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LEGISLATION

Partnerships on tax watch

House OKs carried interest tax provision, but Senate may balk

By Doug Halonen

WASHINGTON — Efforts to derail legislation hiking taxes on alternative investment partnerships might go down to the wire.

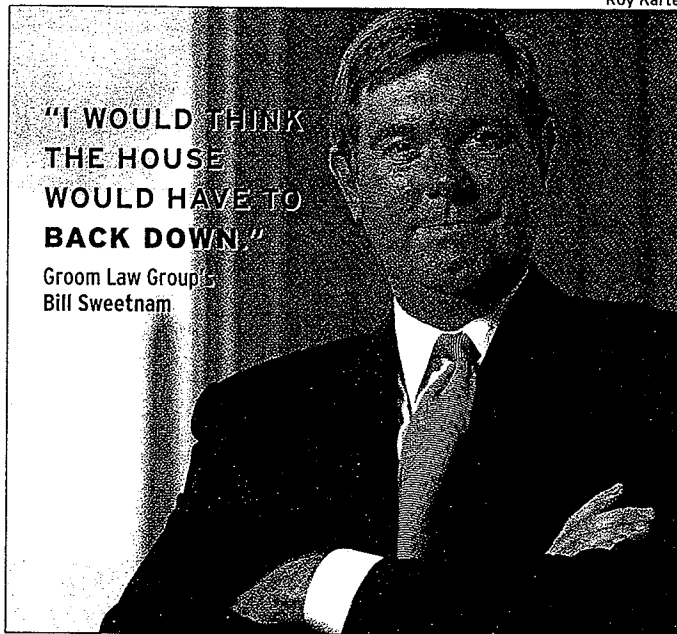
Last week, the House of Representatives approved, on a 216-193 vote, a tax bill that would impose income-tax rates of up to 39.6% on carried interest earned by hedge funds, private equity and other forms of investment partnerships.

But some lobbyists are betting that the partnerships can beat the tax — at least for this year — when leading lawmakers in the House and the Senate put the final touches on the legislation.

Rep. Charles Rangel, D-N.Y., the powerful chairman of the House Ways and Means Committee, pushed through the bill that would

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boost the tax rate on limited partnerships as a way to pay for temporary relief from the alternative minimum tax for millions of Americans.

Leading senators, however, are cool to the tax.

Sen. Max Baucus, D-Mont., chairman of the Senate Finance Committee, is expected to introduce soon AMT-relief legislation that would exclude the tax hike on carried interest.

Ultimately, lobbyists hope that House Democrats will give up the tax hike on partnerships when bills passed by both chambers go to a conference committee composed of House and Senate legislators.

"I would think the House would have to back down," said Bill Sweetnam, a partner with the Groom Law Group, Washington.

Narrow margin

Even those who sense that the industry can beat the new tax this year said the margin of victory would be narrow at best.

Said a lobbyist for the private equity industry who asked not to be identified: "It will be close in the Senate, but I think the Senate will pass an AMT fix without a carried interest tax increase."

Key Senate Republicans, led by Sen. Charles Grassley, R-Iowa,

the ranking member of the Senate Finance Committee, have made clear that they oppose tying AMT relief to tax increases, including the enhanced levies for carried interest. That position has been endorsed by Treasury Secretary Henry Paulson. (White House representatives have also threatened a veto if tax increases are included in the AMT relief bill.)

Alternative investments partnerships claim that more than doubling tax rates would be devastating to investments in those areas.

For example, The Real Estate Roundtable, Washington, released a study on Nov. 6 claiming that as much as half of the \$1 trillion of equity capital estimated to be invested in commercial real estate partnerships could move to other investments over the next 10 years if the carried interest tax rates are hiked.

"A 133% tax increase on real estate general partners will have a very negative effect on jobs, economic growth and local tax bases," Jeffrey DeBoer, roundtable president and chief executive officer, said at a news conference.

"The housing and financial markets already are reeling from housing market corrections, and problems in the subprime lending markets are creating financing difficulties across the economy," Mr. DeBoer said. "Imposing a damaging tax increase on real estate now on top of this turmoil is ill-conceived."

At the same time, venture-capital lobbyists are making a pitch for a carve-out from any new carried-interest tax.

"We're hopeful that lawmakers will recognize the importance of venture capital to America's innovation and economic growth," said Jim Hock, a spokesman for the National Venture Capital Association, Arlington, Va.

Whatever lawmakers do on the subject, they'll have to move quickly, because the Internal Revenue Service needs to complete its tax forms for 2007 returns by Nov. 16 to avoid expensive reprinting costs. If that deadline is missed, the IRS also could face delays of up to 10 weeks in refunding up to \$75 billion to 50 million taxpayers, a message that Rep. Jim McCrery, R-La., the ranking minority member on the House Ways and Means Committee, has been publicizing. Mr. McCrery voted against Mr. Rangel's AMT-relief package when the committee voted Nov. 1.

Even if alternative investment partnerships dodge the carried-interest tax bullet this year, the same provision has already been included in a major tax reform package introduced by Mr. Rangel that is expected to be debated next year.

"I can't imagine the carried interest tax increase is going away," said Heather Slavkin, senior legal and policy adviser in the office of investment, AFL-CIO, Washington. "It's a fundamental issue of tax fairness." †