ECONOMIC IMPACT ANALYSIS OF THE STOP WALL STREET LOOTING ACT

(S.2155/H.R. 3848)

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CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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Executive Summary

Private equity (PE) firms make long-term investments in companies poised for growth as well as undervalued or underperforming businesses. The private equity funds created by private equity firms to invest in various companies throughout the economy are often backed by capital from institutional investors, including public pension funds. PE funds have long played a major role in the development of a broad range of companies, which employ 8.8 million people across the United States, including several hundred thousand people across every state, such as Hilton Hotels, Popeyes, Uber, Airbnb, Dollar General, Dunkin Donuts, Jiffy Lube, LA Fitness, Tate's Bake Shop, Beats Electronics, The Nature's Bounty, and McGraw-Hill Education.

All told, the private funds industry drives a significant amount of economic growth in the United States and supports millions of jobs across the country. After multiplier effects on the economy, such PE-backed companies and the PE firms themselves support over 26 million jobs and contribute over $475 billion in annual Federal and state/local tax revenues.

Private equity fund investments also provide significant assistance to pensions and public retirement systems, including the three largest funds (California Public Employees' Retirement System, California State Teachers' Retirement System, and the New York State Common Retirement Fund) as well as other significant funds (the Massachusetts Pension Reserve Investment Management Board and the School Employees Retirement System of Ohio). Private equity firms contribute over $6.4 billion annually to federal tax revenues and over $2.6 billion to state and local tax revenues.

However, proposed legislation in the current congress, the Stop Wall Street Looting Act (S. 2155/H.R. 3848), would impose significant restrictions, liabilities, and tax increases on the industry. Specifically, the legislation would seek additional caps on leverage for private equity, would tax profits at ordinary tax rates rather than as capital gains, and would hold private equity firms liable for all debts, legal judgements, and pension obligations of their portfolio companies. Additionally, the legislation would reorder bankruptcy law by having courts consider workers' interests above other financial considerations in the bankruptcy process.

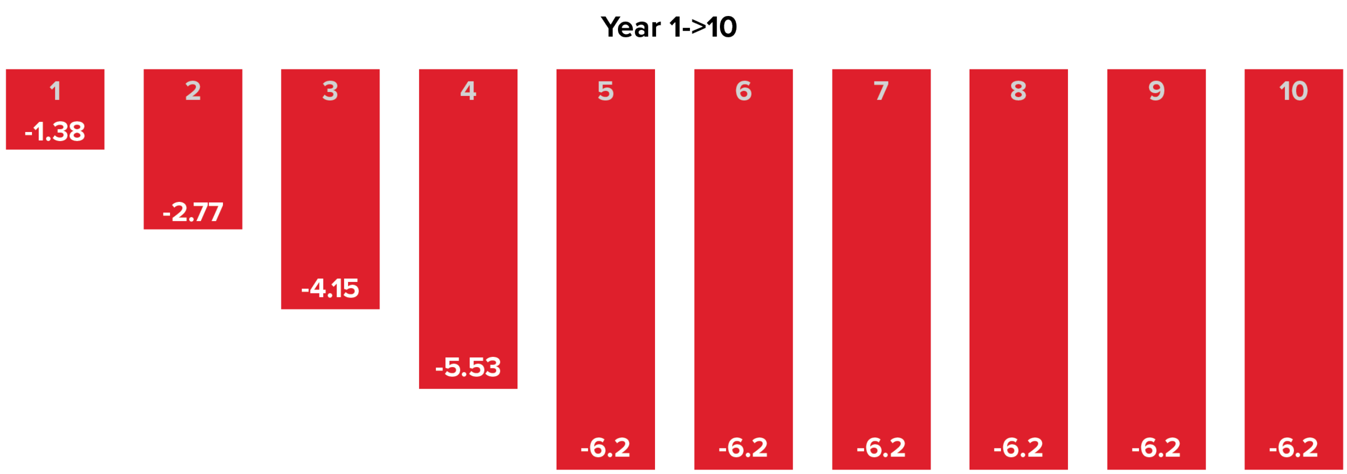
As a result, this study finds that these restrictions and taxes would be so impactful that, if enacted, even in a modest-case scenario, the country's workforce would be reduced by approximately 6 million jobs, and combined federal, state, and local tax revenues would drop by approximately $109 billion per year in the long run.

THIS STUDY'S MAIN FINDINGS ARE THAT ENACTMENT OF THE STOP WALL STREET LOOTING ACT (S. 2155/H.R. 3848)

- **Would result in a loss in the range of 6.2 million to 26.3 million jobs across the United States;**
- **Would result in federal, state, and local governments losing a combined $109 billion annually in tax revenues in a modest-case scenario or $475 billion annually in a worst-case scenario;**
- **Public pension funds, which support retirees, would lose at least $329 million (and possibly $1.65 billion) annually since they would need to switch some (or all) of their investments into lower-yielding investments;**
- **Investors could lose anywhere from $671 million to $3.36 billion per year (about half of which would be lost to pension fund retirees);**
- **Imposition of increased risk, taxes, and restrictions contained in S.2155/H.R. 3848 would likely cause some (and potentially all) of the private equity industry to cease to exist;**
- **Many firms which normally seek PE financing would be unable to find financing and fail (or downsize);**
- **If even 1% of the industry exited, and an equivalent percent of PE portfolio companies failed, the federal governments would lose money.**

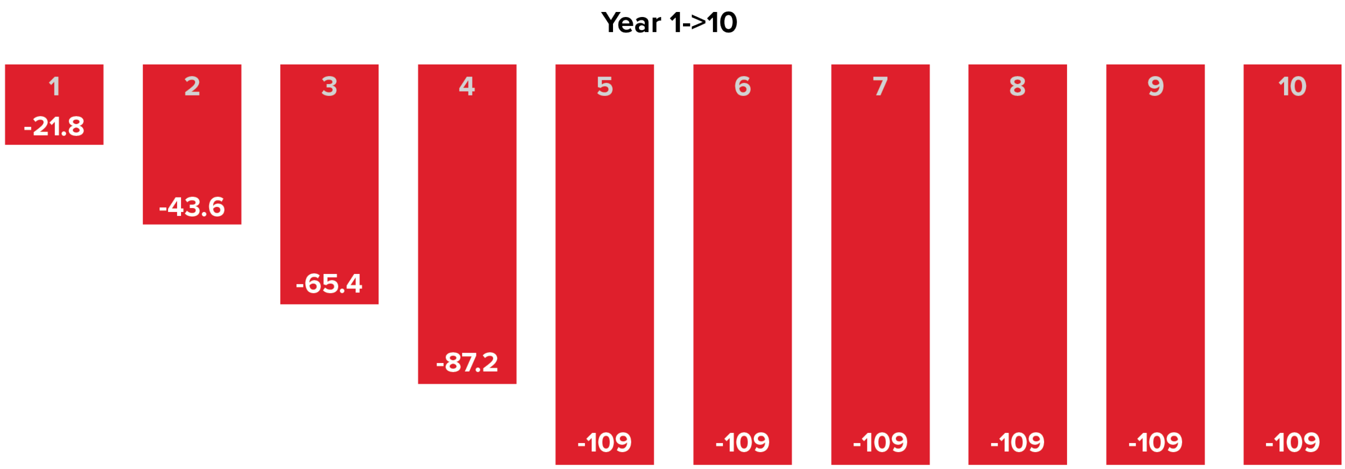
JOB AND TAX REVENUE LOSSES UNDER THE MODEST-CASE SCENARIO ARE SHOWN GRAPHICALLY BELOW:

Job Losses in Millions: Years 1->10 After S.2155/H.R. 3848 Enacted (modest-case scenario)



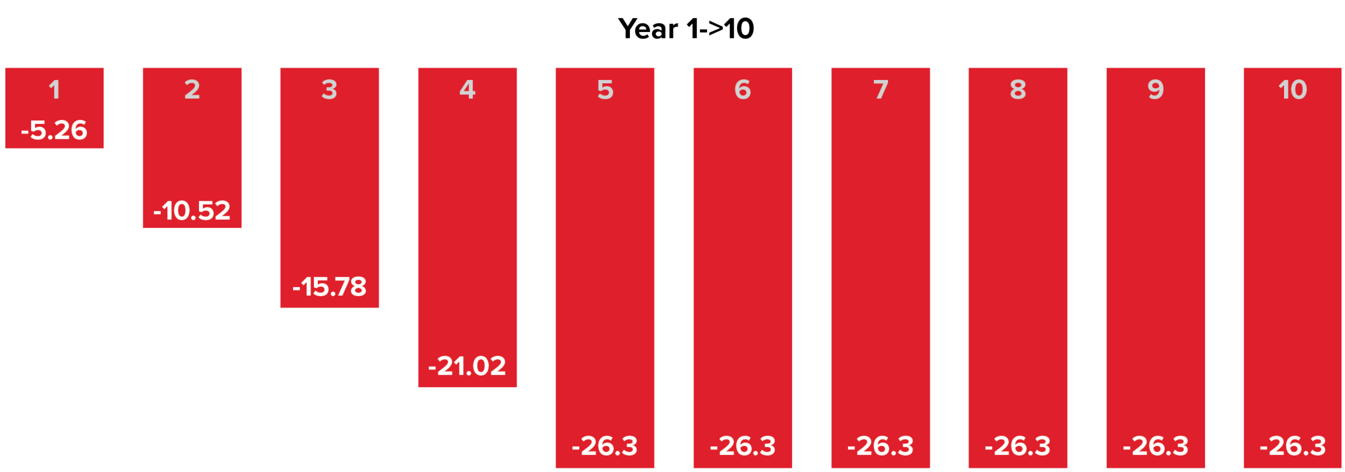
> **The Stop Wall Street Looting Act could reduce America's workforce by approximately 6 million – decreasing combined federal, state and local tax revenues by approximately $109 billion per year.**

Tax Revenue Losses: Years 1->10 After S.2155/H.R. 3848 Enacted (modest-case scenario, $billions)

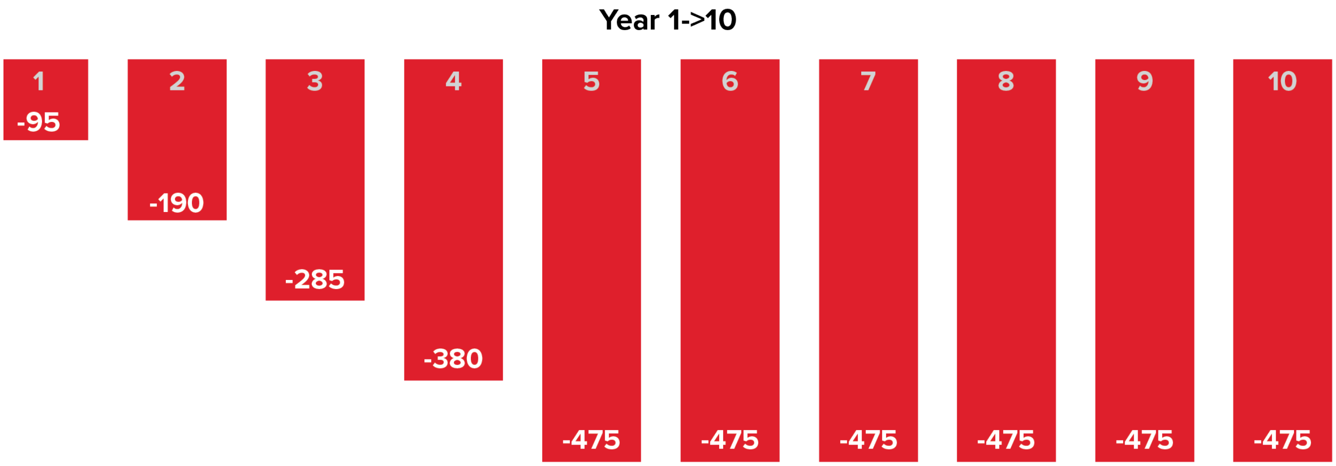


JOB AND TAX REVENUE LOSSES UNDER THE WORST-CASE SCENARIO ARE SHOWN GRAPHICALLY BELOW:

Job Losses in Millions: Years 1->10 After S.2155/H.R. 3848 Enacted (worst-case scenario)

