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Q&A With Arnold & Porter's Benjamin Berk

Law360, New York (January 27, 2014, 3:38 PM ET) -- [Benjamin Berk](#) is a partner in Arnold & Porter's San Francisco office where he is a member of the firm's tax and investment management practice. Berk is engaged in a broadly based business tax practice where he does work in partnership and limited liability company taxation, mergers and acquisitions, equity compensation and international taxation.

Berk has particular expertise representing institutional investors in private equity, venture capital and real estate funds. Other areas of experience include negotiating, drafting and structuring partnership and limited liability company agreements, with an emphasis on private equity and real estate and hedge funds; structuring equity compensation arrangements, including profits interests; advising on unrelated business taxable income; inbound foreign tax planning; and blocker structures. His representative clients include the Regents of the University of California, MLC Limited (a subsidiary of National Australia Bank) and the Gordon and Betty Moore Foundation.

Berk is co-author of "California Limited Liability Company Forms and Practice Manual," the first book on California limited liability companies. He is also a frequent lecturer on limited liability companies and related tax matters.

Berk earned his J.D. from the University of California, Hastings College of the Law and an LLM from New York University School of Law. He received his B.A. from the University of California, Los Angeles, magna cum laude.

Q: What is the most interesting or challenging tax problem you've worked on to date?

A: Structuring foreign investment into U.S. real estate to minimize U.S. tax. We are seeing a lot of interest by foreign persons investing in U.S. real estate, either through fund structures or private investments. This is always a challenge because the potential federal income tax rate from U.S. real estate investments could be as high as 54.5 percent for foreign investors. In contrast, gains from U.S. non-real estate investments generally are not taxed at all to foreign investors. As you can imagine, foreign investors are often surprised at this result.

Once the foreign investor checks around to confirm the potential 54.5 percent tax rate — and determines we are not completely insane — the challenge is then to utilize bona fide structures to minimize U.S. income tax liability. Of course, the foreign investor wants a silver bullet that is simple and eliminates all taxes, however such a thing does not exist.

With some planning and tolerance for complexity and expense, however, we can often reduce the effective tax rate down to an acceptable level. One solution is a leveraged blocker. In a leveraged blocker, the foreign person establishes a U.S. corporation to make the investment. The foreign person loans part of the investment to the U.S. corporation, which generates U.S. tax deductions to the corporation. Because the U.S. corporation can deduct the interest, this lowers the effective U.S. tax rate. For this to work, however, we need to navigate a series of complex U.S. tax provisions, including the debt-to-equity rules, the earnings stripping rules and the portfolio interest exemption from U.S. withholding tax. The foreign person would also typically want to hold its interest in the U.S. corporation through a foreign corporation to avoid the U.S. estate tax.

Another structure to minimize U.S. tax is a domestically controlled real estate investment trust. The structure can be complex, but generally requires that U.S. persons own more than 50 percent of the REIT shares. And of course the detailed REIT requirements must be met. This structure tends to work best for the foreign investor if it ultimately sells its REIT shares, rather than the REIT selling the underlying real property.

Q: Currently, what is a pressing tax concern for your clients, and how are you addressing it?

A: Unrelated business taxable income (“UBTI”) that arises from investments by tax-exempt investors in private equity and venture capital funds. We represent many tax-exempt investors. While tax-exempt organizations typically do not pay tax, they are taxed on UBTI. One way UBTI arises is if the private equity fund invests in an operating business organized as a limited liability company. Historically, private equity funds only invested in C corporations, which does not result in UBTI. However, there is a clear trend towards such funds investing in operating businesses structured as limited liability companies, which would generate UBTI to the tax-exempt investor.

Many uninformed tax-exempt investors simply assume they want to avoid UBTI at all costs. Their solution is to invest through a U.S. corporation to block the UBTI. While this avoids UBTI, the blocker corporation is subject to a full 35 percent federal income tax. Although the tax-exempt organization does not directly pay the tax, this reduces the after tax return to the tax-exempt investor. Often the tax paid by the blocker corporation exceeds the potential tax on UBTI. So I find myself counseling tax-exempt investors to carefully analyze use of a blocker. Often the answer is the tax-exempt organization is better off not using a blocker. I have worked on several projects where after running the numbers the client decided to not invest through a blocker.

Q: What do you anticipate being the biggest regulatory challenge in your practice in the coming year and why?

A: Major tax reform, but I am not really too concerned about it. I think the tax code should be overhauled and simplified. But given the stalemate in Congress, I just don’t see major tax reform happening anytime soon.

Slightly more likely to occur would be taxing carried interest as ordinary income. But, I think that is unlikely to occur in the next couple of years. If it did, it would require rethinking a lot of fund and private business structures. We would be busy.

Q: Outside of your own firm, who is an attorney in your practice area whom you admire, and what is the story of how s/he impressed you?

A: I admire Gary P. Kaplan of Sidley Austin LLP. He was formerly my partner and is a creative, smart and practical lawyer with particular expertise representing non-U.S. persons.

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