purpose of the Safe Harbor is to provide a standard as to how "in-the-money" a call option can be without being considered to be an equity instrument. Essentially, the call option can be no more than 10% "in-the-money" under the Safe Harbor.

6. How does the Safe Harbor rule affect the pricing of an option vs. a warrant?

It is fairly straightforward how to apply the Safe Harbor where the call option is in the form of an option to purchase already existing stock. For example, assume an S corporation whose only asset is $1,000,000 worth of gold. Assume that the corporation has 100 shares outstanding all owned by Shareholder, with each share worth $10,000. If Shareholder wants to sell an option to purchase one of his shares, the minimum exercise price of the option would need to be $9,000 (90% of the value of the share that can be purchased with the option) in order to fall under the Safe Harbor. In other words, the share could not be more than 10% "in-the-money."

What is not so straightforward is how the Safe Harbor is applied to warrants. Under the Safe Harbor, the same test is applied to warrants as to options, even though there are significant differences between these two types of securities. *See* Ross, Westerfield and Jaffe,

[1] Under Regulation Section 1.1361-1(l)(4)(iii)(A), the term call options includes call options, warrants and similar instruments.

Corporate Finance (5th Ed., Irwin McGraw-Hill), p. 603-607. The most important difference between a call option and a warrant is that a warrant is issued by the company and therefore each time a warrant is exercised, the number of shares outstanding increases. *Id.* at 603.

Assume in the above example that instead of Shareholder issuing an option, the company desires to issue 900 warrants to purchase additional shares of stock, with a term of 35 years. In order for the warrants to meet the Safe Harbor, it could be argued that the exercise price of each warrant must be at least $9,000 (90% of the value of a share), for a total exercise price of $8,100,000. For the reasons discussed below, we believe that this interpretation of the Safe Harbor is incorrect.

Under the plain language of the Safe Harbor, the exercise price of the warrant must be at least "90 percent of the fair market value of the underlying stock on that date." In our example, the stock underlying each warrant represents 1/1000th of the total outstanding stock. We believe that it is the fair market value of this interest that must be determined in order to apply the Safe Harbor because that is what the "underlying stock" is worth. The $9,000 per share value is not the value of the underlying stock but rather the value of a share before the warrants were issued. This value does not represent the value of the "underlying stock."

However, the more fundamental problem with applying the Safe Harbor by using the value of a share before the warrants are issued is that if this value is used, the permissible percentage by which a warrant may be "in-the-money" will fluctuate depending on how many warrants are issued. As explained in Ross, *Corporate Finance*, the formula for determining the gain from exercise of a warrant is: (value of company plus total exercise price / number of shares plus the number of warrants) minus the total exercise price. *See* Ross, Corporate Finance, at 605-606. As the following chart illustrates, the percentage by which a warrant is "in-the money" will vary from 11% to less than 1% if the number of warrants in the above example is altered:

ASSUMPTIONS:				
FMV of company before warrant exercise	1,000,000	1,000,000	1,000,000	1,000,000
Number of shares before warrant exercise	100	100	100	100
Number of warrants issued	1	900	9,000	10,000
Exercise price per warrant	9,000	9,000	9,000	9,000
CONCLUSIONS:				
FMV of company after warrant exercise	1,009,000	9,100,000	82,000,000	91,000,000
Percentage of company owned by warrant holder	0.990%	90.000%	98.901%	99.010%
FMV of portion of company owned by warrant holder	9,990	8,190,000	81,098,901	90,099,010
Less Exercise price	9,000	8,100,000	81,000,000	90,000,000
Gain from exercise	990	90,000	98,901	99,010
% each warrant is "in-the-money" (gain / total exercise price)	11.001%	1.111%	0.122%	0.110%

We do not see any technical or policy reason why the permissible percentage each warrant may be "in-the-money" should change depending on the total number of warrants issued.

Indeed, as the above table demonstrates, if only one warrant is issued, the Safe Harbor would not be met while if 900 warrants were issued the Safe Harbor would be met.

We believe the more reasonable interpretation of the Safe Harbor is that it permits each warrant to be up to 10% "in-the-money" regardless of how many other warrants are issued. We reach this conclusion based on the fact that when the Safe Harbor is applied to an option to purchase stock, the permissible percentage does not change if more or less options are issued.

7. Who determines what the value of the warrants are?

The Safe Harbor allows the taxpayer to rely upon an independent valuation as to what the underlying stock is worth. *See* Regulations Section. 1.1361-1(l)(4)(iii)(C) (a good faith determination of value is respected unless the determination of value was not performed with reasonable diligence).

8. How do the valuation groups determine the value of the warrants?

The valuation firms that we have worked with generally first determine the enterprise value of the subject company and subtract all debt to determine the value of the company's equity. For illustration purposes, say that Company A initially has 100 shares of voting stock only. The Company then issues 900 shares of non-voting stock, making the total amount of stock outstanding equal to 1,000 shares. The company desires to issue warrants that, if exercised, would constitute 95% of the total shares outstanding. These transactions are summarized in the following chart:

	Voting	Non-Voting	Warrants	Total
Total Shares Outstanding – Before Recap	100	0	0	100
% of Total Shares Outstanding	100.0%	0.0%	0.0%	100.0%
Total Shares Outstanding- After Recap	100	900	0	1,000
% of Total Shares Outstanding	10.0%	90.0%	0.0%	100.0%
Total Shares Outstanding – After Recap & Warrants	100	900	19,000	20,000
% of Total Shares Outstanding	0.5%	4.5%	95.0%	100.0%

Assume that we issue warrants with a term of 35 years and set the exercise price of each warrant at $2,759.65 per share.

The first step of the valuation firm will be to calculate the present value of the warrant proceeds received by the company, assuming the warrants were exercised. The reason the valuation firm assumes the warrant is exercised at the end of the exercise period is that the warrant holder would not want to exercise early and forego the interest or income that could be earned from investing the funds that would be used to exercise. In addition, not exercising the warrants gives the holder leverage. An option or warrant enables the holder to control large amounts of wealth with very small, or no cash outlays. When exercised early, the benefit of leverage is lost. Another consideration is the fact that one of the elements that contribute to the value of an option or a warrant is the time value. The longer the time to expiration the more valuable the instrument. By exercising early, one loses the value of the option or warrant attributable to its time value.

In our example, if we assume a 6% risk free rate and a present value factor of 0.1296, the proceeds from the exercise of the Warrants will have a present value of approximately $6,800,000. The valuation firm will add this amount to the equity value of the company.

Per Share Warrant Exercise Price	$2,759.65
Times: Total number of New Warrant Shares	19,000
Warrant Proceeds ($000's)	$52,433.00
Warrant Proceeds ($000's)	$52,433
Times: Present Value Factor	0.1296
Present Value of Warrant Proceeds ($000's)	$6,794.88
- Rounded	$6,800.00

The value of the company increases to reflect the proceeds from the warrant exercise. However, the incremental increase per share is quite small because of the long-term nature of the warrants and the dilutive effect of the to be issued shares. Discounts for lack, of control, lack of marketability, and for the lack of voting rights are then applied resulting in a non-marketable, lack of control value.

For example, assume that the value of the company (prior to marketability and minority discounts), without taking into account the warrant proceeds is $95 million. The value of a share of nonvoting stock would be determined as follows:

Controlling Interest Value Conclusion for Nonvoting Shares	$95,000,000
PV of Warrant Proceeds	6,800,000
Controlling Interest Value Conclusion	$101,800,000
Less Discounts	(40,700,000)
Non Voting Non-Marketable Minority Interest Value Conclusion	$61,100,000
Value of Nonvoting Common Share based on 20,000 Shares	$3,055

Per the Safe Harbor, we would compare the value of a nonvoting share to the exercise price of the warrants, to make sure the exercise price is at least 90% of the exercise price of a warrant:

Per-Share Warrant Exercise Price	$2,759.65
Divided By: Per-Share Nonvoting Non-Marketable Minority Interest Value Conclusion	$3,055.00
Percent of Warrant Exercise Price to Fair market Value of Underlying Stock	90.3%

The valuation firms' approach appears reasonable because it is specifically following the test specified in the Safe Harbor. That is, the Safe Harbor provides that we should compare the exercise price to the fair market value of the underlying stock. By comparing the exercise price of the warrants to the value of the stock as determined by the valuation firm, we are doing exactly what the regulation mandates.

9. What if the Safe Harbor rule is not met?

Remember also that if the Service were to determine that the Safe Harbor was not met, it does not automatically lead to a conclusion that the warrants are a second class of stock. It must also be shown that the warrants were substantially certain to be exercised and that the fair market value of the warrants was substantially below fair market value. Reg. Sec. 1.1361-1(l)(4)(iii)(A).

Our advice in this document is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the above-stated facts, assumptions and representations. If any of the foregoing facts, assumptions or representations is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. In rendering our advice, we are relying upon the relevant provisions of the Internal Revenue Code of 1986, as amended, [state and local tax statutes,] the regulations thereunder, and the judicial and administrative interpretations thereof. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our conclusions. We will not update our advice for subsequent changes or modifications to the law and regulations or to the judicial and administrative interpretations thereof.

Message0071	
Subject:	Monday Night Call Questions - SC2
From:	Klein, Wendy (NSS-Tax)
Date:	10/30/2000 9:32:16 AM
To:	Rosenthal, Richard P
Message Body	

S-Corporation Charitable Contribution Strategy (SC2) - Larry Manth

Last revisited July 10.

Observations

* Closed 11 engagements for FY00 worth $9.5 million and 11 engagements for FY01 worth $4.7 million, totaling $13.5 million revenue to date
* Average booked deal worth $643K
* About 80% of the revenue is generated from the West ($11.8 million)
* The activity level continues to be very high, however most areas report little activity beyond the proposal stage. In fact MA has never yet closed a deal.
* A lot of effort expended to conduct ICVs and feasibilities but doesn't appear that we are closing sufficient percentage of these deals
*
* Update since July 10th review:
* 9 new booked deals
* 10 new proposals
* 10 new feasibilities
* 38 new face to face meetings
*
* Questions
*
* General

REDACTED

* We continue to be successful with this solution in the West but unable to capitalize on it to the same degree in other areas -- why? What steps have you taken to aggressively move forward in the remaining geographies?

* How have the BDMs been assisting you in migrating this successfully to other areas? Why hasn't it resulted in the desired level of activity?

* What are your revenue goals for FY01? How is the revenue allotted by area?
*
* How successful have you been with the efforts of the Practice Development Coordinators (telemarketers). (PDCs set up 45 phone appointments)
*
* You only have three proposals outstanding that appear to be viable -- $500K), ($300K) and . ($2.7M). What are you doing to advance these efforts? When do you believe that they will close?
* The largest proposal outstanding is (West $7.5M) which is

marked as <50% and dates back to 6/21. What obstacles are you up against? Is there anything we can do to help close? Is it dead?

* There are a lot of old feasibility opportunities (19 of 29 date back to before last revisit) and the same issue is apparent for earlier stages in the sales cycle. Still viable targets? Why this high level of non-closes?

Attachment
SC2 10-27.XLS

Outlook Header Information
Conversation Topic: Jeff Q's - IHCO - Draft Subject: Monday Night Call Questions - SC2 From: Klein, Wendy (NSS-Tax) Sender Name: Klein, Wendy (NSS-Tax) To: Rosenthal, Richard P Delivery Time: 10/30/2000 9:32:16 AM Creation Time: 10/30/2000 9:32:16 AM Modification Time: 10/30/2000 9:32:17 AM Submit Time: 10/30/2000 8:32:16 AM Importance: 101 Priority: 100 Sensitivity: 100 Flags: 1017 Size: 10223825

Message0203	
Subject:	**Potential Deals that may close between January and April**
From:	Huber, Robert
Date:	11/10/2000 10:52:49 AM
To:	Schrier, John V; Speiss, Timothy P; Bogos, Nicholas G; Lipschultz, Brent S; Duty, James V; Silver, Lawrence G; Remo, Dee Ann; Leak, Councill; Reach, Gary; Messing, Steven G; Pichette, Craig L; Cohen, David-CHI; Wise, Richard; Hutchison, Mark-Warner Cntr; Terracina, Michael P; Dorn, Tina M

Message Body

Please forward to all members of your team.

Everyone who is working on selling or have sold SC2 projects that will not close by 12/31(stock transfer), but thinks there is a greater than 50% chance of closing the deal in January through March of 2001 there is the opportunity do some planning in December of 2000. One of the most difficult things about a transaction that closes in the beginning of the year is having the ability to make a large enough distribution to cover future taxes and cash flow needs of the shareholders.

Based on the mechanics of the transaction, most of the shareholders basis or ability to make distributions is lost in the recapitalization of the company. The shareholders are limited in the amount they can distribute to the income earned in the first few months of the year (2001). To prevent this limitation the corporation should make a distribution in December to cover taxes for 2000 as well as the projected cash needs of the shareholder in 2001, 2002 and 2003, assuming a three year strategy.

Please call Andrew Atkin or myself if you have any questions regarding this matter.

Robert E. Huber
kpmg
355 South Grand Avenue
Suite 2000
Los Angeles, CA 90071
(213) 630-5378 (phone)
(213) 630-2279 (fax)
rehuber@kpmg.com

engagement letter.

Outlook Header Information

Conversation Topic: Potential Deals that may close between January and April
Subject: Potential Deals that may close between January and April
From: Huber, Robert
Sender Name: Huber, Robert
To: Schrier, John V; Speiss, Timothy P; Bogos, Nicholas G; Lipschultz, Brent S; Duty, James V; Silver, Lawrence G; Remo, Dee Ann; Leak, Councill; Reach, Gary; Messing, Steven G; Pichette, Craig L; Cohen, David-CHI; Wise, Richard; Hutchison, Mark-Warner Cntr; Terracina, Michael P; Dorn, Tina M
Received By: Terracina, Michael P
Delivery Time: 11/10/2000 10:52:49 AM
Creation Time: 11/10/2000 10:52:46 AM
Modification Time: 11/10/2000 10:58:00 AM
Submit Time: 11/10/2000 10:52:47 AM
Importance: 111
Priority: 110
Sensitivity: 110
Flags: 111
Size: 1110651

Message0184	
Subject:	**SC2 and professional services firms in SW**
From:	Duncan, Douglas P
Date:	11/20/2000 12:24:43 PM
To:	Terracina, Michael P

Message Body

Mike,

One item I did not mention this morning, but I know we discussed it a few times: Any thoughts on professional services firms you would like to pursue regarding SC2 for their respective client bases? Let me know if and how you want to proceed.

Thanks
Doug

P. Douglas Duncan, Jr.
KPMG, LLP
Suite 2000
355 South Grand Avenue
Los Angeles, CA 90071-1568
Phone: (213) 630-5376
Fax: (213) 955-8650
E-Mail: pdduncan@kpmg.com

Outlook Header Information

Conversation Topic: SC2 and professional services firms in SW
Subject: SC2 and professional services firms in SW
From: Duncan, Douglas P
Sender Name: Duncan, Douglas P
To: Terracina, Michael P
Received By: Terracina, Michael P
Delivery Time: 11/20/2000 12:24:43 PM
Creation Time: 11/20/2000 12:24:41 PM
Modification Time: 11/20/2000 12:24:43 PM
Submit Time: 11/20/2000 12:24:42 PM
Importance: 111
Priority: 110
Sensitivity: 110
Flags: 113
Size: 112204

Permanent Subcommittee on Investigations
EXHIBIT #96u

Message7738	
Subject:	**RE: SC2 - Follow-up to 1/29 Revisit**
From:	Klein, Wendy (NSS-Tax)
Date:	1/31/2001 5:32:23 PM
To:	Jones, David P (NY)

Message Body

thanks for following up on this. Sorry I couldn't help ... but vacation calls. Actually I am en route to Chicago now for a meeting tonight and tomorrow in the middle of the vacation. But after that hopefully the weekend will be clear. We will regroup on Monday, Feb 5. The deployment model will come to you some time this weekend. Thanks again.

-----Original Message-----
From: Jones, David P (NY)
Sent: Tuesday, January 30, 2001 12:22 PM
To: Manth, Larry E
Cc: Rosenthal, Richard P; Klein, Wendy (NSS-Tax)
Subject: SC2 - Follow-up to 1/29 Revisit

Larry:

To memorialize our discussion, we agreed the following:

* Over the next two weeks Manth will deploy Andrew Atkin to call each of the SC2 area solution champions.
* Andrew will work with the champion to establish a specific action plan for each opportunity. To be at all effective, the plans should very specific as to who is going to do what when.
* Getting the accurate solution status in OMS should be on the radar as an action step.
* There should be agreement as to when Andrew will next follow-up with them to create a real sense of urgency and accountability.
* Andrew will involve Manth where he is not getting a response within 24 hours or receiving inappropriate "pushback". Manth will enlist Jones or Rick to help facilitate responsiveness where necessary given the urgency of the opportunity.

* Resource will be assigned to adequately address the market opportunity in the Midwest.
* Manth believes inadequate resources are currently deployed to exploit the Midwest SCorp client and target population. Craig Pichette has not yet been able to dedicate enough time to this solution to effectively penetrate the client base (or target population).
* Manth believes John Schrier (NE Stratecon) or Councill Leak (SE Stratecon) could be effective at penetrating the MW marketplace. John has had prior success in the MW and may be a better solution logistically. Councill is buried.
* Jones will confirm Shrier's availability to focus on the MW marketplace. Shrier's goals must be adjusted with his performace manager and included in Dialogue including a percentage weighting based on expected time commitment.
* Jones will discuss with Rick and seek to agree a plan to overcome any area boundary type issues (e.g., MW v. NE).

Proprietary Material
Confidentiality Requested

* Resource will be assigned to adequately address the market opportunity in Florida.
* There are a significant number of SCorps in Florida. Councill is busy chasing live situations and cannot adequately address the Florida market opportunity.
* Manth will discuss situation with Atlee Harmon on Wednesday, 1/31. Manth will outline the specific criteria and time commitment of the person necessary for him/her to be effective. Could be partner or senior manager. Goals must be explicit and included in Dialogue including a percentage weighting based on expected time commitment.
* Manth will execute and/or discuss with Jones if further options must be considered.

KPMG 0048915

Permanent Subcommittee on Investigations
EXHIBIT #96v

Manth will explore with Rick the opportunity to form alliances with other accounting firms to drive distribution. Conference on this topic is scheduled for today.

