



## Lawmakers Still Focused on Proposed Changes to Carried Interest Taxation

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U.S. lawmakers have taken another step toward closing a supposed “loophole” on carried interest. Under current law, carried interest is considered capital gains and can result in favorable rates dependent upon the holding period of the interests that created the capital gain.

What is carried interest? Carried interest, or carry, in finance terms, is a contractual right that allows the general partner of an investment fund to share in the fund’s profits.

Currently, taxation of carried interest follows the investment capital gains process, whereby the allocated profit participation of the fund is taxed based upon either short term capital gains rates (as high as 37%) for assets held for under three years, and at preferred long term capital gains rates (20%) for assets held at least or longer than three years. So what changes are the U.S. lawmakers trying to make?

In the new proposed budget for fiscal year 2023, the federal government would like to start taxing carried interest as ordinary income. This would apply if the partner's taxable income from all sources exceeds \$400,000. Self-employment tax would also apply if the partner's taxable income from all sources exceeds \$400,000. This would significantly raise taxes for investment fund partners and may also include partnerships with a real estate focus.

In considering the impact of this proposal, taxpayers should understand there are also proposals to increase the long-term capital gain tax rate for those with income in excess of \$1,000,000 - to the top ordinary income tax rate. This proposal will thus lessen the tax benefits arising from current tax law for carried interest arrangements.

While this conceptual change to carried interest taxation is only a proposal, SKP will continue to monitor the situation for any 2022 and 2023 tax law changes that may affect you. At this point, President Biden has had little success in passing any proposed tax bills including the Build Back Better tax act and has many other issues in front of legislators. Please reach out to your SKP tax advisor if you feel this may apply to you and are looking for additional details.