About This Series…

A periodic update of current finance-related issues covering audit and accounting, tax, and regulatory matters affecting organizations that operate within the financial services sector.

FINANCE ALERT

Carried Interest: Proposed Tax Increase

Currently in the investment management industry, income from "carried interest" (usually, a partnership interest received for services) generally would be taxed at favorable capital gains rates. Congress is proposing a bill that would tax carried interest at higher rates.

The American Jobs and Closing Tax Loopholes Act of 2010, which was passed by the House of Representatives at the end of May, includes a provision that would treat income from a carried interest as a combination of ordinary income and capital gain. When fully phased in, it would be taxed at 75% ordinary income and 25% capital gains. The House bill would have an effective date in 2011, but not fully phased in until 2013.

More favorably, the Senate is now considering an amendment to this legislation that would treat income from carried interest differently, depending on how it was earned. Income generated from assets held for a longer period of time would be taxed at a lower rate than those held for a shorter period of time. Subsequent amendments went further and provided that income derived from the assets held for at least five years would be taxed at 50% ordinary income and 50% capital gains as compared to the 75% / 25% income split in the House bill. Each of these bills differs dramatically from the President's original 2011 budget proposal which would have taxed 100% of income from a carried interest as ordinary income. The carried interest tax legislation has gone through many iterations and will likely continue with more iterations until there is sufficient consensus in Congress.

Even though several prior attempts to adjust the tax treatment of carried interest have failed, the current economic conditions make the possibility of change more probable. According to the Senate Finance Committee, the carried interest component of the proposed amended bill would raise $13.6 billion of additional revenue over 10 years.

Should this bill be passed, managers at funds must begin to review their current operating and other agreements. Most likely, there will be a need to adjust these agreements to reduce the results of such new taxes on net income, returns and incentives.

The Financial Services Group at Holtz Rubenstein Reminick works in conjunction with management's counsel to provide tax planning strategies, including estate tax planning and succession planning. Our partners have extensive experience within the alternative investment industry. We also understand the importance of partner involvement and, as such, we ensure that our partners manage all aspects of client engagements. Our clients know that we are always available and knowledgeable about their business. Since a high degree of partner involvement allows for increased efficiencies, we are able to remove unnecessary bureaucracy. Our clients speak directly with the decision-maker to work through the issues.

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