Dave

David P. Jones

(212) 872-3255
(212) 872-6275 (Assistant - Carmen Calderon)
dpjones@KPMG.com

KPMG
36th Floor, 345 Park Avenue
New York, NY 10154

Outlook Header Information
Conversation Topic: SC2 - Follow-up to 1/29 Revisit Subject: RE: SC2 - Follow-up to 1/29 Revisit From: Klein, Wendy (NSS-Tax) Sender Name: Klein, Wendy (NSS-Tax) To: Jones, David P (NY) Delivery Time: 1/31/2001 5:32:23 PM Creation Time: 1/31/2001 5:32:22 PM Modification Time: 1/31/2001 5:32:23 PM Submit Time: 1/31/2001 5:32:23 PM Importance: 1/1 Priority: 1/0 Sensitivity: 1/0 Flags: 1/1 Size: 1/7486

Message0571	
Subject:	**FW: Mini-Lab to Discuss Enhancements to SC2**
From:	Springer, Mark A
Date:	2/6/2001 5:14:00 PM
To:	Brockway, David H; Smith, Richard H (WNT)

Message Body

FYI -- Individuals below meet today to explore enhancements to SC2...Rosenthal is very interested in "us" pushing this forward...wanted you to know given his previous comments on development process for original SC2. Will keep you informed.

Mark
-----Original Message-----
From: Galbreath, Phillip L
Sent: Tuesday, February 06, 2001 4:19 PM
To: Manth, Larry E; Speizman, Richard A; Kelliher, William B; Atkin, Andrew S; Moore, V
Cc: Springer, Mark A
Subject: RE: Mini-Lab to Discuss Enhancements to SC2

Thanks to all of you for attending today's meeting and making it so productive. Here's the list of action items as I have them. Please feel free to edit or add to them and share with the group. Also, please let me know if you need my assistance with anything.

With respect to strategy 1:
Rick and V will resolve open Section 170 issues and provide feedback to Larry and Andrew ASAP so that they can approach target client in Atlanta.
Larry and Andrew will have a conference call with Larry DeLap to discuss marketing strategy to donee entitles and possible fee structures.
Bill will research quid pro quo contribution issues and provide feedback to Larry and Andrew.

With respect to strategy 2:
Bill will put together a "wish list" of facts that will make him will feel more comfortable with the strategy.
Rick and V will look at whether the capital loss potentially trapped in the donee entity can be used to someone's benefit.

With respect to the enhanced solution:
Andrew will work with Mark and me to get the TSA revised to reflect the enhancements.
Andrew and Larry will work with Mark and me to determine the best way to inform the tax practice of the enhancements.

-----Original Appointment-----
From: Galbreath, Phillip L
Sent: Monday, January 29, 2001 11:04 AM
To: Galbreath, Phillip L; Springer, Mark A; Manth, Larry E; Speizman, Richard A; Kelliher, William B; Atkin, Andrew S; Stern, Bruce L
Cc: Moore, V
Subject: Mini-Lab to Discuss Enhancements to SC2
When: Tuesday, February 06, 2001 9:00 AM-2:00 PM (GMT-05:00) Eastern Time (US & Canada).

Permanent Subcommittee on Investigations
EXHIBIT #96w

Where: Conference Room 5043 - Washington National Tax

As a follow up to last Friday's conference call to discuss tonight's revisit of SC2, we are hosting a mini-lab meeting next Tuesday (Feb 6) to discuss and resolve issues regarding the technical aspects of enhancing SC2 by developing variations so that we may introduce SC2 to a new group of targets. The meeting will take place in the Washington National Tax office. Please let me know as soon as possible whether you will be able to attend. Also, please let me know whether there are others who should attend. If there are materials you would like for others to review prior to the meeting, please send those materials to me and I will distribute them to the group. Thanks.

Outlook Header Information
Conversation Topic: Mini-Lab to Discuss Enhancements to SC2 Subject: FW: Mini-Lab to Discuss Enhancements to SC2 From: Springer, Mark A Sender Name: Springer, Mark A To: Brockway, David H; Smith, Richard H (WNT) Received By: Brockway, David H Delivery Time: 2/6/2001 5:14:00 PM Creation Time: 2/6/2001 5:12:46 PM Modification Time: 2/6/2001 5:14:00 PM Submit Time: 2/6/2001 5:14:00 PM Importance: 2/1 Priority: 2/0 Sensitivity: 2/0 Flags: 2/2 Size: 2/4130

Message0384	
Subject:	**RE: SC2 Solution--New Development**
From:	Warley, Carol G
Date:	3/5/2001 1:53:57 PM
To:	Terracina, Michael P

Message Body

Mike, I think we still need to discuss this.

-----Original Message-----
From: Warley, Carol G
Sent: Wednesday, February 28, 2001 1:50 PM
To: Terracina, Michael P
Subject: FW: SC2 Solution--New Development

Lets send this out. Do you think we should sent to the entire mgt group in the SW area?

-----Original Message-----
From: Atkin, Andrew S
Sent: Friday, February 23, 2001 12:54 PM
To: Atkin, Andrew S; Atlas, Rozeta; Bogos, Nicholas G; Brody, Evan J; Choate, Gary M; Cohen, David (US/CHICAGO); Duncan, Douglas P; Duty, James V; Engel, Greg A; Gaston, Jon; Googins, Linda; Gray, Mike - RALEIGH; Huber, Robert; Hutchison, Mark-Warner Cntr; Jackman, Thomas E; Johnston, Michael L; Jordan, Ty N; Leak, Councill; Lipschultz, Brent S; McDonald, Warren K; Messing, Steven G; Peterson, Kurt; Pichette, Craig L; Reach, Gary; Schrier, John V; Silver, Lawrence G; Speiss, Timothy P; Terracina, Michael P; Warley, Carol G; Wise, Richard
Subject: FW: SC2 Solution--New Development

To all:

Please see below an email that Councill Leak sent around the SE regarding our new twist on SC2. If you deem it appropriate, please feel free to distribute this among your respective regions to get the word out.

Thanks

Andrew Atkin

-----Original Message-----
From: Manth, Larry E
Sent: Friday, February 23, 2001 6:01 AM
To: Leak, Councill
Cc: Atkin, Andrew S

Subject: RE: SC2 Solution--New Development

Great e-mail, Councill!! Andrew, you may consider sending this to other regions.

Thanks,

Larry

-----Original Message-----
From: Leak, Councill
Sent: Thursday, February 22, 2001 1:52 PM
To: Avent, Thomas W; Bornstein, Howard R; Branan, Carolyn B; Brawley, David F; Butler, Charles P; Cates, Bernard V; Chomiak, Leon W; Currie Jr, Arthur D; Dunn II, Wallace; Eischeid, Jeffrey A; Elker, Stephen P; Engel, James C; Fouts, Patricia A; Fowler, Jamie B; Gerrits, Dianne; Gillis, Timothy H; Giroux, Peter J; Glenn, Neil; Harmon, Atlee O; Heinz, James A; Henderson, Tracie K; Huber II, Frank E; Igarashi, Mie; Johnson, Peder R; Kay, Sheldon-ATLANTA M; Kelly, Timothy M; Leak, Councill; Leone, Steven P; Lopez, Rolando; Lusk, Gary; Mcgarr, Samuel H; Mcintosh, Betty W; Mcleighton, Steven W; Medford, Mark A; Messing, Steven G; Miller, David-TAMPA; Pace, Katherine A; Propst, Tamara C; Rich Jr, Donald E; Ritchie, Lewis R; Sanabria, Edgardo; Saron, Carole B; Satalino, Frank P; Sheridan-moore, Catherine M; Suarez, Oscar J; Tuley, Patrick A; Turner, G.Chris; Weil, Jerry M; Weld, Gary E; Williams, Patrick A; Zukowski, Philip M; Anderson, Mark E; Corrigan Jr, J Eustis; Smith, Gregory L; Ellis, William E; Horan, James L; Larsen, Cheryl A (US\Charlotte); Jones, James R; Lawter, Robert
Cc: Colley, Peter M; Smith, Jerry N; Gray, Mike - RALEIGH; Manth, Larry E; Atkin, Andrew S; Parker, Paul C
Subject: SC2 Solution--New Development
Importance: High

Quick Snapshot--We are now offering a modified SC2 solution. S Corp shareholders can use the structure to direct significant gifts to 501(c)(3) tax exempts of their choice. Net tax benefit is less than original SC2...shareholder "feel good" factor is higher. We need targets and ICV's.

More Detail Than You Really Want:

SC2 is designed to allow an S Corp shareholder to obtain a charitable deduction for a gift of non-voting stock to a qualified tax exempt entity. After the gift, the tax exempt will be allocated a significant portion of the S Corp taxable income. The S Corp will curtail cash distributions that would otherwise have been made to fund quarterly tax obligations. The cash will build up inside the S Corp and can be used for any corporate purpose. After two or three years, the tax exempt has the right to "put" the stock back to the S Corp for redemption. After redeeming the shares, the S Corp can resume making cash distributions. The end result is a deferral of income tax and the ultimate conversion from ordinary to capital gain tax rates on S Corp income.

Those of you who have gone on SC2 ICV's with Mike Gray or me know that one of the difficult issues to overcome in closing an SC2 transaction is finding a tax exempt entity that can absorb S Corporation income without incurring any unrelated business income tax (UBIT). Typically these are 501(c)(3) entities with UBIT net operating losses or other tax exempt entities that are not subject to UBIT at all. Currently we have five or six tax exempts that have reviewed the transaction, are comfortable they are not subject to UBIT and are eager to receive gifts of S Corp stock. These organizations are well established, solid organizations, but generally aren't organizations our clients and targets have made gifts to in the past. This point hit painfully home when, just before signing our engagement letter for an SC2 transaction with a $3 million fee, an Atlanta target got cold feet.

New SC2 Solution Development:

As a result of the Atlanta target experience, I asked WNT and the SC2 solution developers from the West to expedite the technical review of a modified SC2 structure. The modification was approved for Beta Test use by WNT last week. The modification will allow S Corp shareholders to make a gift of non-voting stock that will ultimately benefit a 501(c)(3) entity of the shareholder's choosing (i.e. church, synagogue, university, etc...). We have discussed the modified structure with the Atlanta target and have received very positive reaction. They have committed to a full shareholder meeting in mid-March and we are confident they are going to move forward. The trade-off for having the ability to direct the gift to any 501(c)(3) entity is that some level of UBIT will likely be incurred. The shareholder must therefore make additional cash contributions to make the tax exempt whole. We have created an economic model for the modified structure. As a general rule, the modified SC2 benefit will be between 55% and 65% of the benefit expected in the original SC2 structure.

Why Should You Care?:

In the last 12 months the original SC2 structure has produced $1.25 million in signed engagements for the SE. Three or four large SC2 transactions failed to move to implementation due in large part, I think, to the shareholders being nervous about gifting stock to a tax exempt they aren't familiar with. Some of you probably knew of S Corps in your area that you were reluctant to contact due to this fact. The 501(c)(3) modification opens up the door to get back in front of these targets with a solid solution that produces a compelling tax benefit, while at the same time fulfilling a shareholder's personal charitable objectives. Because the benefit is a bit smaller, we need to target S Corps with at least $5 million of annual taxable income for the modified solution. Pricing is set at 75% of the original SC2 price, with a minimum fee of $500,000. The original solution still works (we just finished our second SE implementation on 2/1/01). The modified solution just gives us something that may appeal to some of the more conservative SE targets we are pursuing.

Look at the last partner scorecard. Unlike golf, a low number is not a good thing... A lot of us need to put more revenue on the board before June 30. SC2 can do it for you. Think about targets in your area and call me.

Councill

J. Councill Leak
Partner, Federal Tax Services/Stratecon Practice
kpmg LLP, Charlotte, NC
Direct: 704.371.8135
Fax: 704.335.5377
Cell: 704.906.4520
e-mail: cleak@KPMG.com

Outlook Header Information

Conversation Topic: SC2 Solution--New Development
Subject: RE: SC2 Solution--New Development
From: Warley, Carol G
Sender Name: Warley, Carol G
To: Terracina, Michael P
Received By: Terracina, Michael P
Delivery Time: 3/5/2001 1:53:57 PM
Creation Time: 3/5/2001 1:53:56 PM
Modification Time: 3/5/2001 1:53:57 PM
Submit Time: 3/5/2001 1:53:57 PM
Importance: 3/1
Priority: 3/0
Sensitivity: 3/0
Flags: 3/1
Size: 3/14327

Message 0002

Subject:	**FW: SC2 - Client Base Expansion**
From:	DeLap, Larry
Date:	3/16/2001 5:04:30 PM
To:	Manth, Larry E
CC:	Kelliher, William B; Smith, Richard H (WNT)

Message Body

Larry -

Before committing to an expansion of the client base for SC2 to auto dealers contacted through a referral fee arrangement and to community trusts, I think we should have a discussion with Bill Kelliher and Richard Smith as to whether it would be advisable to put an overall limit on the number of engagements given the downside risks if the strategy were ultimately disallowed.

Larry

-----Original Message-----
From: Choate, Gary M
Sent: Friday, March 09, 2001 2:54 PM
To: DeLap, Larry; Duer, Walter M
Cc: Manth, Larry E; Atkin, Andrew S; Kirkpatrick, Richard D; Mckee, James F
Subject: Alliance Agreement -

REDACTED

Attached is the first draft of an alliance agreement with I have requested info on their current audit firm and financials. I will send this info when I have it. If you have any questions, please let me know.

Gary

Attachment

alliance approval form1.doc

Forwarded Message

Subject:	SC2
From:	Kelliher, William B
Date:	3/30/2000 3:45:23 PM
To:	DeLap, Larry; Manth, Larry E; Atkin, Andrew S; Duncan,

	Douglas P; Huber, Robert
CC:	Smith, Richard H (WNT); Springer, Mark A; Galbreath, Phillip L; Watson, Mark T; Bailine, Richard W; Cvach, Gary Q; Speizman, Richard A; Manfreda, Richard H

Message Body

Larry, et al.:

Per Larry DeLap's phone conversation earlier today with Richard Smith and me, this is to advise you that, as the WNT partner responsible for coordinating the technical review and approval of SC2, I have "signed off" on it. Based on the collective views of the various WNT partners who have reviewed specific portions of the SC2 strategy, as described in the most recent version of the white paper (dated March 28, 2000), and on my review of the overall strategy, I believe that KPMG can issue a "more likely than not" opinion on the strategy as a whole and on each of the specific issues addressed in the white paper --- provided that the actual facts are consistent with the facts in the white paper. I also believe that KPMG can issue a "should" level of opinion that the strategy will not result in a termination of a participating corporation's S election. Any potential material deviation of facts from those in the white paper should be discussed with me first, because it could adversely affect our ability to issue an opinion.

Gary Cvach raised two technical points, with which I concur, in a separate message this afternoon. While these points should be addressed, they do not affect the issuance of the opinions mentioned above. Also, Richard Smith and I believe that the taxpayer's position would be strengthened if the S corp were to pay a dividend each year, rather that paying no dividends. Failing to pay dividends would not adversely affect our ability to issue a "more likely than not" opinion on the strategy; nor would the payment of dividends enable us to issue a higher level of opinion. However, we think payment of dividends would reduce the taxpayer's level of risk by making it more difficult for the IRS to successfully argue that the taxpayer has retained beneficial ownership of the stock contributed to the exempt pension fund. We think it would also bolster the taxpayer's "economic substance" argument. Although the payment of any dividends to the exempt pension fund would be an additional cost to the taxpayer, that cost would provide a corresponding benefit in the event of an examination challenge.

If a dividend were to be paid it should be more than a de minimis amount (for example, $100,000 each year under the hypothetical facts in the whitepaper, 90% of which would go to the exempt pension fund). At the very least, we believe that prospective clients should be advised that paying a dividend would result in a stronger position in the event of examination, while failing to pay a dividend could weaken the taxpayer's position on examination.

Bill Kelliher
KPMG/ Washington National Tax
(202) 467-3885

Outlook Header Information

Conversation Topic: SC2
Subject: SC2
From: Kelliher, William B
Sender Name: Kelliher, William B
To: DeLap, Larry; Manth, Larry E; Atkin, Andrew S; Duncan, Douglas P; Huber, Robert
CC: Smith, Richard H (WNT); Springer, Mark A; Galbreath, Phillip L; Watson, Mark T; Bailine, Richard W; Cvach, Gary Q; Speizman, Richard A; Manfreda, Richard H
Received By: DeLap, Larry
Delivery Time: 3/30/2000 3:45:23 PM
Creation Time: 3/16/2001 4:57:26 PM
Modification Time: 3/16/2001 4:57:26 PM
Submit Time: 3/30/2000 3:45:22 PM
Importance: 3/1
Priority: 3/0
Sensitivity: 3/0
Flags: 3/1
Size: 3/10649

Message0005	
Subject:	RE: Stratecon Solutions (SC2, etc.)
From:	Pence, Robert M
Date:	3/17/2001 1:53:47 PM
To:	Byrnes, Dennis M; Schierman, Laurie A; Schrier, John V
CC:	Mollerus, Michael R; Richmond, Ronald D; Craig, Debra S; Brooks, Patrick A

Message Body

In preparation for the SC2 call, I have attached two lists. The first is the SC2 activity in OMS for Missouri. The second is a download of companies that file a Texas franchise tax return that the firm has obtained that can be used to help generate leads. The companies on the Texas list may not all be S Corps.

Regards,

Bob Pence
KPMG Cleveland
Direct: (216)875-8375
Fax: (216)696-7792
email: rpence@kpmg.com

-----Original Message-----
From: Byrnes, Dennis M
Sent: Friday, March 16, 2001 1:39 PM
To: Schierman, Laurie A; Pence, Robert M; Schrier, John V
Cc: Mollerus, Michael R; Richmond, Ronald D; Craig, Debra S
Subject: RE: Stratecon Solutions (SC2, etc.)

Let do it on Tuesday, March 27th at 10:00 am ET / 9:00 am CT. I will have Debbie Craig set-up a conference call number for everyone.

Dennis M. Byrnes, Tax Partner
KPMG, LLP
St. Louis, MO 63102
(314) 444-6770
(314) 444-1435 (fax)
dbyrnes@kpmg.com (e-mail)

The information and advice included in this e-mail (including attachments) is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the stated facts, assumptions and/or representations included. In rendering our service, we may consider tax authorities that are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our advice. We will not update our advice for subsequent changes or modifications to the law and regulations, or to the judicial and administrative interpretations thereof.

-----Original Message-----
From: Schierman, Laurie A
Sent: Friday, March 16, 2001 11:03 AM
To: Byrnes, Dennis M
Subject: FW: Stratecon Solutions (SC2, etc.)

Hi Dennis,

John is available in the a.m. on all these days - 9am and 10am would be best for him because he might have to travel to Spain.

