

Private Equity Taxation: The Secret Tax on Your Retirement

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- Since Sarbanes-Oxley passed, many companies have chosen to de-list from U.S. stock exchanges (332 in 2004 and 2005 alone). In some cases, they have migrated off-shore to other exchanges like London; in other cases, they have gone private.
- Much of the investment that used to go toward buying shares in public companies now goes to buying stakes in private companies. This large-scale purchasing of private company ownership is called **private equity**. In the last 15 years, private equity firms have distributed \$430 billion in profits to their partners.
- Many defined benefit pension funds, college endowments, and charitable foundations are invested in private equity funds. Their investment stake is in the billions of dollars.
- Private equity is a partnership arrangement with a managing general partner. Under current tax rules, he is compensated using the “**2-and-20**” method. That is, he gets paid a salary equal to 2% of the assets under management every year (taxed as ordinary income, like any other wage). He also gets to receive 20% of the capital gains (called “**carried interest**”), if any, from the investments of the partnership (taxed at the lower capital gains tax rate). The partnership itself is pass-through and pays no taxes; rather, the partners pay tax on investment gains.
- **S. 1624 (Grassley-Baucus)** would introduce a third layer of tax on this arrangement for private equity firms that trade publicly going-forward. Under S. 1624, the underlying investment pays tax, the partners pay tax, and (under the bill) the partnership pays the 35% corporate income tax. This cascading of taxes would lead to an effective total tax rate of 64% on partner dividends. **ATR will soon declare this to be a Pledge violation.** This bill may be referred to as the “publicly-traded partnership”, “Blackstone” or “PTP” bill for short.
- **H.R. 2834 (Levin-Rangel)** would tax the “20” part of “2-and-20” as ordinary income. That would mean that 20% of the capital gains from these investments wouldn’t be taxed at the capital gains rate (15%), but at ordinary rates (35%, rising to nearly 40% in 2011). **ATR has declared this to be a Pledge violation.** This bill may be referred to as the “carried interest bill” for short.
- **There are three main arguments against these related measures:**
 1. **Assault on Pensions and Charities.** This is a direct assault on every firefighter’s, cop’s, nurse’s, and teacher’s pension in America. It’s an assault on the nest egg of every local college. It’s an attack on the resources charities have to do work in their communities.
 2. **Assault on Savings and Growth.** Since the 2003 tax cut that lowered the capital gains and dividends rate to 15%, the S&P 500 Index has increased by over 13% a year. Household net worth has grown by over \$12 trillion, or 27%. The Democrat plan to raise the tax rate on savings from 15% to 40% will wreck the economy. This is just the first assault on the lower rates that have given us such undeniable prosperity.
 3. **“Liberal Tax Hike of the Week.”** This is just the latest money-grab from Congressional Democrats this year. They want to raise taxes on energy, raise taxes on businesses that sell U.S. goods overseas, raise taxes on Americans abroad, raise taxes on smokers, and now they want to raise taxes on every pension, college and charity in America.