# THE CURIOUSER AND CURIOUSER CASE OF CARRIED INTERESTS[1]

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*In late July 2022, as the Inflation Reduction Act was being finalized, a provision limiting the carried interest preference, which allows billionaire hedge fund managers to qualify for the long-term capital gains rate on their highly lucrative "carry," was scrapped. This continued a string of defeats for sensible policy reform dating back at least as far as Victor Fleischer's congressional testimony in 2007 and his seminal Two and Twenty law review article. The usual special interest view of politics took the blame for the inertia.*

*In this Article, we explain how a "reverse Mancur Olson," or an ex-ante rent extraction model, better explains what has—and has not—been going on. Lawmakers of both political parties have a financial interest in "stringing along" carried interest and similar issues to extract rents in the form of campaign contributions. We illustrate how presidents and congressional members of both parties have played this game over the past 15 years, preserving the appearance of wanting to end the preference while maintaining the reality of doing nothing. The phenomenon not only makes sensible law reform difficult by keeping both rents and rent-extracting mechanisms in the law, but it also contributes to the overwhelming incumbency advantage that prevents more dynamic democratic turnover and change.*

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1. "'Curiouser and curiouser!' cried Alice (she was so much surprised, that for the moment she quite forgot how to speak good English)." LEWIS CARROLL, ALICE'S ADVENTURES IN WONDERLAND 12 (1865). We thank Carus Newman and Rae Williams for excellent research assistance, and Victor Fleischer for very helpful conversations.

## INTRODUCTION

### *Opening Scene: Forgetting About the Woman?*

On Wednesday July 27, 2022, Democratic Senators Joe Manchin and Chuck Schumer made a grand public announcement on what was to become the Inflation Reduction Act ("IRA"),[2] the $737 billion relic[3] of President Joe Biden's six-times-as-ambitious, $4.7 trillion Build Back Better proposal ("BBB").[4] The Manchin–Schumer Announcement included some righteous bragging about what the gentlemen and mainstream media proclaimed was the end of the longstanding "carried interest" loophole, a tax break for wealthy fund managers that Manchin and

2. *See* Press Release, Senate Democrats, Joint Statement from Leader Schumer and Senator Manchin Announcing Agreement to Add the Inflation Reduction Act of 2022 to the FY2022 Budget Reconciliation Bill and Vote in Senate Next Week (July 27, 2022), https://www.democrats.senate.gov/newsroom/press-releases/senate-majority-leader-chuck-schumer-d-ny-and-sen-joe-manchin-d-wv-on-wednesday-announced-that-they-have-struck-a-long-awaited-deal-on-legislation-that-aims-to-reform-the-tax-code-fight-climate-change-and-cut-health-care-costs [https://perma.cc/HT2M-Y3NP].

3. SENATE DEMOCRATS, SUMMARY: THE INFLATION REDUCTION ACT OF 2022, https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_one_page_summary.pdf [https://perma.cc/2CFX-DYAJ] (Aug. 11, 2022).

4. COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET, *Full Estimates of the House Build Back Better Act* (Nov. 18, 2021), https://www.crfb.org/blogs/full-estimates-house-build-back-better-act; *see also The Build Back Better Framework*, THE WHITE HOUSE, https://www.whitehouse.gov/build-back-better/ [https://perma.cc/M3C2-UE36] (last visited Mar. 18, 2024).

Schumer had long publicly opposed.[5] At long last, Congress had decided to honor fundamental tax principles by fixing a glaring and obvious inequity.[6]

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5. Juliana Kaplan & Alcynna Lloyd, *A Profitable Tax Loophole for Real Estate Could Be Axed in Manchin's New Deal to Ease Inflation*, BUS. INSIDER (July 30, 2022, 3:45 PM), https://www.businessinsider.com/carried-interest-loophole-real-estate-investors-inflation-manchin-deal-2022-7 [https://perma.cc/V6BP-YSRT].

6. The doctrinal path to the carried interest loophole is winding and fascinating. It is most recently explained in *ES NPA Holding, LLC v. Comm'r*, T.C.M. (RIA) 2023-55, 2023 WL 3222704 (May 3, 2023). Prior to 1974, taxpayers reported no taxable income upon receipt of an inchoate "profit share" as compensation for services. *See* J. MARTIN BURKE & MICHAEL K. FRIEL, TAXATION OF PARTNERSHIPS AND LIMITED LIABILITY COMPANIES TAXED AS PARTNERSHIPS 65 (2016) ("Given the speculative value of profits-only interests, it is not surprising that practitioners long assumed that the receipt of a profits-only interest in a partnership did not result in gross income to the partnership or trigger any gain at the partnership level."). The government approved, if only by turning a blind eye to grants of carried interests. Diamond v. Comm'r, 492 F.2d 286, 290 (7th Cir. 1974) ("[T]he Commissioner has not by regulation or otherwise acted affirmatively to reject [taxpayer assertions of nontaxability], and in a sense might be said to have agreed by silence."). But in *Diamond*, the taxpayer took too-obvious advantage of the government's blind eye. *See id.* The taxpayer received a profit interest in exchange for brokerage services. *Id.* at 288. Had he included the profit interest in income, it would have been compensation taxed at ordinary rates. *Id.* at 288 ("The Tax Court's holding rests upon the general principle that a valuable property interest received in return for services is compensation, and income."); *See also* I.R.C. § 61(a)(1) (including compensation for services in gross income). By not reporting the profit interest—asserting instead that its value was speculative and therefore not income—the taxpayer avoided ordinary income treatment. *Diamond*, 492 F.2d at 288 ("Taxpayer's analysis is that under the regulations the receipt of a profit-share February 18, albeit having a market value and being conferred in return for services, was not a taxable event, and that the entire proceeds of the March 8 sale were a capital gain."). Within a few weeks, though, the taxpayer sold the interest for $40,000 and reported the gain as short-term capital gain, against which he deducted short term capital losses. *Id.* at 287. The government prevailed in its argument that the entire transaction resulted in illegitimate conversion from less advantageous ordinary income to more advantageous capital gain. *Id.* at 291. The Court determined the taxpayer should have reported the profit interest as ordinary income upon receipt. *Id.* Had he done so, his tax cost basis in the interest would have equaled the amount included as ordinary income, and when he sold the interest soon thereafter, he would have recognized neither gain nor loss. *Id.* at 288, 291. The Court's solution was elegant, but it precipitated consternation amongst practitioners and the government alike because valuation would not always be as easy as it was in *Diamond*. *See* BURKE & FRIEL, *supra* note 6, at 66 ("The Service mercifully relieved the considerable anxiety generated by *Diamond* and its progeny . . . ."). Taxpayers would rarely, if ever, sell an asset purportedly incapable of valuation for an agreed value a few weeks later. For reasons never thoroughly explained, the government sought to give back its victory in *Diamond*. *See* I.R.S. Gen. Couns. Mem. 36,346, at 5 (July 23, 1975) ("The Internal Revenue Service will not follow the decision in *Sol Diamond* to the extent that it holds that the receipt by a partner of an interest in future partnership profits as compensation for services results in taxable income."). In *Campbell v. Comm'r*, the government conceded error on appeal, after the tax court applied Diamond's ordinary income conclusion to a case practically identical, except for ease of valuation. 943 F.2d 815, 818 (8th Cir. 1991). The Eighth Circuit rejected the disavowal, discussed and defended *Diamond*, but reversed the lower court on valuation. *See id.* at 818–23. Nevertheless, the government proceeded to