Thank you,

Laurie A. Schierman
Stratecon
Administrative Assistant
P: 212-872-4454
F: 212-954-2750
E: lschierman@kpmg.com

-----Original Message-----
From: Schrier, John V
Sent: Thursday, March 15, 2001 3:35 PM
To: Schierman, Laurie A
Subject: FW: Stratecon Solutions (SC2, etc.)

Could you please help coordinate?

-----Original Message-----
From: Byrnes, Dennis M
Sent: Thursday, March 15, 2001 2:56 PM
To: Schrier, John V; Pence, Robert M
Cc: Brasher, James J (US/Chicago AMP); Eichhorn, John O; Richmond, Ronald D; Mollerus, Michael R
Subject: RE: Stratecon Solutions (SC2, etc.)

John & Bob,

Due to other commitments, we will need to schedule a conference call for the last week in March. Let us know what time works for the two of you on Tuesday through Thursday, March 27 - 29. We will include myself, Ron Richmond and Mike Mollerus. Send us whatever information will be needed in advance so that we can be prepared for the conference call.

Dennis M. Byrnes, Tax Partner
KPMG, LLP
St. Louis, MO 63102
(314) 444-6770
(314) 444-1435 (fax)
dbyrnes@kpmg.com (e-mail)

The information and advice included in this e-mail (including attachments) is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the stated facts, assumptions and/or representations included. In rendering our service, we may consider tax authorities that are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our advice. We will not update our advice for subsequent changes or modifications to the law and regulations, or to the judicial and administrative interpretations thereof.

Proprietary Material
Confidentiality Requested

-----Original Message-----
From: Schrier, John V
Sent: Thursday, March 15, 2001 1:48 PM
To: Eichhorn, John O
Cc: Byrnes, Dennis M; Brasher, James J (US/Chicago AMP)

KPMG 0049228

Subject: RE: Stratecon Solutions (SC2, etc.)

I will pull such information together.

Dennis, can you give me a hand in coordinating something along the lines suggested in my message to John?

-----Original Message-----
From: Rose, Rebecca J On Behalf Of Eichhorn, John O
Sent: Thursday, March 15, 2001 2:27 PM
To: Schrier, John V
Cc: Byrnes, Dennis M; Brasher, James J (US/Chicago AMP)
Subject: RE: Stratecon Solutions (SC2, etc.)

Dennis Byrnes is in charge of this initiative in St. Louis. Please coordinate with him. John, it would be helpful if you could relay to us some of your successes in New York City, the types of companies, the charities used and other pertinent information about where this has been successful so that we can replicate. Thank you for your assistance.

John

-----Original Message-----
From: Schrier, John V
Sent: Thursday, March 15, 2001 1:00 PM
To: Eichhorn, John O
Subject: Stratecon Solutions (SC2, etc.)

John,

Larry Manth, National Product Champion of SC2, and Jim Brasher have asked that I pitch in to assist in marketing SC2 in the Midwest. I was born and raised in St. Louis, so it seems like a logical place for me to start. I was wondering whether it would be helpful to pull together some of the tax partners, directors and senior managers or managers in the St. Louis office for a discussion of SC2 and a targetting exercise. If you'd like, I can also help to expound upon some other Stratecon ideas in deployment or in beta that may be of interest to clients of the St. Louis office, particularly those relating to Structured Finance/Yield Enhancement Services.

I have discussed SC2 with some of my tax friends at Bryan, Cave, and that firm has expressed a willingness to help clients implement the transaction and provide a companion opinion, if desired. They indicated that they may have some clients who are interested in the idea as well.

I have scheduled a tentative meeting in St. Louis for 3/22 or 3/23 (subject to one transaction that may unexpectedly require attention), and would enjoy the opportunity to meet you and some of the other tax professionals in your office. I would also be interested in seeing if there may be a meeting or two with potential candidates (S corporations, $5MM or more of net income/year, 6 or fewer owners) that we might approach relatively soon.

Thanks,

John

Attachment
Missouri OMS.xls

Attachment
Missouri.xls

Proprietary Material
Confidentiality Requested

KPMG 0049229

Outlook Header Information
Conversation Topic: Stratecon Solutions (SC2, etc.) Subject: RE: Stratecon Solutions (SC2, etc.) From: Pence, Robert M Sender Name: Pence, Robert M To: Byrnes, Dennis M; Schierman, Laurie A; Schrier, John V CC: Mollerus, Michael R; Richmond, Ronald D; Craig, Debra S; Brooks, Patrick A Received By: Schrier, John V Delivery Time: 3/17/2001 1:53:47 PM Creation Time: 3/17/2001 1:53:19 PM Modification Time: 3/19/2001 9:09:41 AM Submit Time: 3/17/2001 1:53:35 PM Importance: 3/1 Priority: 3/0 Sensitivity: 3/0 Flags: 3/17 Size: 3/97069

Message0001	
Subject:	**RE: SC2 target list**
From:	Auerbach, Barry S
Date:	4/23/2001 8:33:40 AM
To:	Schrier, John V; Crawford, Thomas W
CC:	Manth, Larry E; Atkin, Andrew S; Stile, Richard
Message Body	

John,

We have an S Corp client, . you might want to explore with Russell Cammeyer.

KPMG LLP
Barry S. Auerbach, Partner

REDACTED

-----Original Message-----
From: Schrier, John V
Sent: Sunday, April 22, 2001 10:29 PM
To: Crawford, Thomas W
Cc: Manth, Larry E; Atkin, Andrew S; Stile, Richard; Auerbach, Barry S
Subject: RE: SC2 target list

1. I do not know how to ascertain whether we have effectively exhausted all of our contacts. Activities to date have involved getting the word out, and fully mining the lists described in (2), below.
2. This is a new list, that was obtained only shortly before the new no-cold-call rule was adopted. We have not previously reviewed it. To date, the lists we've worked through to my knowledge have been the following (a) tax returns we handle, (b) a list devolved by our marketing department based upon certain criteria they selected, and (b) a list of NY S corporations that have filed Texas franchise tax returns.
3. I have not yet run a comparison between this and the other S corporation lists we've had, but on an eyeball basis I do not believe there are many material overlaps.
4. I think there are over 300 Tri-State real-estate related companies on the list; we have not yet determined precisely how many are S corporations and therefore haven't determined how many would make good candidates.
5. Although few if any of these companies likely are clients (we'll have to check), I am hopeful that we will find many instances in which people within our NE practice (in the Tri-State area in particular) will recognize a name/relationship they had not heretofore considered a potential candidate. It may also be possible to identify instances in which we do not directly have relationships with the owners of one or more particular company, but a professional has relationships with a person outside KPMG who does have relationships with many of these companies. I note in this connection that all of these companies are tied together in at least two respects: real-estate related services, and involvement with Israel Bonds. Where we have clients involved with real estate activities, it seems logical to expect that we have run across these companies in connection with their providing services to our clients.

-----Original Message-----
From: Crawford, Thomas W
Sent: Sunday, April 22, 2001 8:35 PM
To: Schrier, John V
Cc: Manth, Larry E; Atkin, Andrew S; Stile, Richard; Auerbach, Barry S
Subject: RE: SC2 target list

didn't we already go to (or call) all clients and companies we have contacts? Didn't we previously review this list and use it to call additional potential targets this fall? IS this a new list? or how many new cos are here?

-----Original Message-----

Permanent Subcommittee on Investigations
EXHIBIT #96aa

From: Schrier, John V
Sent: Friday, April 20, 2001 5:36 PM
To: Auerbach, Barry S; Crawford, Thomas W
Cc: Manth, Larry E; Atkin, Andrew S; Stile, Richard
Subject: RE: SC2 target list

Barry and Tom,

We've been able to pull together a list (attached) of what we expect represent a good number of S corporations that we think may have income and shareholder information making them good candidates for the SC2 solution. Tom, I think you've actually seen this list. The list is of real estate-related companies that participate in Israel Bonds activities, such as contractors, architects, suppliers and the like (including, for example, Redacted by Permanent Subcommittee on Investigations which we've already called). We are trying to find a way to identify warm leads into these companies, perhaps through introductions provided by companies with which we already have good relationships or client relationships, since cold calls are no longer permitted for this structure.

I would appreciate your thoughts as to how best to tackle this opportunity.

Thanks,

John
<< File: 3595.XLS >>

-----Original Message-----
From: Atkin, Andrew S
Sent: Friday, April 20, 2001 5:29 PM
To: Schrier, John V; Stile, Richard
Cc: Manth, Larry E
Subject: RE: SC2 target list

John:

Sorry about that. I thought it was from Richard.

I still am not sure who to send it to though.

Andrew

-----Original Message-----
From: Schrier, John V
Sent: Friday, April 20, 2001 2:28 PM
To: Atkin, Andrew S; Stile, Richard
Cc: Manth, Larry E
Subject: RE: SC2 target list

Not a bad idea, as it is my list. Note that very few are architects; all are in the real estate industry. The key is to try to identify relationships that our professionals may have with these firms, or relationship with people who have relationships with these companies.

-----Original Message-----
From: Atkin, Andrew S
Sent: Friday, April 20, 2001 5:26 PM
To: Stile, Richard
Cc: Schrier, John V; Manth, Larry E
Subject: SC2 target list

Richard:

Thanks for sending me the list of architects in the NE. Unfortunately, the firm has recently decided not to continue our cold calls for SC2 and to only use warm relationships to market the solution. I am not sure who to send the list to around the NE to see if anyone has relationships. I would suggest working with John Schrier on this issue.

Thanks

Andrew S. Atkin
KPMG
355 South Grand Avenue
Suite 2000
Los Angeles, CA 90071
(213) 955-8830
Fax (213) 630 2279
aatkin@kpmg.com

Outlook Header Information
Conversation Topic: SC2 target list Subject: RE: SC2 target list From: Auerbach, Barry S Sender Name: Auerbach, Barry S To: Schrier, John V; Crawford, Thomas W CC: Manth, Larry E; Atkin, Andrew S; Stile, Richard Received By: Schrier, John V Delivery Time: 4/23/2001 8:33:40 AM Creation Time: 4/23/2001 8:33:39 AM Modification Time: 4/23/2001 8:47:32 AM Submit Time: 4/23/2001 8:33:39 AM Importance: 4/1 Priority: 4/0 Sensitivity: 4/0 Flags: 4/1 Size: 4/13451

Message0045	
Subject:	SC2
From:	Atkin, Andrew S
Date:	4/30/2001 5:34:21 PM
To:	Atkin, Andrew S; Atlas, Rozeta; Bogos, Nicholas G; Brody, Evan J; Brooks, Patrick A; Choate, Gary M; Cohen, David (US/CHICAGO); Corbett, Donald A; Duncan, Douglas P; Duty, James V; Engel, Greg A; Gaston, Jon; Googins, Linda; Gray, Mike - RALEIGH; Huber, Robert; Hutchison, Mark-Warner Cntr; Jackman, Thomas E; Johnston, Michael L; Jordan, Ty N; Leak, Councill; Lipschultz, Brent S; McDonald, Warren K; Messing, Steven G; Peterson, Kurt; Pichette, Craig L; Reach, Gary; Schrier, John V; Silver, Lawrence G; Speiss, Timothy P; Terracina, Michael P; Warley, Carol G; Wise, Richard
CC:	Duer, Walter M; Jones, David P (NY); Lyle, Hunter; Rosenthal, Richard P; Songey, Jim H

Message Body

To all:

Per our last conference call on Fri, please note the following changes with respect to SC2:

1. Effectively immediately, there should be no more cold calling. We need to have at least some relationship with the company or shareholders. The relationship can be lukewarm, but there needs to be something.

2. The $500,000 minimum fee will be strictly enforced.

3. Any grand fathered deals (i.e. below $500k and in the sales cycle other than Pre-ICV) must be closed by June 30, 2001.

4. Any potential alliances must first go to Larry Manth for evaluation prior to taking to Larry Delap.

These should be viewed as position changes that will help protect the clients that have already done the transaction, help maximize the fee potential to KPMG and reduce risks to the firm. If you have any questions, feel free to give me a call.

Andrew

Andrew S. Atkin
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Los Angeles, CA 90071
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Fax (213) 630 2279
aatkin@kpmg.com

Our advice in this email and any attached documents is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the above-stated facts, assumptions and representations. If any of the foregoing facts, assumptions or representations is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. In rendering our advice, we are relying upon the relevant provisions of the Internal Revenue Code of 1986, as amended, the regulations thereunder, and the judicial and administrative interpretations thereof. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our conclusions. We will not update our advice for subsequent changes or modifications to the law and regulations or to the judicial and administrative interpretations thereof.

Proprietary Material
Confidentiality Requested

KPMG 0050816

Permanent Subcommittee on Investigations
EXHIBIT #96bb

Outlook Header Information
Conversation Topic: SC2 Subject: SC2 From: Atkin, Andrew S Sender Name: Atkin, Andrew S To: Atkin, Andrew S; Atlas, Rozeta; Bogos, Nicholas G; Brody, Evan J; Brooks, Patrick A; Choate, Gary M; Cohen, David (US/CHICAGO); Corbett, Donald A; Duncan, Douglas P; Duty, James V; Engel, Greg A; Gaston, Jon; Googins, Linda; Gray, Mike - RALEIGH; Huber, Robert; Hutchison, Mark-Warner Cntr; Jackman, Thomas E; Johnston, Michael L; Jordan, Ty N; Leak, Councill; Lipschultz, Brent S; McDonald, Warren K; Messing, Steven G; Peterson, Kurt; Pichette, Craig L; Reach, Gary; Schrier, John V; Silver, Lawrence G; Speiss, Timothy P; Terracina, Michael P; Warley, Carol G; Wise, Richard CC: Duer, Walter M; Jones, David P (NY); Lyle, Hunter; Rosenthal, Richard P; Songey, Jim H Received By: Leak, Councill Delivery Time: 4/30/2001 5:34:21 PM Creation Time: 4/30/2001 5:33:57 PM Modification Time: 5/1/2001 2:34:31 PM Submit Time: 4/30/2001 5:34:15 PM Importance: 4/1 Priority: 4/0 Sensitivity: 4/0 Flags: 4/1 Size: 4/16026

Message0450	
Subject:	RE:
From:	Atkin, Andrew S
Date:	7/13/2001 4:25:31 PM
To:	Campbell, Matthew S
CC:	Terracina, Michael P

Message Body

Matt:

I think there has been some confusion here because this alternative version of SC2 will only work with community foundations, not universities. In order for the strategy to work, the gift of stock needs to be made to a community foundation. In turn, the community foundation could potentially gift some or all of the redemption proceeds to a university. Without the communtiy foundation though, there is no tax savings achieved.

I will be in the office on Mon if you want to give me a call to discuss

Thanks

Andrew

-----Original Message-----
From: Campbell, Matthew S
Sent: Friday, July 13, 2001 3:22 PM
To: Atkin, Andrew S
Cc: Terracina, Michael P
Subject: RE:

Andrew:

Actually, the client or potential clients I have in mind are alumni of my alma mater
college.
I am on my college's national alumni board and at our last national alumni board
meeting
in April, I mentioned to various people at the college that I have worked on a
charitable
contribution planning idea that could benefit the institution. Basically, I discussed
the idea
as a pure charitable contribution and did not get into any specifics because I wanted
the
administration to get interested in it enough that a meeting could be set in the future.
The President of the college, and the director of alumni affairs were interested in
hearing

anything that could be beneficial to the school and I got the impression that they
have
been involved in some complex gift-giving transactions. The college is a bit cash-
poor
right now and I think they may be willing to suggest prospective alumni to us that
might
be good candidates for this. Particularly if there is a price discount for an alumni
doing
a beta test on the modified strategy with them. If we need an institution to use for
other clients,
they may be interested in that too. From their perspective, I think they would be most
concerned
that the UBTI gets taken care of and making sure that their 501(c)(3) status is not
harmed.
Depending on their risk level they may want to do only a limited number of these
transactions.
However, I do think the opportunity is there to do at least a few of these and I would
like to get
a meeting set up with the appropriate individuals at the school and with the KPMG
staff to find
out. I have established relationships with the President of the college and other
administrative
officials. Who else should go on a meeting like that with me? You or someone out
there
or my boss Mike Terracina? I should let you know that Mike had major surgery
recently and
likely will be out of the office for the next two weeks. From what I know everything
went really
well and I expect a speedy recovery from him.

Do we have any institution size limits or parameters that we need to look at to help
minimize
risk of audit? This is a college with less than 1000 students annually. I'm not sure the
size of
its endowement. I want to say around $50M.

I likely will be leaving the office shortly, but let me know what you think and when
we might
be able to set-up a meeting. If it meets with LA office approval, I'd like to get one
with them
by the first or second week in August.

Best regards,
Matt Campbell

-----Original Message-----

From: Atkin, Andrew S
Sent: Friday, July 13, 2001 4:54 PM
To: Campbell, Matthew S
Subject: RE:

Matt:

We do have an initial approval on the idea now. So we can present it now. However, we do not have a community trust lined up so we need to be upfront with the client that this is an idea only right now and we will need to find the other party to participate.

Is there any chance of standad SC2 working?

Thanks

Andrew

-----Original Message-----
From: Campbell, Matthew S
Sent: Friday, July 13, 2001 1:02 PM
To: Atkin, Andrew S
Subject:

Andrew,

Hey how are you doing? I wanted to check with you to find out the status of the modified SC2 strategy with WNT and what the issues are that are holding it up from it being approved. I have a company in mind that I would like to approach with it, but know I can't do that until we get sign-off.

Hope everything is going well with you and look foward to hearing from you.

Best regards,
Matt

Matthew S. Campbell
KPMG--Stratecon, Houston
wk (713) 319-2522
fax (713) 319-2290
mscampbell@kpmg.com

Outlook Header Information

Subject: RE:

From: Atkin, Andrew S
Sender Name: Atkin, Andrew S
To: Campbell, Matthew S
CC: Terracina, Michael P
Received By: Terracina, Michael P
Delivery Time: 7/13/2001 4:25:31 PM
Creation Time: 7/13/2001 4:25:31 PM
Modification Time: 7/13/2001 4:25:31 PM
Submit Time: 7/13/2001 4:25:31 PM
Importance: 7/1
Priority: 7/0
Sensitivity: 7/0
Flags: 7/1
Size: 7/9532

Message3437	
Subject:	RE: CLP
From:	Walla, Michael E
Date:	9/21/2001 6:49:24 PM
To:	Warley, Carol G; Speiss, Timothy P
CC:	Edwards, Kay D

Message Body

Carol:

It sounds like a substantial charitable motive would be required. I don't have this. Consequently, I don't think it is necessary that we talk. Unless of course, you still do. If you think we should talk, reply so, otherwise lets cancel the call.

