

An aerial photograph of a city, likely Los Angeles, showing various residential and commercial buildings, streets, and green spaces. The entire image is overlaid with a semi-transparent green filter. In the bottom right corner, there is a large, stylized graphic of a human eye, composed of concentric circles and a grid pattern, looking towards the center of the image.

APRIL 18, 2018

HEDGE PAPERS NO. 56

CALIFORNIA HEDGE FUNDS &
*Their Billion-Dollar
Tax Loophole*

Simply stated, the carried interest loophole is the mistreatment of hedge fund and private equity fees as capital gains, rather than ordinary income.

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INTRODUCTION: THE CARRIED INTEREST LOOPHOLE

Understanding what the Carried Interest Loophole is and why Trump and Congressional Republicans kept it alive in the Federal Tax Law.

The carried interest loophole is among the most costly and wasteful tax loopholes out there.

It's a massive giveaway to hedge fund and private equity firms that costs federal taxpayers \$18 billion each year. Here's how it works: These firms charge their investors fees for managing their money, but rather than classifying this as income they deem it carried interest, allowing them to pay lower tax rates.

Despite agreement from economists and tax experts across the political system that the carried interest loophole, should be closed, Trump and Republicans have refused to touch it.¹

Instead, with last year's new federal tax law, Trump and Republicans chose to increase the trillions of dollars going to billionaires and corporations while threatening vital investments in housing, education and healthcare.²

During his presidential campaign, President Donald Trump pledged to close the loophole, saying that "the hedge fund guys are getting away with murder...I have hedge fund guys that are making a lot of money that aren't paying anything."

Now, of course, many of those "hedge fund guys" are in the Trump administration or otherwise advising or funding Trump.



So it's not surprising that Trump and Republicans left the carried interest loophole intact. Former hedge fund and private equity fund billionaires in the Trump administration include Commerce Secretary Wilbur



Trump advisor Stephen Schwarzman, the billionaire CEO of private equity firm the Blackstone Group.

Commerce Secretary Wilbur Ross, former hedge fund and private equity fund billionaire.

Treasury Secretary Steven Mnuchin, former hedge fund and private equity fund billionaire.

Ross and Treasury Secretary Steven Mnuchin. Trump advisor Stephen Schwarzman, the billionaire CEO of private equity firm the Blackstone Group, hosted a fundraiser for Trump the day after the Senate first passed the tax bill, in November.

Besides occupying key positions in the Trump administration, the hedge fund and private equity also spent enormous sums lobbying on the federal level and making donations to Congress to ensure that the new federal tax law would not impact carried interest.

According to the Center for Responsive Politics, this cycle Schwarzman's Blackstone Group is the #1 donor to Senate majority leader Mitch McConnell,³ the #2 donor to Paul Ryan,⁴ and the #3 donor to Senate minority leader Chuck Schumer.⁵

Steven Rosenthal, a tax expert at the Urban-Brookings Tax Policy Center, summed up the failures of the bill for Bloomberg: "Carried interest was a key litmus test of whether the bill can be called tax reform, and it failed. This legislation was a Swiss cheese."

The bill delivered major new giveaways for billionaire investment managers – the Wall Street Journal called the legislation a "shot in the arm" for private equity and quoted a managing director at private equity firm Hamilton Lane saying the industry "is very much a big winner out of the reform."

STATES TAKING ACTION: CALIFORNIA SPOTLIGHT

It's still possible for Californians to act. California can join states around the country in closing the loophole and raising much-needed revenue to fund schools, hospitals, and vital infrastructure.

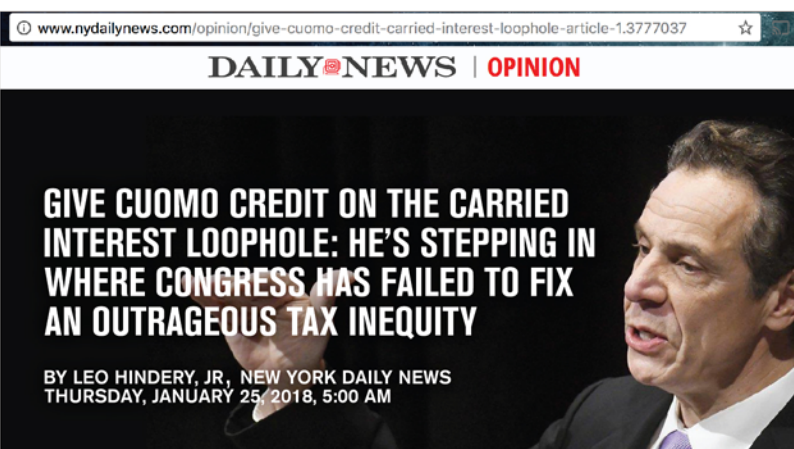
Regular, everyday Americans were the losers in the federal tax bill. But there's still a chance to change that.

As hedge fund and private equity billionaires increasingly call the shots on the federal level, state and local action is crucial.

Legislatures across the country can pass legislation to tax the carried interest of hedge funds, private equity firms, and other investment vehicles headquartered in their jurisdictions at ordinary rates – and raise money to fund schools, hospitals, and vital infrastructure.

In New York State, Governor Andrew Cuomo included a fairness tax on carried interest income in his 2018 budget.

Similar legislation has been proposed in Massachusetts, Rhode Island, Connecticut, New Jersey, Maryland, Virginia, the District of Columbia and last year passed the Illinois State Senate. The legislation would raise billions or hundreds of millions of dollars in much-needed revenue in all of these states.



The legislation would raise billions or hundreds of millions of dollars in much-needed revenue in all of these states.

