NATIONAL TAXPAYERS UNION

October 19, 2021

The Honorable Elizabeth Warren
Chair, Subcommittee on Economic Policy
Senate Banking Committee
Washington, DC 20510

The Honorable John Kennedy
Ranking Member, Subcommittee on Economic Policy
Senate Banking Committee
Washington, DC 20510

Dear Chair Warren, Ranking Member Kennedy, and Members of the Subcommittee,

On behalf of the National Taxpayers Union, the nation's oldest taxpayer advocacy organization, I write to express our views ahead of an October 20 hearing titled "Protecting Companies and Communities from Private Equity Abuse" that will be before your subcommittee. NTU is concerned that this hearing will be used to push a big government agenda that could have significant consequences on the American economy and target a specific industry with punitive measures. As will be mentioned below, there are many reasons to resist the opportunity to impose additional regulatory and tax burdens onto American businesses and investors. We therefore urge you to stand with taxpayers by supporting free market policies that create wealth and prosperity for all.

Reports indicate that this hearing could be used as a platform for the reintroduction of the deeply-flawed "Stop Wall Street Looting Act." While the final details of this year's version of the legislation are not certain, it is expected to be similar to the previous iteration. Based on the last version of the bill, its introduction would be problematic for taxpayers and the American economy as it is likely to retain provisions to increase taxes and add more regulations onto private equity companies. We fear passage of this legislation would suppress private sector investment, hurt workers, and threaten the ability of companies to save businesses on the brink of failure. Together these effects would have negative consequences and could stunt America's economic recovery from the COVID-19 pandemic, which is already in an uncertain position.

As it relates to federal tax policy, this bill includes many dubious sections that would harm our overall competitiveness. Most problematic is the modification of the long-standing tax treatment of carried interest, which is the share of long-term profits that flow to investment managers who partner with investors. For over a century, the federal government has recognized carried interest as investment income, rather than wage income. As a result of this differing classification, any income derived from carried interest is treated as a capital gain instead of being taxed at ordinary income tax rates. Like other sources of investment income, carried interest is subject to more favorable tax treatment, with a top rate of 20 percent, compared to the top individual income tax rate of 37 percent.

Yet, the Stop Wall Street Looting Act would treat carried interest as ordinary income, which for some, could be a near doubling of their tax liability. As NTU noted in May, "this tax structure has allowed partnerships of entrepreneurs and investors to funnel capital into startups and construction. Those seeking to raise taxes claim this legislation would 'close a tax loophole.' This is false. As a 2017 letter from 22 Members of Congress aptly points out, "the classification of carried interest as capital gains is the correct one."

Additionally, the bill applies a 100 percent surtax on certain fees paid by target firms to private fund managers. A 100 percent tax rate is punitive and confiscatory. Separate provisions amend the amount of interest some funds are permitted to deduct on their tax liability. Certainly, the ideal tax structure would have a low rate and include no special provisions, but this legislation is an overall net tax increase without commensurate reductions to the capital gains tax rate.

On the regulatory side, the bill would hold private equity firms liable for all debts, legal judgments, and pension obligations of their portfolio companies - a concerning and unprecedented step. Further, it would effectively rewrite bankruptcy law with new rules and regulations when a private equity-owned company goes bankrupt. Section 302 adjusts the priority structure for creditor payments by reclassifying severance and employee benefit plans as administrative expenses.

While the aim of the bill is to force "Wall Street bigs" to pay a higher rate, the tax increase would ultimately be passed on to middle-class investors. Funds would simply pass along these higher expenses in the form of higher service charges to their clients, which could suppress realized returns. In some cases, the additional regulatory burdens would make it prohibitive for private equity to invest in solutions to turn businesses around. The irony is that without cash injections from private equity companies, many businesses would fail sooner, leaving employees out in the cold.

Supporters of the Stop Wall Street Looting Act may characterize private equity investments into failing companies as "legal looting," but these legitimate investments are a key part of a free functioning society. Private equity can help Main Street companies return to profitability and retain as many employees as possible. In fact, a 2019 piece by the *Wall Street Journal* Editorial Board sums up the role of private equity perfectly, they write, "private-equity firms make long-term investments in underperforming companies and aim to create value - and turn a profit - by fixing inefficiencies."

Thank you for considering our viewpoints on this critical issue. Should you have any questions, we stand ready to work with you.

Sincerely,

Thomas Aiello
Director of Federal Affairs

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