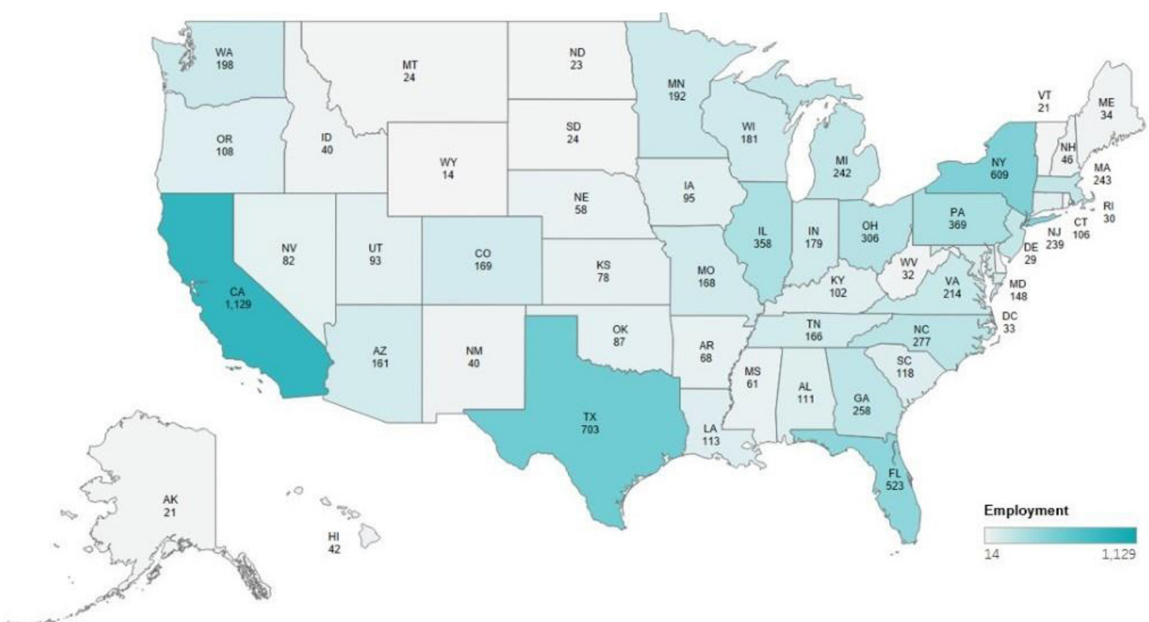


Tax Revenue Losses: Years 1->10 After S.2155/H.R. 3848 Enacted (worst-case scenario, $billions)



PE EMPLOYMENT IN THOUSANDS, FOR STATES THAT HAVE THE MOST PRIVATE EQUITY INVESTMENT, WHICH WOULD BE MOST NEGATIVELY IMPACTED BY THE LEGISLATION, ARE SHOWN BELOW[1]:

Employment by State for PE Backed Companies (thousands)



[1] Data provided by EY, LLP 2018 report prepared for American Investment Council (AIC).

Sensitivity analyses indicate that if even 1% of the industry exited and an equivalent percent of PE portfolio companies failed the federal governments would lose money. In the worst-case scenario, the significant risk, regulation, and tax increases would cause the industry to cease to exist, companies normally backed by PE would fail, and the national workforce would drop by 26.3 million jobs (over 15% of the country's workforce), resulting in a loss of $475 billion annually in combined federal, state and local revenues. Investors could lose anywhere from $671 million to $3.36 billion per year (about half of which would be lost to pension fund retirees). In either the modest- or worst-case scenarios, there would also be negative impact on other firms in the private funds space, although quantification of such impacts is more difficult.

> **In the worst-case scenario, the industry would cease to exist, companies normally backed by PE would fail, and the national workforce would drop by 26.3 million jobs (over 15% of the country's workforce).**

The increased restrictions and taxes in this legislation have a disincentive effect on labor supply as well as business formation and growth. The essentially unlimited liability exposure the legislation would create would impose significant risks for managers and investors in PEs, discouraging investments in companies throughout the economy, which in turn would result in higher business failures and lower returns to such PE investors as pension funds, university endowments, and charitable foundations. Although the private funds industry is composed of businesses, such businesses are mostly partnerships or limited liability companies, which means that their taxes are paid by owners (partners) of the business on their individual tax returns. Thus, increased taxes under the legislation are in a large sense a tax on the entrepreneurial efforts of the owners of PE firms who help grow businesses. It is important to note that many of the tax increases under the legislation are discriminatory insofar as the carried interest tax increase applies to only a subset of entrepreneurs investing in "specified assets" (including but not limited to securities, real estate, etc.). Nor do the 100% taxes on distributions from investments apply to other industries. Similarly, the bill's proposed restrictions on interest deductions would be hurtful to PE funds and their portfolio companies, which rely on debt financing. In addition, the bill's joint and several liability provisions and bankruptcy provisions would have costly negative implications for most if not all economic participants, not just private equity or the companies in which PE funds invest.

When private equity is combined with other private funds, which would also be affected by the legislation reviewed in this economic analysis, including venture capital and hedge funds, the private funds industry contributes over $37 billion annually to federal tax revenues and over $11 billion to state and local tax revenues. Private equity firms also directly employ approximately 124,000 people, and an additional 270,000 people are employed via the industry's "ripple-through" effect on the rest of the U.S. economy. When we look at the total private funds industry, it provides 472,000 jobs directly and over 1.5 million jobs after the "ripple-through" effect. The average annual wage in this industry is more than $199,000 (i.e., these are "good paying" jobs). When we add PE portfolio firms, there are 8.8 million people employed (26.3 million after multiplier effects on the economy), earning average wages of $71,000 per year.

Economic Impact of Private Funds

EMPLOYMENT AND TAX REVENUE IMPACTS OF PRIVATE EQUITY FUNDS

According to the Bureau of Labor Statistics, private equity firms directly employ over 124,000 people in the U.S.[2] When we add PE portfolio companies, there are 8.8 million people employed, and more than 26 million after multiplier effects on the economy. **Exhibit 1** shows the economic footprints of the private equity sector (composed of private equity firms, funds and the portfolio companies they support).

EXHIBIT 1

Estimated Employment, Income, and Output Effects of Private Equity Sector in U.S. (dollar values in millions)[3]

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	8,800,000	$600,000	$1,100,000	$1,700,000
Indirect Effect	7,200,000	$500,000	$900,000	$1,400,000
Induced Effect	10,300,000	$600,000	$1,000,000	$1,600,000
Total Effect	**26,300,000**	**$1,700,000**	**$2,900,000**	**$4,700,000**

"Direct Effect" refers to actual employment, labor income (wages), value added (added profit to owners in the local economy), and output (revenues generated in the U.S. economy).

"Indirect Effects" (often referred to as "type I multiplier effects") are similar effects but are measured as the impact on all of the U.S. economy, beyond the new business itself, as a result of business-related purchases rippling through the U.S. economy.

"Induced Effects" (often referred to as "type II multiplier effects") are similar effects but are measured based on the result of direct and indirect effects on employees, who then spend in the U.S. economy.

The **"Total Effect"** is the total of direct, indirect, and induced effects. All values are expressed in today's U.S. dollars.

As shown above, using multipliers across numerous industries, the "ripple through" impact of these companies is an estimated 26.3 million jobs, with an average wage of $71,000. There are an estimated 35,000 PE-backed companies from a very broad cross-section of industries.[4] As shown in **Appendix B**, such companies are scattered across all 50 states and all congressional districts.

Employment, income, and output effects of just the private equity industry itself (not including portfolio companies), both before and after multiplier effects, are shown in **Exhibit 2** below. After such multiplier effects, the industry accounts for more than 414,000 jobs and more than $30 billion in wages paid.[5] The average annual wage in this industry is more than $94,000, i.e., these are "good paying" jobs.

[2] Data from Bureau of Labor Statistics and Census.
[3] Source: Ernst &Young analysis done for AIC (2019).
[4] Employment by broad industry group (as percents) is as follows: consumer products and services (36%); business products and services (29%); healthcare (13%): information technology (19%); financial services (7%); materials and resources (2%); and energy (2%). Source: Ernst &Young analysis done for AIC (2019).
[5] For a discussion of multiplier analysis in a tax setting, see Swenson, C., and M. Moore. "Use of Input-Output Analysis in Tax Research." Advances in Taxation 1 (1987): 49-83.

EXHIBIT 2

Estimated Employment, Income, and Output Effects of Private Equity Firms in U.S. (dollar values in millions)

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	124,207	$11,751	$7,882	$24,233
Indirect Effect	145,651	$10,625	$15,420	$27,168
Induced Effect	144,456	$7,776	$13,696	$24,243
Total Effect	**414,314**	**$30,152**	**$36,998**	**$75,644**

The above are calculated using IMPLAN[6], a widely accepted general equilibrium software. Value added is proprietor's income. Employees in PE firms include portfolio managers, research analysts, investor relations personnel, compliance specialists, legal counsel, tax specialists, information technology professionals, human resources staff, office support staff, etc. The industry also has a significant "ripple-through" or multiplier effect on the national economy as a whole. That is, the industry creates additional jobs and value added through indirect and induced effects. These include, for example, such firms paying accountants, attorneys, investments banks, consultants, real estate entities (for leases, etc.), and the monies spent in the U.S. economy by the industry's employees and investors. The multiplier effect is reflected in the 414,000 jobs shown in **Exhibit 2.**

The private equity sector (comprised of private equity firms and the portfolio companies in which private equity funds invest) accounts for a significant amount of federal taxes paid. Such taxes include income (individual and corporate for other industries), employment taxes, excise taxes, import taxes, and numerous other taxes and fees. Annual tax revenues to federal, state, and local governments contributed by the overall private equity sector is reported in **Exhibit 3.** We see that this sector contributes over $174 billion and $475 billion after multiplier effects.

[6] See www.IMPLAN.com. Multipliers are blends of the NAICS groups.

EXHIBIT 3

Estimated Annual Federal Taxes and Fees Generated by the Private Equity Sector
*** After Multiplier Effects[7] (in $billions)**

US private equity sector					
	Business Taxes	Employee Taxes	Total	Suppliers to US Private Equity	Related Consumer Spending
Federal taxes	**$36**	**$77**	**$113**	**$93**	**$102**
Individual income taxes	$7	$52	$59	$49	$53
Payroll taxes	$21	$21	$42	$34	$37
Corporate income taxes	$7	$0	$7	$6	$7
Excise taxes	$1	$2	$3	$3	$3
Customs duties and fees	$0	$1	$1	$1	$1
State and local taxes	**$26**	**$35**	**$61**	**$50**	**$55**
Property taxes	$11	$9	$19	$16	$17
Sales taxes	$6	$9	$15	$12	$13
Individual income	$2	$13	$14	$12	$13
Excise, license, other taxes	$6	$5	$11	$9	$10
Corporate income taxes	$2	$0	$2	$2	$2
Total taxes	***$63**	***$112**	***$174**	***$144**	***$157**

*Totals reflect some rounding.

For the private equity industry itself (excluding PE portfolio companies), annually there are $6.4 billion in federal tax revenues generated (after multiplier effects) and $2.6 billion in state and local tax revenues generated (after multiplier effects) giving a total tax revenue contribution of $9 billion.

DATA ON INVESTORS IN PRIVATE EQUITY FUNDS (INCLUDING PENSIONS)

Numerous investors have stakes as limited partners in the PE funds that own portfolio companies. **Exhibit 4** shows types of investors and their relative investments in PEs.

[7] Ibid. Includes private equity firms, hedge fund firms, and venture capital firms. Calculations performed by EY for AIC. Individual taxes include taxes on capital gains.

EXHIBIT 4
Investors in PE Funds[8]

Investor Type	Ownership
Pension Funds	49%
Investment and Family Offices	14%
Insurance Companies	11%
Foundations and Endowments	11%
Sovereign Wealth Funds and Development Funds	10%
Banks	4%
Corporate Investors	1%
	100%

PE funds typically outperform other investments in terms of rates of return. Although there is incomplete public data on PE investors' alternative investments, there is such data for public pension funds. Over the last decade (2008–2018), such funds have earned a 9.7% return on their PE investments on average.[9] This is 2.25% higher than the 7.45% average rates of return on the largest pension funds. Since there is at least $149.33 billion of pension funds' money in PEs[10], this implies that as much as $3.36 billion (or $149.33 billion*2.25%) would be lost aggregate returns for pension funds if these pensions instead put their money in non-PE investments. Since the majority of such investors may be tax-exempt, tax impacts here are not estimated.

EMPLOYMENT AND TAX IMPACTS OF ALL PRIVATE FUNDS

Although the legislation is targeted largely at private equity firms, the liability exposure, tax increases, and other parts of this bill potentially apply to the entire private funds industry and in some cases even beyond it. Thus, it is instructive to examine the economic contribution of the industry as a whole. Exhibit 5 reports such data. Here, we see that after "ripple through" effects, the industry employs over 1.5 million people and has more than $163 billion in wages paid.[11]

[8] Source: American Investment Council (2018)
[9] Internal rates of return for US buyout firms; see Global Private Equity Report 2018 (Bain and Company)
[10] For 10 largest pension fund investors in PEs. See Public Pension Study (2019), American Investment Council.
[11] Data from Bureau of Labor Statistics and Census. Since this is 2017—the most recent data-employment in 2019 may be higher than this.