Thanks

Mike

Michael E. Walla
KPMG LLP
Partner
Tax Industry Leader, Real Estate
602-250-8114 (direct line)
602-452-4251 (fax)
602-321-0124 (cell)
mewalla@kpmg.com

-----Original Message-----
From: Warley, Carol G
Sent: Friday, September 21, 2001 4:39 PM
To: Speiss, Timothy P; Walla, Michael E
Cc: Edwards, Kay D
Subject: RE: CLP

We didn't get very far on looking at using a partnership to do something similar to SC2. We decided that the IRS was already focused on charitable limited partnerships that used different valuation approaches to benefit the non charitable partner. We decided not to move forward with this. Our CLP does not involve the approach used in SC2 to significantly reduce the dollars going to charity. Rather, the dollars going to charity are significant. Tracy Stone, Bob Perez and I spent time talking about this earlier this year.

I am available at 11:00 your time Monday to talk Mike if you would like.

-----Original Message-----

From: Speiss, Timothy P
Sent: Friday, September 21, 2001 6:29 PM
To: Walla, Michael E; Warley, Carol G
Subject: RE: CLP

Thanks. TPS

-----Original Message-----
From: Walla, Michael E
Sent: Friday, September 21, 2001 7:28 PM
To: Speiss, Timothy P; Warley, Carol G
Subject: RE: CLP

i've asked my asst to set up a call with carol.

thanks

mike

Michael E. Walla
KPMG LLP
Partner
Tax Industry Leader, Real Estate
602-250-8114 (direct line)
602-452-4251 (fax)
602-321-0124 (cell)
mewalla@kpmg.com

-----Original Message-----
From: Speiss, Timothy P
Sent: Friday, September 21, 2001 4:25 PM
To: Warley, Carol G; Walla, Michael E
Subject: RE: CLP

Mike, Carol, We should discuss - Mike, I believe my comments re this issue were with respect to my understanding that I was unsure of our inability to use SC2 with partnerships (not CLP), because of Sec 704 allocation matters. I have not reviewed or researched this and therefore cannot say I am correct. Mike, let me know if there was anything else you recall from our discussion. Again, my comments were directed at SC2.

Thanks

TPS

-----Original Message-----

From: Warley, Carol G
Sent: Friday, September 21, 2001 7:17 PM
To: Speiss, Timothy P
Subject: FW: CLP
Importance: High

Mike left me a message that you said there was a 704(c) problem with the CLP?

-----Original Message-----
From: Edwards, Kay D
Sent: Friday, September 21, 2001 12:54 PM
To: Warley, Carol G
Subject: CLP
Importance: High

Hi Carol,

Mike Walla wanted me to set up a time he could talk to you about CLP technology. Please let me know your availability.

Today - 9/21 Mike is available all afternoon
Monday - 10:00 am to 2:30 pm (AZ time-2 hrs. behind Central)
Tuesday - 1:00-2:00

Let me know if you need more dates if none of these work for you.

Thanks.

Kay Edwards
Sr. Admin. Asst. to Mike Walla
kpmg LLP
Phoenix Office
602-250-8191
602-452-4251 (fax)

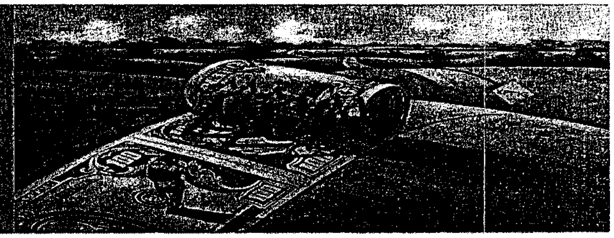
Outlook Header Information

Conversation Topic: CLP
Subject: RE: CLP
From: Walla, Michael E
Sender Name: Walla, Michael E
To: Warley, Carol G; Speiss, Timothy P
CC: Edwards, Kay D
Received By: Speiss, Timothy P
Delivery Time: 9/21/2001 6:49:24 PM

Creation Time: 9/21/2001 6:45:45 PM
Modification Time: 9/21/2001 6:49:24 PM
Submit Time: 9/21/2001 6:49:22 PM
Importance: 9/1
Priority: 9/0
Sensitivity: 9/0
Flags: 9/0
Size: 9/8521

KPMG

Presentation Materials for S Corporation Charitable Contribution Strategy



October
2001

Proprietary Material
Confidentiality Requested

KPMG 0007897

KPMG

With You Today

- **Mark Hutchison**
  Partner
  West Region Solution Champion
  Los Angeles
- **Andrew S. Atkin**
  Senior Manager
  National Solution Co-Champion
  Los Angeles
- **Robert E. Huber**
  Senior Manager
  National Solution Co-Champion
  Los Angeles

KPMG

Table of Contents

WOC 11468

Transaction Overview - Recapitalization

[redacted]

WOC 11468

Transaction Overview - Recapitalization

Shareholders own 100% of the common stock of the corporation. (Assume 1,000,000 shares of voting common stock.)

KPMG

Transaction Overview - Recapitalization

Shareholders own 100% of the common stock of the corporation. (Assume 1,000,000 shares of voting common stock.)

→

Corporation makes a stock dividend of 9,000,000 shares of non-voting stock to shareholders

→

KPMG

Transaction Overview - Recapitalization

Shareholders own 100% of the common stock of the corporation. (Assume 1,000,000 shares of voting common stock.)

→

Corporation makes a stock dividend of 9,000,000 shares of non-voting stock to shareholders

→

Corporation issues warrants to purchase 90,000,000 shares of non-voting stock to shareholders

→

[redacted]

WOC 11468

KPMG 0007903

Transaction Overview – Charitable Contribution

[redacted]

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Transaction Overview – Charitable Contribution

The value of the non-voting stock will be less than 5% of value of the corporation.

[redacted]

KPMG

Transaction Overview – Charitable Contribution

The value of the non-voting stock will be less than 5% of value of the corporation

Shareholders contribute the non-voting shares of stock to a qualified tax exempt organization. The shareholders may receive a charitable contribution deduction if the deduction is included on their individual tax return

KPMG

Transaction Overview – Charitable Contribution

The value of the non-voting stock will be less than [illegible]% of value of the corporation.

→

Shareholders contribute the non-voting shares of stock to a qualified tax exempt organization. The shareholders may receive a charitable contribution deduction if the deduction is included on their individual tax return.

→

The shareholders and the tax exempt organization enter into a [illegible] year repurchase agreement whereby the tax exempt organization can demand that the shareholders and/or their assignees purchase the non-voting stock at fair market value (measured at the time of redemption).

→

[redacted]

Transaction Overview - Repurchase

[redacted]

After a minimum of 3 years, the tax exempt organization decides to sell back the non-voting stock to the shareholders at fair market value pursuant to the repurchase agreement.

KPMG

Transaction Overview - Repurchase

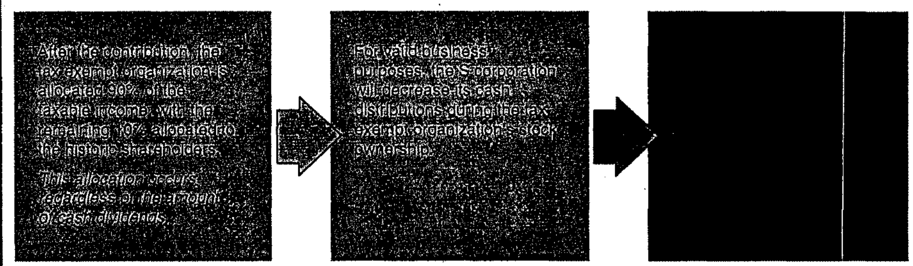
After the contribution, the tax exempt organization is allocated 90% of the taxable income, with the remaining 10% allocated to the historic shareholders.

This allocation occurs regardless of the amount of cash dividends.

After a minimum of 3 years, the tax exempt organization decides to sell back the non-voting stock to the shareholders at fair market value pursuant to the repurchase agreement.

KPMG

Transaction Overview - Repurchase



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Effect on Shareholders

Taxable Income of corporation $10,000,000	Taxable Income of corporation $10,000,000
100 % of taxable income is allocated to shareholders	10% of taxable income is allocated to historic shareholders
	90% of taxable income is allocated to tax exempt shareholder
Taxes Due @45% = $4,500,000	Taxes Due @45% = $450,000

Proprietary Material
Confidentiality Requested

WOC 11468

KPMG 0007911

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Business Considerations

- Tax-exempt organization
- Bank covenants
- Cash flow needs of shareholders
- Valuation
- Insurability of tax benefits

Tax Considerations

- Income reallocation
- Disallowance or reduction of charitable contribution deduction
- Second class of stock
- Penalties

KPMG Commitments

- Resolution of issues identified in fieldwork and implementation phases
- Creation of optimal structuring
- Creation of timetable
- Facilitation of contribution
- Tax opinion letters

KPMG

Concluding Remarks

- Unanswered questions?
- Additional comments?

January 11, 2002

PRIVATE AND CONFIDENTIAL
MR.XYZ
MR.MNO
ABC Company, Inc.
Street Address
City, State Zip

Re: Charitable Contribution to City of XXX Police and Firefighters Retirement Plan

Dear Sirs:

You have requested the opinion of KPMG LLP ("KPMG") as to certain federal income, Florida state income and federal gift tax consequences to you and ABC Company, Inc. ("ABC") with respect to the charitable contribution described below. We have included below the facts upon which we will rely in the issuance of our opinion. We ask that you contact us immediately if any fact is not entirely complete or accurate, as the incompleteness or inaccuracy could cause us to change our opinion. We will not independently verify the completeness of any of the following facts. In addition, we have assumed that all steps taken were properly effectuated under applicable federal and state law.

In rendering our opinion, we are relying upon the Internal Revenue Code of 1986 and Treasury Department regulations thereunder, as amended and in effect on the date hereof, and Revenue Rulings, Revenue Procedures, the Florida Administrative Code of 1980, as amended, and reported judicial decisions as they existed on the date of this opinion letter. Each of the foregoing is subject to change or modification by subsequent legislation, or regulatory, administrative or judicial decisions. Any such change could also have an effect on the validity of the conclusions set forth herein retroactively or prospectively. Further, the opinion which is rendered should be considered together with various risks set forth in the Discussion and Caveat sections of this letter. Unless requested otherwise, we undertake no responsibility to update our opinion in the event of any subsequent change in the foregoing.

Our opinion is limited solely to the federal income, Florida state income and federal gift tax consequences of the charitable contribution discussed herein to the parties described above. No opinion is rendered, expressed or implied with respect to the tax consequences of the consummated transaction to any other party. Furthermore, no opinion is expressed with respect to issues not specifically discussed herein, any other federal, state or local tax, or the legal aspects of the charitable contribution.

FACTS

ABC is a Florida corporation that was incorporated on February 6, 1998. On February 6, 1998, ABC also filed an election to be taxed as a subchapter S corporation. On May 25, 1998, the Internal Revenue Service accepted ABC's S Corporation election effective as of February 6, 1998.

As of December 18, 2001, ABC had 20,000 shares of voting common stock outstanding. Ten thousand (10,000) of these shares were voting common stock owned by MR.XYZ. MR. MNO owned the remaining ten thousand (10,000) voting shares of ABC. MR.XYZ and MR.MNO are collectively referred to herein as "Shareholders."

Shareholders are United States persons and are permissible owners of subchapter S corporation stock under the Internal Revenue Code of 1986.

On December 6, 2001, ABC's Shareholders and Board of Directors took action to authorize the issuance of up to 10,000,000 shares of nonvoting common stock. They also added a provision to the corporate Bylaws providing that all nonvoting common stock would be subject to a right of first refusal ("the Right of First Refusal"). Under the Right of First Refusal, ABC has the right to purchase the outstanding nonvoting common stock for the amount of any bona fide offer received by any holder of the nonvoting common stock. In addition, if ABC is unable or unwilling to exercise the Right of First Refusal, the holders of the voting common stock are entitled to a right of first refusal. The nonvoting common stock and the voting common stock are identical in all respects, except as to voting rights.

On December 20, 2001, ABC distributed by way of a dividend 180,000 shares of nonvoting common stock to Shareholders. MR.XYZ and MR.MNO each received 90,000 shares of nonvoting common stock.

On May 29, 1997, pursuant to Act 97-689, the XXX State Legislature established the City of XXX Police And Firefighters Retirement Plan ("Retirement Plan") with the purpose of providing pension benefits for certain members of the Police Department and the Fire Department of the City of XXX. In addition, Retirement Plan provides benefits to disabled members[1] and also provides support to spouses and children of deceased members.[2] MR.XYZ and MR.MNO desire to support Retirement Plan in its ability to supply these benefits.

---

[1] 1997 Al. XX 689, Sec. 5, Art. 4 (4.02).
[2] 1997 Al. XX 689, Sec. 5, Art. 4 (4.04).

On March 23, 1998, the Internal Revenue Service issued a favorable determination letter to Retirement Plan, finding that Retirement Plan satisfied the requirements of IRC Section 401(a).[3]

Section 2, Article 1 (1.09) of 1997 Al. XX 689 states that the Retirement Plan's fund consists of "assets of the plan held in trust by the board." Under Section 8, Article 7 (7.04) of 1997 Al. XX 689, the Police and Fire Pension Board has, "full power to invest and reinvest the fund in such investments as the board may from time to time approve and to hold, purchase, sell, assign, transfer, and dispose of any such investments in which the fund shall have been invested." Moreover, under Section 8, Article 7 (7.08) of 1997 Al. XX 689, the Board, "shall use that degree of care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use in a similar situation." Furthermore, under Section 9, Article 8 (8.01) of 1997 Al. XX 689, the Board has, "all powers granted to trustees under any XXX statute or regulation which are necessary or desirable for it to fulfill its duties with respect to the plan . . . ." Given these obligations imposed on the Board under 1997 Al. XX 689, it appears that the trust requirement is met.

Retirement Plan was created for the City of XXX by the State of XXX.[4] Therefore, Retirement Plan should be considered a qualifying municipal pension plan under Revenue Ruling 58-154.

In accordance with Shareholders' desire to support Retirement Plan, on December 27, 2001, MR.XYZ donated 90,000 shares of nonvoting common stock of ABC to Retirement Plan, and MR.MNO donated 90,000 shares of nonvoting common stock of ABC to Retirement Plan. On December 27, 2001, Retirement Plan accepted the nonvoting common stock via express mail delivery. Retirement Plan will credit the contribution for the use and benefit of Retirement Plan.

Neither MR.XYZ nor Mr. MNO is a beneficiary of Retirement Plan. In addition, Retirement Plan did not transfer any cash or other property to Shareholders in return for their contributions and Shareholders will receive no benefit from the contribution other than tax benefits derived from their personal charitable contribution deductions.

On December 27, 2001, ABC and Retirement Plan entered into a redemption agreement ("the Redemption Agreement"). Under the Redemption Agreement, after a period of three years, Retirement Plan may present the nonvoting stock it owns for redemption by ABC. The redemption amount is the fair market value of the stock on the date that Retirement Plan presents the stock for redemption. Neither ABC nor Shareholders have the power to compel Retirement Plan to present the stock it owns for redemption.

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[3] *See* IRS Determination Letter to City of XXX, dated March 23, 1998.
[4] 1997 Al. XX 689.

CONCLUSION

Based on the facts set forth above, it is our view that Shareholders and ABC should prevail with respect to conclusions number one, two, and four (Distribution of nonvoting stock, Single class of stock requirement and Retirement Plan should be considered a permissible holder of ABC stock) if challenged by the IRS, and that with respect to all other issues discussed below, it is more likely than not that Shareholders and ABC would prevail if challenged by the IRS:[5]

1. Distribution of nonvoting stock. Section 305(a) provides that gross income does not include a corporation's distribution of stock or stock rights to its Shareholders. Therefore, the distribution of the nonvoting common stock by ABC to Shareholders should be a tax-free distribution, without Shareholders being taxed on the distribution. Likewise, ABC should not be taxed on the distribution of the nonvoting stock under Section 311(a).

2. Single class of stock requirement. The distribution of nonvoting common stock should not create a second class of stock under Section 1361(c)(4) and Regulation Section 1.1361-1(l)(1), which provide that a corporation shall not be treated as having more than one class of stock solely because there are differences in voting rights among the shares of common stock.

   In addition, the existence of the Right of First Refusal and the Redemption Agreement should not create a second class of stock. Under Regulation Section 1.1361-1(l)(2)(iii), buy-sell agreements among Shareholders are generally disregarded in determining whether there is more than one class of stock.

3. Taxation of redemption proceeds. Shareholders should not be taxed on any potential redemption proceeds that may be received by Retirement Plan. The IRS held in Revenue Ruling 78-197, 1978-1 C.B. 83, that it will treat the proceeds of a redemption of donated stock as income to the donor only if the tax-exempt organization is legally bound, or can be compelled by the corporation, to surrender the shares. Since neither ABC nor Shareholders has the power to compel a redemption, Shareholders should not be taxed on any potential redemption proceeds received by Retirement Plan.

[5] In various sections of this opinion letter, language may be used (e.g., use of the word "will" or "should") that might indicate an opinion at a different standard of likelihood of success than listed above. Notwithstanding the use of this language, we intend our conclusions to be confined to a standard of "should" with respect to conclusion numbers one, two, and four and "more likely than not" with respect to all other issues.

4. Retirement Plan should be considered a permissible holder of subchapter S corporation stock. Under Section 1361(c)(6), an organization which is "described in section 401(a)" and that is "exempt from taxation under section 501(a)" may be a Shareholder in a subchapter S corporation. Since Retirement Plan meets these requirements, it should be an eligible Shareholder.

5. Shareholders should be entitled to a charitable deduction for the fair market value of the stock Shareholders donated. Under Section 170(a), Shareholders should be entitled to a charitable contribution deduction in the 2001 tax year for the fair market value of the stock Shareholders donated, taking into consideration the limitations of § 170(b)(1)(C), as described below. However, under Section 170(e)(1), the amount of the deduction may be reduced. Specifically, "in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply" to reduce the amount of the deduction by the amount of any ordinary income that would have been realized had the assets of the corporation been sold. The significant items that would give rise to ordinary income had there been a sale of the assets include unrealized receivables and Sections 1245 and 1250 recapture items for previously claimed depreciation. Thus, the charitable deduction should be reduced by the portion of the fair market value of the donated stock that is attributable to such ordinary income items.

   Under Section 170(b)(1)(C), the amount of Shareholders charitable deduction for the contribution of the stock should be limited to 30% of Shareholders' adjusted gross income ("AGI"). In addition, under Section 170(b), Shareholders overall contributions for the year (including this stock contribution) may not exceed 50% of their AGI.