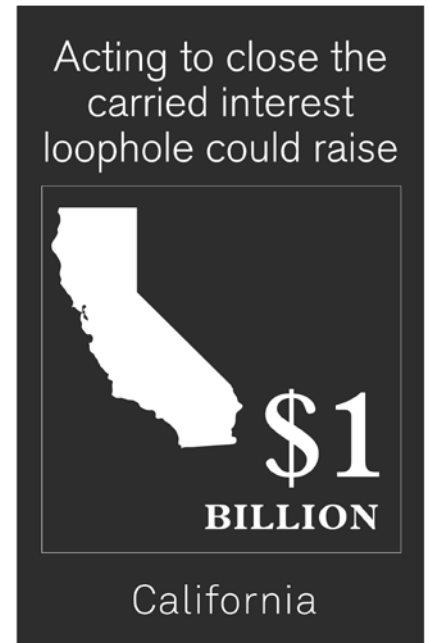
California: This year Assembly Member Mike Gipson introduced Assembly Bill Number 2731 (AB 2731) to do it in California. ⁶

CALIFORNIA COULD RAISE \$1 BILLION OR MORE FROM CLOSING THE LOOPHOLE.

This report from Hedge Clippers uses hedge fund and private equity data from Preqin to show that California could raise huge sums of revenue by acting to close the carried interest loophole.

Using a conservative methodology for estimating the potential annual revenues, the analysis in this report reveals that state action on carried interest could recapture many billions of dollars across the country, with hundreds of millions or billions for each state





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WHAT IS THE CARRIED INTEREST LOOPHOLE?

Simply stated, the carried interest loophole is the mistreatment of hedge fund and private equity fees as capital gains, rather than ordinary income.

According to the New York Times,

Partners at private-equity firms and hedge funds typically treat a big portion of the fees they charge their clients as a capital gain — that is, as profit on the sale of an investment — so they can pay tax at the capital-gains rate of 20 percent (plus a surtax of 3.8 percent typically).

Ordinary income is taxed at a rate of up to 39.6 percent. But labeling fees as capital gains is a stretch, in part because the partners generally earn their fees by managing other people's money, not by investing their own.⁷

Hedge fund and private equity funds are usually structured as partnerships. The fund manager is the general partner of the funds, and the investors are limited partners.

Investors often supply the majority of the capital, and the fund manager is supposed to supply investment expertise. For the services the investment manager provides, they charge certain fees.

In both hedge funds and private equity funds, the standard fee structure is “2 and 20”—two percent of the fund assets per year are taken as the management fee, which covers operating costs.

Twenty percent of all gains over a certain benchmark rate are taken by the fund manager as the performance fee.⁸

As the name implies, managers' “performance fees” are based on how well they've performed for their clients. Anyone who has ever worked on commission will understand this arrangement—by providing workers a percentage of the profits they generate, employers maximize the incentive to increase those profits.⁹

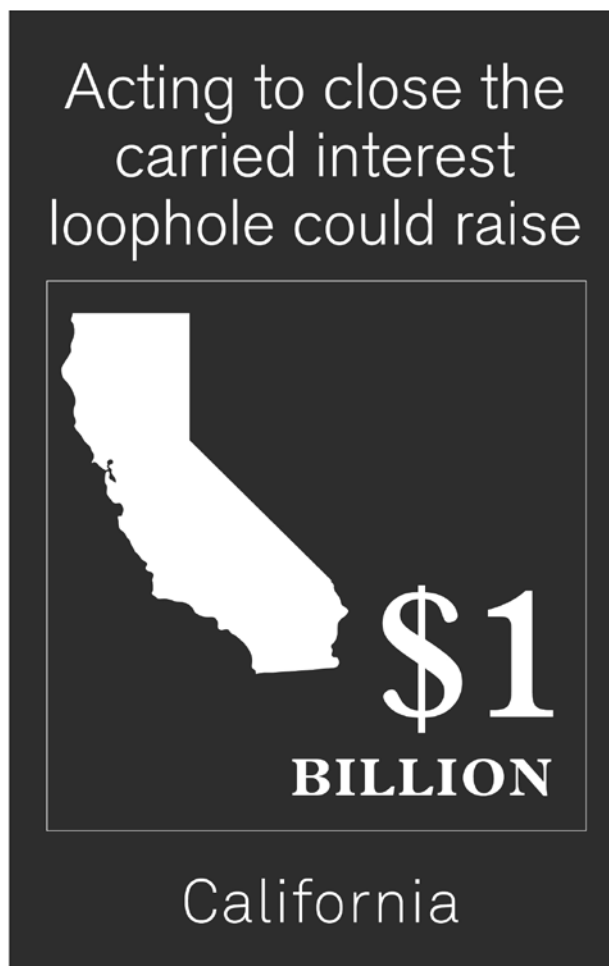
By contrast, investors' returns are based not on performance but on the amount of money they have put into the fund. They may gain profits from their investments, or they may lose the money they have invested, while hedge fund managers only gain.

Not surprisingly, given these differences between the position of hedge fund managers and investors, the vast majority of legal and economic experts consider ‘carried interest’ income.¹⁰

If the federal tax code reflected this consensus, carried interest would be taxed as ordinary income at a top rate of 37 percent. Instead, many fund managers treat this fee as an investment profit, taxed as long-term capital gains at a rate of 20 percent or less.¹¹ That 17 point difference costs taxpayers \$18 billion per year.¹²

While the GOP-controlled Washington has failed to act, California can reclaim some of that lost revenue.

States with a lot of hedge fund and private equity managers can raise hundreds of millions or billions of dollars – and all states can raise something, merely by imposing tax fairness on an out-of-control loophole.



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THE CARRIED INTEREST LOOPHOLE

Simply stated, the carried interest loophole is the mistreatment of hedge fund and private equity fees as capital gains, rather than ordinary income.