EXHIBIT 5

Estimated Employment, Income, and Output Effects of Private Funds* Firms in U.S. (employment in thousands; dollar values in millions)

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	471.99	$93,937.5	$29,950.1	$92,083.9
Indirect Effect	553.47	$40,375.1	$58,597.8	$103,240.9
Induced Effect	548.93	$29,551.3	$52,045.1	$92,122.5
Total Effect	**1,574.39**	**$163,864.0**	**$140,592.9**	**$287,447.3**

*Includes private equity firms, hedge funds, and venture capital firms.

The private funds industry annually accounts for $37.1 billion in federal taxes paid and $11.3 billion in state and local taxes paid for a total of over $48 billion. **Tables A1 and A3 in Appendix A** report employment data for two of the states with the largest employments in the private funds industry, California and New York. We see that these two states employ over 70,000 and 250,000 people, respectively (after multiplier effects) and pay average wages of over $112,000 and $200,000, respectively. Not shown in such tables are employment impacts in other states such as Massachusetts and Texas which have hundreds of thousands of PE industry employees.

OTHER ECONOMIC IMPACTS: PRIVATE EQUITY FIRMS AND FUNDS[12]

Private equity firms invest in a number of companies via their funds. Such investments are typically over a number of years, during which time the PE fund aims to grow and strengthen the acquired company and make it more profitable for its investors. According to the American Investment Council (AIC), U.S. PE companies invested $3.4 trillion in U.S. companies over the 2013–2018 period. As noted previously, these companies contributed over 26.3 million jobs to the U.S. economy (after multiplier effects). **Exhibit 6** shows some of the more prominent PE-backed U.S. firms.

> **Private equity companies invested $3.4 trillion in U.S. companies between 2013-2018.**

[12] Sources include Pitchbook (various issues) and industry representatives.

EXHIBIT 6

Examples of U.S. PE-Backed Businesses

This impact is quite significant in such states as California, Texas, Illinois, Florida, and New York. According to the American Investment Council, PE funds invested $343.11 billion in New York companies over the 2008–2018 period. These companies had over 600,000 employees. In California, the AIC reports that California PE companies invested $85.61 billion in 659 California companies in 2018 alone. Private equity backed companies in California employ over 1 million people. Data on investments for other states include: Massachusetts, with 234,000 jobs and $18 billion in wages and benefits; Texas, with 703,000 jobs and $55 billion in wages and benefits; and Florida, with 523,000 jobs and $33 billion in wages and benefits.

As noted previously, almost half of PE investors are pension funds. For example, in New York, the New York State Common Retirement Fund has invested approximately $17.5 billion in PE funds.[13] In California, two of the state's largest pension funds—the California Public Employees' Retirement System and the California State Teachers' Retirement System—have invested approximately $43 billion in PE funds. Since historically, returns on private equity investment substantially exceed those of investments in public markets, fixed income, and real estate, *PE funds contribute significantly to the well-being of retirees.*

Economic Impact of the Legislation

SECTION-BY-SECTION DISCUSSION: DISINCENTIVE EFFECTS AND OVERALL ECONOMIC EFFECTS

Section 101: Joint and Several Liability for Controlling Private Funds

This section holds private funds that are control persons jointly and severally liable for all debt incurred by a target firm, including for legal judgments, liabilities in connection with violations of the Worker Adjustment and Retraining Notification (WARN) Act, and pension-related obligations.

Section 102: Joint and Several Liability for Holders of Economic Interests in Controlling Private Funds[14]

This section holds holders of an economic interest, or with a right to participate in the governance of, private funds that are control persons jointly and severally liable for all debt incurred by a target firm, including for legal judgments, liabilities in connection with violations of the WARN Act, and pension-related obligations.

Discussion. Section 101 effectively eliminates corporate separateness between a PE fund and its portfolio companies by making the PE fund jointly and severally liable for all liabilities of its portfolio companies, including any debt incurred as part of the acquisition of that portfolio company and employee/pension liabilities. Minority investments of at least 20% of the company's voting securities would trigger this joint and several liability if the PE fund participates in the direction of the management or policy of the company.

[13] Public Pension Study, American Investment Council (May 2018).
[14] Section 103, "Indemnification Void as Against Public Policy" holds that any indemnification of a private fund that is a control person or affiliate for the liabilities of the target firm and its affiliates is void against public policy. While this Section is not separately addressed above, it essentially prevents private funds from avoiding Section 101 and 102 risk though indemnifications.

Section 102 extends the joint and several liability of Section 101 to individuals who have an economic interest in or the right to participate in the governance of the PE fund. This proposal is the equivalent of requiring PE funds and their principals to guarantee the performance of their portfolio companies to all of their creditors, which would just end PE investing altogether and is contrary to a fundamental principle of American business, which is to respect the corporate form. This provision, and others in the bill, may increase financial stability/contagion risk. For example, this section imposes joint and several liability on any “holder of an economic interest in a private fund” for all liabilities of a portfolio company controlled by the private fund. Thus, under certain circumstances, liability could be shared by pension plans and others that currently have limited liability by virtue of the nature of their investment. And since Section 501 of the legislation would require the disclosure of a PE fund’s limited partners (information that is currently available to the Securities Exchange Commission [SEC]), the markets would understand that pension plans or insurance companies that own interests in a private equity fund could be liable for “all liabilities” of each of the portfolio companies controlled by the private fund. In case of financial distress or bankruptcy of the target, creditors of the target may turn to such large financial companies (as “deep pockets”) for payment and/or the market may lose confidence in the financial companies because of such losses.

Incentive Effects and Economic Impacts: Private Funds. These sections significantly increase risk of any company invested in. One bankrupt portfolio company could result in sufficient liability claims such that other assets of the PE fund complex, including limited partner investors such as pensions, might be needed to pay for such debts. If such assets are insufficient to pay the debts, creditors could then take personal assets of PE general partners and investment assets of PE investors (such as pension funds). At an extreme, PE funds would cease to exist since long-standing protection against joint and several liability in the investment context is essential to enable PE funds and other entrepreneurs to invest in startups and other businesses, and defaults could lead to personal bankruptcy of PE general partners and other economic hardship for employees and even pension plan investors. In this extreme case, it would be difficult to attract investors due to the potential of losing other assets in the case of the failure of a portfolio company. Less extreme results would be that PE firms would significantly curtail investments, focusing only on investments with very high probabilities of success. Although quantifying the percent of PE deals which would be avoided in this more modest scenario is difficult, a reasonable estimate is as follows. Since approximately 19% of companies backed by PEs have debt which is very risky, this implies that PEs would on average avoid about one-fifth of their typical investments in such a more modest scenario.[15]

In either case, the PE industry would decline and jobs in that sector would be lost, and related federal, state and local tax revenues would decline accordingly.[16]

Incentive Effects and Economic Impacts: Investors in PE funds. Since liability also extends to investors, this increases risk to such investors, including in certain circumstances, pension plans, charitable foundations and university endowments. In a moderate scenario, investors would demand a risk premium for their investments, requiring higher rates of return to compensate for higher risk. This in turn could cause PEs to reject investments in companies which would not offer such a potentially higher rate of return; here, there would be fewer PE investment opportunities and investors would thus shift portfolios to less profitable financial instruments. As noted above, this would suggest that approximately 19% of PE deals would be rejected in the more modest outcome, implying a 19% reduction in PE investment. In either case, overall returns to PE investors would decline as they shifted investments into less profitable investments.[17] This would negatively affect pensions (thus retirees), which hold almost half of PE investments. At an extreme, investors would no longer invest in PE funds and would instead shift investments to other financial instruments. Such instruments would have lower rates of return than those of PE investments.

[15] See “Leveraged Finance – US: Tracking the largest private equity sponsors LBO credit quality is weak, bodes ill for next downturn” (Moody’s, Oct. 18 2018). The 19% figure is the percent of PE-backed firms having debt rated as B3N (“distressed”). This is not to be confused with actual defaults of PE-backed companies, which was 6%, lower than the market average of 6.4% (see Announcement: Post-Crisis Default Rates of PE-Sponsored and Non-Sponsored Companies Similar (Moody’s, June 18 2014).

[16] Although PEs have in the past experienced “dry powder” scenarios (that is, there were insufficient profitable investments), the permanent change in investment opportunities here suggest that the PE industry would downsize to match the lower number of opportunities.

[17] Pension managers are subject to fiduciary responsibilities (see “Reclaiming Fiduciary Duty Balance” by James Hawley, Keith Johnson, and Ed Waitzer, Rotman, International Journal of Pension Man agement, Volume 4, Issue 2 (Fall 2011)). Accordingly, they may avoid investments which put overall pension assets at risk.

Incentive Effects and Economic Impacts: Companies normally invested in. Companies seeking PE investments are often declining and have lower (or too costly) access to other forms of finance. Investment by PEs also provide valuable operating and financial expertise, increasing their odds of survival. To the extent PE investments become unavailable, some of these firms will fail and jobs (with related tax revenues) will be lost. Others will continue to decline, with more protracted job and tax revenue losses. Even with a modest outcome, approximately 19% of PE supported businesses would fail (see above discussion). At an extreme, eventually all PE supported firms would fail.

Overall Economic Impact. These sections will have a negative impact on PE firms and funds, their investors, and companies needing PE investments. In a modest-case scenario, there would be a 19% reduction in the PE industry, up to a 19% failure rate of PE-backed companies, and up to a 19% reduction in returns to PE investors (such as pensions). In a worst-case scenario, PEs would disappear, PE investors (such as pensions) would have lower profitability due to shifting into other investments, and companies seeking PE funding would be unable to survive.

Section 201: Limitations on Post-Acquisition Dividends, Distributions, Redemptions, and Buybacks

This section prohibits target firms from making a capital distribution during the 24 months following a buyout transaction. It also holds related parties that aid or abet any violation of this section jointly liable for such violations. Finally, the section provides a private right of action for any employee or creditor to enforce this section.

Incentive Effects and Economic Impacts: Private funds. The inability to make distributions before the company is sold by the PE fund decreases the rate of return on that investment, due to the time value of money (that is, a return of investment earlier in time is worth more than a later return). There is also increased risk on the investment if (despite the best efforts of the PE) the company fails or is sold for no profit. Both of these would cause some projects not to be undertaken, if the expected return were already low, or the risk of failure is relatively high.

Incentive Effects and Economic Impacts: Investors in PE funds. Perhaps most importantly, many limited partner investors, including pensions, would be harmed by the arbitrary prohibition on dividend recapitalizations. To the extent that fewer companies are invested in (per the above discussion), investors (such as pensions) would shift some of their investments to other investments, which would provide lower rates of return, and in the case of pensions would hurt retirees.

Incentive Effects and Economic Impacts: Companies normally invested in. As noted above, fewer companies would receive PE funding due to potentially lower rates of return and increased risk.

Overall Economic Impact. It is difficult to quantify the impact of the above. Here we assume that the 19% risky investments which would be avoided (discussed above) would be from the same group with no additive downsizing from this provision per se.

Section 202: Prevention of Fraudulent Transfers

This section allows the claw back of money transferred out of portfolio companies by removing existing safe harbors in fraudulent transfer laws for certain kinds of transactions in cases where such transfers are connected to a change in control transaction. It also creates a positive presumption of fraudulent transfer for transactions connected to a change in control and for affiliated transactions involving portfolio companies for eight years following a leveraged buyout (LBO). This section also extends the statute of limitations for fraudulent transfers when the U.S. government is a claimant to at least eight years after the transfer was made, if it was connected to a change in control.

Discussion. This section will make it easier to challenge buyouts and affiliated transactions as fraudulent conveyances, thereby increasing the risk of fraudulent conveyance litigation for distressed PE-owned companies. In turn, this will make it more difficult for those companies to restructure and more likely for them to liquidate.[18]

Incentive Effects and Economic Impacts: Private funds. PE funds may avoid riskier acquisitions (i.e., those with higher potential for bankruptcy). In the absence of any empirical evidence, it is assumed here that the same 19% of firms which are riskier (as discussed above) would not be invested in, implying an equivalent downsizing of PE firms with attendant reductions in employment and tax revenues.

Incentive Effects and Economic Impacts: Investors in PE funds. To the extent such riskier transactions are avoided, more investment would switch from PE to other financial investments. See above for the 19% percent of firms avoided as investments, with equivalent lowered investments by investors and resultant lower returns due to investments in other non-PE investments.

Incentive Effects and Economic Impacts: Companies normally invested in. To the extent that riskier companies are not financed by PEs, a number of them may fail, causing loss of employment and tax revenues. Alternatively, Section 202 will make it easier to challenge LBOs and affiliated transactions as fraudulent conveyances, thereby increasing the risk of fraudulent conveyance litigation for distressed PE-owned companies. In turn, this will make it more difficult for those companies to restructure and more likely for them to liquidate, causing job and tax revenue losses.

Overall Economic Impact. The economic impact here is expected to be part of the that covered in the Section 101 analysis above, noting that the provisions in Sections 201 and 202 would not be expected (by themselves) to cause a complete exodus of the PE industry and failure of PE-backed firms.