6. Gift Tax. Shareholders should be entitled to a gift tax deduction for the amount of the contribution. Under Section 2522(a)(1), gifts made to or for the use of "the United States, any state, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes" are deductible. Furthermore, Shareholders should be exempt from filing a gift tax return under Section 6019(3).

DISCUSSION

1. Distribution of nonvoting stock. Under Section 305(a), shareholders of a corporation are not taxed on the amount of any distribution by the corporation, so long as the property that was distributed was stock in the corporation. Therefore, Shareholders should not be taxed on the

distribution of the nonvoting common stock received from ABC. In addition, ABC should not be taxed on the distribution; under Section 311, no gain is recognized by a corporation due to the distribution of its own stock to the Shareholders of the corporation. Under Florida law, a stock dividend of the same class of stock distributed by a corporation is not taxable to the distributing corporation or the distributee Shareholders.[6] Although Florida law does not address the tax treatment of distributions by an S corporation to its Shareholders, Florida generally adopts the federal rules with respect to such distributions.[7]

2. Single class of stock requirement. Under Section 1361(b)(1)(D), an S corporation may not have more than one class of stock. In determining whether a corporation has more than one class of stock, only stock which is outstanding is considered.[8] An S corporation has one class of stock if all outstanding shares confer identical rights to distribution and liquidation proceeds.[9] In making this determination, differences in rights that occur under the corporate charter, Articles or Bylaws, by operation of state law, or under binding agreements relating to distribution and liquidation proceeds must be taken into account in making this determination.[10] As long as the liquidation and distribution rights provided in these so-called "governing provisions" are identical, no second class of stock is created. Moreover, in determining whether there is more than one class of stock, differences in voting rights are disregarded.[11]

It does not appear that the issuance of the nonvoting stock will create a second class of stock. The nonvoting common stock contains identical rights to distribution and liquidation proceeds as the voting common stock and is otherwise identical, except with respect to voting rights. Therefore, the authorization, issuance and donation of the nonvoting common stock should not create a second class of stock under Section 1361(b)(1)(D).

The fact that the nonvoting common stock is subject to the Right of First Refusal and that Retirement Plan has a right to present its nonvoting common stock for redemption should not alter the conclusion that there is no second class of stock. Under Regulation Section 1.1361-1(l)(2)(iii):

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[6] FLA STAT. Ch. 607.0623(2000).
[7] FLA STAT Ch. 220.02(3), 220.13(2)(i) (2000) and FLA. ADMIN. CODE ANN. r. 12C-1.013(1)(b) (1996).
[8] Reg. Sec. 1.1361-1(l)(1).
[9] *Id.*
[10] I.R.C. Sec. 1362(d)(2).
[11] I.R.C. Sec. 1361(c)(4) and Reg. Sec. 1.1361-1(l)(1).

> [b]uy-sell agreements among Shareholders, agreements restricting the transferability of stock and redemption agreements are disregarded in determining whether a corporation's outstanding shares of stock confer identical distribution and liquidation rights unless
>
> (1) A principal purpose of the agreement is to circumvent the one class of stock requirement of Section 1361(b)(1)(D) and this paragraph (1), and
>
> (2) The agreement establishes a purchase price that, at the time the agreement is entered into, is significantly in excess of or below the fair market value of the stock.

For the reasons discussed below, it does not appear that the Right of First Refusal or the Redemption Agreement were entered into to circumvent the one class of stock requirement. In addition, the purchase price under both the Redemption Agreement and the Right of First Refusal are at fair market value. Therefore, no second class of stock is created due to the Right of First Refusal or the Redemption Agreement.

1) Principal purpose test. As explained above, there is more than one class of stock if there are different distribution rights or rights to liquidation proceeds among the Shareholders. Therefore, in analyzing whether the purpose of the Right of First Refusal or the Redemption Agreement was to circumvent the one class of stock rule, the key issue is whether these agreements alter the right to distributions or Shareholders' respective share of liquidation proceeds.

Neither the Right of First Refusal nor the Redemption Agreement was created to alter Shareholders' right to distributions or liquidation proceeds. The Right of First Refusal was enacted to provide protection to Shareholders that no objectionable person would be able to acquire an ownership interest in his closely-held business. The Redemption Agreement was executed in order to give Retirement Plan a market to sell its stock. Therefore, the purpose of these agreements is not to circumvent the one class of stock requirement.

2) Fair market value test. Under the Right of First Refusal, ABC and the holders of the voting common stock have the right to match the bona fide offer to exercise the right. In addition, under the Redemption Agreement, the purchase price for any redemption is the fair market value measured at the time of redemption. Since fair market value must be paid under both agreements, the second test for avoiding a second class of stock should also be satisfied.

For Florida income tax purposes, an electing small business corporation and the Shareholders thereof shall be treated in the same manner as provided in Subchapter S of the Internal Revenue Code and the Federal regulations issued thereunder.[12]

3. Taxation of redemption proceeds. In the past, the IRS has recharacterized certain stock contributions followed by a redemption. Specifically, where there was a prearranged plan to have the corporation redeem stock previously donated to a tax-exempt entity, the IRS treated the transaction as a redemption of the stock by the donor followed by a contribution of the redemption proceeds to the tax-exempt entity. Therefore, the donor would be taxed on the redemption proceeds less the Shareholders' basis in the stock contributed. However, the IRS has subsequently stated in a Revenue Ruling that it will treat the proceeds of a redemption of donated stock as income to the donor only if the tax-exempt organization is legally bound, or can be compelled by the corporation, to surrender the shares.[13]

Under the Redemption Agreement, neither ABC nor Shareholders have the power to compel Retirement Plan to surrender its shares. Retirement Plan will likely desire to present the stock it owns for redemption because it has no ready market in which to sell the stock. However, neither ABC nor Shareholders can compel a redemption. Rather, this fact simply makes it more desirable for Retirement Plan to want a redemption. Therefore, neither ABC nor Shareholders should be taxed on any potential redemption proceeds that may be received by Retirement Plan.

There is no Florida law directly on point on this issue. In the absence of any conflicting law, the federal interpretation would presumably apply.

4. Retirement Plan should be considered a permissible holder of subchapter S corporation stock. Under Section 1361(c)(6), an organization "which is described in section 401(a)" and which is "exempt from taxation under section 501(a)" may be an owner of subchapter S corporation stock. Retirement Plan meets both of these criteria and should therefore be considered an eligible holder of subchapter S corporation stock.

1) Retirement Plan should be considered an organization described in Section 401(a). Congress provided in Section 401(a) that, "a trust created or organized in the United States and forming part of a stock bonus, pension, or profit sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries" is a tax-qualified trust if it meets all of the requirements specified in that provision. State and local government plans were permanently

[12] FLA STAT Ch. 220.02(3), 220.13(2)(i) (2000) and FLA. ADMIN. CODE ANN. r. 12C-1.013 (1996).
[13] Rev. Rul. 78-197, 1978-1 C.B. 83.

exempted from many of the requirements specified in the statute, effective August 5, 1997.[14] As stated previously, the IRS issued a favorable determination letter to Retirement Plan on March 23, 1998. Moreover, Retirement Plan has given a written representation that it meets these requirements. Therefore, Retirement Plan should be considered an organization described in Section 401(a).[15]

2) Retirement Plan should be considered an organization which is exempt from taxation under Section 501(a). Section 501(a) provides that, *inter alia*, an organization which is described in Section 401(a) is exempt from taxation. Since as discussed above, Retirement Plan is an organization described in Section 401(a), it should also be considered an organization exempt from taxation under Section 501(a). In addition, Retirement Plan has given a written representation that it is an organization described in Section 501(a).

Retirement Plan should also be considered an eligible S corporation Shareholder under Florida law.[16]

5. Shareholders should be entitled to a charitable deduction for the fair market value of the stock Shareholders donated. Section 170(a) provides that, "[t]here shall be allowed as a deduction any charitable contribution . . . payment of which is made within the taxable year." The term "charitable contribution" is defined in Section 170(c)(1) to include:

> "a contribution or gift to or for the use of a state, a possession of the United States, or any political subdivision of any of the foregoing or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes."[17]

The IRS has given more specific guidance with respect to contributions to pension funds established for the benefit of municipal employees, municipal policemen or municipal firemen. Specifically, the IRS held in Revenue Ruling 58-154, 1958-1 C.B. 125, that:

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[14] *See* Taxpayer Relief Act of 1997, P.L. 105-34, Sec. 1505.
[15] The organization described in Section 401(a) is technically the trust, not the plan itself. Commentators have noted that for many governmental plans, "there is no formal trust document." *See* Karen B. Kotner and Leslye G. Laderman, Defined Benefit Plans of Churches and State and Local Governments, 372 Tax Management. (BNA) (1990) at Sec. III(e). However, "the Section 401(a) trust requirement would apparently be satisfied if the statutory language imposes duties on the plan administrator equivalent to those imposed on a private sector trustee." *Id.*
[16] FLA STAT Ch. 220.02(3), 220.13(2)(i) (2000) and FLA. ADMIN. CODE ANN. r. 12C-1.022 (1996).
[17] I.R.C. Sec. 170(c)(1).

> "contributions made by third parties to pension funds established under a state law for the benefit of municipal employees, municipal policemen, or municipal firemen, which are deposited by the administering pension board to the credit of the particular fund for the use and benefit of the respective pension system, are deductible by the donors in computing their taxable income in the manner and to the extent provided by section 170 of the Code."[18]

Although Retirement Plan was created by the City of XXX, under United States Supreme Court precedent the city charter provision creating Retirement Plan is considered a state law because the City of XXX obtained its power to create Retirement Plan from the State of XXX. Specifically, the Supreme Court has held that an ordinance adopted under a power granted by the state legislature is to be regarded as in effect a statute of the state.[19] Therefore, Retirement Plan should be considered to be established under a state law and hence a qualifying municipal pension plan under Revenue Ruling 58-154.

The donations should be considered as deductible gifts because Retirement Plan did not transfer any cash or other property to Shareholders in return for its contribution. Although Shareholders will obtain tax benefits from the contribution, the contribution should still be considered to be a deductible gift. The United States Tax Court has held that, "[a] charitable contribution may be motivated by the basest and most selfish of purposes as long as the donor does not reasonably anticipate benefit from the donee in return."[20]

In that case, the Tax Court found that, while it was "not unmindful of the tax benefits petitioners received from the contribution, that is not pertinent to an analysis of donative intent."[21] Therefore, even though Shareholders, may receive tax benefits as a result of making the contribution, they should still be entitled to a charitable contribution deduction.

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[18] Rev. Rul. 58-154, 1958-1 C.B. 125.
[19] *See New Orleans Waterworks Company v. Louisiana Sugar Refining Co.*, 125 U.S. 18, 31 (1888) ("So a by-law or ordinance of a municipal corporation may be such an exercise of legislative power delegated by the legislature to the corporation as a political subdivision of the State, having all the force of law within the limits of the municipality, that it may properly be considered as a law, within the meaning of this article of the Constitution of the United States."); *see XXo North American Cold Storage Co. v. Chicago*, 211 U.S. 306, 313 (1908) ("In this case the ordinance in question is to be regarded as in effect a statute of the State, adopted under a power granted it by the state legislature, and hence it is an act of the State within the Fourteenth Amendment.")
[20] *Weitz v. Commissioner*, T.C. Memo. 1989-99.
[21] *Id.*

Shareholders should be entitled to its deduction in the 2001 tax year. Under Regulation Section 1.170A-1(b), "a contribution is made at the time delivery is effected." With regard to stock certificates specifically:

> "[i]f a taxpayer unconditionally delivers or mails a properly endorsed stock certificate to a charitable donee or the donee's agent, the gift is completed on the date of delivery or, if such certificate is received in the ordinary course of the mails, on the date of mailing."[22]

Since the stock certificates were delivered to Retirement Plan on December 27, 2001, Shareholders should be entitled to their charitable gift deductions in the 2001 tax year.

The amount of each Shareholder's deduction should be the fair market value of the stock contributed, measured on December 27, 2001.[23] Should the stock be redeemed later for an amount greater than the fair market value on December 27, 2001, Shareholders will not be entitled to any additional deductions.

In addition, under Section 170(e)(1), the amount of the deduction may be less than the fair market value on December 27, 2001. Section 170(e)(1) provides that, "in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply" to reduce the amount of the deduction by the amount of any ordinary income that would have been realized had the assets of the corporation been sold. The significant items that would give rise to ordinary income had there been a sale of the assets include unrealized receivables and recapture items under Sections 1245 and 1250 (relating to previously claimed depreciation). Thus, the charitable deduction should be reduced by the portion of the fair market value of the donated stock that is attributable to such ordinary income items.

The amount of the charitable deduction that can be claimed in the 2001 tax year will be limited to 30% of each Shareholder's adjusted gross income (AGI).[24] In addition, each Shareholder's overall contributions for the year (including this stock contribution) may not exceed 50% of AGI.[25] If the deduction exceeds either of these amounts, it must be carried over to be used in subsequent tax years.

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[22] Reg. Sec. 1.170A-1(b).
[23] Reg. Sec. 1.170A-1(c). For a charitable contribution of property valued in excess of $5,000 to be deductible, however, the appraisal and written acknowledgement requirements of Reg. Secs. 1.170A-13(c) and (f) must XXo be satisfied.
[24] I.R.C. Sec. 170(b)(1)(C).
[25] I.R.C. Sec. 170(b).

6. Gift tax. In computing the amount of each Shareholder's taxable gifts for the year, the charitable contribution should be allowed as a deduction. Under Section 2522(a)(1), gifts made to or for the use of "the United States, any State, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes" are deductible. Given that this language is identical to Section 170(c) as discussed above, each Shareholder should be entitled to a gift tax deduction for the contribution. In addition, it does not appear that either Shareholder will be required to file a gift tax return for the charitable donation. Under Section 6019(3), an individual is not required to file a gift tax return for a gift which was allowed as a deduction under Section 2522, so long as the transfer was of the donor's entire interest in the property transferred and no other interest in such property is transferred for less than full consideration to a person for a use not described in Section 2522. Since each Shareholder donated his entire interest in the nonvoting stock, there should be no need to file gift tax returns.

CAVEAT

No opinions are provided with respect to issues not specifically set forth in this letter. No inference should be drawn regarding any matter not specifically opined upon. Our opinion does not cover any foreign or local tax consequences, including but not limited to sales, use, excise or transfer taxes.

This opinion sets forth our views based on the completeness and accuracy of the above stated facts. If any of the foregoing is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. In rendering our opinion, we are relying upon the relevant provisions of the Internal Revenue Code of 1986, as amended, the regulations thereunder, and judicial and administrative interpretations thereof, and the Florida Administrative Code of 1980, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes could also have an effect on the validity of our opinion. This opinion is not binding on the IRS, any other tax authority, or any court. No assurance is given that a position different than that expressed herein will not be asserted by a tax authority and sustained by a court.

This opinion may only be provided to the IRS or any state taxing authority in connection with an examination of the underlying transaction.

Very truly yours,

KPMG LLP

J. Councill Leak
Partner

Unknown

From: Smith, Richard H (US/WEST AMP)
Sent: Saturday, February 23, 2002 12:45 PM
To: Rosenthal, Richard P
Subject: FW: Stratecon

-----Original Message-----
From: Manth, Larry E
Sent: Saturday, February 23, 2002 6:28 AM
To: Smith, Richard H (US/WEST AMP)
Subject: RE: Stratecon

Richard, we had our bi-weekly Stratecon call yesterday and I spoke about our current situation -- We have been "funding" longer term strategic growth with two products -- Triple By-Pass and SC2, making our plan with these two products so that we could diversify into other areas -- captives, structured finance, structured leasing, and other higher end, tailored made strategies. I mentioned the negative IRS reaction on certain tax products, and that the IRS is aggressively pursuing these types of products and have been in discussions with all the Big Five. People have been asking whether we should be marketing SC2. I told them that I did not know. Walter and I spoke last week and he has provided no direction for us. Do we simultaneously hand somebody an engagement letter for SC2 and an amnesty letter? So basically, I have told people that our "canned products" will probably be discontinued (that was Walter's feeling as well). Since our business in the West (and elsewhere) is 85% canned solutions, I told people, in speculation, that the firm will probably focus on two solution groups -- the FSG solutions (TAS, ACRA, NOL carrybacks, MEALS) and the higher end, structured solutions (structured finance, structured leasing). I told people we are in a state of transition, and to be prepared for this.

We had a partner conference call (Bergmann, Harrison, Hutchison, Jackman) where we discussed the rankings. There were many questions I did not know the answers to, such as "how many Stratecon people will be let go?". Your prior e-mail indicated you wanted us to identify up to 15 people that were not "keepers", so we identified 15. I told the partners that I did not know how many will be let go, but it could be up to 15, and if we were to redeploy some people, it probably would not be in any other practice except for Fed Tax, maybe SALT.

Also, it is Affonso's and Greenberg's understanding that you have approved for Greenberg and his people (3 managers and 1 staff) to immediately transfer out of Stratecon and into Fed Tax. I did not recall your approval for an immediate transfer, but this is in process, and everyone knows about it.

We have let go 2 BDMs in LA that worked about 100% with Stratecon.

Not a very pretty picture. But I can assure you that some of the "keepers" are continuing their focus on generating revenue (they have been focusing on the higher-end strategies) and I am working with some of the others (Atkin and Huber) to redeploy their efforts to the higher end market.

Thanks,

Larry

-----Original Message-----
From: Smith, Richard H (US/WEST AMP)
Sent: Friday, February 22, 2002 7:37 PM
To: Manth, Larry E
Subject: Stratecon

Larry,

I just received a forwarded email among two partners in LA suggesting that Stratecon is essentially dissolving in LA. Their discussion was very positive in that they were strategizing about how they might pick up the slack and pursue some of the most attractive parts of the market that in their view is being left unattended by these developments. What is your view of these reports?

Thanks,

Richard

KPMG, LLP
Western Area Managing Partner -- Tax
Phone: (650) 404-4652
rhsmith@kpmg.com

KPMG 0032375

Date

Mr. Shareholder1
Mr. Shareholder2
S Corporation
Address
City, State

Re: Charitable contribution to Municipal Plan

Dear Mr. Shareholder1 and
Mr. Shareholder2:

You have requested the opinion of KPMG LLP ("KPMG") as to certain Federal income, California State income and Federal gift tax consequences to you and S Corporation ("S Corporation") with respect to the charitable contribution described below. We have included below the facts upon which we will rely in the issuance of our opinion. We ask that you contact us immediately if any fact is not entirely complete or accurate, as the incompleteness or inaccuracy could cause us to change our opinion. We will not independently verify the completeness and accuracy of any of the following facts. In addition, we have assumed that all steps taken were properly effectuated under applicable Federal and State law.