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Management Fees

2% of the fund assets per year are taken to cover **Operating Costs**

Salary

The **Fund Manager** also receives a **Salary & Benefits** from the hiring firm in addition to the 20% of gains taken from the fund

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Performance Fees

20% of all gains over a certain benchmark rate are taken by the **Fund Manager**

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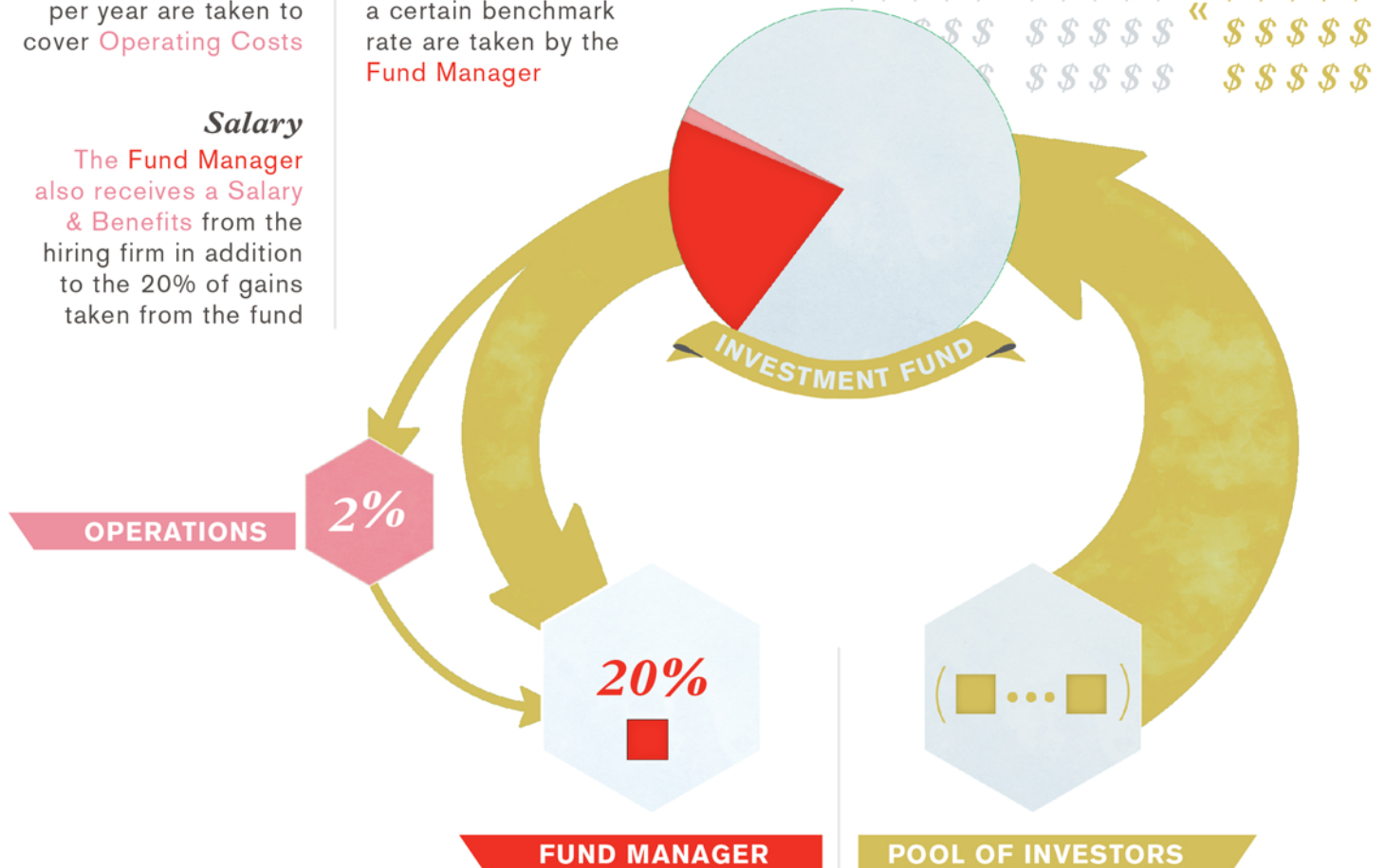
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Ordinary income is taxed at a rate of up to 37%

Labeling fees as capital gains is a stretch, partly because the partners earn their fees by managing other people's money, not investing their own.

The difference of 17%...

The tax revenue loss from the carried interest loophole (which only benefits a handful of the ultra-rich) is estimated to be a whopping \$18 billion per year.

Investors Pay Fees

20% of annual gains are taken by the hedge fund's manager

Supply Capital

Investors supply the majority of capital that builds the investment fund

TAX REVENUE LOSS FROM THE CARRIED INTEREST LOOPHOLE = \$18 BILLION PER YEAR

THE FIGHT TO HOLD CALIFORNIA'S BILLIONAIRES ACCOUNTABLE

Since Proposition 13 first threatened California's ability to invest in education, housing and other basic public goods, the state's ultra-wealthy have argued that paying their fair share in taxes would stop them from creating jobs and growing the economy.

Yet the wealthy private equity and hedge fund managers profiled in the following pages have done little to support California communities. In fact, many of them have made their fortunes profiting off of economic downturns in which regular people lost everything. Others have actively exploited communities through predatory lending practices or price gouging.

Far from creating jobs, these investors have sought to extract wealth from Californians, all while developing tax havens and lobbying to keep provisions like the carried interest loophole.

Here's a snapshot of some of the California hedge fund and private equity managers currently enjoying a billion-dollar tax loophole while the rest of California pays the bill.