Section 203: Confiscatory Surtax on Certain Amounts Received by Investment Firms from Controlled Target Firms

This section applies a 100% tax on fees paid by portfolio companies to private fund managers, including "monitoring" or "transaction" fees. An "applicable payment" is any amount paid or incurred by an "applicable entity" to an "applicable controlling entity." Interest and dividend payments are excluded. An applicable entity generally is any person conducting an active trade or business (e.g., a portfolio company). An applicable controlling entity generally is any person (e.g., an investment fund) that controls (or is related to a person controlling) the applicable entity and is engaged in an "applicable trade or business," some of the activities of which relate to the applicable entity.[19] An "applicable trade or business" is any "activity" that consists (in whole or in part) of: (i) raising or returning capital, and (ii) either (a) investing in or disposing of specified assets (or identifying specified assets for investing or disposition), or (b) developing specified assets. A specified asset generally refers to any security, partnership interest, and real estate held for rental or investment.[20]

[18] It is also worth noting that creditors are already protected by the combination of potential fraudulent conveyance claims under the bankruptcy code and under state laws (which have longer lookback periods than the bankruptcy code). From this viewpoint, Sec. 202 may be superfluous.

[19] Control means at least 50 percent of vote or value in the case of a corporation, or at least 50 percent of the capital, profits or other beneficial interests in the case of a person other than a corporation.

[20] The constructive ownership rules of section 318 would generally apply in determining whether persons are related. The tax generally could not be offset with credits. The tax would be imposed on nonresident aliens and foreign corporations if the payments are effectively connected with a U.S. trade or business. The Treasury Secretary would be given regulatory authority to: (i) prevent avoidance of the surtax, including through the use of unrelated persons and conduit transactions; and (ii) modify the section 318 constructive ownership rules to apply them to capital, profits, and other beneficial interests. This Section would be effective for payments paid or accrued on or after the date of enactment.

Discussion. Although described as "looting" by the authors of the Act, such payments are instead a means by which the PE manager is compensated for bona fide services that it provides to the portfolio company–to the extent that it receives these fees. These fees are generally shared with investors in the private equity fund through management fee offsets. As such, this tax stands to harm limited partner investors most, including pension plans, by effectively increasing the net amount of fees they pay to the PE fund manager.

Incentive Effects and Economic Impacts: Private funds. The 100% tax makes it economically untenable for the PE to perform such services. Accordingly, the incentive would be to outsource the services. Thus, part of the fee revenue normally shared with investors such as pension funds would disappear. The costs to PE portfolio companies might be higher, as outsourced monitoring companies may have lower familiarity with the PE portfolio company and its operations.

Incentive Effects and Economic Impacts: Investors in PE funds. As noted above, this tax would harm limited partner investors most, including pension plans, by effectively increasing the net amount of fees paid to the PE fund manager.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. This is difficult to quantify, although the efficiency loss and extra cost to the industry of outsourcing monitoring services could be non-trivial.

Section 204: Limitation on Deduction for Business Interest of Certain Businesses Owned by Private Funds

This section imposes a stricter (albeit currently unspecified) limit under Section 163(j) of the internal revenue code on the deduction of interest by portfolio companies and other entities controlled by investment funds. Any applicable entity owned by an applicable controlling entity (or any related person) with a debt-to-equity ratio greater than one will be subject to a stricter limitation on the deduction for interest under Section 163(j) than the current 30% of EBITDA limitation. The bill does not specify, yet, how much stricter the percentage limitation will be. The definition of applicable entity and applicable controlling entity is the same as described above in connection with the surtax on fees. Also, the constructive ownership rules of Section 318 would apply similarly. The debt-to-equity ratio is: (i) the taxpayer's total indebtedness, over (ii) the net cash and other assets held by the taxpayer (reduced by the total indebtedness). The amount of an asset taken into account for this purpose is equal to its adjusted basis for purposes of determining gain. Note that because of the availability of 100% expensing, the amount of many assets taken into account will be zero, making it even more likely that large numbers of businesses will be subject to the stricter limitation. The amount of debt taken into account includes the amount of any original issue discount previously accrued.[21] This section is effective generally for taxable years beginning on or after the date of enactment.

[21] The constructive ownership rules of Section 318 would generally apply in determining whether persons are related. The tax generally could not be offset with credits. The tax would be imposed on nonresident aliens and foreign corporations if the payments are effectively connected with a U.S. trade or business. The Treasury Secretary would be given regulatory authority to: (i) prevent avoidance of the surtax, including through the use of unrelated persons and conduit transactions; and (ii) modify the Section 318 constructive ownership rules to apply them to capital, profits, and other beneficial interests. This section would be effective for payments paid or accrued on or after the date of enactment.

Incentive Effects and Economic Impacts: Private funds. PE acquisitions are financed through a combination of debt and equity investments. Thus, reducing the tax deductibility of interest payments increases the after-tax cost of debt. The costs here are difficult to quantify and are estimated to reduce after-tax rates of return by 0.6%. [22]When multiplied by average aggregate PE equity investments of $300 billion, this translates into an annual cost to the industry of $1.8 billion.

Incentive Effects and Economic Impacts: Investors in PE funds. Because of the above effects at the PE level, PE investors can expect lower returns on PE funds using the above estimate.[23]

Incentive Effects and Economic Impacts: Companies normally invested in. Because interest deductions would also be limited on target firms' borrowings after being acquired by a PE, the after-tax costs of debt increase, which case lower rates of return on PE investments. At the margin, target companies with lower potential of success (i.e., those with "borderline" expected rates of return) may not receive PE investments and potentially downsize or fail if they could not secure other investors.

Overall Economic Impact. This section will likely cause negative economic effects, the most likely of which is lower returns to PEs and PE investors, including pension funds. Additionally, since this provision potentially applies to other industries with higher debt ratios, there may be harm to the broader economy.

Section 301: Increased Priority for Wages in Bankruptcy

This section raises the 507(a)(4) priority claim for unpaid wages and severance from $10,000 to $20,000 per worker and eliminates the 180-day time restriction. It also raises the 507(a)(5) priority claim for employee benefit contributions from $10,000 to $20,000 per worker and eliminates the 180-day time restriction.

Section 302: Priority for Severance Pay and Contributions to Employee Benefit Plans

This section classifies severance pay owed to employees ("under a plan, program or policy generally applicable to employees . . . [or] pursuant to a collective bargaining agreement") as administrative expenses for the purposes of the priority of claims in Chapter 11 bankruptcy. It also classifies unsecured claims for contributions to an employee benefit plan due on or after the bankruptcy filing as administrative expenses for the purposes of the priority of claims in bankruptcy.

Section 303: Priority for Violations of Federal and State Laws

This section increases the priority of back pay or damages arising from any violation of federal or state labor and employment law (including the WARN Act) to the level of administrative expenses.

[22] Increasing the after-tax cost of debt decreases the relative cost of equity financing (or funds received from PE investors). In finance theory, capital structure can either follow the pecking order concept (where a constant debt:equity ratio is sought), or the opportunistic approach, where managers react to changes in borrowing rates and taxes in picking debt:equity ratios. Here we assume the pecking order theory, on the idea that it would be difficult for PE managers to ask investors to contribute more equity for the same amount of total return (which implies a lower rate of return for each dollar of equity invested). Accordingly, a very rough estimate of the impact of Section 204 is as follows. Assuming 70% of a deal is financed through debt on average, this rule would limit interest deductibility to that on 50% debt, or a loss of deductibility of interest on 20% of debt. Thus, the after-tax cost of capital would increase by .2*(Debt)*r*t, where r is the interest rate and t is the tax rate. Assuming an 8% borrowing rate and a tax rate of .3 (a blend of the top corporate and individual top rates), this implies an increased after-tax cost of debt of .2*.3*.08=.0048 or about half a "basis point." This would also be the extra amount paid in U.S. taxes, and assuming an average state income tax rate of 8% (and n0n-deductibility of state tax) we have a tax-reduced rate of return of .006. Using an example of a $500 million acquisition with 70% debt and an 8% interest rate, the loss in cash flows would be .2(to get to the 1:1 debt ratio limit)*$350 million in debt*8%*38%, or $2.13 million per year. This would also be the increase in overall US, state and local taxes on such an investment.

[23] Using the above estimates, a .6% decrease in returns would not appear to be significant enough for PE investors to shift away from PEs and into other investments. Thus the .6% loss would be absorbed by PE investors as well as PE general partners.

Discussion. Sections 301, 302 and 303 will increase the costs of Chapter 11 bankruptcy cases involving companies with large employee/pension obligations. This could make it prohibitively expensive to reorganize certain businesses and force liquidations, which would hurt employees of those businesses even more.

Incentive Effects and Economic Impacts: Private funds. Because of increased costs of Chapter 11 bankruptcy cases involving companies with large employee/pension obligations, it could make it prohibitively expensive to reorganize certain businesses and force liquidations. PE funds may thus avoid acquiring riskier firms (with high risk of bankruptcy), which will harm the most vulnerable businesses that need PE investment by making them less attractive investment opportunities. Quantification of the negative effects on PE funds here is difficult.

Incentive Effects and Economic Impacts: Investors in PE funds. Because of fewer investment opportunities at the PE level, investors will shift some investments away from PE funds and into other types of investments.

Incentive Effects and Economic Impacts: Companies normally invested in. If there are forced liquidations, job losses will occur. Also, if PE funds avoid investment in riskier firms (which might go bankrupt), such risky firms (if unable to obtain other forms of financing) may go bankrupt with potential job losses. Quantification of potential costs to such firms here is difficult.

Overall Economic Impact. As noted above, the negative consequences here are difficult to quantify.

Section 304: Limitation on Executive Compensation Enhancements

This section expands the 503(c) restriction against executive payments to include any incentive compensation, bonus, or severance payment to senior executives, any of the next 20 most highly compensated employees, consultants of the company, and department or division managers of the company.

Section 305: Prohibition Against Special Compensation Payments

This section prohibits bankruptcy courts from approving any payments to an insider, senior executive, highly compensated employee, or consultant of the company if the company has not paid promised severance pay to employees or has reduced employee benefits within the year before declaring bankruptcy.

Section 306: Executive Compensation Upon Exit From Bankruptcy[24]

This section prohibits bankruptcy courts from approving a company's reorganization plan if an insider, senior executive, highly compensated employee, or consultant of the company will receive payments that are not generally applicable to the company's employees when the company exits bankruptcy or that the court determines are excessive or disproportionate compared to payments to the company's non-management workforce.

Discussion. Sections 304, 305 and 306 will limit debtors' ability to hire and retain management during bankruptcy cases and upon exit from bankruptcy, which may translate to lower recoveries/value for creditors and shareholders of these companies.

[24] Related to this is Section 308,"Voidability of Preferential Compensation Transfers". This Section allows the trustee to void any payment made in violation of executive compensation provisions and allows any party of interest to apply to void any payment made in violation of those provisions.

Incentive Effects and Economic Impacts: PE funds. Historically, approximately 6% of PE-funded firms experience bankruptcy. The potential costs for these 6% of PE-funded companies is difficult to quantify.

Incentive Effects and Economic Impacts: Investors in PE funds. See above.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. See above.

Section 307: Collateral Surcharge for Employee Obligations

This section deems all unpaid wages and benefits for services rendered on and after bankruptcy to be necessary costs and expenses of preserving, or disposing of, property securing an allowed secured claim and therefore recoverable even if the trustee has otherwise waived certain provisions.

Discussion. Section 307 may increase financing costs for PE sponsors and other companies. In addition, to the extent that the employees' services benefitted the secured creditor, the bankruptcy code already provides that the costs of those services can be recovered from the secured creditor's collateral (although this can be waived by the trustee with court approval).

Incentive Effects and Economic Impacts: Private funds. The potential costs for the roughly 6% of PE-funded companies which undergo bankruptcy is difficult to quantify.

Incentive Effects and Economic Impacts: Investors in PE funds. See above.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. See above.

Section 309: Protection for Employees in a Sale of Assets

This section requires that in cases where there are multiple offers to purchase the property of a company in Chapter 11 bankruptcy, bankruptcy courts are directed to approve the offer that best preserves the company's jobs and maintains the terms and conditions of employment for its workers. The section also requires that in approving the sale of property by a company in bankruptcy, courts are directed to give substantial weight to the extent to which the purchase would preserve jobs and maintain the terms and conditions of employment for the company's employees.

Discussion. To approve a sale of assets under the bankruptcy code, a court must find that the sale is in the best interest of the debtor and its creditors and that the debtor obtained the highest or best price for the assets. Bankruptcy judges attempt to balance the interests of different stakeholders, including employees and other creditors, which in practice generally favor transactions that preserve jobs when possible. This section directs courts to give more weight to job preservation at the expense of other creditors. This may depress creditor recoveries (including unsecured creditors such as employees and retirees whose claims are not assumed as part of a sale) and ultimately increase financing costs for companies.

