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Hedge Fund Managers

Carried interest tax loophole.

Democrats want to close it.

The loophole benefits private equity.

Public equity could benefit from closing this loophole.

What?
Tax avoidance is a powerful motivator. Hedge funds use investor's money to, among other things, purchase businesses, either public or private, with the intention of a profitable return. Public equity transactions are regulated by the Securities Exchange Act of 1934 while private equity transactions are not. These funds may or may not use hedging, so the name may be a little misleading. They use investor's money to purchase a business with the intention of a profitable return. They typically charge "2 & 20" meaning they are paid a fee, say 2% (a negotiated fee for management) and also a share of the gain each period, say 20%. This 20% is referred to as carried interest. For income tax purposes, the hedge fund manager pays ordinary income tax on the 2% and capital gain tax on the 20%. A pretty good incentive for hedge fund promotion. The NYSE (New York Stock Exchange, a public equity market) consists of 2400 companies with market value of $23 trillion. I can't find a good estimate of the private equity market but I'm pretty sure a great deal of money is allocated to private rather than to public due to the tax incentive. This serves to motivate business to be private and narrows the field of publically traded business

Simply put, Carried Interest is a method of compensating private equity and hedge fund managers. The controversy over carried interest arises because of the fact that tax law allows the managers to pay taxes on carried interest at the capital gains tax rate rather than the higher tax rate that normally applies to ordinary income.

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