November 29, 2017

The Honorable Mitch McConnell
Majority Leader
United States Senate
Washington, D.C. 20510

The Honorable Charles Schumer
Minority Leader
United States Senate
Washington, D.C. 20510

Dear Majority Leader McConnell and Minority Leader Schumer:

We thank you for your efforts to ensure a tax reform package that stimulates economic growth in the United States. On behalf of the Institutional Limited Partners Association (ILPA)[1], we are writing this letter to relay our significant concern about a specific provision, Section 5001, in the House of Representatives version of the Tax Cuts and Jobs Act (H.R. 1). The application of Section 5001 would subject certain investments of state and local governmental pension plans, in particular those in alternative investments, to the unrelated business income tax (UBIT) under Section 511 of the Internal Revenue Code. These provisions would have immediate, harmful impacts on the beneficiaries of public pension plans, and alternative asset classes including private equity, real estate, natural resources, among others. We applaud the Senate for not including provisions similar to Section 5001 of H.R. 1 in the Senate version of the Tax Cuts and Jobs Act and encourage lawmakers to continue to exclude any such provisions in the final tax reform package that is brought to the Senate floor.

ILPA represents its members, which include the majority of U.S. public pension plans, in the context of their investment in the private equity asset class. Increasingly, many U.S. public pensions have relied, in part, on private equity investment to generate the returns necessary to meet their obligations to their beneficiaries, which include teachers, first responders, and government employees. The application of Section 5001 in the House legislation is particularly problematic for pensions investing in private equity, where there is a high risk of Unrelated Business Tax Income (UBTI) flowing through to investors due to the structure of these investments as partnerships and LLCs. Implementation of this provision will cause immense disruption and significant cost to the entire private equity asset class, including public pension investors. This provision may have further long-term

[1] The ILPA is the only organization dedicated exclusively to representing the interests of institutional investors in private equity, otherwise known as limited partners (LPs). Our 450+ member institutions include public pension funds, corporate pensions, insurance companies, university endowments, charitable foundations, family offices and sovereign wealth funds, all of whom invest in the US private equity market. Our members represent over $1.0 trillion in private equity assets under management. The ILPA's members provide the capital that fuels private equity and venture capital investment, generating significant economic growth and job creation, across America and around the world. Of particular importance to the subject of this letter, ILPA represents over 90 U.S. public pension plans at the state and local level, serving over 7 million beneficiaries and issuing over $212 billion in benefits in FY 2016.

harmful effects for the businesses that rely upon private equity investment for job creation and economic growth.

If Section 5001 is included in the Senate version of the Tax Cuts and Jobs Act, the immediate impact will be that tens of thousands of existing private equity investments and contractual obligations, often extending up to ten years, will have to be restructured by January 1, 2018. It will be impossible for this task to be accomplished in such a short time frame, resulting in a tax rate of 39.6% being applied to these investments, which U.S. public pensions rely upon to meet their obligations to their beneficiaries. These non-restructured investments may result in a significant decline in investment returns. These declines may have to be addressed through additional outlays to the pensions by states, municipalities and pension beneficiaries, increasing the strain on state and local governments across the country, particularly those with underfunded plans.

In the longer-term, if Section 5001 is implemented, private equity investment by public pensions may be less attractive due to heightened compliance, monitoring, and structuring costs in order to address the impact of exposure to UBTI. These costs will be a significant drag on returns in alternative investments, and will harm the retirement savings of average American pension holders. The resulting decreased attractiveness of private equity investment by public pensions due to these factors may severely disrupt the U.S. private equity industry for both managers and investors, and impact the deployment of capital into U.S. businesses large and small. Ultimately, this scenario would result in the opposite effect of what the tax reform effort seeks to accomplish – ensuring increased economic growth and job creation.

Finally, there are significant Constitutional concerns to the implementation of this provision. State agencies, such as public pensions, are exempt under the U.S. Constitution from taxation, and the application of Section 5001 to public pension plans erodes the sovereign immunity enjoyed by both federal and state governments from mutual taxation.

We would appreciate the opportunity to discuss this important issue with you and your staff in more detail. Please contact Chris Hayes, the Director of Industry Affairs at the ILPA at chayes@ilpa.org or (202) 871-9367 to explore this issue further.

Sincerely,

Michael Mazzola
Chief Executive Officer
Institutional Limited Partners Association (ILPA)