Incentive Effects and Economic Impacts: Private funds. The potential costs for the roughly 6% of PE-funded companies which undergo bankruptcy is difficult to quantify.

Incentive Effects and Economic Impacts: Investors in PE funds. See above.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic Impact. See above.

Section 310: Protection of Gift Card Purchasers

This section creates a new priority in Chapter 11 bankruptcy (behind employee wages and benefits) for claims by individuals arising from: the purchase, lease, or rental of property; the purchase of services that were not delivered; and the purchase of gift cards that have not been redeemed.

Incentive Effects and Economic Impacts. Uncertain and difficult to quantify.

Section 311: Commercial Real Estate

This section eliminates the time limit on retailers for deciding whether to assume or reject a commercial real estate lease, easing restrictions on seasonal retailers seeking to reorganize.

Incentive Effects and Economic Impacts. Uncertain and difficult to quantify.

Section 402: Partnership Interests Transferred in Connection with Performance of Services[25]

Under this section, the recipient of a partnership interest in connection with the performance of services generally would be treated as having made an election under Section 83(b) to include the liquidation value of the interest in income at the time the interest is transferred. The recipient would be allowed to affirmatively elect out of Section 83(b) treatment. This section would be effective with respect to interests in partnerships transferred after the date of enactment.

Incentive Effects and Economic Impacts. Uncertain and difficult to quantify.

[25] Section 401 is not discussed here since it only allows subsequent sections to amend the 1986 Internal Revenue Code.

Section 403: Special Rules for Partners Providing Investment Management Services to Partnerships

This section taxes carried interest, currently taxed at the preferential capital gains rate at the higher earned income rates. The bill would repeal Section 1061, added by the Tax Cuts and Jobs Act, which generally requires a three-year holding period for long-term capital gain treatment of gains attributable to a carried interest. Technical details of this section are in **Appendix C.**

Discussion. Carried interest is a profit-sharing mechanism which rewards investors for the long-term "sweat equity" investments they make in businesses. Carried interest is used in real estate businesses, the financial services industry, oil and gas ventures, and many other types of business partnerships. The concept is that general partners (or managing members of LLCs) invest sweat equity, money and expertise in such ventures along with limited partner investors who invest money in the ventures. If the venture is successful, the general partners are entitled to a portion of the net profits from the sale of such ventures, typically 20% only after the limited partner investors are returned their capital plus a hurdle rate of return of 8%.

In the private funds industry, companies having carried interest are typically in the private equity, venture capital and hedge fund fields. In this structure, the general partners or managing members of a fund manage the operations of the fund while limited partners are passive investors. General partners or managing members are compensated for their services via a management fee (similar to a salary as a payment for services rendered and taxed at ordinary income rates), often at 2% of assets under management.[26] In addition, the general partners retain a share of profits, which is not a fee. The profits' interest is typically set at 20% of gains earned by the fund once invested capital is returned and a hurdle rate of return for limited partner investors (typically 8%) has been fulfilled. Limited partners receive the other 80% of the remaining profits.

In private equity, general partners only realize carried interest if gains exceed a certain hurdle rate of return.

For federal tax purposes, since the start of the Federal Income Tax in 1913, carried interest capital gains have always been taxed as capital gains income even though the capital gains rates have varied over time. Indeed, carried interest tax treatment is consistent with the tax treatment afforded to other long-term investments in capital assets and is founded on two sound and settled tax policies. The first is that capital gains are designed to reward entrepreneurial risk-taking. The second is that partnership profits should be taxed on a "pass-through" basis. As recognized by the Joint Committee on Taxation in its description of the tax treatment of carried interest, "The character of partnership items passes through to the partners, as if the items were realized directly by the partners. Thus, for example, long-term capital gain of the partnership is treated as long-term capital gain in the hands of the partners."[27]

Starting in 2018, however, the new federal tax law imposes differential treatment for some long-term carried interest capital gains by changing the time window it takes for a long-term carried interest capital gain to be realized from one year to three years. Under this new law, a general partner's carried interest capital gains is only taxed at the lower long-term rates after three years. A general partner's carried interest capital gains on an asset held for less than three years are short-term capital gains, taxed at the same rates as ordinary income. Limited partners' share of profits, on the other hand, can be fully taxed like all other long-term capital gains at lower rates after one year.[28]

[26] Typically, it is 2% of committed capital and then it transitions into 2% of invested capital over the life of a fund.

[27] See https://www.cbo.gov/budget-options/2018/54795

[28] Note that limited partners that are non-taxable entities, for example pension plans, endowments and charitable foundations are not taxed on these gains.

Because there are no revenue estimates provided to accompany the legislation, this report provides a rough estimate of the potential tax revenues generated by a tax on carried interest using federal estimates of carried interest. The Joint Committee on Taxation (as reported by the Congressional Budget Office) estimated in 2018 that making carried interest taxable at regular rates would generate an average of $1.4 billion in additional federal tax revenues per year[29] assuming no behavioral adjustments such as tax avoidance, switching business forms, etc.[30] Since this would involve taxing carried interest generally at the top U.S. rate of 40.8% instead of the capital gains rate of 23.8%, an estimate of total carried interest nationally is $8.2 billion.[31] This also implies a 71.4% increase in federal taxes on PE general partners.[32]

Incentive Effects and Economic Impacts: Private funds. Increased taxes have a disincentive effect on labor supply as well as business formation and growth. Although the private funds industry is composed of businesses, such businesses are mostly partnerships or limited liability companies, which means that their taxes are paid by owners (partners) of the business on their individual tax returns. Thus, increased taxes are in a large sense a tax on the entrepreneurial efforts of the owners of financial services businesses. A considerable body of research indicates that increased taxes on individuals have an especially high "elasticity" response for individuals with higher incomes. That is, there is a significant percent decrease in taxable income to percent changes in tax rates. For wealthier individuals, such responses can include moving to tax-favored jurisdictions, increasing tax deductions, changing forms of business organization, increasing substitution of wages for tax-free perquisites, increased use of retirement plans, and switching to lower-skilled labor to perform tasks.[33]

Longer-run elasticities for high-income individuals have in the past been estimated at .57%; i.e., each 1% increase in the tax rate results in a .57% decrease in pre-tax income.[34] Since taxing carried interest at ordinary rates implies a 71.4% tax increase on PE general partners (see above discussion), *this suggests a 40.7 % reduction in pretax income would result for PE general partners. Since PE general partners generally share in 20% of overall PE profits, this implies an 8.1% reduction in overall PE pretax income (or 40.7%*20%). Note that while this 8.1% results in a reduction in tax revenues to the government, this figure represents a combination in lost labor supply (effort to business, and/or switching professions) and other tax avoidance methods. In the absence of any empirical guidance here, it is assumed that half of this, or 4%, represents an actual downsizing of the PE industry due to such effects.*

Incentive Effects and Economic Impacts: Investors in PE funds. As discussed above, it is assumed that the PE industry shrinks by 4%, thus overall returns to investors would decline by the same amount.

Incentive Effects and Economic Impacts: Companies normally invested in. Assuming the above 4% decline, there would be a similar 4% decline in PE firms invested in.

Overall Economic Impacts. There would be an 8% decline in tax revenues from PEs, a 4% decline in industry size (including employment), 4% decline in returns to investors (including pensions), and a 4% decline in PE portfolio firms (both employment and tax revenues generated from them).

[29] https://www.cbo.gov/budget-options/2018/54795
[30] Similar effects are not reflected in the $2 billion number at the federal level.
[31] Computed as $1.4 billion/(40.8%–23.8%). Over the 2019-2028 period total federal estimated revenues from taxing carried interest as ordinary income are $14 billion; the $1.4 billion noted above is annual.
[32] Since most states already tax capital gains at ordinary tax rates, the state tax increase to PE general partners here would be modest.
[33] See for example Saez, E., J. Slemrod, and S. Giertz. "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review." Journal of Economic Literature 50, no. 1 (2012): 3–50.
[34] See, for example Gruber, J., and E. Saez. "The Elasticity of Taxable Income: Evidence and Implications." Journal of Public Economics 84, no. 1 (2002): 1–32.

Section 501: Disclosure of Fees and Returns

This section defines a private equity fund. It also requires the SEC to issue rules requiring each private equity fund to make certain annual disclosures, including the identities of those with interests in the fund and their ownership interests, the debt held by the fund and its portfolio companies, the performance of the portfolio companies, and fees and payments collected by the firm. This section also requires the SEC to review these rules once every five years to ensure that they reflect contemporary trends. Finally, this section requires the SEC to make the information disclosed under these rules available to the public.

Discussion. This section adds additional costs to PEs due to increased regulatory compliance costs. Much of this disclosure appears redundant, since Form PF and Form ADV filed with the SEC, provide responsible regulators with much of this disclosure. PEs also have other disclosures to investors.[35]

Incentive Effects and Economic Impacts: Private funds. The increased regulatory compliance costs here are difficult to quantify. An additional cost difficult to quantify may include confidential information regarding investors or confidential information regarding the private fund's investment strategy, trade secrets, or other aspects of its business that may be damaging (to both PE managers and investors in private funds) if publicly disclosed.

Incentive Effects and Economic Impacts: Investors in PE funds. See above.

Incentive Effects and Economic Impacts: Companies normally invested in. See above.

Overall Economic impact. See above.

Section 502: Fiduciary Obligations

This section amends the Employee Retirement Income Security Act of 1974 (ERISA) to clearly require private fund managers to have a fiduciary duty to pension plans whose assets they manage. It also prohibits investment advisers, including private fund managers, from requiring investors (including pension plans) to waive any fiduciary duty. It also prohibits preferential side letters between a fund and any one of its limited partners that is not offered to them all.

Discussion. For purposes of ERISA, this section would treat a pension plan's interest in a private fund in the same manner as an interest in a mutual fund and would prohibit waivers of fiduciary duty under state and other laws. In practice, fiduciary duties present costs and benefits that PE managers and investors may decide to modify and tailor to the particular expectations and needs of the particular transaction or investment. For example, PE managers and investors may agree to modify the duties owed with respect to affiliate transactions to benefit the private fund as the PE manager's affiliates may be able to offer the highest quality service at the most reasonable price. This section removes such flexibility.

Incentive Effects and Economic Impacts: PE funds. The negative impact here is difficult to quantify.

Incentive Effects and Economic Impacts: Investors in PE funds. The negative impact here is difficult to quantify.

Incentive Effects and Economic Impacts: Companies normally invested in. The negative impact here is difficult to quantify.

Overall Economic Impact. The negative impact here is difficult to quantify.

[35] These include extensive information over the life of their investment including, typically, quarterly reports and annual audited financial statements. Investors also have the ability to request access to the current list of investors and information regarding the affairs of the private fund (e.g., financial statements), subject to reasonable conditions which investors have an opportunity to negotiate. Note also that regulators (e.g., the SEC, and monitoring under the Financial Stability Oversight Council)) have existing oversight tools, including provisions of the Dodd-Frank Act.

Section 503: Disclosure Relating to the Marketing of Private Equity Funds

This section requires the SEC to issue rules requiring each private equity firm to make extremely detailed disclosures of their marketing related to the performance of their previous funds and the target firms they controlled.

Discussion. The required disclosures go beyond the types of disclosures that are required for retail investors; current disclosure requirements under Form ADV already require that PE managers disclose affiliations and other information with respect to their employees and investments. An argument against these types of disclosures is that highly sophisticated investors are in the best position to determine the type of information they need in order to make investment decisions.

Incentive Effects and Economic Impacts: Private funds. There would be additional accounting and legal costs, quantification of which is difficult.

Incentive Effects and Economic Impacts: Investors in PE funds. Additional disclosures may be of use to such investors. Much of the additional accounting/legal expenses could be passed onto such investors. Quantification here is difficult.

Incentive Effects and Economic Impacts: Companies normally invested in. The potential negative impact here is difficult to quantify.

Overall Economic Impact. The overall potential negative impact here is difficult to quantify.

Section 601: Risk Retention Requirements for Securitization of Corporate Debt[36]

This section requires arrangers of corporate loan securitizations to retain a share of the risk of those securitizations by clarifying that managers of collateralized debt obligations are subject to the risk retention requirements established in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Incentive Effects and Economic Impacts on Private Funds, PE investors, Companies, and Overall Economy. The potentially negative impact here is difficult to quantify.

[36] The Act also contains Sections 701 and 702 which are not analyzed here. Section 701, “Anti-Evasion” prohibits activities, such as entering into agreements, contracts, and transactions, and structuring entities, to willfully evade or attempt to evade any provision of this bill. Section 702, “Severability”, requires that in the event that any provision of this bill is held to be invalid or unconstitutional, the remainder of the bill and its application shall not be affected.