Carried interests date back at least as far as the thirteenth century, when European trade ship captains were compensated for their risky labor by a 25% share of their cargo's profits.[7] Seafarers bore risk to their lives and limbs, of course, rather than their financial capital. And nothing suggests they were further compensated for their risky labor by an historic equivalent to favorable capital gains taxation schemes.[8] Nevertheless, modern scholars extrapolate from that history to argue that fund managers, too, bear considerable entrepreneurial risk and that their service compensation is therefore appropriately taxed as capital gain. We think the argument simultaneously proves too much and too little. Every profit-sharing service provider bears the risk that there shall be no profit. The Tax Code does not normally tax worker profit share as capital gain, and nor should it.[9] Even more telling, a worker is not entitled to a deduction when profits fail to materialize because the worker has not lost previously taxed and invested income.[10] Only long-term investment creates the problem—taxation of nominal rather than real gain—that capital gains rates are designed to cure.[11] It is the presence of long-term financial investment, not risk alone, that best justifies capital gains taxation. But we merely summarize the majority view—measured by political platforms adopted by both political parties—that carried interests are inappropriately taxed as gains to capital. We do not intend to relitigate the merits.

Professor Victor Fleischer exposed this fundamental incongruity in his 2007 testimony before Congress and in his groundbreaking article, which was

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dismantle *Diamond* centuries after *Campbell*. It issued revenue procedures (thereby not explicitly overruling two circuit court opinions because revenue procedures aren't supposed to represent substantive law) announcing that it would not assert a tax liability upon receipt of a profit interest and that a recipient could nevertheless be treated as a partner upon receipt of the interest. *E.g.*, Rev. Proc. 93-27, 1993-2 C.B. 343 (clarified by Rev. Proc. 2001-43; 2001-2 C.B. 191) ("providing guidance on the treatment of the grant of a partnership profits interest that is substantially nonvested for the provision of services to or for the benefit of the partnership"). Those concessions effectively condoned the income conversion condemned in *Diamond* and *Campbell* and are the most direct causes of the current treatment of yields to carried interests as capital gain. In 2005, the Treasury Department proposed regulations that would codify and strengthen the nontaxability of profit interest and the resulting conversion exploited by fund managers to obtain capital gain treatment. I.R.S. Notice 2005-43, 2005-1 C.B. 1221. And there the matter remained until Congress enacted I.R.C. § 1061. *See generally* Act of Dec. 22, 2017, Pub. L. No. 115-97, §1061, 131 Stat. 2130 (codified at 26 U.S.C § 1061).

7. Tim Murphy, *The Carried Interest Loophole is Going to Outlast Us All*, MOTHER JONES (Aug. 8, 2022), https://www.motherjones.com/politics/2022/08/inflation-reduction-act-carried-interest-private-equity-kyrsten-sinema/ [https://perma.cc/9HVE-6AXU].

8. Historically, capital gains referred to yields from real property, not labor, and those yields were entirely untaxed. Calvin H. Johnson, *A Conceptual Framework for Capital Gain*, 20 FLA. TAX REV. 664, 671–72 (2017). The major European sea-faring nations did not even tax yields to capital until the twentieth century. France first taxed capital gains in 1914, England in 1965, and Spain not until 1977.

9. *See* I.R.C. § 61(a)(1) (regarding compensation for services); I.R.C. § 83 (regarding property transferred as compensation for services).

10. *See* I.R.C. § 83(b)(1)(B) (denying a deduction upon forfeiture of property transferred in connection with the performance of services).

11. Johnson, *supra* note 8, at 682.

circulating for peer comments the year before.[12] George W. Bush was president when the problem gained wide public attention beyond academic circles and in the popular media.[13] At its essence, carried interest taxation aggravates a populist nerve and politicians on both sides of the aisle quickly sought to capture the populist indignation. Legislative fixes—taxing carried interests as ordinary income—were easy enough to come by and have in fact lingered in the halls of Congress since 2007,[14] endorsed in succession by Presidents Barack Obama, Donald J. Trump, and Joe Biden, along with presidential candidates such as Jeb Bush and Hilary Rodham Clinton.[15] Fleischer's exposé convinced the center almost instantly, and given the bipartisan support it seemed it would only be a matter of time until Congress passed corrective legislation.[16] Yet the Tax Code's "stain" persisted virtually untouched until the Manchin–Schumer Announcement in 2022.

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12. Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 3–4 (2008) [hereinafter Fleischer, *Two and Twenty*]. The paper was posted in draft form on the Social Science Research Network on March 23, 2006. *See generally* Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds* (Legal Stud. Rsch. Paper Series, Working Paper No. 06-27, 2007) [hereinafter Fleischer, Working Paper], https://papers.ssrn.com/sol3/papers.cfm?abstract_id=892440 [https://perma.cc/FJQ6-3XZ5]. The paper caused an uproar and led to calls for reform even before it was finally published. *See* Lisa Lerer, *Professor's Proposal Angers Wall Street*, POLITICO (Oct. 30, 2007, 6:45 AM), https://www.politico.com/story/2007/10/professors-proposal-angers-wall-street-006594 [https://perma.cc/5UQN-NX5V].

13. *See* Lerer, *supra* note 12.

14. Darryll K. Jones, *Sophistry, Situational Ethics, and the Taxation of the Carried Interest*, 29 NW. J. INT'L L. & BUS. 675, 677 n.7 (2009).

15. *Id.*; Lynnley Browning, *Trump Says He Still Wants to End Carried Interest Tax Benefit*, BLOOMBERG (May 20, 2019, 8:33 AM), https://www.bloomberg.com/news/articles/2019-05-20/trump-says-he-still-wants-to-end-carried-interest-tax-benefit [https://perma.cc/A26D-PJ27]; Tim Murphy, *Biden and Trump Both Trashed Private Equity's Favorite Tax Dodge. Surprise! It's Still Here*, MOTHER JONES (May/June 2022), https://www.motherjones.com/politics/2022/05/carried-interest-loophole-biden-trump-private-equity-tax-break/ [https://perma.cc/P5BB-MHR4].

