Eliminate the “carried interest” loophole

One of the most extreme examples of Wall Street privilege is the tax loophole that allows financial executives to pay lower tax rates than teachers, firefighters, and nurses. Private equity and hedge fund managers pay a 20 percent capital gains rate on the bulk of their income, rather than the 39.6 percent ordinary income rate.

This loophole is a “policy mistake” won by Wall Street lobbyists, according to President Reagan’s Assistant Treasury Secretary for Tax Policy, John Chapoton. He and many other leading tax and finance experts argue that the profit share (known as “carried interest”) investment fund managers receive is a form of compensation for their services and should not be treated as capital gains.

Why eliminate the loophole?

1. **Correct an egregious example of tax unfairness.** This loophole is a significant factor in the growing gap between the richest 1% and everyone else in America. The top 25 hedge fund managers earned a total of $16.8 billion in 2017, according to *Forbes*. By comparison, the country’s 158,000 kindergarten teachers earn about $8.5 billion a year in total. Private equity fund managers also receive massive paychecks. Stephen Schwarzman, co-founder of the Blackstone Group, for example, earned nearly $1 billion in 2018.

2. **Raise significant revenue.** The Joint Committee on Taxation estimates that closing this loophole would generate $20 billion over 10 years. A more updated estimate is needed from the JCT to reflect the revenue potential of fully closing this loophole after minor changes were made to it in the recent tax law. Other tax experts predict far larger amounts. Victor Fleischer, Professor of Law at the University of San Diego, for example, estimates that fixing this loophole would result in $180 billion over 10 years.

3. **Respond to universal public opposition**. By a margin of 75% to 20%, voters want to “eliminate the loophole that allows hedge fund managers to pay a lower tax rate than middle-class taxpayers.” Even a strong majority of investment professionals believe carried interest should be taxed as ordinary income. In addition, there is support for reform from across the political spectrum. President Obama included a fix in his budget proposals and Democratic proposals passed the House several times, only to fail in the Senate. Republican supporters include Jeb Bush, former House Ways & Means Chairman Dave Camp, and former Deputy Under Secretary for Tax Policy Michael Graetz. Industry leaders from Warren Buffett to hedge fund managers Marc Lasry, Scott Fearon, and Jim Chanos have also been critical of this loophole.

4. **Level the industry playing field and curb tax dodging.** Eliminating this loophole would remove a tax preference that currently favors private equity firms over other U.S. corporations. It would also discourage tax dodging aimed at converting short-term to long-term gains for tax purposes.

Bill

The Carried Interest Fairness Act of 2017 (H.R. 2295/S. 1020) requires that the “carried interest” compensation received by private equity and hedge fund managers be taxed at ordinary income rates rather than the much lower capital gains rate.

Let's build a financial system for
working families, White, Black & Brown,
not big Wall Street banks.

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