Overall Economic Impacts of the Stop Wall Street Looting Act

MODEST-CASE SCENARIO

In the modest-case scenario, the Stop Wall Street Looting Act would result in over 23% of the PE industry ceasing to exist over time, and that 19% of firms normally financed and managed by PEs would be unable to find other financing and management, and fail. This and other negative effects of the legislation in this modest-case scenario are shown by Section in **Exhibit 7.**

EXHIBIT 7

Modest-Case Scenario: Estimated Direct Impact of S.2155/H.R. 3848[37] by Section

S.2155/H.R. 3848 Section	Direct Impact on PE Firms	Direct Impact on PE Investors (including pensions)	Direct Impact on PE Portfolio Companies	Direct Impact on Other Private Funds Firms
101 and 102	19% downsizing (long run)	Annual loss of $638 million (long run)	19% failure rate (long run)	Negative**
201,202, and 203	Negative*	Negative*	Negative*	Negative*
204	.6% decrease in profits	.6% decrease in profits, or $20.2 million	Potential failure of some marginal firms*	Negative*
301 though 311	Negative*	Negative*	Negative*	Negative*
401 and 402	Negative*	Negative*	Negative*	Negative*
403	4% down-sizing (long run)	Annual loss of $13.4 million due to downsizing (long run)	Failure rate increase of 4% rate (long run)	Negative*
501,502, and 503	Negative*	Negative*	Negative*	Negative*
601	Negative*	Negative*	Negative*	Negative*
701 and 702	Negative*	Negative*	Negative*	Negative*
Net Result	**23.6% downsizing**	**Annual loss of $671.1 million (long run)**	**23% increase in failure rate**	**Negative***

*difficult to quantify ** hedge funds

[37] Long run impacts would be the 5th year after implementation of S.2155/H.R. 3848. PE firms hold a portfolio company on average approximately 5 years. Thus, after 5 years, existing PE companies (pre-S.2155/H.R. 3848) will have been sold and there would be no new PE investments by this time.

Exhibit 8 shows the impacts of the above after multiplier effects. There is a loss of 97.7 thousand jobs (related to the PE industry, after multipliers) assuming all PE firms exit the market, and an additional 6.1 million lost jobs (after multipliers) due to PE-backed firms failing (i.e., unable to find suitable financing which also provides PE-type management skills), for a total long run job loss, in the modest-case scenario, of approximately 6.2 million jobs. Although not shown in **Exhibit 8**, investors in PEs would experience an annual (long-run) loss of over $671 million in earnings (about half of which would be pension funds). Also not shown in **Exhibit 8** is the effects of the legislationon other private funds firms (hedge funds and venture capital firms), who would also experience some negative effects, which are difficult to quantify.

EXHIBIT 8

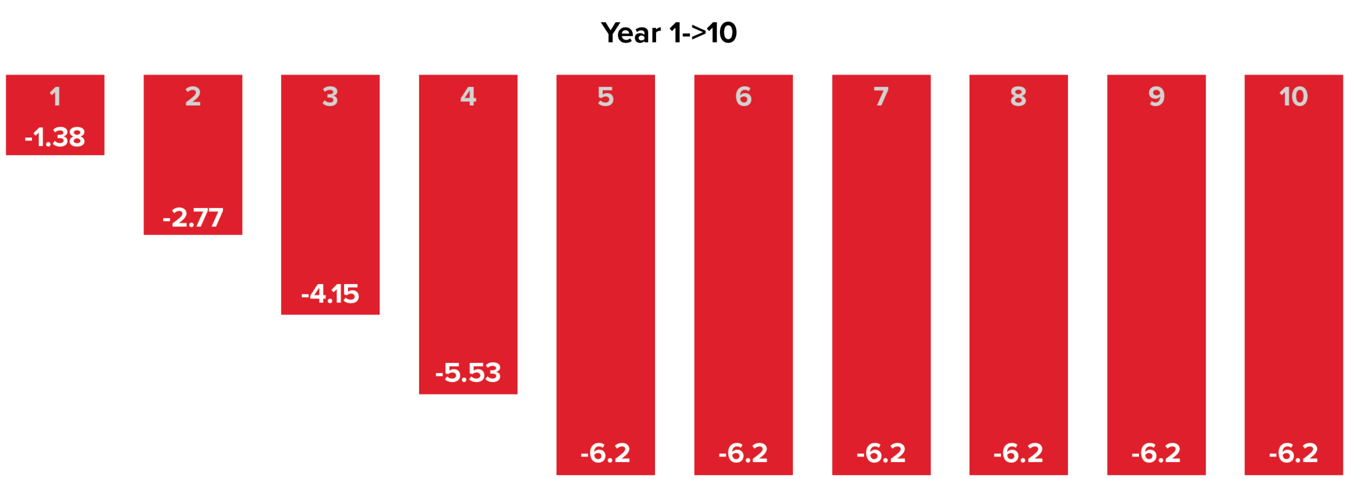
Modest-Case Scenario: Estimated Long-Run Loss in Employment and Tax Revenues (after multiplier effects) Due to S.2155/H.R. 3848[38]

	PE Firms	Portfolio Companies	Combined
Job Losses	97,704	6,109,096	6,206,800
Loss in Federal Tax Revenues	$400,000,000	$69,850,000,000	$70,250,000,000
Loss in State/Local Tax Revenues	$790,000,000	$38,040,000,000	$38,830,000,000
Total Loss in Tax Revenues	**$1,190,000,000**	**$107,890,000,000**	**$109,080,000,000**

Exhibit 9 shows the ten year, post S.2155/H.R. 3848 trajectory of such job losses.[39]

EXHIBIT 9

Modest-Case Scenario: Years 1->10 Trajectory in Job Losses After S.2155/H.R. 3848 (after multiplier effects, in millions)

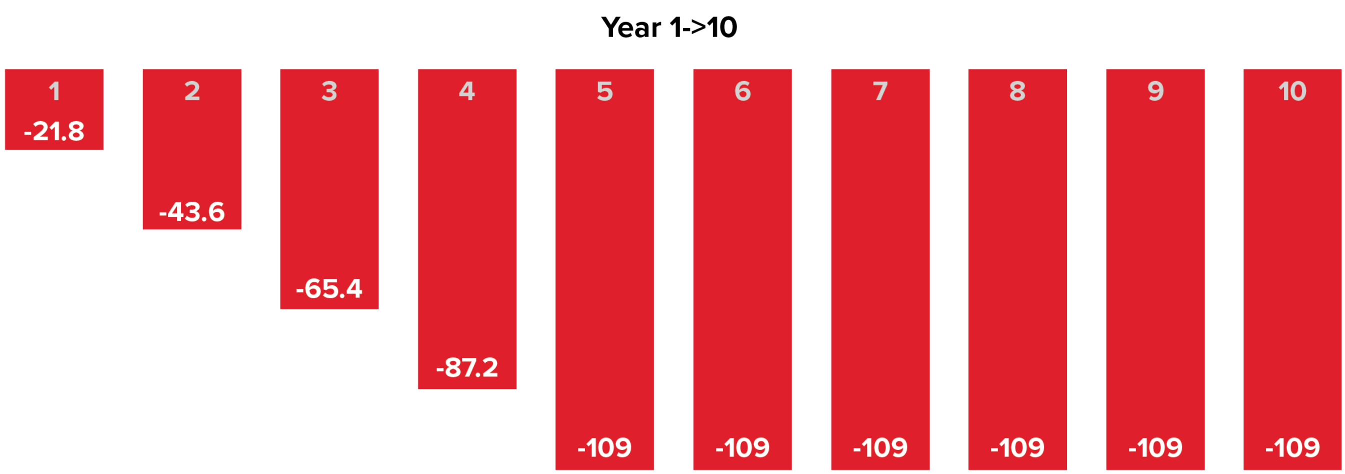


[38] Both employment and tax revenue losses are in the 5th year after implementation. Calculations use IMPLAN.
[39] PE firms hold a portfolio company on average approximately 5 years. Thus, after 5 years existing PE companies (pre-S.2155/H.R. 3848) will have been sold and there would be no new PE investments by this time.

Exhibit 8 also shows that there would be over $109 billion in combined lost federal, state and local tax revenues in this modest-case scenario, after multiplier effects and adding together the effects on the PE industry and the failure of PE-backed companies. Note that the downsized PE industry, in this modest-case scenario, would yield some additional potential taxes on carried interest, management fee payments, and interest expense deduction limitations for the remaining PE sector, which would add a small offset to other tax revenues lost. The ten-year trajectory of such tax revenue losses is shown graphically in **Exhibit 10.**

EXHIBIT 10

Modest-Case Scenario: Years 1->10 Trajectory in Federal, and State and Local Tax Revenue Losses After S.2155/H.R.3848 (in $billions, after multiplier effects)



WORST-CASE SCENARIO

As a result of the above disincentives, it is possible that the entire PE industry would cease to exist over time, and that firms normally financed and managed by PEs would be unable to find other financing and management and fail. **Exhibit 11** shows the predicted negative impact of the Stop Wall Street Looting Act by section in this worst-case scenario.

[40] The estimate includes increased tax revenues on carried interest and reduced deductibility of interest expense for surviving PE and portfolio companies. Note that most states already tax carried interest as ordinary income, so this provision would have little impact on state revenues. Since most PE investors are tax exempt, no tax effects for them are estimated here.

EXHIBIT 11

Worst-Case Scenario: Estimated Direct Impact of S2155/H.R. 3848[41] by Section

S.2155/H.R. 3848 Section	Direct Impact On PE Firms	Direct Impact On PE Investors (including pensions)	Direct Impact On PE Portfolio Companies	Direct Impact On Other Private Funds Firms
101 and 102	100% industry exit (long run)	Annual loss of $3.36 billion (long run)	100% failure rate (long run)	Negative**
201,202, and 203	Negative*	Negative*	Negative*	Negative*
204				
301 though 311	Negative*	Negative*	Negative*	Negative*
401 and 402	Negative*	Negative*	Negative*	Negative*
403	4% down-sizing (long run)	Annual loss of 4% due to downsizing (long run)	4% failure rate increase of (long run)	Negative*
501,502, and 503	Negative*	Negative*	Negative*	Negative*
601	Negative*	Negative*	Negative*	Negative*
701 and 702	Negative*	Negative*	Negative*	Negative*
Net Result	**100% industry exit**	**Annual loss of $3.36 billion**	**100% failure rate**	**Negative***

*difficult to quantify ** hedge funds

Exhibit 12 shows the impacts of the above after multiplier effects. There is a loss of 414 thousand jobs (related to the PE industry, after multipliers) assuming all PE firms exit the market, and an additional 26 million lost jobs (after multipliers) due to PE-backed firms failing (i.e., unable to find suitable financing which also provides PE-type management skills), for a total long run job loss, in the worst-case scenario, of 26.3 million jobs. In this setting there, would be a combined federal and state/total tax revenue loss of $475 billion. **Exhibit 12,** investors in PEs would shift $149.3 billion into lower-yield investments, resulting in an annual (long-run) loss of $3.36 billion in earnings (about half of which would be pension funds). Also not shown in **Exhibit 12** is the effects of S.2155 on other private funds firms (hedge funds and venture capital firms), which would also experience negative effects that are difficult to quantify.

[41] Long run impacts would be 5th year after implementation of S.2155/H.R. 3848.