16. Fleischer's 2008 article laid out a strong case against the carried interest preference. *See generally* Fleischer, *Two and Twenty*, *supra* note 12. There has been some dissent AMONG academics in favor of the current treatment, most prominently from David Weisbach. *See* David A. Weisbach, *The Taxation of Carried Interests in Private Equity*, 94 VA. L. Rev. 715, 716–20 (2008). We do not intend to rehash the terms of the debate in this Article; we intend instead to stress the lack of principled discussion around the ultimate inaction on carried interest in the IRA. The fact that all Republicans and all Democrats except Senator Sinema ultimately expressed support for extending the holding period of carried interests, as we discuss *infra*, also mitigates the need to discuss the merits at greater length here. But we will quote the wealthy fund manager Bill Ackman's tweet of July 28, 2022, the day after the Manchin–Schumer Announcement, to give a sense of how even Wall Street views the matter: "The carried interest loophole is a stain on the tax code. It does not help small businesses, pension funds, other investors in hedge funds or private equity and everyone in the industry knows it. It is an embarrassment and it should end now." Aimee Picchi, *Democrats Want to Close a "Stain" of a Tax Break. Some Say It's Not Enough*, CBS NEWS: MONEYWATCH, https://www.cbsnews.com/news/carried-interest-loophole-close-inflation-

There was a hardly noticed bipartisan curiosity about the Announcement. Even as Manchin and Schumer delivered it, they faced united Republican opposition and would thus need every Democratic vote in the closely divided Senate. Yet the two seemingly triumphant male Democrats had forgotten or purposefully excluded their female colleague, Senator Krysten Sinema, from the media event.[17] Since all 49 other Democrats, plus the Vice President, could be counted on to support the effort, Senator Sinema's vote would prove crucial. (Republicans' uniform opposition was equally curious because Republicans were the first to limit the carried interest loophole. In 2017, Republicans helped President Trump fulfill a campaign promise, enacting new Internal Revenue Code ("I.R.C.") §1061.[18])

Manchin and Schumer announced their putative triumph slightly more than a week before one of the few fixed points in the life of Congress: Summer Recess.[19] But what about the woman? It turned out that Senator Sinema took no offense at the Manchin–Schumer slight. In fact, the junior senator from Arizona had a busy week, meeting with private equity representatives.[20] On Thursday, August 4—just over a week after the Manchin–Schumer Announcement and just in time for weekend votes so that lawmakers could make their scheduled flights home after all—came word that all necessary parties, including Sinema, had agreed to an IRA deal.[21] Except the deal included no carried interest provision.[22] The press, which had been following

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reduction-act/ [https://perma.cc/778J-3NN4] (Aug. 4, 2022, 1:08 PM) (quoting Bill Ackman (@BillAckman), TWITTER (July 28, 2022, 5:52 PM), https://twitter.com/BillAckman/status/1552819316806090752 [https://perma.cc/DBW3-KVQ2]).

17. Theoretically, any single Democrat might have wielded the same influence as Manchin and Sinema. But those Senators were from the most ambiguously "blue states," and were thus more likely to be influenced by arguments that repealing the carried interests was a Democratic effort to raise taxes.

18. Still on the books today, that provision imposed a three-year long-term holding period on gains to carried interests. I.R.C. § 1061(d)(1)(A). Gains to carried interests held for less than three years are now treated as short term capital gain, taxed nominally as ordinary income. That new law did not do all that much, given that the average carried interest was held for 5.4 years by 2020. *Private Equity Holding Periods Reach All-Time High in 2020*, PRIVATE EQUITY WIRE (Apr. 22, 2021, 8:06 AM), https://www.privateequitywire.co.uk/2021/04/22/299092/private-equity-holding-periods-reach-all-time-high-2020 [https://perma.cc/55DC-Q5VA].

19. Emily Cochrane & Annie Karni, *After Clash, Manchin and Schumer Rushed to Reset Climate and Tax Deal*, N.Y. TIMES (July 28, 2022), https://www.nytimes.com/2022/07/28/us/politics/manchin-schumer-climate-tax-deal.html [https://perma.cc/U9TR-ALMW].

20. *See* Emily Cochrane, *With Climate Deal in Sight, Democrats Turn Hopes on Sinema*, N.Y. TIMES (Aug. 3, 2022), https://www.nytimes.com/2022/08/03/us/politics/sinema-climate-deal-manchin.html [https://perma.cc/R3MR-KEBH].

21. Kevin Breuninger, *Schumer Says Sinema Left 'No Choice' but to Cut Carried Interest Provision from Tax and Climate Bill*, CNBC: POLITICS, https://www.cnbc.com/2022/08/05/sinema-made-schumer-cut-carried-interest-loophole-from-reconciliation-bill.html [https://perma.cc/UV7T-Q2GN] (Aug. 5, 2022, 8:03 PM); *c.f.* Editorial Board, *Democrats Blink on Carried Interest*, WALL ST. J.: OPINION (Sept. 13, 2021, 6:59 PM), https://www.wsj.com/articles/democrats-blink-on-carried-interest-house-ways-and-means-tax-bill-11631569436 [https://perma.cc/U22Z-LC2H].

22. *See* Emily Cochrane, *Sinema Agrees to Climate and Tax Deal, Clearing the Way for Votes*, N.Y. TIMES (Aug. 4, 2022), https://www.nytimes.com/2022/08/04/us/politics/sinema-inflation-reduction-act.html [https://perma.cc/T4WC-DZPC].

the whole matter as it played out in plain sight, reported that special interests had won the day yet again.[23]

But had they? We use the phrase "reverse Mancur Olson" to suggest it is too simple to think that only lobbyists extract rents. We write to complexify the simple, familiar story of special interest politics. We have been following the tax legislative process for some time. The actual story of the IRA and its disappearing carried interest provision is considerably curiouser than the no-longer-curious fact that the wealthy and powerful in America seldom get taxed.[24] Our fundamental assertion is that shrewd and wealthy fund managers, and the financiers whose capital they manage, have been shaken down, not entirely unwillingly, and that the true winners were incumbents, especially Sinema.[25] We think incumbents set the whole thing up; the private equity crowd—and taxpayers writ large—were the marks all along. Nothing else explains the carried interest loophole's continuing existence even as both sides profess indignation about it. Incumbents emerge better off than all the other actors in our saga. The politics of tax played out as usual, every detail following the money. We think Manchin and Schumer had in fact done their colleague Sinema an intentional solid.

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23. *E.g.*, Julie Bykowicz & Miriam Gottfried, *How the Private-Equity Lobby Won—Again*, WALL ST. J.: POLITICS (Aug. 7, 2022, 6:00 AM), https://www.wsj.com/articles/how-the-private-equity-lobby-wonagain-11659834467 [https://perma.cc/Q597-VQRU].

24. *See generally* Edward J. McCaffery, *Death of the Income Tax (or, The Rise of America's Universal Wage Tax)*, 95 IND. L.J. 1233 (2020); Edward J. McCaffery, *Taxing Wealth Seriously*, 70 TAX L. REV. 305 (2017) [hereinafter McCaffery, *Taxing Wealth Seriously*].