**MEET THE BILLIONAIRES:
SELECT CALIFORNIA
BILLIONAIRES AND
MULTIMILLIONAIRES**

OAKTREE CAPITAL

Vicious vulture investors driving up housing costs, pushing gentrification and school privatization and profiting from human misery in Puerto Rico

Oaktree Capital was founded by Howard Marks and Bruce Karsh in 1995.

The firm's model is built on profiting off of others' misfortunes, taking advantage of debt crises where defaults rise, credit is hard to come by and many other investors suffer significant losses. As co-founder Howard Marks explained in one of his famous memos, the cycle of loose credit followed by crisis has "delivered the best buying opportunities in our 26 years in distressed debt."¹³

The firm was one of several private equity players to see the housing crash as an opportunity, purchasing "distressed" mortgages and converting owner-occupied housing into rentals. Oaktree sold off its rental properties when it found it could not continue to raise rents at the same rate as it had immediately after the crisis.¹⁴

Oaktree Capital has also sought to profit off of misfortune in hurricane-ravaged Puerto Rico, where it has bought up hundreds on millions of dollars in debt from the Puerto Rico Employees Retirement System (ERS), the pension fund for public employees.

While the island has faced an eleven year recession and a slow recovery from Hurricane Maria, Oaktree and other bondholders filed a complaint in federal bankruptcy court, requesting that ERS divert employer contributions to repay bondholders, putting



retirees at risk of even steeper cuts.¹⁵

This business model has served Marks and Karsh well, as both are reportedly worth \$2 billion.¹⁶

Karsh and his wife Martha are major donors to the controversial charter school chain KIPP¹⁷, and Oaktree has given money to the privatizing chain as well.¹⁸



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TPG CAPITAL

Pushing deadly opioid drugs and foreclosing on families in Puerto Rico

The largest investor in Endo Pharmaceuticals is the hedge fund TPG Capital, whose 9.9% stake in the company was worth \$171.7 million, according to a February 2018 SEC filing.¹⁹ In 2016, 25% of Endo's revenues came from sales of Opana and Percocet, Endo's name brand opioids.²⁰

TPG Capital is led by David Bonderman, an investor famous for his lavish birthday parties. Bonderman's 70th birthday party featured performances by Paul McCartney and Robin Williams.²¹ Bonderman was pressured into stepping down from his seat on the board of directors of the ride-hailing company Uber after making sexist comments at a board meeting in the wake of accusations of a corporate culture of sexual harassment at the company.²²

TPG also owns a mortgage operation that is foreclosing on more homes in Puerto Rico than all but one bank.²³



<https://dealbook.nytimes.com/2012/11/19/what-happens-in-vegas-a-buyout-birthday-blowout/> ☆

The New York Times

Tough Times? You Wouldn't Know at Party for Private Equity Titan

BY PETER LATTMAN NOVEMBER 19, 2012 12:32 PM 14



A live performance of "Long and Winding Road," by Paul McCartney in the 1990's.

Opulent celebrations thrown by the rich and famous are de rigueur in New York and Hamptons society. And in buyout land, there is something about private equity bosses and 60th birthdays: In 2002, [David Bonderman](#), co-founder of TPG, had the [Rolling Stones](#) and [John Mellencamp](#) play at his celebration at the Hard Rock in Las Vegas.

But where Mr. Schwarzman's \$3 million birthday party came to be seen as a symbol of a new Gilded

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ARES CAPITAL MANAGEMENT

Led by dark-money-donor school privatizers

Antony Ressler and John Kissick are partners of Ares Capital Management, a private equity and alternative investments firm. Both contributed to Americans for Job Security, the dark-money Super PAC exposed in 2016 by Hedge Clippers.²⁴

At the time of his contribution, Ressler was a board member of the Alliance of College Ready Public Schools in Los Angeles; a charter school operator currently managing twenty-seven schools in L.A.²⁵ In the year following his donation to the Americans for Job Security, Ressler would be promoted to board chair.

Collectively, schools in the Alliance for College Ready Public Schools network received \$8,806,279 in Prop. 30 funds for the 2013-14 school year alone. The Alliance Gertz-Ressler Richard Merkin 6-12 Complex, named for Prop. 30 opponent Anthony Ressler, got \$560,839 in Prop. 30 funds.²⁶

John Kissick is a board member of LA's Promise, which operates three public schools in the Los Angeles Unified School District.²⁷ As a district, LAUSD has received more than \$1.1bn in badly-needed Prop. 30 funds since the proposition's passage.

Ares Capital manages \$94 billion dollars, a substantial portion of which they manage on behalf of public pension funds and endowments.²⁸



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LEONARD GREEN & PARTNERS

Born in scandal, mired in labor battles, enjoying huge profits and private jets

Sitting on a panel at the Milken Institute Global Conference in Beverly Hills, Leonard Green director Jonathan Sokoloff complained that private equity firms like his were “generally viewed negatively by most people who don't understand us.” He joined Blackstone principal Stephen Schwarzman in citing the money the firms raised for investors as a counterpoint to critics citing private equity's penchant for layoffs and destroying iconic brands with excessive debt.²⁹

While Sokoloff blamed the negative view of private equity on bad public relations, his own firm's practices and origins offer another explanation.

Both Sokoloff and his fellow managing partner, John Danhaki, began their careers under notorious white collar felon Mike Milken who was banned from working in the finance industry after being indicted for insider trading in 1989.³⁰

Shortly after the death of founder Leonard I. Green, his family sued Danhaki, Sokoloff and the rest of the firm's leadership for allegedly filching \$3 million from their former boss' estate.³¹

Leonard Green acquired the Palms Casino in Las Vegas in 2011.³² The Culinary Workers Union 226, the largest union in Nevada, faced an uphill battle with the firm, which refused to allow workers to organize without management interference.