EXHIBIT 12

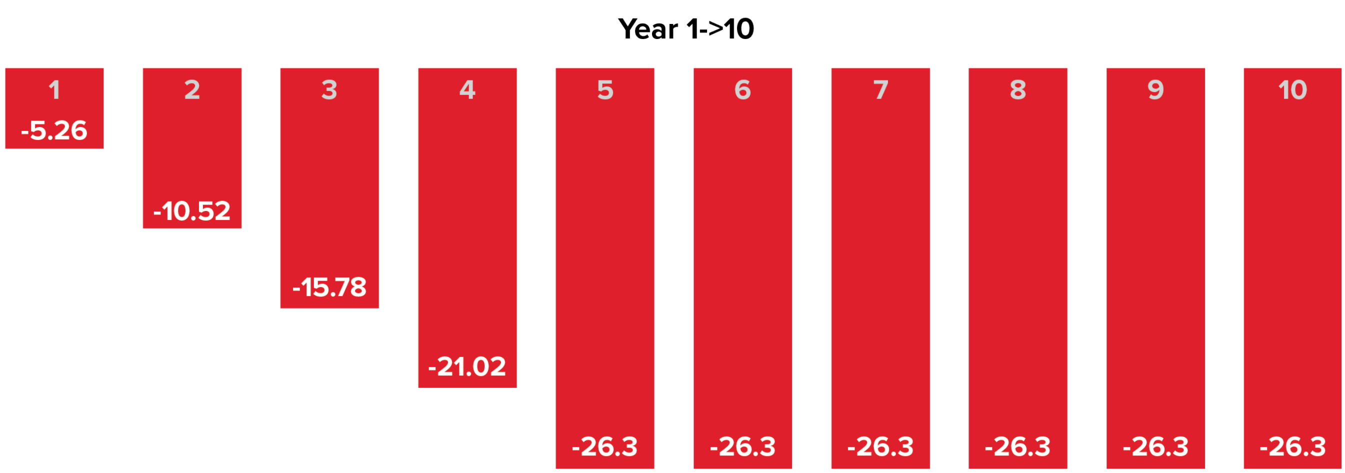
Worst-Case Scenario: Estimated Long-Run Loss in Employment and Tax Revenues (after multiplier effects) Due to S.2155/H.R. 3848[42]

	PE Firms	Portfolio Companies	Combined
Job Losses	414,000	25,866,000	26,300,000
Loss in Federal Tax Revenues	$6,400,000,000	$302,600,000,000	$309,000,000,000
Loss in State/Local Tax Revenues	$2,600,000,000	$163,400,000,000	$166,000,000,000
Total Loss in Tax Revenues	**$9,000,000,000**	**$466,000,000,000**	**$475,000,000,000**

The ten-year trajectory of such job losses is shown in **Exhibit 13**.[43]

EXHIBIT 13

Worst-Case Scenario: Years 1->10 Trajectory in Job Losses After S.2155/H.R. 3848 (after multiplier effects)

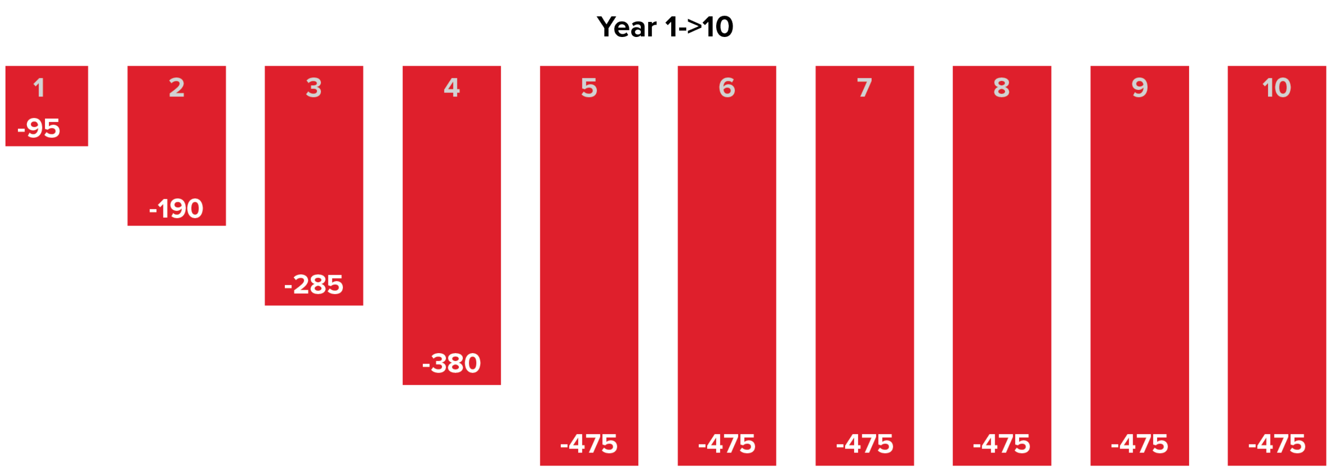


[42] Both employment and tax revenue losses are in the 5th year after implementation. Calculations use IMPLAN.
[43] PE firms hold a portfolio company on average approximately 5 years. Thus, after 5 years, existing PE companies (pre-S.2155/H.R. 3848) will have been sold and there would be no new PE investments by this time

Exhibit 12 also shows that there would be roughly $475 billion in lost federal, state and local tax revenues in this worst-case scenario, after multiplier effects and adding together the loss of the PE industry and the failure of PE-backed companies. Note that the disappearance of the PE industry, in this worst-case scenario, would yield no additional taxes on carried interest, management fee payments, and interest expense deduction limitations due to the disappearance of the tax base (PE industry). The ten-year trajectory of such tax revenue losses is shown graphically in **Exhibit 14**.[44]

EXHIBIT 14

Worst-Case Scenario: Years 1->10 Trajectory in Federal and State/Local Tax Revenue Losses After the Stop Wall Street Looting Act (in $billions, after multiplier effects)



We see that under every scenario, the governments would lose hundreds of millions of dollars of revenue under S.2155/H.R. 3848, which suggests that unless revenues are raised from other sources programs may need to be cut.

SENSITIVITY OF RESULTS TO ASSUMPTIONS

Appendix D performs sensitivity analyses to assumptions used in the foregoing analyses. Calculations show that if as little as 1% of private funds companies exit the market and an equivalent percent of PE-sponsored firms fail, the federal government will "lose money."

[44] Since many PE investors are tax free entities, tax revenue losses here are based on losses related to the PE industry itself, and related portfolio companies, both after multiplier effects.

OTHER NEGATIVE IMPACTS OF THE STOP WALL STREET LOOTING ACT

Retail Sector

One significant negative effect would be on the struggling retail sector. PEs have invested significantly in such companies. To the extent that such companies cannot get financing due to the downsizing of PEs or PEs increased risk exposure, many retailers may fail with resultant losses of jobs in many states.

Other Firms

While the focus of S.2155/H.R. 3848 is on private equity firms, a number of its section can apply beyond PEs. For example, Sections 301 through 310 apply to all companies. Additionally, the tax increasing provisions of S.2155/H.R. 3848 (dealing with carried interest and interest expense deduction limitations) in principle apply to venture capital funds, real estate funds, hedge funds, and other private funds as well. Since quantification of these costs related to these other firms is difficult, the impact here is simply noted aas “negative” in exhibits under both the worst-case and modest-case scenarios.

Markets in General

The risk assumption provisions of Sections 101 and 102 may spill over to other markets. If a number of PE-funded companies happen to fail, and liabilities of these companies exceed asset values, creditors will pursue investors (such as pensions) who in turn may be connected to other financial markets, causing potential financial contagion risk.

About the Author

Charles (Chuck) Swenson, PhD, CPA, is professor and Leventhal Research Fellow at the Marshall School of Business at the University of Southern California, where he has taught since 1987. Chuck has previously served as a visiting professor at UCLA and Caltech. Author of more than 50 academic research and professional articles on taxation which have appeared in such economics journals as the *National Tax Journal, the Journal of Public Economics, and the Journal of Law and Economics,* Dr. Swenson has won the Tax Manuscript Award from the American Taxation Association three times. He is author of two tax texts and is the general editor of the treatise *Bender’s State Taxation: Principles and Practice* (LexisNexis, 2009, updated quarterly). His economics-based research has been presented before the New York Senate Revenue and Taxation Committee, the New York Assembly Committee on Jobs, the California State Assembly, and the City of Los Angeles. He is on the editorial boards of the Journal of *Accounting and Public Policy and the Asia Pacific Journal of Taxation.* His bio and curriculum vitae can be found at: https://www.marshall.usc.edu/personnel/charles-swenson

About the U.S. Chamber of Commerce Center for Capital Markets Competitiveness

The Center for Capital Markets Competitiveness's (CCMC) mission is to advance America's global leadership in capital formation by supporting diverse capital markets that are the most fair, transparent, efficient, and innovative in the world. CCMC advocates on behalf of American businesses to ensure that legislation and regulation strengthen our capital markets allowing businesses—from the local flower shop to a multinational manufacturer—to mitigate risks, manage liquidity, access credit, and raise capital.

Appendices

APPENDIX A: ECONOMIC IMPACTS AND TAX REVENUES OF PRIVATE FUNDS INDUSTRY – SELECT STATES

NEW YORK:

EXHIBIT A1

Estimated Employment, Income, and Output Effects of Private Funds in New York (employment in thousands; dollar values in $millions)

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	133.6	$26,726.7	$25,748.0	$41,625.9
Indirect Effect	79.2	$8,698.0	$12,398.5	$18,420.9
Induced Effect	157.2	$9,629.6	$16,927.9	$25,802.5
Total Effect	**370.0**	**$45,054.3**	**$55,074.4**	**$85,849.3**

EXHIBIT A2

Estimated Annual State and Local Taxes and Fees Generated by the Private Funds Industry in New York After Multiplier Effects[45]

Description	Employee Compensation	Tax on Production and Imports	Households	Corporations
Dividends				$6,259,832
Social Insurance Tax- Employee Contribution Employer Contribution	 $46,275,106 $92,583,976			
Sales Tax		$951,294,220		
Property Tax		$1,214,472,638		
Motor Vehicle License		$13,071,943		
Severance Tax		$528,621		
Other Taxes		$160,636,633		
Other Fees		$3,677,187		
Corporate Profits Tax				$172,832,405
Personal Tax: Income Tax			$1,530,740,622	
Personal Tax: Fines-Fees			$210,565,748	
Personal Tax: Motor Vehicle License			$29,126,076	
Personal Tax: Property Taxes			$26,754,027	
Personal Tax: Other Taxes/Licenses			$4,151,986	
Total State and Local Tax	**$138,859,082**	**$2,343,153,622**	**$1,801,338,189**	**$179,092,237**
	$4,462,443,130			

[45] Ibid. Taxes on proprietors' incomes excluded since tax losses are reported by the pass-through entities.

CALIFORNIA:

EXHIBIT A3

Estimated Employment, Income, and Output Effects of Private Funds Financial Services in California (employment in thousands; dollar values in $millions)

Impact Type	Employment	Labor Income	Value Added	Output
Direct Effect	102.6	$11,557.8	$384.6	$18,283.2
Indirect Effect	63.6	$2,889.4	$211.5	$10,557.4
Induced Effect	87.2	$3.005.0	$57.7	$13,712.4
Total Effect	**253.4**	**$17,452.2**	**$653.8**	**$42,553.0**

EXHIBIT A4

Estimated Annual California State and Local Taxes and Fees Generated by the Private Funds Financial Services Industry After Multiplier Effects[46]

Description	Employee Compensation	Tax on Production and Imports	Households	Corporations
Dividends				$2,232,681
Social Insurance Tax- Employee Contribution Employer Contribution	 $36,985,620 $77,474,310			
Sales Tax		$490,418,718		
Property Tax		$404,119,112		
Motor Vehicle License		$11,120,826		
Severance Tax		$528,621		
Other Taxes		$72,707,102		
Other Fees		$13,733,836		
Corporate Profits Tax				$40,159,411
Personal Tax: Income Tax			$683,121,188	
Personal Tax: Fines-Fees			$112,336,897	
Personal Tax: Motor Vehicle License			$23,410,431	
Personal Tax: Property Taxes			$8,252,651	
Personal Tax: Other Taxes/Licenses			$4,638,125	
Total State and Local Tax	**$114,459,931**	**$992,628,215**	**$831,759,292**	**$42,392,092**

[46] Ibid. Taxes on proprietors' incomes excluded since tax losses are reported by the pass-through entities.