25. As a first term Senator, and the first acknowledged bisexual woman in a male-dominated and increasingly conservative political environment, Sinema is inherently more vulnerable than her multi-term colleagues. *See* Daniela Altimari et al., *A Year and a Half Out, These Are 2024's Most Vulnerable Senators*, ROLL CALL (May 3, 2023, 5:00 AM), https://rollcall.com/2023/05/04/a-year-and-a-half-out-these-are-2024s-most-vulnerable-senators/ [https://perma.cc/5W7V-3795] (listing Sinema as the second most vulnerable Senator behind Senator Manchin). Her ability to garner support from those enriched by the carried interest loophole remains crucial. *See* Eugene Scott, *Kyrsten Sinema Broke a Slew of Barriers with Her Senate Win. So How Was Identity a Nonissue in Her Race?*, WASH. POST (Nov. 20, 2018, 9:58 AM), https://www.washingtonpost.com/politics/2018/11/20/kyrsten-sinema-broke-slew-barriers-with-her-senate-win-so-how-was-identity-non-issue-her-race/ [https://perma.cc/JNX2-KQJ6]. As it turns out, Senator Sinema left the Democratic party, vowing to run for reelection as an independent candidate. But she found herself at odds with the Republican party, as well. She became "politically homeless" and eventually decided not to run for reelection at all. Jonathan J. Cooper, *Independent Sen. Kyrsten Sinema of Arizona says She Won't Seek Reelection, Avoiding a 3-way Race*, A.P. (Mar. 6, 2024), https://apnews.com/article/kyrsten-sinema-arizona-8043c3333e6d87da2404f58339f1e1e6 [https://perma.cc/G5ZM-J2LF]. The immediate cause for her decision was her previous estrangement from the Democratic party, according to media reports, coupled with increasing partisanship in Congress. *Id.* But reports also cite her close relationship with opponents of repealing the carried interest loophole. *Id. See also* Brian Slodysko, *Sinema Took Wall Street Money While Killing Tax on Investors*, A.P. (Aug. 13, 2022), https://apnews.com/article/sinema-took-wall-street-money-while-killing-tax-on-investors-0c07f73ba6db92f87fa33f1aad8dbeac [https://perma.cc/6J38-MBR9].

We write to explain these claims, highlighting several especially curious aspects of the most recent iteration of the curious case of carried interest.[26] The full story refutes any idea that "principle" is a driving force behind the legislative actions. Part I of this Article takes us back to 2007 and Professor Fleischer's testimony to Congress, ultimately leading to what Professor Howard Abrams has called "the reform that didn't happen."[27] Part II adds a touch of political economic theory, explaining the "reverse Mancur Olson phenomenon" to show how legislators' interests *in their own fundraising* best explains what is really going on in a wide range of tax and other legislative settings, including carried interests. Part III moves to a Republican turn at the wheel, in part to illustrate that the game is fully nonpartisan. We show how the Tax Cut and Jobs Act of 2017 ("TCJA"), President Trump's signature legislative accomplishment, paired the *appearance* of curtailing the carried interest break—which Trump repeatedly claimed would be shut down—with the *reality* of not doing much of anything at all. Part IV returns to Senator Sinema and the most recent round of high drama and ultimate inaction. We address some of the curiousest facts that emerged in this latest round of the ongoing saga of carried interest and show how the seemingly more curious explanation we offer best explains them. Finally, Part V points to a future where we think better about what is going on in Washington and other corridors of legislative power, and we offer some thoughts about what to do about the whole thing—matters that transcend in importance the narrow issue of taxing carried interests. The details show the active agency of Congress and presidents in keeping vast sums of money in politics.[28] If we are going to reduce the role of money in politics, we must better come to terms with the reasons why money is in politics in the first place. But first, we go back in time.

## I. BACK TO WHERE IT ALL BEGAN

Part of what makes carried interests such a rich subject for the political economic analysis we present here is that the underlying issue is simple to explain, and legislative cures are easy to find. "People get this really easily—we're giving a whole lot of rich people more money for no reason other than them being rich," says Mandla Deskins of Take on Wall Street, an organization formed to pressure

26. *See infra* Part IV.

27. *See generally* Howard E. Abrams, *Taxation of Carried Interests: The Reform that Did Not Happen*, 40 LOY. U. CHI. L.J. 197 (2009).

28. *Citizens United v. Federal Election Commission* represents a high-water mark regarding "dark money" in politics. 558 U.S. 310 (2010). The Supreme Court held that the First Amendment prohibited Congress from limiting the amount corporations could spend to influence elections. *Id.* at 365. Although government could not prohibit or limit corporate election spending, some sought to mitigate the harm by requiring that political speakers disclose the source of their fundings. But that effort failed when the Supreme Court ruled the requirement of donor disclosure unconstitutional. Ams. for Prosperity Found. v. Bonta, 141 S. Ct. 2373, 2389 (2021) ("[T]he Attorney General's disclosure requirement imposes a widespread burden on donors' associational rights. And this burden cannot be justified on the ground that the regime is narrowly tailored to investigating charitable wrongdoing, or that the State's interest in administrative convenience is sufficiently important. We therefore hold that the up-front collection of Schedule Bs is facially unconstitutional, because it fails exacting scrutiny in 'a substantial number of its applications . . . judged in relation to [its] plainly legitimate sweep.'") (quoting United States v. Stevens, 559 U.S. 460, 473 (2010)).

lawmakers to end carried interest and other breaks for the financier class.[29] The main variable in the legislative fixes ultimately proposed or enacted is simply the length of time a fund manager must hold their carried interest to get the more favorable capital gains tax rate; I.R.C. § 1061, which we discuss below, is about as simple a Tax Code section as there is these days. No detailed tax expertise is needed to follow the stories about carried interest. This helps to explain why every president, and most presidential candidates, since George W. Bush have endorsed closing the loophole: it plays well on the stump.[30] What needs explanation is not the loophole or its cures, but why so little has been done about it. This Part sets out the relevant background.

### *A. Carried Interest*

To explain carried interest, we could go all the way back to the thirteenth century and the time of the Conquistadors, when intrepid explorers were given a cut of their ship cargo's profits as compensation for the not inconsiderable risks of their trade.[31] Instead, we move through the centuries to the twentieth.

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29. Murphy, *supra* note 15; *see generally* TAKE ON WALL ST., https://takeonwallst.com [https://perma.cc/5GDB-RMLQ] (last visited July 30, 2023).

30. *See* Eric Pianin, *Trump, Obama and Bush Agree: Close the Carried Interest Tax Loophole*, FISCAL TIMES: POLICY & POLITICS (Sept. 16, 2015), https://www.thefiscaltimes.com/2015/09/16/Trump-Obama-and-Bush-Agree-Close-Carried-Interest-Tax-Loophole [https://perma.cc/93QT-DAQG].

31. The etymology and first uses of "carried interests" is fascinating:

> Long-distance trade had the potential for enormous profit, but it carried a substantial risk. An enterprising young man could more than double his money if he could fill a ship with goods to trade with Constantinople and the Eastern Mediterranean. However, raising the capital to buy the original goods and hire a ship was beyond the reach of someone trying to get a start in the merchant trade. Additionally, there were pirates, bad weather, and shipwrecks to consider. Any of these factors could affect the profitability of the trip. . . .
>
> This is where the idea of carried interest enters the story. Start-up merchants needed investors, and investors needed some incentive to finance the merchants. For the investor, there was the risk of their investment literally sailing out of the harbor never to be seen again. The Venetian government solved this problem by creating one of the first examples of a joint stock company, the "colleganza." The colleganza was a contract between the investor and the merchant willing to do the travel. The investor put up the money to buy the goods and hire the ship, and the merchant made the trip to sell the goods and then buy new foreign goods that could then be brought back and sold to Venetians. Profits were then split between the merchant and investor according to the agreements in the contract.
>
> This arrangement limited the liability for both parties. For the first time, poorer merchants had a chance to improve their lot in life by taking on the inherent risks of travel. This shared liability and carried interest agreement opened the doors to a greater number of Venetians participating in trade and wealth-building. Without the colleganza, Venice would have never grown so successfully, and its people would have been

Capitalists make money from ownership, laborers from effort. In investment funds, capitalists aggregate their cash and hire laborers, commonly referred to as "fund managers."[32] Managers use their skills to determine the best investments, invest the cash accordingly, and then pay profits or report losses to the capitalists.[33] Fund managers do not typically invest their own capital (other than their human capital), though a wise capitalist may sometimes insist fund managers have financial "skin in the game"[34] to further incentivize wise deployments.[35] Capitalists typically pay fund managers a fixed annual fee equal to a percentage of assets under management (often called the "Two" because the fixed fee is traditionally 2%) and a percentage of investment profits (the "Twenty," because

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> stuck in a class system with no opportunity for economic mobility. No longer was wealth reserved for those lucky few born into it. Instead, wealth was available to anyone willing to work for it.