In rendering our opinion, we are relying upon the Internal Revenue Code of 1986 and Treasury Department regulations thereunder, as amended and in effect on the date hereof, and Revenue Rulings, Revenue Procedures, the California Revenue & Taxation Code, as amended, and reported judicial decisions as they existed on the date of this opinion letter. Each of the foregoing is subject to change or modification by subsequent legislation, or regulatory, administrative or judicial decisions. Any such change could also have an effect on the validity of the conclusions set forth herein retroactively or prospectively. Further, the opinion which is rendered should be considered together with various risks set forth in the Discussion and Caveat sections of this letter. Unless requested otherwise, we undertake no responsibility to update our opinion in the event of any subsequent change in the foregoing.

Our opinion is limited solely to the Federal income, California State income and Federal gift tax consequences of the charitable contribution discussed herein to the parties described above. No opinion is rendered, expressed or implied with respect to the tax consequences of the consummated transaction to any other party. Furthermore, no opinion is expressed with respect to issues not specifically discussed herein, any other Federal, state or local tax, or the legal aspects of the charitable contribution.

FACTS

S Corporation is a California corporation that was incorporated on Date1. The effective date of its election to become a subchapter S corporation was Date2.

As of Date3, S Corporation had Number1 shares of stock outstanding. All of these shares were voting common stock. Number2 of these shares were owned by Mr. Shareholder1 and Number3 shares were owned by Mr. Shareholder2 (collectively referred to as the "Shareholders").

The Shareholders are citizens of the United States and are permissible owners of subchapter S corporation stock under the Internal Revenue Code of 1986.

On Date4, S Corporation amended its Articles of Incorporation to allow for it to issue nonvoting common stock in S Corporation. This nonvoting common stock has identical rights to distribution and liquidation proceeds as the voting common stock of S Corporation.

On Date5, S Corporation distributed Number5 shares of nonvoting common stock to the Shareholders in proportion to their ownership of the voting common stock.

On Date6, the Shareholders donated all of the nonvoting common stock to Municipal Plan ("Municipal Plan"). On Date6, Municipal Plan accepted the nonvoting common stock via hand delivery. Municipal Plan will credit the contribution for the use and benefit of Municipal Plan.

The City of City established Municipal Plan in Year. Pursuant to Article ____ of the Charter of the City of City, the purpose of Municipal Plan is to "provid[e] pension benefits for certain members of the Fire Department and of the Police Department of the City of City . . . ."

On Date, the Internal Revenue Service (the "IRS") issued a favorable determination letter to Municipal Plan, finding that, "[t]his is a governmental plan that is deemed to satisfy the requirements of sections 401(a)(4) and 401(a)(26) of the Code. . . ."

Charity has given a written representation to the Shareholders and S Corporation, that it is an entity described in Sections 401(a) and 501(a).[1]

[1] All references to Sections herein are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.

None of the Shareholders are beneficiaries of Municipal Plan. In addition, Municipal Plan did not transfer any cash or other property to the Shareholders in return for their contributions and Shareholders will receive no benefit from the contributions other than tax benefits.

On Date6, S Corporation and Municipal Plan entered into a redemption agreement (the "Redemption Agreement"). Under the Redemption Agreement, Municipal Plan may present the nonvoting stock it owns for redemption by S Corporation, beginning Date7. The redemption amount is the fair market value of the stock on the date that Municipal Plan presents the stock for redemption. Neither S Corporation nor the Shareholders have the power to compel Municipal Plan to present the stock it owns for redemption.

On Date6, Shareholders entered into a pledge with Municipal Plan, providing that the Shareholders will make additional contributions to Municipal Plan, should the value of the nonvoting stock decrease from the time it is contributed until the time that Municipal Plan first has the right to present the stock for redemption. The amount due under the pledge will be the difference between the fair market value of the stock on the date that it was contributed and the fair market value on the date that Municipal Plan first had the right to present the stock for redemption. The pledge will become due six months from the date that Municipal Plan actually presents the stock for redemption. In addition, the pledge will be payable over one year, in monthly installments, with a market rate of interest. S Corp is not a party to the pledge and does not guarantee its payment.

CONCLUSION

Based on the facts set forth above, it is our view that it is more likely than not that the Shareholders and S Corporation will prevail on the following issues if challenged by the IRS:[2]

1. Distribution of nonvoting stock. Section 305(a) provides that gross income does not include a corporation's distribution of stock or stock rights to its shareholders. Therefore, the distribution of the nonvoting common stock by S Corporation to the Shareholders should be a tax-free distribution, without the Shareholders being taxed on the distribution. Likewise, S Corporation should not be taxed on the distribution of the nonvoting stock under Section 311(a).

2. Single class of stock requirement. The distribution of nonvoting common stock should not create a second class of stock under Section 1361(c)(4) and Regulation

[2] In various sections of this opinion letter, language may be used (e.g., use of the word "will" or "should") that might indicate an opinion at a different standard of likelihood of success than "more likely than not." Notwithstanding the use of this language, we intend our conclusions to be confined to a standard of "more likely than not."

Section 1.1361-1(l)(1), which provide that differences in voting rights are disregarded in determining whether there is more than one class of stock.

Likewise, the execution of the Redemption Agreement should not trigger a second class of stock. Under Regulation Section 1.1361-1(l)(2)(iii), redemption agreements are generally disregarded in determining whether there is more than one class of stock.

The fact that Shareholders entered into a pledge with Municipal Plan should not create a second class of stock because the pledge is an agreement between Shareholders, individually and Municipal Plan. Since S Corp is not a party to this pledge and does not guarantee the payment, the pledge should not create a second class of stock.

3. Taxation of redemption proceeds. The Shareholders should not be taxed on any potential redemption proceeds that may be received by Municipal Plan. The IRS has held in Revenue Ruling 78-197, 1978-1 C.B. 83, that it will treat the proceeds of a redemption of donated stock as income to the donor only if the tax-exempt organization is legally bound, or can be compelled by the corporation, to surrender the shares. Since neither S Corporation nor the Shareholders have the power to compel a redemption, the Shareholders should not be taxed on any potential redemption proceeds received by Municipal Plan.

4. Municipal Plan should be considered a permissible holder of subchapter S corporation stock. Under Section 1361(c)(6), an organization which is "described in section 401(a)" and that is "exempt from taxation under section 501(a)" may be a shareholder in a subchapter S corporation. Since Municipal Plan meets these requirements, it should be an eligible shareholder.

5. Each Shareholder should be entitled to a charitable deduction for the fair market value of the stock the Shareholder donated. Under Section 170(a), each Shareholder should be entitled to a charitable contribution deduction in the Year tax year for the fair market value of the stock the Shareholder donated. However, under Section 170(e)(1), the amount of the deduction may be reduced. Specifically, "in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply" to reduce the amount of the deduction by the amount of any ordinary income that would have been realized had the assets of the corporation been sold. The significant items that would give rise to ordinary income had there been a sale of the assets include unrealized receivables and Sections 1245 and 1250 recapture items for previously claimed depreciation. Thus, the charitable deduction should be reduced by the portion of the fair market value of the donated stock that is attributable to such ordinary income items. KPMG is in the process of determining if there are any such items that could reduce the amount of the contribution.

Under Section 170(b)(1)(C), the amount of each Shareholder's charitable deduction for the contribution of the stock should be limited to 30% of the Shareholder's adjusted gross income ("AGI"). In addition, under Section 170(b), each Shareholder's overall contributions for the year (including this stock contribution) may not exceed 50% of their AGI.

If Shareholders should pay any amount under the pledge, they should be entitled to a charitable contribution deduction for the amount paid under Section 170(c).

6. Gift Tax. Each shareholder should be entitled to a gift tax deduction for the amount of the contribution. Under Section 2522(a)(1), gifts made to or for the use of "the United States, any State, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes" are deductible. Furthermore, each shareholder should be exempt from filing a gift tax return under Section 6019(3).

DISCUSSION

1. Taxability of distribution of nonvoting stock. Under Section 305(a), shareholders of a corporation are not taxed on the amount of any distribution by the corporation, so long as the property that was distributed was stock in the corporation. Therefore, the Shareholders should not be taxed on the distribution of the nonvoting common stock received from S Corporation. In addition, S Corporation should not be taxed on the distribution; under Section 311, no gain is recognized by a corporation due to the distribution of its own stock to the shareholders of the corporation Sections 305(a) and 311 are also applicable under California law.[3]

2. Single class of stock requirement. Under Section 1361(b)(1)(D), a subchapter S corporation may not have more than one class of stock. In determining whether a corporation has more than one class of stock, only stock which is outstanding is considered.[4] A subchapter S corporation has one class of stock if all outstanding shares confer identical rights to distribution and liquidation proceeds.[5] In making this determination, differences in rights that occur under the corporate charter, articles or bylaws, by operation of state law, or under binding agreements relating to distribution and liquidation proceeds must be taken into account in making this determination.[6] As long as there is identity in liquidating and distribution rights provided in these so-called "governing provisions," no second class of stock is created. Moreover, in determining whether there is more than once class of stock, differences in voting rights are disregarded.[7]

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[3] *See* Ca. Rev. & Tax. Code Sec. 17321.
[4] Reg. Sec. 1.1361-1(l)(1).
[5] *Id.*
[6] I.R.C. Sec. 1362(d)(2).
[7] I.R.C. Sec. 1361(c)(4) and Reg. Sec. 1.1361-1(l)(1)

It does not appear that the issuance of the nonvoting stock will create a second class of stock. The nonvoting common stock donated to Municipal Plan contains identical rights to distribution and liquidation proceeds as the voting common stock owned by the Shareholders. Therefore, the authorization, issuance and donation of the nonvoting common stock should not create a second class of stock under Section 1361(b)(1)(D).

In addition, the execution of the Redemption Agreement should not trigger a second class of stock. Redemption agreements are generally disregarded in determining whether there is more than one class of stock.[8] Specifically, a redemption agreement does not trigger a second class of stock unless: 1) a principal purpose is to circumvent the one class of stock requirement; and 2) the agreement establishes a purchase price that, at the time of the agreement, is significantly in excess of or below fair market value.[9]

1) Principal purpose test. As explained above, in determining whether there is more than one class of stock, the key issue is whether there are different distribution rights or rights to liquidation proceeds. The purpose of the Redemption Agreement in the proposed transaction is to give Municipal Plan a market to sell its stock, not to give it additional or different rights from other shareholders. The Redemption Agreement does not in any way change distribution or liquidation rights. Therefore, it should not be considered a principal purpose of the Redemption Agreement to circumvent the one class of stock requirement.

2) Fair market value test. Under the redemption agreement, the purchase price for any redemption is the fair market value at the time of redemption. Therefore, the second test for avoiding a second class of stock should also be met.

The fact that Shareholders entered into a pledge with Municipal Plan also should not create a second class of stock because the pledge is an agreement between Shareholders, individually and Municipal Plan. Since S Corp is not a party to this pledge and does not guarantee the payment, the pledge should not create a second class of stock.

California law follows the federal law with respect to the S corporation single class of stock requirements.[10]

3. Taxation of redemption proceeds. In the past, the IRS has recharacterized certain stock contributions followed by a redemption. Specifically, where there was a prearranged plan to have the corporation redeem stock previously donated to a tax-exempt entity, the IRS treated the transaction as a redemption of the stock by the donor followed by a contribution of the redemption proceeds to the tax-exempt entity. Therefore, the donor would be taxed on the redemption proceeds less the shareholder's basis in the stock contributed. However, the IRS has subsequently stated in a Revenue

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[8] *See* Reg. Sec. 1.1361-1(l)(2)(iii).
[9] *Id.*
[10] *See* Ca. Rev. & Tax. Code Sec. 17087.5

Ruling that it will treat the proceeds of a redemption of donated stock as income to the donor only if the tax-exempt organization is legally bound, or can be compelled by the corporation, to surrender the shares.[11]

Under the Redemption Agreement, neither S Corporation nor the Shareholders have the power to compel Municipal Plan to surrender its shares. Municipal Plan will likely desire to present the stock it owns for redemption because it has no ready market in which to sell the stock. However, this fact does not prove that S Corporation or the Shareholders can compel a redemption. Rather, this fact simply makes it more desirable for Municipal Plan to want a redemption. Therefore, the Shareholders should not be taxed on any potential redemption proceeds that may be received by Municipal Plan.

There is no California law directly on point on this issue. In the absence of any conflicting law, the federal interpretation would presumably apply.[12]

4. Municipal Plan should be considered a permissible holder of subchapter S corporation stock. Under IRC §1361(c)(6), an organization "which is described in section 401(a)" and which is "exempt from taxation under section 501(a)" may be an owner of subchapter S corporation stock. Municipal Plan meets both of these criteria and should therefore be considered an eligible holder of subchapter S corporation stock.

1) Municipal Plan should be considered an organization described in section 401(a). Congress provided in Section 401(a) that, "a trust created or organized in the United States and forming part of a stock bonus, pension, or profit sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries" is a tax-qualified trust if it meets all of the requirements specified in that provision. State and Local governmental plans were permanently exempted from many of the requirements specified in the statute, effective August 5, 1997.[13] As stated previously, the IRS issued a favorable determination letter to Municipal Plan on Date, stating that it did meet the requirements then imposed on it. Moreover, Charity has given a written representation

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[11] Rev. Rul. 78-197, 1978-1 C.B. 83.
[12] *See* Ca. Rev. & Taxation Code Sec. 23051.5
[13] *See* Taxpayer Relief Act of 1997, P.L. 105-34, Sec. 1505.

that it meets these requirements. Therefore, Municipal Plan should be considered an organization described in Section 401(a).[14]

2) Municipal Plan should be considered an organization which is exempt from taxation under Section 501(a). Section 501(a) provides that, *inter alia*, an organization which is described in Section 401(a) is exempt from taxation. Since as discussed above, Municipal Plan is an organization described in Section 401(a), it should also be considered an organization exempt from taxation under Section 501(a). In addition, Municipal Plan has given a written representation that it is an organization described in Section 501(a).

Municipal Plan should also be considered an eligible S corporation shareholder under California law.[15]

5. Each shareholder should be entitled to a charitable deduction for the fair market value of the stock the shareholder donated. Section 170(a) provides that, "[t]here shall be allowed as a deduction any charitable contribution . . . payment of which is made within the taxable year." The term "charitable contribution" is defined in Section 170(c)(1) to include:

> a contribution or gift to or for the use of a state, a possession of the United States, or any political subdivision of any of the foregoing or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.[16]

The IRS has given more specific guidance with respect to contributions to pension funds established for the benefit of municipal employees, municipal policemen or municipal firemen. Specifically, the IRS held in Revenue Ruling 58-154, 1958-1 C.B. 125, that:

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[14] The organization described in Section 401(a) is technically the trust, not the plan itself. Commentators have noted that for many governmental plans, "there is no formal trust document." *See* Karen B. Kotner and Leslye G. Laderman, Defined Benefit Plans of Churches and State and Local Governments, 372 Tax Management. (BNA) (1990) at Sec. III(e). However, "the Section 401(a) trust requirement would apparently be satisfied if the statutory language imposes duties on the plan administrator equivalent to those imposed on a private sector trustee." *Id.* Under Section 524 of Article XXXV of the Charter of the City of City, Municipal Plan is "under the exclusive management and control of the Board. . . ." and not the City of City. Therefore, it appears that the trust requirement is met. Moreover, the IRS apparently believes that Municipal Plan meets the trust requirement because it ruled that Municipal Plan met the requirements of Section 401(a)(26), which provides that a trust is not a qualified trust unless it benefits a statutory minimum number of beneficiaries. *See* Letter from the IRS to the City of City, dated June 27, 1997. Obviously, Municipal Plan could not meet this requirement unless it was considered to have a trust as part of the pension plan.

[15] *See* Cal. Rev. & Tax. Code Secs. 23800.5(c) and 17631.

[16] I.R.C. Sec. 170(c)(1).

> contributions made by third parties to pension funds established under a state law for the benefit of municipal employees, municipal policemen, or municipal firemen, which are deposited by the administering pension board to the credit of the particular fund for the use and benefit of the respective pension system, are deductible by the donors in computing their taxable income in the manner and to the extent provided by section 170 of the Code.[17]

Although Municipal Plan was created by the City of City, under United States Supreme Court precedent the city charter provision creating Municipal Plan is considered a state law because the City of City obtained its power to create Municipal Plan from the State of State.[18] Specifically, the Supreme Court has held that an ordinance adopted under a power granted by the state legislature is to be regarded as in effect a statute of the state.[19] Therefore, Municipal Plan should be considered to be established under a state law and hence a qualifying municipal pension plan under Revenue Ruling 58-154.

The donations should be considered as deductible gifts because Municipal Plan did not transfer any cash or other property to the Shareholders in return for their contributions. Although Shareholders will obtain tax benefits from the contributions, the contributions should still be considered to be deductible gifts. The United States Tax Court has held that, "[a] charitable contribution may be motivated by the basest and most selfish of purposes as long as the donor does not reasonably anticipate benefit from the donee in return."[20]

In that case, the Tax Court found that, while it was "not unmindful of the tax benefits petitioners received from the contribution, that is not pertinent to an analysis of donative intent."[21] Therefore, even though the Shareholders may receive tax benefits as a result of making the contributions, they should still be entitled to charitable contribution deductions.

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[17] Rev. Rul. 58-154, 1958-1 C.B. 125.
[18] The City of City obtained the power to create Municipal Plan under Article XI, Sec. 7 of the State Constitution, which provides that, "[a] county or city may make and enforce within its limits all local, police, sanitary, and other ordinances and regulations not in conflict with general laws."
[19] *See New Orleans Waterworks Company v. Louisiana Sugar Refining Co.*, 125 U.S. 18, 31 (1888) ("So a by-law or ordinance of a municipal corporation may be such an exercise of legislative power delegated by the legislature to the corporation as a political subdivision of the State, having all the force of law within the limits of the municipality, that it may properly be considered as a law, within the meaning of this article of the Constitution of the United States."); *see also North American Cold Storage Co. v. Chicago*, 211 U.S. 306, 313 (1908) ("In this case the ordinance in question is to be regarded as in effect a statute of the State, adopted under a power granted it by the state legislature, and hence it is an act of the State within the Fourteenth Amendment.").
[20] *Weitz v. Commissioner*, T.C. Memo. 1989-99.
[21] *Id.*

Each shareholder should be entitled to their deduction in the Year tax year. Under Regulation Section 1.170A-1(b), "a contribution is made at the time delivery is effected." With regard to stock certificates specifically:

> [i]f a taxpayer unconditionally delivers or mails a properly endorsed stock certificate to a charitable donee or the donee's agent, the gift is completed on the date of delivery or, if such certificate is received in the ordinary course of the mails, on the date of mailing.[22]

Since the stock certificates were hand delivered to Municipal Plan on Date6, the Shareholders should be entitled to their deductions in the Year tax year.

