Wednesday, January 29, 2020

Budget and Taxation Committee - Bill Hearing SB-216

1:00 PM - West Miller Senate Building, Room 3, Annapolis, MD

Testimony: Charles Khan, Organizing Director, Strong Economy For All Coalition

Good afternoon members of the Senate Budget and Tax Committee. My name is Charles Khan, and I serve as the Organizing Director of the Strong Economy for All Coalition. Chairman Guzzone, thank you for the opportunity to present testimony today.

Strong Economy for All is a labor-community coalition working on issues of economic fairness, jobs, income inequality and effective government policies to promote broad prosperity.

We are made up of some of New York’s most effective unions and community organizations, within NY and across the country

Strong for All was established to fight for policies and programs that will address income inequality, and we’d like to say clearly and directly that fair-share tax policies are essential to addressing economic inequality in the United States, properly funding needed investments in our future, and assuring broader prosperity for all Americans.

We urge the General Assembly to take action to repatriate revenue lost to the federal-level carried interest loophole and bring it to Maryland for new investments in schools, jobs, housing, and essential government services. We urge passage of legislation introduced to close the loophole, and suggest that the General Assembly consider incorporation of its language into this year's state budget.

Across the country states stand to gain hundreds of millions if not billions of dollars by acting where the federal government has failed. Elected officials on both sides of the aisle have called for closing something known as the "carried interest loophole," a legal fiction used by wealthy financiers to lower their federal tax rates below those paid by many working Americans.[1]

Unfortunately the Federal Tax Cut and Jobs Act in 2017 created even more loopholes and reinforced the incredible levels of inequality that already exist across the country.

The loophole is one of the clearest symbols of the inequity that exists in our economy and our tax code. It is among one of the most widely known and widely hated Wall St. loopholes.

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1 www.usatoday.com/story/opinion/2015/09/15/hedge-fund-carried-interest-donald-trump-jeb-bush-editorials-debates/72268922/

Hedge Fund and Private Equity funds are structured as partnerships. The fund manager is the known general partner of the funds, they make decisions about the fund and provide investment expertise. The investors are known as limited partners they supply the capital. It's important to note that general partners invest almost none of their own money. For the services the investment manager provides, he/she charges certain fees.

In both hedge funds and private equity funds, the standard fee structure is “2 and 20”. 2% of the total assets per year are taken as the management fee, which is supposed to cover operating costs and 20% of all gains are taken by the fund manager as the performance fee.

This 20% performance fee is where the magic happens for Hedge Funds and Private Equity. Instead of paying the ordinary income rate for what amounts to be a fee for services. They instead claim the capital gains rate which should only be available to the investor. Their justification is that they have invested “sweat equity”. Which if you are wondering is not a real or measurable form or equity. By doing this they can pay the 20% long term capital gains rate as opposed to the 37% top rate for ordinary income.[2]

[2] https://www.fas.org/sgp/crs/misc/RS22689.pdf

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This loophole at the federal level amounts to an estimated $18 billion per year, according to a 2016 analysis by law professor Victor Fleischer. [3]

Maryland's private equity and hedge funds are very conservatively estimated to be earning $264 million per year in under-taxed carried interest.

What that means is Senate Bill 216– to recapture this lost revenue by adding a 17% tax on only miscatergorized long term capital gains would add an estimated $45 million additional dollars to Maryland's general fund every year.

Really closing the carried interest loophole can be boiled down to a fairness issue. Small businesses pay their share of taxes. Hedge Funds don't. Nurses, Teachers and Construction workers pay their share Private Equity Firms don't.

The Strong Economy for All Coalition urges the Legislature to take action to repatriate revenue lost to the federal-level carried interest loophole and bring it to Maryland for new investments in schools, jobs, housing, clean energy infrastructure and essential governments services.

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3 www.nytimes.com/2015/06/06/business/dealbook/how-a-carried-interest-tax-could-raise-180-billion.html?_r=0