Drew Armstrong, *The Medieval Geniuses Who Invented Carried Interest and the Modern Barbarians Who Want to Tax It*, FEE STORIES (Mar. 20, 2017), https://fee.org/articles/the-medieval-geniuses-who-invented-carried-interest-and-the-modern-barbarians-who-want-to-tax-it/ [https://perma.cc/6VY4-Q8XE].

32. So that we may focus on the fundamental issue—the legitimacy of a tax preference provided to laborers as though they were capitalists—we focus on the essential features. For an in-depth analysis and discussion of the structure of hedge funds, the entities most likely to employ carried interests, see Bankim Chadha & Anne C. Jansen, *The Hedge Fund Industry: Structure, Size, and Performance*, *in* HEDGE FUNDS AND FINANCIAL MARKET DYNAMICS 27–41 (1998).

33. *Id.* at 34 ("[T]he one—and perhaps the only—characteristic that all 'hedge funds' have in common is that managers are compensated on the basis of performance and not as a fixed percentage of assets under management. While there are variations, the industry norm appears to be that hedge fund managers receive 15-20 percent of the funds' realized trading profits, plus a management fee of 1 percent of assets annually. Some hedge funds have 'hurdle'-based incentive fees, which reward the general partner or manager for performance in excess of an agreed benchmark. Others have 'high watermark' provisions requiring the general partner to make up losses prior to being able to receive additional incentive fees.").

34. *Id.* ("[H]edge fund managers, as partners in the limited investment partnerships, have their own capital invested in the funds they manage."). *See also* Lewis Braham, *Why It Pays to Invest with Managers Who Have Skin in the Game*, BARRONS (Mar. 22, 2023, 2:00 AM), https://www.barrons.com/articles/invest-with-managers-who-have-skin-in-the-game-e16798a4 [https://perma.cc/A8R9-AXMC] ("What's shocking is how many fund managers don't invest at all in their own funds, even though many consider insider ownership an important positive sign in the stocks they buy. Some 4,643 out of a total of 7,108 funds have zero manager investment, according to Morningstar. Only 1,174 funds have over $1 million in manager investment. It almost seems as if most managers have no faith that they can do their own jobs.").

35. We emphasize that service income is not usually taxed at preferential rates, not to assert that it should be disadvantaged relative to the taxation of income from invested capital. Indeed, there is a wealth of scholarship disputing the underlying justifications for taxing capitalists less than laborers. As noted, we are not here debating the merits of capital gain taxation. There are two articles that set forth relevant arguments. *See generally* Nohel B. Cunningham & Deborah H. Schenk, *The Case for a Capital Gains Preference*, 48 TAX L. REV. 319 (1993); Jeffrey A. Schoenblum, *Tax Fairness or Unfairness? A Consideration of the Philosophical Bases for Unequal Taxation of Individuals*, 12 AM. J. TAX POL'Y 221 (1995).

20% is the current industry standard).[36] The Twenty represents yields to the manager's "carried interest," invoking the shipping metaphor of yore. Typically, the modern entity is taxed as a partnership, and most early examples involved real estate. The twenty-first century tax story we tell here, in contrast, focuses almost exclusively on private equity and hedge fund managers; a fact that plays curiously in our unfolding tale.

The normative question is how the Twenty should be taxed. The question involves both a timing, or *when*, issue and a character, or *tax rate*, issue. The question typically didn't arise early on. Taxpayers simply assumed there was no income on receipt and the government hardly cared until the conversion abuse became too obvious to ignore. A 1974 appellate case, *Diamond v. Commissioner*,[37] shook things up for rich folk and their tax advisors. The taxpayer reported no income on receipt of a profits interest, relying on the commonly accepted notion that the carried interest was incapable of valuation.[38] Three weeks later, the taxpayer sold the interest for $40,000, claiming short-term capital gain.[39] Finding this intolerable, the Seventh Circuit held that, at least where a partnership profits interest had a "determinable market value," it was income on receipt, and thus taxed at "ordinary income" rates—those that generally apply to wages.[40] This rule is essentially incorporated today in I.R.C. § 83, except that under the current interpretation, the carried interest is considered valueless on receipt.[41]

*Diamond*, which involved a real estate partnership, left uncertainty and confusion, especially since most carried interests would not have "determinable market value." Fortunately, the IRS, acting on its own, early on showed a willingness to resolve matters in favor of Wall Street.[42] (Note that special interest

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36. Fleischer, *Two and Twenty*, *supra* note 16, at 3.

37. 492 F.2d 286 (7th Cir. 1974), *aff'g* 56 T.C. 530 (1971).

38. 492 F.2d at 287, 289.

39. *Id.*

40. *Id.* at 290–01 ("[W]e think it sound policy to defer to the expertise of the Commissioner and the Judges of the Tax Court, and to sustain their decision that the receipt of a profit-share with determinable market value is income.").

41. For the Tax Court's most recent discussion and application of the rules underlying carried interest taxation, see *ES NPA Holding, LLC v. Comm'r*, T.C.M. (RIA) 2023-55, 2023 WL 3222704 (May 3, 2023). "Revenue Procedure 93-27 is amplified by Revenue Procedure 2001-43, which acknowledges the time and valuation rules of section 83." *Id.* at 10 n.8. The result thus far is not offensive even though the fund manager pays no tax upon receipt of a clear economic benefit. If the fund manager reports no income upon receipt of the future right to receive profit, the capitalists are similarly denied a compensation deduction because the value of compensation paid is zero as a matter of law. The government suffers no illegitimate revenue loss, so valuation on receipt is ultimately a matter between the investors and fund managers. The rub, of course, is that the fund manager is granted entry into the maze of Subchapter K as a "partner" whose allocations are characterized at the partnership level, effectively disregarding the fact that the fund manager's later profit allocations represent compensation for labor. *See* I.R.C. § 702(b).

42. *See* Darryll K. Jones, *The Taxation of Profit Interests and the Reverse Mancur Olson Phenomenon*, 36 CAP. U. L. REV. 853, 868 (2008) (footnotes omitted) ("The Seventh Circuit Court of Appeals affirmed *Diamond* in 1974 and by the end of 1975 the Treasury Department had already suggested on two separate occasions that the holding be ignored.").

