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### Why New York Subpoenas Won't Change How Managers Like Mitt Are Taxed

[\*The New York Times\*](#)' page one splash about the investigation of Mitt Romney's private equity firm foments continued debate about something we should have been talking about for years. New York issued subpoenas to a dozen firms, not just Mitt's. The question is whether and how they converted ordinary management fees into carried interests. That's hardly seems surprising.



Tax Day New York. April 17, 2012 (Photo credit: Sunset Parkerpix)

New York is only pursuing its state taxes but the broader and bigger concern is federal. The Obama campaign must relish the continuing unsavory appearance of Romney's entire industry. Really, though, rich tax breaks for private equity and hedge fund managers have long been widely known. Management fees are taxed as ordinary income.

Carried interests—deemed fund investments—are taxed as capital gain. Like it or not, under existing tax law, carried interest is capital. The issue seems unfair, has been attacked before, and could be changed by statute or even administratively.

But that hasn't happened. Ways and Means Committee Ranking Member Sander Levin (D-MI) has twice authored legislation to tax carried

interests as ordinary income. It has passed the House four times but never the Senate.

In fairness to New York's investigation, it is asking whether **conversions** of 35% management fees to 15% carried interests were legit or abused. New York can and should satisfy itself the deals pass muster. Although there are different ways of doing it, it is often called a "management fee waiver." 40% of U.S. based funds do it, according to a Dow Jones survey.

A comprehensive overhaul of the tax code is overdue and this is a good example of why. What is ordinary and what is capital is not always obvious. See [Capital Gains, Ordinary Income and Shades of Gray](#). Plus, how partnership income is taxed is determined by how the **partnership** earns a profit, not by what the **partners** contribute. For that reason, even if Congress decides to tax carried interests as ordinary income, it may be easier said than done. See [Mitt's Taxes Stoke "Carried Interest" Flames](#).

Is this poetry? You be the judge:

The millions and billions the hedge fund guys reap;  
Those obscenely big earnings? They mostly do keep.  
For tax law rains gently on pockets so deep;  
Their interests are subject to rates oh so cheap.  
Surely Congress will fix this, as sure as can be.  
They'll spread the tax burden to help you and me.  
If fund managers pay more, they'll all surely see;  
Of how big a tax bite they've so far been free!

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