According to union members, Palms employees who



sought to organize faced harassment by management. Palms employee Juan Sanchez was written up by his supervisors for his organizing efforts, before the National Labor Relations Board required the casino to rescind the reprimand.³³

While Leonard resisted employee efforts to exercise their guaranteed right to organize to improve working conditions, it was condemned for its extravagance in chartered flights for executives. The Culinary Workers Union cited the \$4.62 million for over four hundred flights paid for by the firm, suggesting the payments may have come at the expense of investors.³⁴

Between 2013 and 2015, Leonard Green & Co's jets made 1,898 flights, including: 115 flights to McCall, Idaho, where one of the partners has a summer home; 74 to Westhampton; 18 to Aspen, Colo.; 14 to Cabo San Lucas, Mexico; 14 to Hawaii; 12 to the Bahamas; and 2 to Turks & Caicos.³⁵

After engaging in a range of union busting tactics including outsourcing two hundred positions to Sodexo, Leonard chose to sell the casino for a profit well below the standard rate of return.³⁶

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ALTAMONT CAPITAL PARTNERS

Driving the “Retail Apocalypse” and pushing rip-off car loans on consumers

Founded in 2010 by private equity veteran³⁷ Jesse Rogers, Altamont capital manages \$1.3 billion in funds.

Rogers was the founder of Bain Capital's Private Equity Group, leading the firm as it shifted its business model from investing in promising startups to leveraged buyouts.³⁸ The firm spent subsequent decades funding hostile takeovers with large amounts of debt that forced layoffs and ultimately drove businesses into bankruptcy.³⁹

Rogers left Bain in 2000⁴⁰ to found Golden State Capital, a private equity firm that continued the damaging practices pioneered by firms like Bain. Golden State Capital was cited by creditors in Payless shoe stores 2017 bankruptcy filing as one of the driving forces behind the bankruptcy.

Creditors pointed to the \$350 million in fees extracted by Golden State and Blum Capital, another private equity firm, as well as the more than \$700 billion in debt forced on the company.

Payless' private equity owners eventually paid the company's creditors \$20 million to avoid a lawsuit over their actions.⁴¹

Rogers' most recent firm, Altamont joined other private equity firms who, in the wake of the housing market crash, sought to replicate the predatory practices of the mortgage industry in the auto loan market.



JESSE ROGERS

Altamont, along with Blackstone, KKR and other large PE firms invested over \$3 billion in finance companies that targeted car buyers with low credit scores. In just six years, defaults on auto loans had increased 72 percent.⁴²

Bloomberg LP [US] <https://www.bloomberg.com/graphics/2017-retail-debt/>

Bloomberg f t

America's 'Retail Apocalypse' Is Really Just Beginning

By Matt Townsend, Jenny Surane, Emma Orr
and Christopher Cannon
November 8, 2017

The so-called retail apocalypse has become so ingrained in the U.S. that it now has the

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VISTA EQUITY PARTNERS

Spending tens of millions to lobby pension trustees, dodging taxes in the Cayman Islands

Robert F. Smith, founder, chair and CEO of Vista Equity Partners, is one of the richest men in America with a net worth of around \$2.5 billion.⁴³

The former Goldman Sachs⁴⁴ executive has developed a unique arrangement with investors that allows Vista Equity to take risky gambles with investor funds, including those from public institutions like the New Jersey State Investment Council and the Oregon Public Employees Retirement Fund.⁴⁵

Vista has spent thousands lobbying for investments from CalPERS and the University of California⁴⁶ and has received over \$80 million from the nation's largest public pension fund in capital and fees through CalPERS Capital Links funds.⁴⁷

While Vista's offices are on Embarcadero in San Francisco and Robert Smith is a long-time California resident, most of Vista's funds are incorporated in the Cayman Islands,⁴⁸ a notorious tax haven.⁴⁹ The remainder are incorporated in Delaware.⁵⁰



VISTA EQUITY PARTNERS FOOTNOTES

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Vista Equity Endeavor Fund I-A, L.P.;
- VISTA EQUITY FUND II LP; VISTA EQUITY PARTNERS FUND III GP, LLC;
Vista Equity Partners Fund III LP; Vista Equity Partners Fund III Parallel LP;
Vista Equity Partners Fund IV (Parallel), L.P.;
Vista Equity Partners Fund IV, L.P.;
Vista Equity Partners Fund V Executive, L.P.;
Vista Equity Partners Fund V, L.P.; Vista Equity Partners Fund V-A, L.P.;
Vista Equity Partners Fund VI, L.P.; Vista Equity Partners Fund VI-A, L.P.;
Vista Equity Partners Fund VI-DE, L.P.; VISTA EQUITY PARTNERS MANAGEMENT, LLC formerly:
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KEY FINDINGS: CALIFORNIA

California Hedge Funds, Private Equity Funds & the Carried Interest Loophole

Private equity companies, venture capital firms, and hedge funds all take advantage of this loophole.

We don't know how many of these funds use the loophole, we only know what percentage of financial industry partnership income is paid at the long-term capital gains rate. We're using a total population of potentially eligible funds, and assuming that the distribution of their tax income approximates the national distribution for financial partnerships.

In California, there are 432 hedge fund managers and 245 private equity managers that could potentially be taking advantage of this loophole.

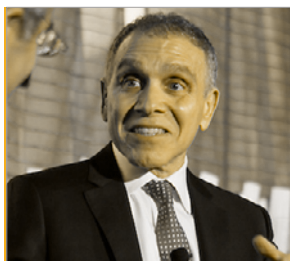
This count excludes some investment advisers managing between \$25mn and \$100mn, who may not be registered with the SEC.