"capture" of a regulatory body[43] like the IRS works differently than capture of a legislative body, as we continue to explore in this Article.) The lobbying efforts led to formal pronouncements. Revenue Procedure 1993-27 set out "safe harbor" rules—rather easily met—for when a partnership profits interest would *not* be found to have a determinable market value and hence not be subject to current taxation.[44] Revenue Ruling 2001-43 would later clarify that the carried interest would be entitled to capital gains treatment on ultimate sale or other realization.[45]

At the time our story picks up steam circa 2006, the long-term capital gains rate was 15%, compared to a top ordinary income tax rate of 35%;[46] by 2022, when the IRA was passed, the highest capital gains rate sat at 23.8% while the top ordinary rate was 37%.[47] In addition to the deferral of tax brought about by the favorable timing rule of Revenue Procedure 93-27, the characterization preference thus saves top fund managers 13.2% to 20% of their carry. This means, as we shall see, that the wealthiest few managers are handed *hundreds of millions of dollars* in tax savings *on an annual basis*.

Why? There are various reasons offered for a capital gains preference under the income tax, typically turning on arguments against "double taxation" and an anti-savings and investment bias of any true income tax.[48] But these claims hardly apply to the initial receipt of income from labor. The capitalist investor has, in theory, *already* paid some tax on the funds she invests (or will pay tax, ultimately, if she has borrowed to invest, because no deduction is allowed for the repayment of borrowed principal[49]); the hedge fund manager is earning his income, for the first time, by labor efforts. And while the argument that the outsized returns paid over to private equity and hedge fund managers require a tax break to generate adequate incentives for taking risk seems laughable in the face of the magnitudes involved today, it hardly prevents the case from being made. But while some tax law scholars

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43. The theory of regulatory capture is generally thought to have originated with the work of Nobel Laureate George Stigler. *See generally* George Stigler & Claire Friedland, *What Can Regulators Regulate? The Case of Electricity*, 4 J. L. & ECON. 1 (1962); George Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 3–5 (1971). *See also* Sam Peltzman, *George Stigler's Contribution to the Economic Analysis of Regulation*, 101 J. POL. ECON. 818, 818 (1993) ("George Stigler changed the way economists analyze government regulation.").

44. Rev. Proc. 93-27, 1993-2 C.B. 343.

45. *See supra* note 6 and accompanying text.

46. *Federal Capital Gains Tax Rates, 1988-2013*, TAX FOUND. (June 13, 2013), https://taxfoundation.org/federal-capital-gains-tax-rates-1988-2013/ [https://perma.cc/A3YY-YJM4].

47. Bob Haegele, *Capital Gains vs. Investment Income: How They Differ*, BANKRATE (Feb. 28, 2024), https://www.bankrate.com/investing/capital-gains-vs-investment-income/ [https://perma.cc/KQ7L-4T89]; Laura Saunders, *Capital Gains Tax Rates and Tax Brackets*, WALL ST. J.: PERSONAL FINANCE (Mar. 1, 2023, 3:47 PM), https://www.wsj.com/articles/capital-gains-dividend-tax-rates-2022-2023-da562ba6 [https://perma.cc/5C4X-N5FV]. Note that the 23.8% tax is a 20% tax on long-term capital gains plus 3.8% from the Net Investment Income Tax. *See id.*

48. *See generally* Johnson, *supra* note 8, at 682–84.

49. *E.g.*, *id.* at 706–08.

such as David Weisbach[50] and Howard Abrams[51] have indeed questioned the case against carried interest, the overwhelming consensus in the tax policy literature is and has long been that carried interest should *not* get capital gains treatment.[52] A 2021 survey of 165 tax law professors found that 93% of respondents agreed that the law should "[t]ax carried interest as ordinary income," by far the most support for any tax reform proposal.[53] Fund managers themselves, such as Bill Ackman, see the preference for carried interest as a "stain on the tax code" and an "embarrassment"[54]—a characterization not questioned by any president since Bush nor by the 99 sitting senators who have by now shown a willingness to limit the break. Commentators in the press, such as Alan Blinder in a *New York Times* opinion piece from July 2007, have been consistent in calling for an end to the windfall.[55] Warren Buffett told Congress in 2010 that "[i]f you believe in taxing people who earn income on their occupation, I think you should tax people on carried interest."[56]

Fortunately enough for our readers, we do not have to dwell on nettlesome matters of tax policy or principle in the present analysis because principle will never be in play in the particular actions we discuss. Lawmakers blocking action on carried interest reform themselves do not generally bother to make arguments of principle.[57] Something else—something more primordial—beyond tax law theory is in play, as we shall see.

### *B. A Sense of the Stakes*

As often happens in tax, a little thing that favors taxpayers becomes a very big thing that favors not just wealthy taxpayers but extremely wealthy taxpayers.[58]

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50. *See* Weisbach, *supra* note 16.

51. *See* Abrams, *supra* note 27.

52. *See, e.g.*, Jones, *supra* note 42, at 857–58; Paul Caron, *Abrams Dissents from the Academic Consensus on Carried Interest*, TAXPROF BLOG (Aug. 1, 2007), https://taxprof.typepad.com/taxprof_blog/2007/08/howard-abrams-d [https://perma.cc/TW4Z-6PLD].

53. Jonathan Choi, *A Survey of Law Professors on Tax Reform*, YALE J. ON REGUL. (Aug. 25, 2021), https://www.yalejreg.com/nc/a-survey-of-law-professors-on-tax-reform/ [https://perma.cc/88YX-V44Z].

54. *See* Bill Ackman (@BillAckman), TWITTER (July 28, 2022, 5:52 PM), https://twitter.com/BillAckman/status/1552819316806090752 [https://perma.cc/DBW3-KVQ2].

55. *See* Alan S. Blinder, *The Under-Taxed Kings of Private Equity*, N.Y. TIMES, July 29, 2007 (Business), at 4 ("Why shouldn't they pay taxes like the rest of us?").

56. James Surowiecki, *Special Interest*, NEW YORKER (Mar. 7, 2010), https://www.newyorker.com/magazine/2010/03/15/special-interest-2 [https://perma.cc/ZNZ4-XXSK] (internal quotation marks omitted).

57. *See, e.g.*, James B. Stewart, *A Tax Loophole for the Rich That Just Won't Die*, N.Y. TIMES (Nov. 9, 2017), https://www.nytimes.com/2017/11/09/business/carried-interest-tax-loophole.html [https://perma.cc/5TTM-JRC2] (quoting Professor Victor Fleischer's statement that "[i]f [Congress] were designing something that perfectly avoids [closing the loophole,] this would be it[]") (internal quotations marks omitted).