The amount of the each shareholder's deduction should be the fair market value of the stock they contributed, measured on Date6.[23] Should the stock be redeemed later for an amount greater than the fair market value on Date6, each shareholder will NOT be entitled to any additional deductions.

In addition, under Section 170(e)(1), the amount of the deductions may be less than the fair market value on Date6. Section 170(e)(1) provides that, "in the case of a charitable contribution of stock in an S corporation, rules similar to the rules of section 751 shall apply" to reduce the amount of the deduction by the amount of any ordinary income that would have been realized had the assets of the corporation been sold. The significant items that would give rise to ordinary income had there been a sale of the assets include unrealized receivables and recapture items under Sections 1245 and 1250 (relating to previously claimed depreciation). Thus, the charitable deduction should be reduced by the portion of the fair market value of the donated stock that is attributable to such ordinary income items. KPMG will be analyzing whether the charitable deduction should be decreased under this provision and will provide you such an analysis prior to the filing of the applicable tax returns.

The amount of the charitable deductions that can be claimed in the Year tax year will be limited to 30% of each shareholder's adjusted gross income (AGI).[24] In addition, each shareholder's overall contributions for the year (including this stock contribution) may not exceed 50% of AGI.[25] If the deduction exceeds either of these amounts, it must be carried over to be used in subsequent tax years.

If Shareholders should pay any amount under the pledge, they should be entitled to a charitable contribution deduction for the amount paid under Section 170(c).

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[22] Reg. Sec. 1.170A-1(b).
[23] Reg. Sec. 1.170A-1(c).
[24] I.R.C. Sec. 170(b)(1)(C).
[25] I.R.C. Sec. 170(b).

California law conforms to Federal law with respect to charitable contributions.[26]

6. Gift tax. In computing the amount of each shareholder's taxable gifts for the year, the charitable contribution should be allowed as a deduction. Under Section 2522(a)(1), gifts made to or for the use of "the United States, any State, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes" are deductible. Given that this language is identical to Section 170(c) as discussed above, each shareholder should be entitled to a gift tax deduction for the contribution. In addition, it does not appear that the Shareholders will be required to file gift tax returns for the charitable donations. Under Section 6019(3), an individual is not required to file a gift tax return for a gift which was allowed as a deduction under Section 2522, so long as the transfer was of the donor's entire interest in the property transferred and no other interest in such property is transferred for less than full consideration to a person for a use not described in Section 2522. Since each shareholder donated their entire interest in the nonvoting stock, there should be no need to file a gift tax return.

CAVEAT

No opinions are provided with respect to issues not specifically set forth in this letter. No inference should be drawn regarding any matter not specifically opined upon. Our opinion does not cover any foreign or local tax consequences including but not limited to, sales, use, excise or transfer taxes.

This opinion sets forth our views based on the completeness and accuracy of the above stated facts. If any of the foregoing is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. In rendering our opinion, we are relying upon the relevant provisions of the Internal Revenue Code of 1986, the California Revenue & Taxation Code, as amended, the regulations thereunder, and judicial and administrative interpretations thereof, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes could also have an effect on the validity of our opinion. This opinion is not binding on the IRS, any other tax authority, or any court. No assurance is given that a position different than that expressed herein will not be asserted by a tax authority and sustained by a court.

This opinion may only be provided to the IRS or any state taxing authority in connection with an examination of the underlying transaction.

[26] *See* Ca. Rev. & Tax. Code Sec. 17201. One exception is that I.R.C. Sec. 170(e)(5), relating to special rules for contributions of stock for which market quotations are available, does not apply. Ca. Rev. & Tax. Code Sec. 17251.5.

Very truly yours,

KPMG LLP

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Date

Mr. Shareholder1
Mr. Shareholder2
S Corporation
Address
City, State

Re: Warrant distribution by S Corporation

Dear Mr. Shareholder1 and
Mr. Shareholder2:

You have requested the opinion of KPMG LLP ("KPMG") as to certain Federal and California state income tax consequences to you and S Corporation ("S Corporation") with respect to the warrant distribution by S Corporation described below. We have included below the facts upon which we will rely in the issuance of our opinion. We ask that you contact us immediately if any fact is not entirely complete or accurate, as the incompleteness or inaccuracy could cause us to change our opinion. We will not independently verify the completeness and accuracy of any of the following facts. In addition, we have assumed that all steps taken were properly effectuated under applicable Federal and State law.

In rendering our opinion, we are relying upon the Internal Revenue Code of 1986 and Treasury Department regulations thereunder, as amended and in effect on the date hereof, and Revenue Rulings, Revenue Procedures, the California Revenue & Taxation Code, as amended, and reported judicial decisions as they existed on the date of this opinion letter. Each of the foregoing is subject to change or modification by subsequent legislation, or regulatory, administrative or judicial decisions. Any such change could also have an effect on the validity of the conclusions set forth herein retroactively or prospectively. Further, the opinion which is rendered should be considered together with various risks set forth in the Discussion and Caveat sections of this letter. Unless requested otherwise, we undertake no responsibility to update our opinion in the event of any subsequent change in the foregoing.

Our opinion is limited solely to the Federal and California income tax consequences of the warrant distribution discussed herein to the parties described above. No opinion is rendered, expressed or implied with respect to the tax consequences of the warrant distribution to any other party. Furthermore, no opinion is expressed with respect to issues not specifically discussed herein, any other Federal, state or local tax, or any legal issue.

FACTS

S Corporation is a California corporation that was incorporated in Date1. The effective date of its election to become a subchapter S corporation was Date2.

As of Date3, S Corporation had Number shares of stock outstanding. All of these shares were voting common stock. Number1 of these shares were owned by Mr. Shareholder1 and Number2 shares were owned by Mr. Shareholder2 (collectively referred to as the "Shareholders").

The Shareholders are citizens of the United States and are permissible owners of subchapter S corporation stock under the Internal Revenue Code of 1986.

On Date4, S Corporation distributed Number4 warrants to purchase nonvoting stock of S Corporation to the Shareholders in proportion to their ownership of the voting common stock. The exercise price is $ Amount per share. The warrants have a term of Term years.

The exercise price of each warrant is equal to at least ninety percent (90%) of the fair market value of the underlying stock as of Date4.

CONCLUSION

Based on the facts set forth above, it is our view that it is more likely than not that the Shareholders and S Corporation will prevail on the following issues if challenged by the Internal Revenue Service ("IRS"):[1]

1. Taxability of distribution of warrants. Section[2] 305(a) provides that gross income does not include a corporation's distribution of stock or stock rights to its shareholders. Therefore, the distribution of the warrants by S Corporation to the Shareholders should be a tax-free distribution, without the shareholders being taxed on the distribution. Likewise, S Corporation should not be taxed on the distribution of the warrants under Section 311(a).

[1] In various sections of this opinion letter, language may be used (e.g., use of the word "will" or "should") that might indicate an opinion at a different standard of likelihood of success than "more likely than not." Notwithstanding the use of this language, we intend our conclusions to be confined to a standard of "more likely than not."
[2] All references to Sections herein are to the Internal Revenue Code of 1986, unless otherwise stated.

2. Single class of stock requirement. The distribution of the warrants should not create a second class of stock under the safe harbor provision of Regulation Section 1.1361-1(l)(4)(iii)(C), which provides that if the strike price of the warrants is at least 90% of the fair market value of the underlying stock on the date they are issued, the warrants should not be considered a second class of stock.

DISCUSSION

1. Taxability of distribution of warrants. Under Section 305(a), shareholders of a corporation are not taxed on the amount of any distribution by the corporation, so long as the property that was distributed was stock in the corporation. Under Regulation Section 1.305-1(d) the term "stock" is defined to include warrants to acquire stock. Therefore, the Shareholders should not be taxed on the distribution of warrants received from S Corporation. In addition, S Corporation should not be taxed on the distribution; under Section 311, no gain is recognized by a corporation due to the distribution of its own stock or stock rights to the shareholders of the corporation. Sections 305(a) and 311 are also applicable under California law.[3]

2. Single class of stock requirement. Under Section 1361(b)(1)(D), a subchapter S corporation may not have more than one class of stock. A subchapter S corporation has one class of stock if all outstanding shares confer identical rights to distribution and liquidation proceeds.[4] In making this determination, differences in rights that occur under the corporate charter, articles or bylaws, by operation of state law, or under binding agreements relating to distribution and liquidation proceeds must be taken into account in making this determination.[5] As long as there is identity in liquidating and distribution rights provided in these so-called "governing provisions," no second class of stock is created. In addition, differences in voting rights are disregarded.[6]

In determining whether a corporation has more than one class of stock, only stock which is outstanding is considered.[7] Warrants do not constitute outstanding stock because they do not entitle the holder to any of the attributes of stock ownership such as the right to vote or receive dividends.[8] Therefore, the issuance and distribution of the warrants should not trigger a second class of stock provided that their strike price can be shown to be not substantially below the fair market value of the stock on the date the options are issued or on any date that they may be materially modified.[9]

However, the IRS will treat the warrants as a second class of stock if the warrants are substantially certain to be exercised by the holder or a potential transferee and the

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[3] *See* Ca. Rev. & Tax. Code Sec. 17321.
[4] Reg. Sec. 1.1361-1(l)(1).
[5] I.R.C. Sec. 1362(d)(2).
[6] I.R.C. Sec. 1361(c)(4) and Reg. Sec. 1.1361-1(l)(1)
[7] Reg. Sec. 1.1361-1(l)(1).
[8] *See Hume v. Commissioner*, T.C. Memo 1988-485 (an option to acquire S stock held by an ineligible shareholder did not disqualify the S election because the option was not exercised).
[9] Reg. Sec. 1.1361-1(l)(4)(iii)(A).

warrants have a strike price substantially below the fair market value of the underlying stock.[10] There is a safe harbor provision though, which provides that if the strike price of the warrants is at least 90% of the fair market value of the underlying stock on the date they are issued, the warrants are not considered a second class of stock.[11] Here, the warrants issued by S Corporation have an exercise price at least equal to 90% of the fair market value of underlying stock on Date4. Therefore, the safe harbor is met and the distribution of the warrants should not create a second class of stock.

CAVEAT

No opinions are provided with respect to issues not specifically set forth in this letter. No inference should be drawn regarding any matter not specifically opined upon. Our opinion does not cover any foreign or local tax consequences including but not limited to, franchise, sales, use, excise or transfer taxes.

This opinion sets forth our views based on the completeness and accuracy of the above stated facts. If any of the foregoing is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. In rendering our opinion, we are relying upon the relevant provisions of the Internal Revenue Code of 1986, the California Revenue & Taxation Code, as amended, the regulations thereunder, and judicial and administrative interpretations thereof, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes could also have an effect on the validity of our opinion. This opinion is not binding on the IRS, any other tax authority, or any court. No assurance is given that a position different than that expressed herein will not be asserted by a tax authority and sustained by a court.

This opinion may only be provided to the IRS or any state taxing authority in connection with an examination of the underlying transaction.

Very truly yours,

KPMG LLP

[10] Reg. Sec. 1.1361-1(l)(4)(iii).
[11] Reg. Sec. 1.1361-1(l)(4)(iii)(C). This provision applies to call options, which are defined in Reg. Sec. 1.1361-1(l)(4)(iii)(A) to include warrants.

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[Sample Tax Consulting Engagement Letter
S-Corporation Charitable Contribution Strategy

Firm Letterhead]

[NOTE: DPP-Tax has reviewed and preapproved this standard engagement letter for S-Corporation Charitable Contribution Strategy. If no changes are made to the standard letter, further review or approval by DPP-Tax is unnecessary; however, a copy of both the issued and signed engagement letter is to be provided to the business unit professional practice partner - tax. If modifications to this preapproved standard engagement letter are desired, the reasons for such modifications are to be discussed with the location's professional practice partner - tax. The business unit professional practice partner - tax may approve, at his or her discretion, the desired modifications or may consult with DPP-Tax thereon. **Note – Liability limitation and indemnification provisions cannot be waived on an S-Corporation Charitable Contribution Strategy***]*

PRIVATE & CONFIDENTIAL
AddresseeName
CompanyName
StreetLine1
StreetLine2
CityStateZip

Dear AddresseeName:

We are pleased you and your company, ____________ (collectively referred to herein as "you" or "your") have engaged us to assist you in implementing S-Corporation Charitable Contribution Strategy by providing tax consulting services with respect to a planned charitable contribution of ______________ stock and certain potential income and estate tax consequences. This letter confirms the scope and related terms of your engagement of KPMG LLP (KPMG).

Scope of Services

Pursuant to this engagement, we will provide the following tax consulting services:

- participate in necessary meetings to discuss further the S-Corporation Charitable Contribution Strategy;

Deleted: March 3, 2000

- provide an analysis of the economic consequences to you as a result of implementing the S-Corporation Charitable Contribution Strategy;
- assist you with the implementation of the S-Corporation Charitable Contribution Strategy as part of your overall income and estate plan;
- assist you in contacting the qualified tax exempt organization you identify to receive ______________ stock as a charitable contribution;
- assist in reviewing the instruments drafted by your legal counsel to confirm that they operate in conformity with the goals of the S-Corporation Charitable Contribution Strategy;
- provide an analysis of the projected income and estate tax consequences as a result of implementing the S-Corporation Charitable Contribution Strategy; and
- provide you with an opinion letter that addresses the income and estate tax issues associated with the implementation of the S-Corporation Charitable Contribution Strategy based on your facts and circumstances.

In order to provide these services, we will need access to certain financial data and documentation that you agree to provide to us.

We will base our conclusions on the facts and assumptions that you submit and will not independently verify this information. Inaccuracy or incompleteness of the information you provide could have a material effect on our conclusions. In rendering our advice, we may consider, for example, the applicable provisions of the Internal Revenue Code of 1986, as amended, [and the relevant state statutes,] the regulations thereunder, and judicial and administrative interpretations thereof. These authorities are subject to change, retroactively and/or prospectively, and any such changes could affect the validity of our advice. We will not update our advice for subsequent changes or modifications to the law and regulations, or to the judicial and administrative interpretations thereof, unless you separately engage us to do so after such changes or modifications.

The opinions we render will not be binding upon the Internal Revenue Service, any other tax authority or any court, and no assurance can be given that a position contrary to that expressed therein will not be asserted by a tax authority and ultimately sustained by a court.

Federal Confidential Communications Privilege

A confidentiality privilege under Internal Revenue Code Section 7525 may pertain to certain communications between KPMG personnel and you regarding federal tax advice provided pursuant to this engagement. By retaining KPMG, you agree that KPMG is instructed to claim the privilege on your behalf, with respect to any applicable communications, up to and until such time as you may waive any such privilege in writing.

Deleted: March 3, 2000

As disclosure of any such confidential communications to the Internal Revenue Service or other third party may cause any confidentiality privilege to be waived, you should notify us if the Internal Revenue Service or other third party requests information about any tax advice or tax advice documents provided by us.

[FOR KPMG AUDIT CLIENTS ONLY]
Privileged information may be used by you in preparing your financial statements and, subsequently by KPMG, as your auditors, in auditing those financial statements. In addition, professional standards require members of our audit team to discuss matters that may affect the audit with firm personnel responsible for nonaudit services, which includes tax services. The Internal Revenue Service may take the position that such use or communication results in waiver of the privilege. By executing this agreement, you acknowledge this possibility and authorize KPMG's use of such information in its audit work when required by applicable professional standards.

You understand that KPMG makes no representation, warranty or promise, and offers no opinion with respect to the applicability of such confidentiality privilege to any communication and agree to hold KPMG harmless should the privilege be determined not to apply to particular communications. You agree to indemnify KPMG for any attorneys' fees and other costs and expenses incurred by KPMG in defending the confidential communications privilege on your behalf.

Fees

Our fee will be a fixed fee of $____________, plus out of pocket expenses. We will render progress billings to you as work is performed. Our fees for this engagement will be progress billed as follows:

Progress bill to be mailed on	*Amount to be billed*
Contribution of stock to the tax-exempt entity	$________ plus expenses incurred to date
Issuance of Opinion Letter regarding entitlement to a charitable deduction	$________ plus expenses incurred to date
Issuance of Final Opinion Letter regarding corporate recapitalization and personal tax matters	100% of the fee less previous billings.

Deleted: March 3, 2000

We anticipate issuing the final opinion letter within 60 days after the contribution of stock to the tax-exempt entity.

You agree, by accepting the terms of this letter, to pay all invoices to KPMG within 30 days of receipt.

Issues or circumstances encountered that are beyond the scope of this engagement will be billed at our normal professional rates. We will notify you of such circumstances as they arise and will not incur additional expenses without your prior consent. Specifically, the fees quoted and the scope of the engagement do not include representing you in the event of a challenge by the IRS or otherwise.

It is your responsibility to separately engage and pay an attorney who will be responsible for drafting the documents needed to implement the S-Corporation Charitable Contribution Strategy, and for advising you on the non-tax legal aspects of the strategy. In addition, you will be responsible for separately engaging and paying an independent qualified valuation firm to perform the valuation necessary to substantiate the amount of the charitable contributions deduction to be claimed by you. To the extent services of any other professional service providers are required, you likewise are responsible for engaging and paying such service providers.

You agree to cooperate in supplying the information necessary for performance of the services pursuant to this engagement. Such information shall be provided in a timely manner.

If the potential anticipated benefits are no longer possible to achieve because of legislative or regulatory change or final and controlling adverse judicial decision, or any combination thereof, your sole remedy against KPMG under this agreement is limited to a release of your obligation to KPMG of any fees not yet due as of the date of the enactment of the legislation, promulgation of the regulation, or date of final and controlling judicial decision disallowing the benefit. If, at any time prior to the completion of the engagement (defined as the issuance of the Final Opinion Letter), you decide for any other reason it is not in your best interest to continue with the engagement, you may notify us to that effect. In the event of such notification, you agree to pay KPMG for time charges at standard hourly rates and actual expenses incurred through the date of notification in addition to the fees previously billed. **[If the S-Corporation is an audit client, or if any existing shareholder of the S-Corporation is in a position of significant influence over a public audit client , the following sentence must be omitted from the letter.]** However, if you

Deleted: March 3, 2000

later implement the strategy without our assistance, the fee will be $_______________ (less amounts previously paid).