Additionally, our analysis has excluded real estate and venture capital firms, which have a significant presence in state.

In some states, fiscal analysts and lawmakers have suggested that some real estate investment firms and REITs utilize the loophole and that a state-level carried interest surtax would address this inequity.⁵¹

We estimate that California hedge fund managers oversee \$564 billion in assets, with the state's private equity managers controlling \$332 billion.

In addition to the firms profiled in detail on pages 11 through 18, California is home to dozens of other high-profile hedge funds and private equity funds, including...



SILVER LAKE PARTNERS *Menlo Park*

- Jim Davidson, David Roux, Roger McNamee (founder), **Glenn Hutchins**, Charles Giancarlo, Mark Gillett, Mike Bingle, Egon Durban, Ken Hao, Greg Mondre
- Subpoenaed in tax-dodging investigation, diluted CalPERS investment in its management firm⁵²

ELEVATION PARTNERS *Menlo Park*

- **Roger McNamee**, Marc Bodnick, Fred Anderson, John Riccitiello, Bono
- Attacking jobs, pensions + pay in journalism in takeover and dismemberment of Forbes Magazine⁵³

COLONY NORTHSTAR *Los Angeles*

- **Tom Barrack**, close friend and advisor to Donald Trump
- Profited from housing crisis and California housing gentrification⁵⁴

KAYNE ANDERSON CAPITAL ADVISORS *Los Angeles*

- **Richard Kayne**, Robert Sinnott, Michael Levitt
- Pushing dirty energy & fossil fuels, driving up the cost of student housing, pushing gentrification, foundation supports homeless services while business drives homelessness⁵⁵

CANYON PARTNERS *Los Angeles*

- **Joshua Friedman**, **Mitchell Julis**
- Building luxury condos, profiting from multifamily housing in California cities and suburbs⁵⁶

VALUEACT CAPITAL *San Francisco*

- **Jeffrey Ubben**, Mason Morfit, Kelly Barlow, Greg Spivy, Brandon Boze
- Investing in dirty energy, pharmacy benefits managers, for-profit healthcare⁵⁷

KEY FINDINGS FOOTNOTES

51 State legislators continue to challenge 'carried interest loophole in 2018. *Tax News Updates*. March 9, 2018. <https://taxnews.ey.com/news/2018-0536-state-legislators-continue-to-challenge-carried-interest-loophole-in-2018>

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<http://hedgeclippers.org/hedgepapers-no-37-trumps-unholy-trinity-how-three-of-his-biggest-donors-are-cashing-in-on-california-housing-crisis/>; "Profiting off pain: Trump confidant cashed in on housing crisis,"

55 Kanye Anderson Capital Advisors website, *News and About Us* sections, accessed April 2018. <http://kaynecapital.com>

56 Canyon Partners website, *Strategies* section, accessed April 2018. <https://www.canyonpartners.com>

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Value Act Holdings, L.P. Top Holdings, accessed April 2018. <https://whalewisdom.com/filer/valueact-holdings-l-p>

PRIVATE EQUITY, DISCRIMINATION & PAY EQUITY

Along with paying their fair share of taxes, private equity and hedge funds must step up to meet the responsibilities of the stewardship of public companies

More than fifty years after the Equal Pay Act and the Civil Rights Act were enacted, inequities along race and gender lines remain pervasive. These problems are particularly acute in the hospitality sector, where women, and in particular women of color, earn less than men; are often confined to the lowest paying occupational classifications; and are too often the victims of workplace sexual harassment.

According to a 2015 Cornell University study, women working in hotels earned \$2,368 less than the mean income, while female hospitality managers earned \$6,617 less than the mean income.⁵⁸ The U.S. Bureau of Labor Statistics has found that Black, Latina, and Asian women workers in housekeeping and cleaning occupations earned 72-75% of the compensation of their white male counterparts.⁵⁹

Between 2005-2015, the accommodation and food services sector ranked first among all industries in sexual harassment charges with the Equal Employment Opportunity Commission, and a quarter

of the total came from low wage service sector employees.⁶⁰

A recent report found that 58 percent of hotel workers and more than 75 percent of casino workers surveyed in the Chicago area report having experienced sexual harassment by guests.⁶¹

These are problems which fester in the dark. Currently, a large and growing share of the hospitality industry is owned by private equity firms which are infamous for their lack of transparency.

New legislation in the California Legislature directly addresses these issues. By requiring common-sense transparency measures from these investment managers, Assembly Bill Number 2571(AB 2571)⁶² would represent a significant step forward to address the gender and race pay gap and the epidemic of sexual harassment in the hospitality industry.

The information AB 2571 will provide can help to ensure that the State of California does not subsidize unjust and inequitable practices and that the boards of public pension funds have the information they need to assess the investment risks presented by such practices.

PRIVATE EQUITY, DISCRIMINATION & PAY EQUITY FOOTNOTES

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CARRIED INTEREST BILLS BY STATE

