



February 9, 2022

## Via Electronic Submission

The Honorable Guy Guzzone  
Chair, Budget and Taxation Committee  
Maryland State Senate  
Miller Senate Office Building  
11 Bladen St., Annapolis, MD 21401

The Honorable Jim Rosapepe  
Chair, Budget and Taxation Committee  
Maryland State Senate  
Miller Senate Office Building  
11 Bladen St., Annapolis, MD 21401

**Re: Written Testimony in OPPOSITION to SENATE BILL 361 (“Income Tax – Carried Interest – Additional Tax”)**

Dear Chairman Guzzone, Vice Chairman Rosapepe, and Members of the Budget and Taxation Committee,

Managed Funds Association<sup>1</sup> (“MFA”) appreciates the opportunity to provide written testimony to the Budget and Taxation Committee (the “Committee”) in opposition to Senate Bill 361,<sup>2</sup> entitled “Income Tax – Carried Interest – Additional Tax,” which would impose an additional 17% state tax on both a pass-through entity’s nonresident taxable income (paid on behalf of nonresident partners) and a corporation’s or individual’s Maryland taxable income attributable to “investment management services.” **If enacted, the legislation would result in combined federal, state, and local marginal tax rates up to 66.75%, and Maryland would stand alone as imposing the most punitive state tax on the investment management community. Senate Bill 361 will drive business and investments out of the state.**

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<sup>1</sup> MFA represents the global alternative investment industry and its investors by advocating for regulatory, tax and other public policies that foster efficient, transparent, and fair capital markets. MFA’s more than 150 members collectively manage nearly \$1.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, London, Brussels, and Asia.

In Maryland, the alternative investment industry delivers for retirement security, college education, and the important work done by nonprofits and charities through \$30.67 Billion in investments. Institutional investors – like pensions, university endowments, and nonprofits – use alternative investments to meet financial obligations, diversify their investment portfolios, and manage risk.

The Maryland State Retirement and Pension System invests approximately \$4.3 Billion to help provide secure retirements for its more than 187,430 plan participants. Johns Hopkins University Office of Investment Management invests approximately \$2.7 Billion to help fund education opportunities for its more than 27,000 students. Howard Hughes Medical Institute invests approximately \$4.5 Billion to help fund its support of biomedical scientists and educators. Investing in Opportunity, Maryland: Hedge Funds Deliver for Maryland Retirees, Students, and Nonprofits (June 17, 2021), at <https://investinginopportunity.org/wp-content/uploads/2021/06/Maryland-State-Sheet-MFA-6.17.21.pdf>.

<sup>2</sup> S.B. 361, 2022 Leg., 444th Sess. (Md. 2022).

Specifically, the additional state tax is calculated by reference to the performance of the investment portfolio funds, and not from the investment itself, and is not imposed on fees calculated by reference to the total assets under management of a pass-through entity engaged in investment management services. Notably, the exclusion for management fee income follows the rationale that “[t]he management fee...is subject to ordinary federal and State income tax rates...and the federal self-employment tax.”<sup>3</sup>

Of principal concern, the same exclusion and rationale is not afforded to performance allocations and performance fees included in income as short-term capital gain or ordinary income which are similarly taxed at the graduated ordinary income rates.<sup>4</sup> As a result, Senate Bill 361 creates disproportionately high, and uneconomical, marginal rates on Maryland residents and nonresidents engaged in investment management services as described below.

**PERFORMANCE ALLOCATION INCOME (ASSETS HELD LESS THAN 3 YEARS)**<sup>5</sup>

Federal tax rates

Short-term capital gains or ordinary income – 37%

Net investment income tax – 3.8%

Maryland tax rates

State individual income tax rate – 5.75%

Local income tax – 3.2%<sup>6</sup>

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<sup>3</sup> Dep’t of Leg. Svcs., S.B. 361 (2022) Fiscal and Policy Note 2 (Feb. 4, 2022) (on file with committee).

<sup>4</sup> For example, a taxpayer’s net long-term capital gain with respect to an “applicable partnership interest,” as defined by 26 U.S.C. § 1061(c), will be recharacterized as short-term capital gain to the extent such gain is from the sale or exchange of a capital asset held for not more than 3 years. *See* 26 U.S.C. § 1061(a). Alternatively, the taxpayer may structure this performance element as a fee or make an election under 26 U.S.C. § 475(f), in which cases any income or gain, respectively, will be treated as ordinary income.

<sup>5</sup> *See* 26 U.S.C. § 1061(a).

<sup>6</sup> Please note that local income taxes vary by jurisdiction; minimum taxes are at least 1% of Maryland taxable income, and no more than 3.2%. Nonresidents are subject to a 2.25% tax in addition to state income tax. Nonresidents may further be subject to a retaliatory local tax, up to 3.2% instead of 2.25%, if the nonresident resides in a local jurisdiction that imposes local income tax on Maryland residents. *See* Md. Code Ann., Tax-Gen. §§ 10-106(a)(1)(iii), 10-106.1; Comptroller of Maryland, Tax Information for Individual Income Tax (Feb. 7, 2022), at <https://www.marylandtaxes.gov/individual/income/tax-info/index.php>.

Proposed Maryland State surcharge – 17%

**Combined Federal, State, and Local Marginal Tax Rate –66.75%**

**PERFORMANCE FEE INCOME**

Federal tax rates

Ordinary income – 37%

Medicare taxes – 3.8%

Maryland tax rates

State individual income tax rate – 5.75%

Local income tax – 3.2%

Proposed Maryland State surcharge – 17%

**Combined Federal, State, and Local Marginal Tax Rate –66.75%**

If enacted, Maryland would stand alone as imposing the most punitive state tax on the investment management community. The effective date of Senate Bill 361 is not contingent on the adoption of similar legislation in neighboring states and is likely to result in flight from Maryland and rapid secular decline of the investment management community in Maryland. Taking into account taxpayers' likely behavioral responses to the proposed additional state tax, we believe the fiscal impact is overstated.<sup>7</sup> For these reasons, we respectfully request an unfavorable report on Senate Bill 361.

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We appreciate the opportunity to provide our written testimony to the Committee regarding Senate Bill 361, and we would be pleased to meet with the Committee or its staff to discuss our

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<sup>7</sup> The Department of Legislative Services (“DLS”) has indicated that,

It is likely that State revenues will increase by less than estimated, as it does not take into consideration individuals altering behavior on the state level to avoid the tax. DLS anticipates a significant number of taxpayers altering their behavior to avoid the tax, but the extent to which this occurs cannot be quantified.

Dep't of Leg. Svcs., S.B. 361 (2022) Fiscal and Policy Note 4 (Feb. 4, 2022) (on file with committee). Importantly, geographical proximity to other jurisdictions which provide for a lesser overall tax burden on investment management services is the basis on which we expect responsive behavior to be prevalent.

Budget and Taxation Committee

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testimony. If the Committee or its staff have questions or comments, please do not hesitate to contact the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Joseph E. Schwartz

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