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Citizens for Tax Justice
November 7, 2007
Contact: Bob McIntyre (202) 299-1066 x22

Real Estate and the "Carried Interest" Tax Loophole

Former Economic Advisor to President Bush Hired by Real Estate Developers to Confuse the Public

The Hill newspaper reported today that the Real Estate Roundtable, a trade association for real estate developers, has hired Douglas Holtz-Eakin to defend the tax loophole for "carried interest." Holtz-Eakin was the Chief Economist on President Bush's Council of Economic Advisors and later the director of the Congressional Budget Office.

Carried interest is the share of profits that investors pay to their fund managers to compensate them for managing the investors' money. But fund managers have been allowed to pretend that this compensation represents profits on money they have invested themselves, thus entitling them to pay taxes at the low capital gains rate of 15 percent rather than the regular rate of 35 percent that other highly compensated workers pay.

On November 1, the House Ways and Means Committee approved a bill (H.R. 3996) that would close the tax loophole for carried interest to help pay for relief from the Alternative Minimum Tax (AMT). The Real Estate Roundtable has responded by arguing that closing the loophole will harm the real estate industry, since some developers benefit from the loophole.

According to *The Hill*, Holtz-Eakin asserts that closing the loophole will harm the economy by:

1) "draining talent away from the real estate sector,"

2) "dampening investors' appetite for riskier deals" and

3) "encouraging inefficient economic activity as fund managers seek to dodge the tax hike."

Holtz-Eakin's Arguments Do Not Withstand Scrutiny

1. Even if we accept the dubious assertion that real estate investment managers will leave the real estate sector for greener pastures if they have to pay regular taxes on their earnings, then they'll go to work somewhere else. That somewhere else would presumably not be subsidized, and would therefore be more productive (i.e., have a higher pretax return).

2. This claim is factually incorrect. The bill does not affect investors (or their "appetite for riskier deals"). It only affects non-investor managers. (And, one might ask, after all the problems we've had with subprime mortgages, why would we want to use the tax code to encourage "riskier" activities anyway?)

3. Oddly, this final claim assumes that the events predicted in points 1 and 2 don't happen. And taken to its logical conclusion, it implies that if *any* tax loophole is closed, then the previous beneficiaries will waste time and money trying to find a replacement loophole — and, therefore, that all tax loopholes should be maintained. In sum, this third argument is both contradictory of the previous two arguments and silly.

Holtz-Eakin's client-driven arguments are meant to confuse, not enlighten. The reality is that most people affected by what goes on in the real estate industry — notably, realtors and homeowners — are paying taxes at regular income rates and thus subsidizing the lucky few who benefit from the carried interest loophole. H.R. 3996 will end this unfairness.