APPENDIX B: PE DEALS BY YEAR AND STATE (IN $BILLIONS, 2010–2018)*

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Alabama	$2.26	$1.75	$2.44	$2.26	$3.40	$4.84	$2.90	$4.06	$3.12
Alaska	$0.08	$0.01	$0.05	$0.20	$0.70	$0.46	$0.23	$0.37	$0.52
Arizona	$4.41	$7.19	$7.32	$4.37	$6.12	$27.22	$6.74	$8.49	$10.45
Arkansas	$0.19	$0.79	$0.99	$0.20	$1.44	$1.42	$1.29	$1.07	$1.73
California	$32.68	$43.01	$46.95	$44.35	$61.13	$65.37	$72.22	$67.34	$85.61
Colorado	$11.92	$7.38	$7.40	$10.04	$18.28	$10.79	$18.02	$24.03	$16.43
Connecticut	$8.96	$5.65	$6.45	$7.09	$6.71	$8.52	$7.96	$7.55	$8.39
Delaware	$0.70	$0.52	$1.15	$0.55	$3.00	$0.85	$0.64	$1.06	$0.83
District of Columbia	$0.91	$2.24	$0.63	$0.95	$0.70	$1.46	$0.57	$1.34	$2.75
Florida	$13.67	$18.96	$19.31	$15.77	$34.72	$24.66	$36.04	$35.10	$29.13
Georgia	$12.41	$9.99	$19.36	$14.11	$23.12	$15.85	$19.73	$14.59	$22.33
Guam		$0.10						$0.13	
Hawaii	$0.33	$0.36	$0.34	$1.17	$0.83	$0.27	$0.79	$0.78	$2.27
Idaho	$0.46	$0.30	$0.81	$1.18	$0.80	$0.71	$1.29	$0.87	$1.87
Illinois	$21.53	$15.57	$18.47	$46.82	$33.02	$85.02	$26.81	$34.14	$25.05
Indiana	$4.04	$3.94	$3.69	$4.18	$4.59	$11.70	$8.89	$9.45	$6.08
Iowa	$0.56	$0.16	$1.07	$1.91	$2.92	$1.45	$1.21	$4.00	$3.03
Kansas	$2.60	$1.42	$4.11	$2.25	$3.51	$2.63	$5.28	$3.25	$5.06
Kentucky	$2.38	$1.74	$2.87	$1.51	$3.42	$4.62	$5.82	$4.33	$13.24
Louisiana	$1.71	$1.60	$3.71	$3.33	$6.02	$3.11	$9.06	$5.67	$3.78
Maine	$0.93	$0.78	$0.91	$0.79	$0.95	$0.84	$1.43	$1.63	$0.96
Maryland	$4.07	$4.12	$3.17	$8.08	$10.73	$5.56	$6.74	$8.43	$9.85
Massachusetts	$12.93	$10.31	$9.11	$11.68	$13.70	$12.06	$99.34	$35.86	$26.24
Michigan	$5.30	$4.98	$8.49	$5.46	$14.91	$6.78	$12.19	$13.72	$16.63
Minnesota	$5.36	$6.95	$6.61	$5.02	$8.05	$11.76	$7.74	$7.77	$30.75
Mississippi	$0.63	$0.90	$2.24	$0.30	$1.85	$0.73	$0.65	$0.76	$1.49
Missouri	$3.22	$2.82	$4.09	$3.72	$6.44	$5.60	$7.40	$15.28	$9.27
Montana	$0.24	$0.20		$0.52	$1.09	$0.28	$0.27	$1.12	$0.55
Nebraska	$1.44	$0.97	$0.73	$0.55	$2.03	$1.46	$1.67	$9.47	$1.09
Nevada	$2.36	$1.95	$1.13	$1.35	$3.66	$2.45	$7.77	$2.30	$4.59
New Hampshire	$0.46	$1.71	$2.33	$0.80	$3.74	$1.70	$1.68	$3.05	$2.17
New Jersey	$7.60	$9.77	$12.76	$9.23	$20.20	$13.58	$12.07	$13.12	$14.91
New Mexico	$0.44	$0.32	$0.75	$0.70	$1.09	$0.51	$1.29	$2.21	$0.99
New York	$20.50	$24.99	$27.21	$28.32	$34.50	$46.60	$35.11	$50.03	$43.63
North Carolina	$9.41	$16.57	$12.46	$7.75	$12.53	$15.37	$11.17	$24.44	$20.58
North Dakota	$0.34	$0.93	$0.30	$0.93	$1.13	$2.82	$0.59	$0.46	$0.24
Ohio	$11.40	$13.12	$9.31	$10.84	$19.16	$15.11	$15.73	$13.02	$18.82
Oklahoma	$3.84	$11.04	$6.60	$8.34	$10.27	$6.30	$3.72	$7.52	$8.73
Oregon	$1.23	$1.37	$3.37	$3.13	$3.68	$3.51	$4.18	$3.22	$6.66
Other US Territory	$0.09		$0.02	$0.43	$0.20				
Pennsylvania	$9.16	$14.98	$16.21	$21.26	$19.27	$21.39	$31.68	$24.48	$27.12
Puerto Rico	$0.64	$1.66	$0.20	$0.09	$0.63	$0.23	$0.23	$0.26	$1.39
Rhode Island	$0.71	$0.48	$0.47	$0.75	$0.49	$0.89	$0.84	$0.81	$0.77
South Carolina	$1.71	$1.63	$2.01	$2.88	$2.56	$3.05	$5.53	$3.48	$5.69
South Dakota	$0.19	$0.19	$0.20	$0.51	$1.01	$0.63	$0.42	$0.22	$0.28
Tennessee	$10.31	$10.25	$5.42	$7.09	$10.87	$7.65	$10.82	$18.94	$32.97
Texas	$30.49	$51.42	$54.95	$90.16	$70.29	$54.42	$63.40	$72.25	$110.62
Utah	$2.64	$4.13	$9.28	$3.67	$5.26	$4.66	$3.58	$6.72	$4.57
Vermont	$0.45	$0.78	$0.40	$0.44	$0.57	$0.29	$0.44	$0.10	$1.48
Virgin Islands						$0.01	$0.23		$1.25
Virginia	$7.61	$12.00	$6.89	$19.34	$7.99	$15.44	$14.45	$17.29	$8.21
Washington	$2.57	$3.11	$10.44	$4.92	$9.24	$8.22	$9.72	$7.12	$16.30
West Virginia	$1.01	$0.62	$0.82	$0.06	$0.96	$0.35	$0.50	$1.07	$0.51
Wisconsin	$2.31	$4.98	$7.76	$8.88	$8.83	$8.73	$5.20	$8.39	$11.67
Wyoming	$0.27	$0.30	$0.14	$0.73	$2.11	$0.89	$0.52	$1.32	$0.44
Unknown	$1.10	$0.53	$0.77	$2.56	$2.60	$0.93	$1.49	$6.56	$4.07
Total	$284.74	$343.53	$374.69	$433.53	$527.05	$551.77	$605.28	$610.07	$687.17

*Source: Pitchbook

APPENDIX C: DETAILED EXPLANATIONS OF SECTION 403 OF S.2155/H.R. 3848

Undert his section, net capital gain from an "investment services partnership interest" (ISPI) is treated as ordinary income and is taken into account in determining the partner's net earnings from self-employment. The amount treated as ordinary income (or ordinary loss) is allocated ratably to the items of long-term capital gain (or loss) taken into account in determining net capital gain (or net capital loss). Net long-term capital gain (and loss) is determined under Section 1222, but (i) by only taking into account items of gain (or loss) taken into account by such partner under section 702, and (ii) treating any section 1231 property as held for more than one year.

Gain from the disposition of an ISPI is treated as ordinary income and is taken into account in determining the partner's net earnings from self-employment. The holder generally would be required to recognize such gain without regard to any other income tax provision.[47] Similar recharacterization rules apply to income or gain derived from other "disqualified interests" (e.g., convertible debt, options, or derivatives) held by a person who performs substantial investment management services for any investment entity. The rule generally does not apply to a partnership interest or to taxable C corporations and S corporations, except to the extent provided in regulations. The rule would apply to foreign corporations if substantially all of their income is not effectively connected income (ECI) or subject to a comprehensive foreign income tax.

If any built-in gain property is distributed with respect to an ISPI, the partner receiving such property will recognize gain equal to the FMV of such property over the partner's adjusted basis in the property. Gain recognized due to a distribution will be treated as ordinary to the extent gain on such partner's distributive share would have been treated as ordinary if the distributed property had been sold by the partnership at FMV immediately before the distribution and all of the gain had been allocated to the distributee partner. The basis of the distributed property will be FMV in the hands of the distributee partner. Qualified dividend income and the qualified small business stock rules will not apply to dividends or gain allocated to an ISPI. An ISPI will be treated as a "hot asset" in applying Section 751, and any gain that arises by reason thereof must be recognized without regard to any other income tax provision. Adjustments are made to exclude the amount attributable to a qualified capital interest. An exception to this rule applies to exchanges of interests in publicly traded partnerships that hold ISPIs, except to the extent provided by regulations.

This section also treats net capital loss from an ISPI as ordinary loss but such recharacterization is limited to the amount by which (i) the amount of net income recharacterized from such interest for all preceding partnership taxable years, exceeds (ii) the amount of net loss recharacterized from such interest for all preceding partnership taxable years. Loss from the disposition of an ISPI is treated as ordinary loss, but such recharacterization is limited to the amount by which (i) the amount of net income recharacterized from such interest for all partnership taxable years, exceeds (ii) the amount of net loss recharacterized from such interest for all partnership taxable years.

This section defines an ISPI generally as any interest in an investment partnership acquired or held by a person in connection with the conduct of a trade or business by such person (or a related person), which primarily involves the performance of any of the following services with respect to assets held (directly or indirectly) by one or more such investment partnerships: Providing advice regarding the advisability of investing, purchasing or selling of any "specified asset"; managing, acquiring, or disposing of any "specified asset"; arranging financing with respect to acquisition of "specified assets"; and/or performing any activity in support of the above-listed services. If an ISPI is acquired from a related person, it continues to be treated as an ISPI. Also, an interest does not cease being treated as an ISPI merely because such person holds such interest other than in connection with the described trades or businesses.

[47] An exception is provided for contributions of an ISPI to a partnership in exchange for an interest in such partnership provided the taxpayer elects to treat the partnership interest received as an ISPI and to comply with certain reporting and recordkeeping requirements. Similar rules apply to certain partnership mergers, divisions and technical terminations subject to Section 708(b). Also, the bill would allow transfers of ISPIs by gift or death not to be treated as a disposition triggering ordinary income treatment. However, the transferee or heir must treat the obtained interest as an ISPI. Also, any inchoate income (that would have been recharacterized had the decedent sold the ISPI at the time of death) shall be treated as income in respect of a decedent (IRD).

The term "investment partnership" means any partnership if, at the end of any two consecutive calendar quarters, (i) substantially all of the assets of the partnership are specified assets (determined without regard to any Section 197 intangible), and (ii) "less than 75 percent of the capital of the partnership is attributable to qualified capital interests which constitute property held in connection with a trade or business of the owner of such interest." For this purpose, a specified asset generally includes securities, real estate held for rental or investment, interests in partnerships, commodities, cash (or cash equivalents), or options or derivatives with respect to any such assets. Special look-through rules apply for certain wholly owned entities.

None of the foregoing rules apply to items of income, gain, loss, or deduction to the extent allocable to a qualified capital interest if a "significant" amount of allocations are made in the same manner with respect to other qualified capital interests held by unrelated partners who do not provide investment management services to the partnership. These rules may be applied separately by regulation to a portion of a "qualified capital interest."[48]

A "qualified capital interest" refers to the portion of a partner's interest in the capital of a partnership attributable to (i) the fair market value of money or other property contributed to the partnership in exchange for the interest; (ii) any amount included in gross income under Section 83; and (iii) any partnership amounts previously taken into account as net income or gain. The qualified capital interest shall be reduced by partnership distributions to the partner (after the effective date) or by allocations of net losses or deductions.

A transferee of an ISPI generally will succeed to the qualified capital interest of the transferor. Also, a qualified capital interest generally does not include any contribution of capital that is attributable to any loan or advance made or guaranteed (directly or indirectly) by another partner or the partnership (or a related person to another partner or the partnership). Loans and advances to the partnership made or guaranteed (directly or indirectly) by another partner that does not provide services to the partnership shall be taken into account in determining qualified capital interests of the partners.

The recharacterization rules under the bill (in subsections [a] and [b]) do not apply to items allocated to a domestic C corporation with respect to an ISPI and subsection (e) with respect to disqualified interests does not apply to domestic C corporations, except to the extent provided by regulations. Also, a new 40% penalty is imposed on underpayments resulting from avoidance of the purposes of the provision (as prescribed by regulations) or failure to treat income derived from other ownership interests as ordinary income.[49] Also, income treated as ordinary income from an ISPI generally would not be treated as qualifying income for purposes of determining whether a publicly traded partnership (PTP) can be treated as a partnership.[50]

Treasury is provided broad regulatory authority under the bill to prescribe guidance necessary or appropriate to carry out the purposes of the proposal, including: separate reporting and recordkeeping of income related to an ISPI; modifications consistent with the purposes of the proposal; rules to prevent avoidance of the proposal (including through the use of qualified family partnerships); and coordinate the proposal with other tax provisions. The bill generally would apply to taxable years ending after the date of enactment, but would apply only to dispositions and distributions after the date of enactment.

[48] In situations where there are no significant allocations to non-service providers, Treasury would have regulatory authority to treat partnership items as "properly allocable" to a qualified capital interest. Allocations to a partner in certain qualified family partnerships will be treated as meeting this test even though there is no unrelated qualified capital interest to use as a benchmark for such allocations.
[49] The reasonable cause exception under Section 6664(c) would only apply if the tax treatment has been adequately disclosed, there was substantial authority for the position, and the taxpayer reasonably believed the treatment was more likely than not proper.
[50] This rule would not apply to certain partnerships substantially all of whose assets are interests in PTPs or certain partnerships whose interests are convertible into interests in publicly traded real estate investment trusts (i.e., UP-REIT structures). This rule is not applicable to existing PTPs until taxable years beginning on or after the date that is 10 years after date of enactment.

APPENDIX D: SENSITIVITY ANALYSIS

We can solve for the minimum response rate to S.2155/H.R. 3848 before governments start to lose tax revenues. For the federal case, we solve:

$6.43 billion *(1-x) -$2.45 billion=0, (C1) where x=% response rate to taxation, $2.43 billion is the presumed gain to the federal government on the new taxes from S.2155/H.R. 3848 (without behavioral responses), and $6.43 billion is the total federal tax revenue generated by the industry (after multipliers, and before behavioral responses). The above yields approximately 38%. So, if as little as 38% of PE firms exited the market, the federal government would lose money. When we add in federal tax revenues lost from PE portfolio companies, we see that if as little as 1% of PE firms exited the market, and an equivalent percent of portfolio companies failed, the federal government would lose money.