Other Matters

KPMG will not, pursuant to this agreement, perform any management functions for you or make any management decisions. You are responsible for making management decisions, including accepting responsibility for the results. Additionally, you are responsible for designating a management-level individual or individuals responsible for overseeing the services provided, evaluating the adequacy of the services provided, evaluating any findings or recommendations, establishing and maintaining internal controls, and monitoring ongoing activities.

You acknowledge receipt of a memorandum discussing certain risks associated with the strategy and represent that you have read and understand the matters discussed in that memorandum..

Written advice provided by KPMG to you is for your information and use only and may not be relied upon by any third party without the express written permission of KPMG.

KPMG's maximum liability to you arising for any reason relating to services rendered under this letter shall be limited to the amount of fees paid for these services. In the event of a claim by a third party relating to services under this letter, you will indemnify KPMG and its personnel from all such claims, liabilities, cost and expenses, except to the extent determined to have resulted from the intentional or deliberate misconduct of KPMG personnel.

[IF A PROSPECTIVE CLIENT EVALUATION HAS NOT BEEN COMPLETED:]
Our agreement to provide the professional services described in this letter is subject to the satisfactory completion of certain prospective client evaluation procedures with regard to [CompanyName].

Please sign the enclosed copy of this letter to confirm our agreement and return it to us within 30 days. If you have any questions, please call me.

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Very truly yours,

KPMG LLP

WriterName
[Partner, Principal, Tax Managing Director, Senior Manager, or Manager (if a tax managing director, senior manager, or manager is signing, a partner or principal has reviewed and approved the engagement letter as required by firm policy)]

Enclosure

ACCEPTED:

__________________________ _______________
Signature Date
(Individually, and on behalf of __________________)

Deleted: March 3, 2000

ROUTING/REVIEW INSTRUCTIONS

bcc: business unit professional practice partner - tax

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Draft Script 6/1
S-Corporation Charitable Contribution Strategy

Overview:

If you reach a gatekeeper, first objective is to get to the Owner. If you can't reach the Owner, opt for the Chief Financial Officer, if there is one. If no CFO, see if the gatekeeper knows or can get you the information below to qualify the prospect.

Gatekeeper Script:

Hello, are you ___________'s assistant? Great! This is ___________ with KPMG's Tax Practice. I was wondering if you could help me? We have an innovative tax strategy that could potentially benefit closely-held companies like yours, but I have a couple of questions to make sure we have a good fit with your company's situation. Would s/he have five minutes for me?

Yes

Great, thanks so much!

No

I understand. Is there a CFO in your company whom I could speak to, instead?

Yes No

Perhaps you could help me, then?

Maybe

I understand this might be a bad time. But I'm sure s/he would be interested in how we can possibly mitigate taxes. Which would be better for him/her, ______ or ______ today/ tomorrow ?

Thanks for your help. I'll look forward to speaking with him/her at ______ today/tomorrow.

Owner/CFO Opening:

Hello, ___________? This is ___________ with KPMG's Tax Practice. We have an innovative tax strategy that could potentially benefit closely-held companies like ___________, but I have a couple of questions to make sure we have a good fit with your company's situation. Could you answer a few/handful of questions for me?

1,) Are you an "S," or a "C" corporation?

2.) How many stockholders do you have?

3.) Do you anticipate that your corporation will have net income of at least $3.3 million annually for the next 2-4 years? "Yes," go to Appointment Close. "No," go to Non-appointment Close.

Appointment Close:

Based upon what you've told me, it sounds like your corporation would be a prime candidate to benefit from our tax strategy. I'd like to schedule a time when our Tax Service Professional ____________, could call to discuss the strategy with you, further. Which would be better for you, ______ or ______ tomorrow?

Thank you for your time.

Non-appointment Close:

Based upon what you've told me, KPMG has other tax strategies that may be a better fit for your company. Now that we have a better idea of your company's situation, may we contact you again in the future regarding these other tax strategies?

Thank you for your time.

Date

Mr. Shareholder1
Mr. Shareholder2
S Corporation
Address
City, State

Re: Taxable income allocation of S Corporation

Dear Mr. Shareholder1 and
Mr. Shareholder2:

You have requested the opinion of KPMG LLP ("KPMG") as to how the taxable income of S Corporation ("S Corporation") should be allocated to you for Federal and California State income tax purposes. We have included below the facts upon which we will rely in the issuance of our opinion. We ask that you contact us immediately if any fact is not entirely complete or accurate, as the incompleteness or inaccuracy could cause us to change our opinion. We will not independently verify the completeness and accuracy of any of the following facts. In addition, we have assumed that all steps taken were properly effectuated under applicable Federal and State law.

In rendering our opinion, we are relying upon the Internal Revenue Code of 1986 and Treasury Department regulations thereunder, as amended and in effect on the date hereof, and Revenue Rulings, Revenue Procedures, the California Revenue & Taxation Code, as amended and reported judicial decisions as they existed on the date of this opinion letter. Each of the foregoing is subject to change or modification by subsequent legislation, or regulatory, administrative or judicial decisions. Any such change could also have an effect on the validity of the conclusions set forth herein retroactively or prospectively. Further, the opinion which is rendered should be considered together with various risks set forth in the Discussion and Caveat sections of this letter. Unless requested otherwise, we undertake no responsibility to update our opinion in the event of any subsequent change in the foregoing.

Our opinion is limited solely to how the taxable income of S Corporation should be allocated to you for Federal and California State income tax purposes. No opinion is rendered, expressed or implied with respect to the taxable income allocation to any other party. Furthermore, no opinion is expressed with respect to issues not specifically discussed herein, any other Federal, State or local tax, or legal issue.

FACTS

S Corporation is a California corporation that was incorporated in Date1. The effective date of its election to become a subchapter S corporation was Date2. The taxable year of S Corporation is the calendar year.

As of Date3, S Corporation had Number shares of stock outstanding, consisting of Number1 voting common shares and Number2 nonvoting common shares. The voting common shares and the nonvoting common shares possess the same rights to dividends and liquidation rights.

As of Date4, the Number outstanding shares were owned as follows:

Mr. Shareholder1	Number3 voting shares
Mr. Shareholder2	Number4 voting shares
Municipal Plan ("Municipal Plan")	Number2 nonvoting shares
Total	Number

Municipal Plan acquired all of its stock from contributions made by the Shareholders on Date3. Prior to the contributions, the Shareholders owned all of the stock of S Corporation.

The Shareholders and Municipal Plan have consented to treat the year 2000 taxable year of S Corporation as if it consisted of two separate taxable years, with the first taxable year ending on Date3.

CONCLUSION

Based on the facts set forth above, it is our view that so long as there are no ownership changes, it is more likely than not that for Federal and California State income tax purposes, the post-Date3, the items of income, gain, loss, deduction, or credit of S Corporation will be allocated as follows:[1]

Mr. Shareholder1	Percent1%
Mr. Shareholder2	Percent2%
Municipal Plan	Percent3%
Total:	100%

[1] In various sections of this opinion letter, language may be used (e.g., use of the word "will" or "should") that might indicate an opinion at a different standard of likelihood of success than "more likely than not." Notwithstanding the use of this language, we intend our conclusions to be confined to a standard of "more likely than not."

Any items attributable to the period ending Date 3, would be allocable 100% to the Shareholders.

DISCUSSION

Subchapter S corporations are pass-through entities for federal income tax purposes.[2] Thus, the S corporation must pass through items of income, gain, loss, deduction, or credit separately to its shareholders,[3] and generally, the corporation is not subject to any federal corporate level tax on those items,[4] so long as a valid S corporation election is in effect for the entire year.[5] Because subchapter S corporations are pass-through entities, shareholders are taxed on the income and gain of the corporation even if the corporation does not actually make distributions to the shareholders.[6]

Generally, the income of the subchapter S corporation is aggregated and the net amount passes through as so-called "nonseparately computed income or loss."[7] However, other items must pass through separately where such amounts could affect the shareholder's computation of tax liability.[8] This is similar to the treatment these items would receive in a partnership.[9]

Under Section 1366(a),[10] each shareholder's share of income, gain, loss, deduction, or credit of the corporation is determined on a *pro rata* basis. Specifically, each shareholder's share of a separately or nonseparately stated item for any taxable year is the sum of the amounts determined with respect to the shareholder on a per-share, per-day basis by: (i) assigning an equal portion of such item to each day of the taxable year; and (ii) by dividing that portion pro rata among the shares outstanding on that day.[11] The per-day, per-share rule is a mechanical method for allocating an S corporation's items of income, gain, loss, deduction, or credit among its shareholders.[12] It does not require tracing actual items to the day received or incurred; instead, year-end results are allocated back to each day during the year on a *pro rata* basis.[13]

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[2] *See* I.R.C. Sec. 1366.
[3] *Id.*
[4] I.R.C. Sec. 1366(a). However, there are certain circumstances in which an S corporation may be required to pay tax at the corporate level but only with respect to certain items, and only if the S corporation was ever a C corporation. *See* I.R.C. Sec 1374 and 1375.
[5] I.R.C. Sec. 1362.
[6] *Knott v. Commissioner.*, T.C. Memo 1991-352.
[7] I.R.C. Sec. 1366(a)(1)(B).
[8] I.R.C. Sec. 1366(a)(1)(A). Charitable contributions are one such item that must be separately stated.
[9] *See* Reg. Sec. 1.702-1(a)(8)(i).
[10] All references herein to Sections are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.
[11] I.R.C. Sec. 1377(a).
[12] *See Tax Planning for S Corporations*, §4.01 (Matthew Bender 1998).
[13] I.R.C. Sec. 1377(a).

In determining the shareholders' respective *pro rata* share, no distinction is made between voting and nonvoting stock.[14] In addition, options, warrants and debentures do not constitute outstanding stock and therefore are not allocated any of the taxable income of the corporation provided that their strike price can be shown to be not substantially below the fair market value of the stock on the date the options are issued or on any date that they may be materially modified.[15]

Under Regulation Section 1.1368-1(g)(2), solely for allocation purposes, an S corporation may elect to treat a taxable year as if it consisted of two taxable years, if there is a "qualifying disposition." A "qualifying disposition" is defined as, "[a] disposition by a shareholder of 20 percent or more of the outstanding stock in one or more transactions during any thirty-day period during the corporation's taxable year."[16] Essentially, the S corporation may elect to close its books as of the qualifying disposition date. The shareholders of the corporation prior to the closing of the books are allocated the income of the company as of the closing date. The shareholders after the closing date are allocated the income of the second portion of the year.

The transfers by both Shareholder1 and Shareholder2 should constitute "qualifying disposition[s]" because each transfer represented more than twenty percent of the outstanding stock. S Corporation therefore may elect to close the books as of Date3.[17]

Therefore, the Shareholders should be allocated all of the taxable income as of Date3.[18] Municipal Plan will own 90% of S Corporation's outstanding stock as of Date4. After the closing of the books, 90% of S Corporation's income which is accrued after the closing date should be allocated to Municipal Plan.

California law follows the federal law with respect to the allocation of S corporation taxable income.[19]

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[14] *See* I.R.C. Sec. 1361(c)(4) and Reg. Sec. 1.1361-1(l)(1). Under these provisions, differences in voting rights are ignored and both voting and nonvoting stock are considered to be of the same class of stock so long as distribution and liquidation rights are the same.
[15] *See* Reg. Sec. 1.1361-1(l)(4)(iii)(A); *Hume v. Commissioner*, T.C. Memo 1988-458 (an option to acquire S stock held by an ineligible shareholder did not disqualify the S election because the option was not exercised).
[16] Reg. Sec. 1.1368-1(g)(2)(i)(A).
[17] The time and manner of making the election are specified in Reg. Sec. 1.1368-1(g)(2)(iii).
[18] Treas. Reg. Sec. 1.1377-1(a)(2)(ii) provides that a shareholder who disposes of stock in an S corporation is treated as the shareholder for the day of the disposition.
[19] *See* Ca. Rev. & Tax. Code Sec. 17087.5

Until there are any changes in ownership, income should be allocated as follows:

	Income as of Date3	Income after Date3
Mr. Shareholder1	Percent4	Percent1%
Mr. Shareholder2	Percent5	Percent2%
Municipal Plan	0%	Percent3%
Total:	100%	100%

CAVEAT

No opinions are provided with respect to issues not specifically set forth in this letter. No inference should be drawn regarding any matter not specifically opined upon. Our opinion does not cover any foreign or local tax consequences including but not limited to, income, franchise, sales, use, excise or transfer taxes.

This opinion sets forth our views based on the completeness and accuracy of the above stated facts. If any of the foregoing is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. In rendering our opinion, we are relying upon the relevant provisions of the Internal Revenue Code of 1986 and the California Revenue & Taxation Code, as amended, the regulations thereunder, and judicial and administrative interpretations thereof, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes could also have an effect on the validity of our opinion. This opinion is not binding on the IRS, any other tax authority, or any court. No assurance is given that a position different than that expressed herein will not be asserted by a tax authority and sustained by a court.

This opinion may only be provided to the IRS or a state taxing authority in connection with an examination of the underlying issues.

Very truly yours,

KPMG LLP

S CORPORATION
S CORPORATION CHARITABLE CONTRIBUTION
3 YEAR OPTION

PROJECTED TAXABLE INCOME/ DISTRIBUTIONS (DIVIDENDS)

	INCOME	DISTRIBUTIONS	
1st 12 mos	$5,000,000	$0	Input
2nd 12 mos	$5,000,000	$0	Input
3rd 12 mos	$5,000,000	$0	Input

CHARITABLE CONTRIBUTION AS A PERCENTAGE OF TAXABLE INCOME	15.0%	Input
FEDERAL TAX RATE	39.6%	Input
STATE TAX RATE	9.30%	Input
EFFECTIVE FEDERAL AND STATE TAX RATE	45.22%	Automatic
STATE FRANCHISE TAX	1.5%	Input
COMPANY'S RATE OF RETURN ON INVESTMENT OF TAX SAVINGS	10%	Input
PERCENTAGE OF CASH TO BE DISTRIBUTED AT END OF STRATEGY	0%	Input
CASH DISTRIBUTED NET OF TAXES	($149,108)	Automatic
TOTAL TAX SAVINGS	$6,054,784	Automatic

ASSUMPTIONS USED IN MODEL

1) Shareholders' beginning basis is equal to zero.
2) The amount of the charitable contribution is computed on the lesser of Year 1 or Year 2 projected taxable income.
3) Shareholders are in the top Federal tax bracket with an ordinary income tax rate of 39.6%.
4) Taxable income is allocated 90/10 between the tax exempt and the shareholders.
5) Distributions at the end of the strategy are taxed at a Federal rate of 20% plus the applicable state tax rate.
6) The strategy is in place for 3 years, i.e. the tax exempt is redeemed in the 37th month.
7) The redemption amount is equal to the FMV of the contribution on the date it was contributed to the tax exempt plus 2.5% of the accumulated cash in the Corporation.
8) No distributions will be out of C corporation earnings and profits.
9) The Company has no section 751 property.
10) Taxable income represents "real" cash flow in the corporation. No income is associated with accounting adjustments.

This document is for internal use only. It is not to be provided or used by anyone not a member of management for any purpose. The document is prepared solely for purpo of illustrating the hypothetical results of a tax planning strategy under certain assumptions, which assumptions may be oversimplified and the hypothetical results of which n be subject to challenge. The document is not intended to be and is not a projection of future results of operations, cash flows, or results of operations.

Proprietary Material
Confidentiality Requested

KPMG 0007982

Permanent Subcommittee on Investigations
EXHIBIT #96ll

S CORPORATION
S CORPORATION CHARITABLE CONTRIBUTION
3 YEAR OPTION

PROJECTED TAXABLE INCOME/ DISTRIBUTIONS (DIVIDENDS)

	INCOME	DISTRIBUTIONS	
1st 12 mos	$10,000,000	$0	Input
2nd 12 mos	$10,000,000	$0	Input
3rd 12 mos	$10,000,000	$0	Input

CHARITABLE CONTRIBUTION AS A PERCENTAGE OF TAXABLE INCOME	15.0%	Input
FEDERAL TAX RATE	39.6%	Input
STATE TAX RATE	9.30%	Input
EFFECTIVE FEDERAL AND STATE TAX RATE	45.22%	Automatic
STATE FRANCHISE TAX	1.5%	Input
COMPANY'S RATE OF RETURN ON INVESTMENT OF TAX SAVINGS	10%	Input
PERCENTAGE OF CASH TO BE DISTRIBUTED AT END OF STRATEGY	0%	Input
CASH DISTRIBUTED NET OF TAXES	($349,094)	Automatic
TOTAL TAX SAVINGS	**$12,164,654**	Automatic

ASSUMPTIONS USED IN MODEL

1) Shareholders' beginning basis is equal to zero.
2) The amount of the charitable contribution is computed on the lesser of Year 1 or Year 2 projected taxable income.
3) Shareholders are in the top Federal tax bracket with an ordinary income tax rate of 39.6%.
4) Taxable income is allocated 90/10 between the tax exempt and the shareholders.
5) Distributions at the end of the strategy are taxed at a Federal rate of 20% plus the applicable state tax rate.
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REDACTED

S CORPORATION CHARITABLE CONTRIBUTION
3 YEAR OPTION

PROJECTED TAXABLE INCOME/ DISTRIBUTIONS (DIVIDENDS)

	INCOME	DISTRIBUTIONS	
1st 12 mos	$5,000,000	$0	Input
2nd 12 mos	$6,000,000	$0	Input
3rd 12 mos	$7,000,000	$0	Input

CHARITABLE CONTRIBUTION AS A PERCENTAGE OF TAXABLE INCOME

	10.0%	Input
FEDERAL TAX RATE	38.6%	Input
STATE TAX RATE	9.3%	Input
EFFECTIVE FEDERAL AND STATE TAX RATE	44.31%	Automatic
STATE FRANCHISE TAX	1.5%	Input

COMPANY'S RATE OF RETURN ON INVESTMENT OF TAX SAVINGS

	7%	Input

TOTAL TAX SAVINGS	$6,899,949	(includes redemption & transaction costs)

ASSUMPTIONS USED IN MODEL

1) Shareholders' beginning basis is equal to zero.
2) The amount of the charitable contribution is computed on the lesser of Year 1 or Year 2 projected taxable income.
3) Shareholders are in the top Federal tax bracket with an ordinary income tax rate of 39.1%.
4) Taxable income is allocated 90/10 between the tax exempt and the shareholders.
5) Distributions at the end of the strategy are taxed at a Federal rate of 20% plus the applicable state tax rate.
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