STATE	TITLE OF BILL(S)	SPONSOR(S)	LINK(S)	REVENUE ESTIMATED
NY	"An act to amend the tax law, in relation to investment management services to a partnership or other entity"	Governor: Andrew Cuomo Assembly: Jeff Aubry Senate: Jeff Klein	(Governor) https://www.budget.ny.gov/pubs/archive/fy19/exec/fy19artVII/REVENUE-ArticleVII-MS.pdf (Assembly) http://assembly.state.ny.us/leg/?default_fld=&leg_video=&bn=A03554&term=2017&Summary=Y&Memo=Y (Senate) https://www.nysenate.gov/legislation/bills/2017/S1991	\$3.5B/Yr
NJ	"An Act concerning the taxation of certain investment management services provided to a partnership, amending N.J.S.54A:5-8 and P.L.1945, c.162, and supplementing Title 54A of the New Jersey Statutes and P.L.1945, c.162 (C.54:10A-1 et seq.)"	Governor: Philip Murphy Senate: Troy Singleton, Shirley K. Turner Assembly: Gary S. Schaer	(Governor) http://www.nj.gov/treasury/omb/publications/19bib/BIB.pdf (Senate) http://www.njleg.state.nj.us/2018/Bills/S0500/64_11.HTM (Assembly) http://www.njleg.state.nj.us/2016/Bills/A4000/3868_11.HTM	\$87M/Yr
CT	"An act imposing a surcharge on income derived from investment management services."	House of Representatives Finance, Revenue and Bonding Committee Committee	(See Link) https://www.cga.ct.gov/2017/TO-B/h/2017HB-07313-Roo-HB.htm	\$520M/Yr

STATE	TITLE OF BILL(S)	SPONSOR(S)	LINK(S)	REVENUE ESTIMATED
IL	"An Act Concerning Revenue"	Senate Sponsors: Sen. Daniel Biss, Ira I. Silverstein, Jacqueline Y. Collins, Iris Y. Martinez, Emil Jones, III, Omar Aquino, Cristina Castro, Mattie Hunter House Sponsors: Rep. Emanuel Chris Welch, Mary E. Flowers	(House) Click Here for Website Link (Assembly) Click Here for Website Link	\$1.7B/Yr (calculated by the Illinois Department of Revenue)
MD	"An Act Concerning Income Tax - Carried Interest - Additional Tax"	Senate: Paul Pinsky House: Rep Jimmy Tarlau	(Senate) http://mgaleg.maryland.gov/webmga/frmMain.aspx?id=s-b0605&stab=01&pid=billpage&tab=-subject3&ys=2017rs (House) http://mgaleg.maryland.gov/webmga/frmMain.aspx?pid=billpage&tab=subject3&id=h-b0915&stab=01&ys=2017RS	\$79M/Yr (calculated by the Legislature)
DC	"Closing The Carried Interest Tax Loophole Act Of 2018"	Councilman: David Grusso	(See Link) https://legiscan.com/DC/bill/B22-0701/2017	\$152M/Yr
CA	"An act to add Section 17044 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy"	Assembly Member: Mike A Gipson	(See Link) http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201720180AB2731	\$891M/Yr
RI	"An Act Relating to Taxation — Personal Income Tax"	Senators: Adam J. Satchell, William J. Conley, Stephen Archambault, Joshua Miller	(See Link) webserver.rilin.state.ri.us/BillText/BillText17/SenateText17/So259.pdf	\$39M/Yr
MA	"An Act Closing An Unfair Tax Loophole"	Senator: Patricia Jehlen	(See Link) https://malegislature.gov/Bills/190/SD2050	\$564M/Yr

KEY CALIFORNIA ASSEMBLY BILLS IN THIS REPORT

	TITLE OF BILL(S)	LEGISLATIVE COUNCIL DIGEST: TOP-LINE	INTRODUCED
AB 2731	"An act to add Section 17044 to the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy."	AB 2731, as introduced, Gipson. Income taxes: investment management services interest.	February 15, 2018
	LEGISLATIVE COUNCIL DIGEST: http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201720180AB2731		
AB 2571	"An act to amend Section 16642 of, and to add and repeal Section 7513.76 of, the Government Code, relating to retirement."	AB 2571, as amended, Gonzalez Fletcher. Public employee retirement systems: investments: race and gender pay equity.	February 15, 2018
	LEGISLATIVE COUNCIL DIGEST: https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB2571		

SYNOPSIS + BREAKDOWN OF THE BILLS

ASSEMBLY BILL NUMBER 2731	ASSEMBLY BILL NUMBER 2571
<p>Along with paying their fair share of taxes, private equity and hedge funds must step up to meet the responsibilities of the stewardship of public companies.</p>	
<p>Simply stated, the carried interest loophole is the mistreatment of hedge fund and private equity fees as capital gains, rather than ordinary income.</p> <p>Private equity companies, venture capital firms, and hedge funds all take advantage of the Carried Interest loophole.</p> <p>We estimate that California hedge fund managers oversee \$564 billion in assets, with the state's private equity managers controlling \$332 billion.</p>	<p>More than fifty years after the Equal Pay Act and the Civil Rights Act were enacted, inequities along race and gender lines remain pervasive. These problems are particularly acute in the hospitality sector.</p> <p>By requiring common-sense transparency measures from these investment managers, AB 2571 would represent a significant step forward to address the gender and race pay gap and the epidemic of sexual harassment in the hospitality industry.</p>
<ul style="list-style-type: none"> ▪ Hedge fund and private equity spent enormous sums lobbying on the federal level and making donations to Congress to ensure that the new federal tax law would not impact carried interest. ▪ The small set of ultra-rich that benefit from the loophole aren't contributing their fair share of tax revenue to any level of government. Closing the loophole at state and local levels would be a small offset to the billions in new and old tax breaks they've rigged. ▪ California could raise \$1 billion or more of much needed revenue from closing the loophole. \$1 billion+ in revenue for California to invest in education, housing and other basic public goods. 	<ul style="list-style-type: none"> ▪ In the hospitality sector women, and in particular women of color, earn less than men; are often confined to the lowest paying occupational classifications; and are too often the victims of workplace sexual harassment. ▪ Currently, a large and growing share of the hospitality industry is owned by private equity firms which are infamous for their lack of transparency. New legislation in the California Legislature directly addresses these issues. ▪ The information AB 2571 will provide can help to ensure that the State of California does not subsidize unjust and inequitable practices and that the boards of public pension funds have the information they need to assess the investment risks presented by such practices.

