Carried Interest:
Maintaining Treatment To Incentivize Investment

INNOVATOR Alliance
EMPOWERING INNOVATION THROUGH STRATEGIC TAX POLICY

THE ISSUE:

Launching a startup requires capital that can come from multiple sources, including venture capital, In fact, seven of the ten most valuable companies in the world were backed by venture capital, and 75% of the total market value originates from VC-backed companies. However, much like launching a startup, funding a startup is inherently risky.

Carried interest—or the share of profits allocated to the managers of a private fund—ties a fund manager's compensation to the performance of the fund. This structure aligns incentives for the fund manger with their investors and the portfolio companies they support. If the investments do not succeed and their investors do not benefit, fund managers do not benefit from carried interest.

Currently, carried interest is taxed at the capital gains rate because it is treated as a return on investment, rather than as ordinary income. This tax treatment encourages fund managers to support high-risk, high-reward ventures, particularly in early-stage startups. We support the current tax treatment of carried interest and strongly advocate for its preservation to ensure continued investment in startups and innovation.

IMPACT ON INNOVATION:

The current tax treatment of carried interest is a key factor in sustaining a vibrant and inclusive ecosystem, offering fund managers an incentive to take on the high risks of investing in early-stage startups. This policy drives several significant benefits:

Fueling Groundbreaking Innovation: Carried interest encourages venture capitalists to direct funding toward high-risk, high-reward ventures, enabling startups to develop transformative technologies and scale their operations. Without this incentive, many of the innovations that define the U.S. economy might never have been realized. A higher tax rate would discourage venture capitalists and fund managers from investing in early-stage startups, cutting off essential funding for innovation.

Supporting Economic Growth and Job Creation: Startups backed by venture capital are responsible for driving significant job creation and technological advancement. The current treatment of carried interest helps maintain the flow of capital to these critical contributors to the U.S. economy.

Empowering Emerging Fund Managers and Communities: Emerging fund managers, many of whom are women or people of color, rely heavily on carried interest for compensation due to limited management fees. These managers are more likely to invest in diverse founders, regional startups, and underrepresented communities, spreading the benefits of innovation beyond established tech hubs.

REQUESTED ACTION:

To maintain robust investment in the startup ecosystem to fund critical, new innovation, we respectfully urge Congress to maintain the current tax treatment of carried interest. Any effort to eliminate or limit the current treatment risks the strength of the U.S. innovation ecosystem.