

Client Bulletin

Private Equity Practice



Wildman Harrold
Attorneys and Counselors

April 2007

Proposed Changes in the Tax Treatment of Carried Interest

Recent news reports from Washington, D.C. suggest that Congress is considering a significant change in the tax treatment of the portion of the compensation of private equity fund managers known as the “Carried Interest” compensation. According to the reports, a bipartisan group in the U.S. Senate, led by U.S. Senator Charles Grassley (R-IA), the ranking Republican on the Senate Finance Committee, is considering whether to introduce legislation that would classify the carried interest as ordinary income rather than long-term capital gains – a change which would have a dramatic effect on the taxes paid by private equity fund managers.

A few factors suggest the idea may have political momentum. First, in the wake of several high profile executive compensation flaps, many in Congress believe political points can be scored by targeting salaries, bonuses and payments to top executives including private investment fund managers. Second, the increased overall investment in private equity, especially by public pension funds, has leaders in Congress mulling whether they need to be more involved in all areas of regulating private equity investments. Third, and maybe most important, the Congressional budget pressures may fuel this tax increase. Together, these facts create an environment

where legislators on both sides of the political aisle may agree on private equity tax “reform.”

On the other hand, Congress will face strong opposition to the tax change in fear of jeopardizing the drivers of economic growth. The increased activity in private equity funds has been a significant driver in the economy, and this radical tax change could cool the incentives for those who are fanning the fire. Additionally, the practical implementation of such a tax reform could reach beyond the private equity industry.

To date, Sen. Grassley has not drafted the legislation, so nobody really knows how far-reaching such a proposal would go. It is likely that many details of any proposal remain undecided (e.g., how broadly the carried interest will be defined and what exceptions, if any, will be made to the new tax treatment). But, as the former Finance Committee Chair, Sen. Grassley carries political weight on this issue.

The Private Equity Practice at Wildman Harrold is dedicated to keeping our clients advised of new legislative and judicial developments as they occur. If you have any questions regarding these issues, please feel free to contact your primary attorney at Wildman Harrold or email us at privateequity@wildmanharrold.com for further information.

Client Bulletin

BUSINESS TRANSACTIONS:
John Eisel

EDITORS:
Alan Roth
(312) 201-2633
rotha@wildmanharrold.com

Mark Kromkowski
(312) 201-2768
kromkowski@wildmanharrold.com

Brad Hansen
(312) 201-2173
hansen@wildmanharrold.com

The information contained in this Client Bulletin is intended for general information purposes only and should not be construed as legal advice or opinion on any particular facts or circumstances. Readers are urged to consult an attorney with legal questions concerning specific factual circumstances.

Copyright © 2007 Wildman, Harrold, Allen & Dixon LLP. All rights reserved.

Chicago Office
225 West Wacker Drive
Suite 3000
Chicago, Illinois 60606
(312) 201-2000

www.wildmanharrold.com