METHODOLOGY

Datasets of all fund registered investment advisors were obtained from the SEC's public database. This data was enriched with ADV Part 7(b) data, which contains private funds and their AUM. Registered investment advisors in California were cross-referenced to the funds they manage by SEC file number. Combined, these funds had gross assets under management of nearly \$900bn as of ADV filings dates received by the SEC as of October 2016.

To estimate total earnings, we used private equity and hedge fund return benchmarks for a five year period. One uses the five year average of leading hedge fund and private equity benchmarks, assuming that the large state sample sizes roughly track the mean. For hedge funds, we used the HFRI Fund Weighted Composite's 60 month average.⁶³ For private equity, we used the Cambridge Associates U.S. Private Equity Index 5 year end-to-end pooled return.⁶⁴ By multiplying the return benchmarks by the AUM, we came up with a rough estimation of expected annual earnings.

Next, the carried interest apportioned to hedge fund and private equity managers is estimated. Carried interest applies only to the incentive fee earned by hedge fund and private equity managers. We used 15% of the total of hedge fund and private equity expected annual earnings to arrive at the expected aggregated fund manager annual earnings. We went with 15% because we believe this number to be extremely conservative. With hedge funds, 20% is the

industry standard and 17.14% was the industry average for new funds launched in 2013, as tracked by Preqin.⁶⁵ In private equity, the 20% standard is prevalent in 85% of co-mingled funds, according to a 2015 report by Preqin.⁶⁶ Separate accounts, where approximately one-third of investor capital was committed in late 2014,⁶⁷ are less likely to charge a 20% carry, although 90% charge 10% or more.⁶⁸

To calculate the amount lost to carried interest exemptions, we halved the expected aggregate fund manager annual earnings. This was done to reflect the individual reporting of taxes paid on partnerships interest in financial service partnerships. As Professor Victor Fleisher discovered in his work on the subject, the IRS Statistics of Income shows that roughly half of financial industry partnership income is paid at the favorable carried interest rate.^{69 70}

After halving this sum, we multiplied the remaining amount by 19.6%, the difference between the top bracket for short-term capital gains (equivalent to ordinary income, at 39.6%) and the top bracket for long-term capital gains (20%).

CALIFORNIA CARRIED INTEREST LOSS

	ASSETS UNDER MANAGE- MENT	EXPECTED RETURN RATE	EXPECTED ANNUAL RETURN	INCEVTIME FEE	EXPECTED AGGREGATE FUND MANAGER ANNUAL EARNING	HALVED	EXPECTED CARRIED INTEREST LOSS
HF	\$ 370,578,600,000	4.95%	\$ 18,343,640,700	15%	\$ 2,751,546,10	\$ 1,375,773,053	\$ 269,651,518
PE	\$ 510,118,800,000	13.6%	\$ 69,376,156,800	15%	\$ 10,406,423,520	\$ 5,203,211,760	\$ 1,019,829,505
HF = HEDGE FUND PE = PRIVATE EQUITY					TOTAL	\$ 1,289,481,023	

METHODOLOGY FOOTNOTES

63 https://www.hedgefundresearch.com/mon_register/index.php?fuse=login_bd&1448033777

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67 Jacobius, Arleen. *Assets Invested In Separate Accounts Starting To Add Up. Pensions & Investments*. December 22, 2014. <http://www.pionline.com/article/20141222/PRINT/312229973/assets-invested-in-separate-accounts-starting-to-add-up>

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WHO ARE THE HEDGE CLIPPERS?

Every day, the most unscrupulous hedge fund managers, private equity firms and Wall Street speculators impact the lives of Americans. They play an outsized role in our political process, our education system, and our economy. Hedge Clippers is a national campaign focused on unmasking the dark money schemes and strategies the billionaire elite uses to expand their wealth, consolidate power and obscure accountability for their misdeeds. Through hard-hitting research, war-room communications, aggressive direct action and robust digital engagement, Hedge Clippers unites working people, communities, racial justice organizations, grassroots activists, students and progressive policy leaders in a bold effort to expose and combat the greed-driven agenda that threatens basic fairness at all levels of American society.

The Hedge Papers are researched, written, edited, reviewed and designed by a distributed, networked team of researchers, writers, academics, attorneys, industry experts, community organizers and designers from around the United States, with contributions from international activists.

We welcome contributions from whistleblowers, industry insiders, journalists, lawmakers and regulatory officials as well as from regular Americans who have felt the destructive impact of hedge funds, private equity funds and the billionaire class in their daily lives.

Our collective includes individuals associated with labor unions, community organizations, think tanks, universities, non-governmental organizations, national and international organizing and advocacy networks, student and faith groups as well as non-profit and for-profit organizations.

The Hedge Clippers campaign includes leadership and collaborative contributions from labor unions, community groups, coalitions, digital activists and organizing networks around the country, including: the Strong Economy for All Coalition, New York Communities for Change, Alliance for Quality Education, VOCAL-NY and Citizen Action of New York; Make the Road New York and Make the Road Connecticut; New Jersey Communities United; the Alliance of Californians for Community Empowerment (ACCE) and Courage Campaign; the Grassroots Collaborative in Illinois; the Ohio Organizing Collaborative; ISALAH in Minnesota; Organize Now in Florida; Rootstrikers, Every Voice, Color of Change, 350.org, Greenpeace, the ReFund America Project and United Students Against Sweatshops; the Center for Popular Democracy and the Working Families Party; the United Federation of Teachers and New York State United Teachers; the American Federation of Teachers, the National Education Association, and the Communication Workers of America.

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