Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York

January 21, 2021

The Honorable Anne R. Kaiser
Chairwoman, House Ways and Means Committee
131 House Office Building
6 Bladen Street
Annapolis, Maryland 21401

Re: Oppose House Bill 215

Dear Chairwoman Kaiser and Members of the Committee:

Managed Funds Association ("MFA") welcomes the opportunity to submit this written statement regarding HB 215, *Income Tax – Carried Interest – Additional Tax*. MFA represents the hedge fund and alternative investment industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's members manage a substantial portion of the approximately $3.4 trillion invested in hedge funds around the world.

In Maryland, institutional investors, including pensions, university endowments, and charitable foundations, rely on hedge fund allocations to support retirement security, higher education, and the important work done by foundations and charities. They provide important options to investors seeking to increase portfolio returns with less risk, such as pension funds trying to meet monthly obligations to plan beneficiaries. The Maryland State Retirement and Pension System invests approximately $4.01 billion in hedge funds to help provide secure retirements for its more than 186,000 plan participants[1]. Johns Hopkins University Office of Investment Management invests approximately $1.35 billion in hedge funds to help fund education opportunities for its more than 25,000 students[2]. And Howard Hughes Medical Institute invests approximately $4.07 billion in hedge funds, which helps fund its support of biomedical scientists and educators[3].

MFA's members are also a valuable component of the capital markets. Private investment companies, including hedge funds, provide liquidity and price discovery to capital markets, and capital to companies seeking to grow or improve their businesses.

MFA supports fair taxation of all businesses and investors and opposes discriminatory taxes that impose punitive tax rates on specific businesses for reasons other than sound tax policy. HB 215 fails to meet this test, imposing a punitive tax regime on private investment managers without a clear policy rationale. If HB 215 aims to address perceived gaps in the tax treatment of carried interest income, this bill stops short of that goal. Instead, the bill would increase the combined marginal tax rates on our members from the current 49.75 percent to 66.75 percent by applying the surtax to income that is

[1] 2018 Survey Of Public Pensions: State & Local Datasets, United States Pension Bureau, 2018
[2] "Johns Hopkins University." U.S. News & World Report, 2019.
[3] "About Us." Howard Hughes Medical Institute.

already subject to the highest federal tax rates. Most hedge fund strategies hold assets for less than one year, meaning gains on those investments are taxed at the same rate as ordinary income. Similar to previous legislative proposals, the bill title suggests the proposed 17 percent surtax would be applied to carried interest income. However, notwithstanding some changes made to previous proposals, HB 215 would still apply a surtax on investment management services income that is unrelated to carried interest income, including fee income that is already taxed as ordinary income at the federal and state level.

The bill would impose a punitive 66.75 percent combined marginal tax rate on hedge fund managers based in Maryland, making business uneconomical. In addition, many out-of-state hedge fund managers will face the same excessive tax rate on the services they provide to Maryland investors. This will likely cause investment managers throughout the country to significantly limit the investment options for Maryland pensions, endowments, foundations, and other institutional investors that rely on these services to meet their obligations despite varying market conditions.

If Maryland were to enact the bill, it would be the first state in the country to impose this kind of surtax on the investment management industry, putting the state at a significant competitive disadvantage to other states. The tax, far from bringing in revenue to the state from "Wall Street" will likely have the reverse impact of making Maryland investors significantly less attractive participants in the capital markets and raising Maryland investor costs to meet current returns. Ultimately, the negative economic consequences of enacting HB 215 will outweigh the perceived tax revenue of the surtax.

In considering the likely effects of HB 215, we would like to share with policymakers how our members comply with the federal tax treatment of the income earned by hedge funds.

Hedge fund managers typically earn fee income (either based on assets under management or performance-based), which is taxed as ordinary income at the federal and state level, and they also can earn income that qualifies for treatment under the carried interest provisions. Despite the rhetoric, carried interest income is not automatically taxed at the lower long-term capital gains rate at the federal level. For most hedge fund managers, their carried interest income is taxed at ordinary income tax rates.

Under federal tax law following enactment of the Tax Cuts and Jobs Act, investment managers only pay long-term capital gains rates on their carried interest if the funds they manage own investments that generate capital gains income and the fund holds those investments for at least three years. Hedge funds typically do not hold investments for the three-year period necessary to generate long-term capital gains. As a result, the carried interest earned by hedge fund managers generally is taxed at ordinary income rates up to 37 percent at the federal level.

HB 215 would significantly limit the investment options for Maryland pensions, endowments, foundations, and other institutional investors making it more difficult for them to meet their obligations for their pensioners, students, and the local communities that depend on the generosity of Maryland foundations and charities. HB 215 would apply the 17 percent surtax on (1) investment management services income regardless of the federal tax rate paid on that income and (2) investment management services income that is unrelated to carried interest.

Because HB 215 would negatively impact Maryland's institutional investors and imposes a punitive tax rate with disparate treatment of hedge fund managers, MFA is unable to support the bill and encourages policymakers to oppose enactment of the legislation.

Sincerely,

Louis A. Costantino, Jr.
Executive Vice President and Managing Director,
Managed Funds Association

Cc: The Honorable Nick Mosby