58. *See* AMS. FOR FIN. REFORM, FACT SHEET: CLOSE THE CARRIED INTEREST LOOPHOLE THAT IS A TAX DODGE FOR SUPER-RICH PRIVATE EQUITY EXECUTIVES (Oct. 2021), https://ourfinancialsecurity.org/2021/10/close-the-carried-interest-loophole-that-is-

By the twenty-first century, the favorable treatment of profits interests allowed by Revenue Procedure 93-27 had become industry standard for the top hedge fund managers, as the break extended far beyond real estate entrepreneurs like Sol Diamond.[59]

Enter Victor Fleischer, a young tax law professor then at the University of Illinois. Fleischer had begun working on the issue in 2004, presented testimony to Congress in 2007,[60] and published the most important and influential piece on carried interest, *Two and Twenty*, in 2008.[61] Fleischer laid bare the issue and debunked any idea that significant revenue was *not* at stake. This idea arose from the comforting but lazy assumption that the nontaxation of managers at ordinary income rates was offset by the necessarily concomitant absence of any deduction for salary paid by the fund under I.R.C. § 162, such that the matter was, as tax lawyers say, a "wash."[62] Fleischer pointed out that the fund employers were likely to be tax-

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a-tax-dodge-for-super-rich-private-equity-executives/ [https://perma.cc/V3TX-V24V] ("The carried interest tax loophole is an income tax avoidance scheme that allows private equity and hedge fund executives—some of the richest people in the world—to substantially lower the amount they pay in taxes.").

59. *See supra* note 35 and accompanying text (regarding the industry norm).

60. *University of Illinois Professor Urges Change to Carried Interest Taxation*, TAX NOTES (Sept. 6, 2007), https://www.taxnotes.com/research/federal/other-documents/testimony-other-than-irs-and-treasury/university-of-illinois-professor-urges-change-to-carried-interest-taxation/xp3y [https://perma.cc/2R5U-A4CB].

61. There has been a significant amount of scholarship on carried interest, both prior to and after Fleischer's work. *See, e.g.*, Abrams, *supra* note 27, at 197 n.5 (citing Mark P. Gergen, *Reforming Subchapter K: Compensating Service Partners*, 48 TAX L. REV. 69 (1992); Michael L. Schler, *Taxing Partnership Profits as Compensation Income*, 119 TAX NOTES 829 (2008); Sarah Pendergraft, *From Human Capital to Capital Gains: The Puzzle of Profits Interests*, 27 VA. TAX REV. 709 (2008); Weisbach, *supra* note 16; Note, *Taxing Private Equity Carried Interest Using an Incentive Stock Option Analogy*, 121 HARV. L. REV. 846 (2008); Howard E. Abrams, *A Close Look at the Carried Interest Legislation*, 117 TAX NOTES 961 (2007); Howard E. Abrams, *Taxation of Carried Interests*, 116 TAX NOTES 183 (2007), *reprinted in* 23 TAX MGMT. REAL EST. J. 199 (2007); Lee A. Sheppard, *The Unbearable Lightness of the Carried Interest Bill*, 116 TAX NOTES 15 (2007); Thomas I. Hausman, *Planning for Receipt of a Partnership Compensatory Interest*, 114 TAX NOTES 529 (2007); Leo L. Schmolka, *Taxing Partnership Interests Exchanged for Services: Let Diamond/Campbell Quietly Die*, 47 TAX L. REV. 287 (1991); Laura E. Cunningham, *Taxing Partnership Interests Exchanged for Services*, 47 TAX L. REV. 247, 252 (1991); Mark P. Gergen, *Pooling or Exchange: The Taxation of Joint Ventures Between Labor and Capital*, 44 TAX L. REV. 519 (1989); Barksdale Hortenstine & Thomas W. Ford, Jr., *Receipt of a Partnership Interest for Services: A Controversy That Will Not Die*, 65 TAXES 880 (1987); Sheldon I. Banoff, *Conversions of Services into Property Interests: Choice of Form of Business*, 61 TAXES 844 (1983); Martin B. Cowan, *Receipt of an Interest in Partnership Profits in Consideration for Services: The* Diamond *Case*, 27 TAX L. REV. 161 (1972).

62. "The revenue lost by not requiring the inclusion of ordinary income upon grant of the deduction is perfectly offset, assuming service provider and service recipients are subject to the same tax rates on their ordinary income, by the increased revenue derived from denying a trade or business expense deduction to the service recipients." Jones, *supra* note 42, at 875.

exempt actors, such that the denial of any deduction to them was irrelevant.[63] It has now become accepted fact that the carried interest tax break for managers costs the Treasury *billions* of dollars a year, with Fleischer himself arguing it could be as high as $18 billion annually.[64]

Howard Abrams pointed out that Fleischer's analysis was not especially new, as the carried interest game had been going on even prior to the 1993 Revenue Procedure, but he acknowledged that Fleischer was adding context.[65] It was some considerable context. By the time the earnest Mr. Fleischer went to Washington, the game had moved to advanced stages: Wall Street wolves were making billions off the carried interest game year in and year out. Indeed, by 1997, hedge funds in the United States held nearly $32 trillion under management.[66]

Imagine a fund with an initial stake of $1 billion, which over a period of years doubles in value. The fund manager would get $20 million a year as their "Two," and $200 million as their "Twenty" once the fund had doubled. These are not phantasmagorical numbers. In 2007, the *New York Times* reported that the top 25 hedge fund managers—and only top managers typically get the "carry"[67]—had made at least $240 million *each* in the prior year.[68] James Simon of Renaissance Technologies led the pack at $1.7 billion, about $2.56 billion in 2023 dollars,[69] and two others, Kenneth C. Griffin of Citadel and Edward S. Lampert of ESL Investments and Sears Holdings,[70] topped the $1 billion mark. (George Soros came

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63. *Id.* (citations omitted) ("Fleischer's research virtually shattered the comforting assumption that there were no net losses from the substantive inaccuracy. Most of the largest investors in pooled funds were indifferent, either because they were tax exempt, such as universities and pension funds, or could not have benefited from the denied tax deduction in any event. Scholars who took these facts into consideration estimated the revenue loss from the substantive inaccuracy at amounts as high as $4.2 billion per year.").

64. Victor Fleischer, *How a Carried Interest Tax Could Raise $180 Billion*, N.Y. TIMES (June 5, 2015), https://www.nytimes.com/2015/06/06/business/dealbook/how-a-carried-interest-tax-could-raise-180-billion.html [https://perma.cc/H2DS-DHG8].

65. Abrams, *supra* note 27, at 197–98 ("Professor Fleischer's contribution to the literature does not rest on his recognition of this issue nor on his proposed revisions to the Internal Revenue Code; many have come before, with essentially the same arguments leading to the same proposed solutions. Rather, what put Professor Fleischer on the map was a new contextualization of the carried interest issue: hedge funds and private equity investors operate as partnerships having billions of dollars under management, and the returns to the managing partners of these extraordinarily wealthy organizations have bordered on the astronomical.") (citations omitted).

66. Chadha & Jansen, *supra* note 32, at 32 tbl 3.3.

67. Brian DeChesare, *Private Equity Salary, Bonus, and Carried Interest Levels*, MERGERS & INQUISITIONS, https://mergersandinquisitions.com/private-equity-salary/ [https://perma.cc/QGZ3-DP3M] (last visited Mar. 23, 2024).

68. Jenny Anderson & Julie Creswell, *Top Hedge Fund Managers Earn Over $240 Million*, N.Y. TIMES (Apr. 24, 2007), https://www.nytimes.com/2007/04/24/business/24hedge.html [https://perma.cc/3482-VKJM].

