Council of Institutional Investors®
The voice of corporate governance

ilpa INSTITUTIONAL LIMITED PARTNERS ASSOCIATION

December 7, 2017

Dear Conferees on the Tax Cuts and Jobs Act:

On behalf of the Institutional Limited Partners Association (ILPA)[1] and the Council of Institutional Investors (CII),[2] who represent public pension systems in the context of their role as institutional investors, we are writing 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 like private equity, 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, which include millions of workers and retirees, including first responders (police and fire), school teachers and municipal and state employees. Section 5001 was not included in the Senate version of the legislation, and we urge the conferees to ensure that this provision is not included in the final conference agreement.

If Section 5001 is included in the final conference agreement, the immediate impact will be that 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. This consequence will have considerable impacts on the portfolio construction and diversification of public pension plans, increasing risk for pension holders. Further, these non-restructured investments will

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[1] 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 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.

[2] The Council of Institutional Investors (CII) is a nonpartisan, nonprofit association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding $3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $20 trillion in assets under management. For more information about CII, including its members, please visit the CII's website at http://www.cii.org/members

result in a significant decline in investment returns. These declines will 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 and structuring costs to address the impact of exposure to UBIT. These costs will be a significant drag on returns, 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 will 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.

There are also 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. The application of UBIT to public pensions is a new tax, and overturns a 40-year-old position by the Internal Revenue Service to not apply UBIT to governmental plans. It's important to note that the competition issue that UBIT was created to address generally does not exist in the context of alternative investment structures – as limited partners in private investment funds, public pensions do not control or decide which portfolio companies are invested in. Unfortunately, the nature of the legal structure of these investments as partnerships results in the potential flow of UBTI to the investor.

We thank you for your efforts to ensure a tax reform package that stimulates US economic growth, while encouraging you to not harm that growth by imposing a new tax on public pension plans. Please do not hesitate to contact our representatives listed below if you have any questions or would like additional information:

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