69. *CPI Inflation Calculator*, U.S. BUREAU OF LAB. STAT., https://www.bls.gov/data/inflation_calculator.htm [https://perma.cc/KP94-8GEL] (last visited Mar. 13, 2024).

70. Lampert ended up doing considerably better than Sears. *See* Stephen Garner, *Sears Holdings Reaches $175 Million Settlement with Former CEO Eddie Lampert, 4 years*

up some $50 million short).[71] As the *Times* put it: "Combined, the top 25 hedge fund managers last year [2006] earned $14 billion—enough to pay New York City's 80,000 public school teachers for nearly three years."[72]

These numbers have kept growing. Although 2022 was a bear market—the S&P 500 *lost* nearly 20% on the year[73]—the top hedge fund managers continued to party like bulls. *Institutional Investor*, which compiles an annual "Rich List" of the highest paid hedge fund managers, reported: "Altogether, the top 25 made $21.5 billion in 2022, making last year's total the third highest, after 2020 and 2021. This works out to an average of about $860 million each."[74] Citadel's Griffin now led the list at $4.1 billion; Simons stayed on it, joining six other managers in the billion-a-year club.[75] 2022 was down from the record year of 2020, where the top 25 managers made $32 billion,[76] but everyone must face a few bumps in the road. At $1 billion a year, even a 13.2% tax break (from 37% to 23.8%) is worth $132 *million* annually: enough such that a single billionaire hedge fund manager could, quite rationally, finance a massive political campaign to keep the perk.

This cast of characters is significant. As noted, carried interest is typically only a feature of top managers' pay, and these managers have become household names for their power and influence. Historically, private equity has supported *Democrats*, including the Clintons, Obama, and Biden.[77] As the IRA was marching towards inertia on the carried interest loophole in the Summer of 2022, an article in *Mother Jones* put it this way:

> There's an obvious tension between the [Democratic] party's rhetoric and its Rolodex. Large private equity firms and hedge funds have filled Democrats' coffers for years and served as a comfy landing pad for ex-politicos such as [Evan] Bayh and [Joe] Lieberman. Treasury Secretary Tim Geithner—who once urged Congress to tax private equity "the same way we tax the income of teachers and

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*After Filing for Bankruptcy*, FOOTWEAR NEWS (Aug. 12, 2022, 1:51 PM), https://footwearnews.com/business/legal-news/sears-holdings-reaches-settlement-eddie-lampert-1203322431/ [https://perma.cc/PN3W-W39D].

71. Anderson & Creswell, *supra* note 68.

72. *Id.*

73. PK, *2022 S&P 500 Return*, DQYDJ, https://dqydj.com/2022-sp-500-return/ [https://perma.cc/BG6U-8XR4] (July 35, 2023).

74. Stephen Taub, *The Rich List: The 22nd Annual Ranking of the Highest-Earning Hedge Fund Managers*, INSTITUTIONAL INVESTOR (Mar. 7, 2023), https://www.institutionalinvestor.com/article/2bstpd4t08pc8xwj4we80/corner-office/the-rich-list-the-22nd-annual-ranking-of-the-highest-earning-hedge-fund-managers [https://perma.cc/S26G-ZGSC].

75. *Id.*

76. Robert Frank, *25 Highest-Paid Hedge Fund Managers Made $32 Billion in 2020, a Record*, CNBC, https://www.cnbc.com/2021/02/22/-25-highest-paid-hedge-fund-managers-earned-record-setting-32-billion-in-2020.html [https://perma.cc/6NYD-7D5Q] (Feb. 22, 2021, 3:46 PM).

77. That trend has recently reversed itself. *See* Chris Cumming, *Republicans Lead Race for Private Equity's 2024 Dollars*, WALL ST. J. (Sept. 21, 2023, 6:00 AM), https://www.wsj.com/articles/republicans-lead-race-for-private-equitys-2024-dollars-ba152e12 [https://perma.cc/5JJY-6TG9].

> firefighters"—left the Obama administration for a job in PE. Bill Clinton's first post–White House job was with a PE firm run by a billionaire donor. In 2014, Joe Biden spent Thanksgiving at a 13-acre Nantucket estate belonging to the co-chair of the Carlyle Group, David Rubenstein—himself a former Jimmy Carter staffer. (Bayh stayed there in 2010.) Ex-staffers for Nancy Pelosi and Chuck Schumer lobby Congress on behalf of the industry today.[78]

Of course, it was Democrats who were most likely to oppose the carried interest preference on principled grounds. Yet carried interests took off with regulatory action in 1993, when Bill Clinton was president, so it is no surprise to see private equity support going back to 1990s-era Democrats. The game picked up again with Fleischer and others' work in 2007.[79] And then the money really began to flow. As *Mother Jones* notes: "In 2006, before the carried-interest fight began, private equity and investment firms spent about $3.6 million on DC lobbyists; over the next four years they spent a combined $75 million."[80] As George W. Bush failed to get on board with the anti-carried-interest train—as his brother, Jeb, would later do[81]—Democrats posed the most pressing marginal threat to Wall Street, and Democrats got the most cash to do nothing.

This just makes more curious the case of Donald Trump, who was able to create the appearance of threatening carried interest . . . and thus help *Republicans* rake in plenty of private equity dough when they got their turn at the wheel in 2017. We shall get to that later. Meanwhile, the Democrats had to find a way to do nothing in 2007.

### *C. Senator Schumer Sinks the Ship*

Doing nothing turned out not to be so hard. Back to the first decade of the millenium: something fundamental happened as Professor Fleischer and friends went to Washington throughout 2007. The carried interest game moved from the executive branch and the IRS, which had ignored *Diamond* and unilaterally passed pro-Wall Street rules to keep the game stable and alive for over half a century, to Congress. And therein lay a considerable, if curious, difference. Over the next 15 years, Congress, which had done nothing up to then, would hold multiple hearings, introduce dozens of bills, and have several high-profile legislative showdowns to shut down the carried interest loophole.[82] There was lots of activity, only nothing real would happen. Meanwhile, the IRS and the executive branch generally stood aside, doing nothing as the legislative shenanigans played out down the street—although any president could have shut it all down at any time with a unilateral stroke of the pen.

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78. Murphy, *supra* note 15.
79. *Id.*
80. *Id.*
81. Andrew Ross Sorkin, *The Surprising Target of Jeb Bush's Tax Plan: Private Equity*, N.Y. TIMES (Sept. 14, 2015), https://www.nytimes.com/2015/09/15/business/dealbook/jeb-bushs-tax-plan-is-brimming-with-surprises.html [https://perma.cc/F2A3-NKKS]; Eric Pianin, *supra* note 30.
82. Murphy, *supra* note 15.

Darryll Jones was another young law professor, then at Stetson, on the panel with Fleischer testifying before the House Ways and Means Committee in September 2007.[83] Jones was thus both a participant in and a savvy academic observer of the drama. Before 2007 had ended, Jones put in writing what followed from the congressional hearings and related media attention:

> In remarkably short order, both the U.S. House of Representatives and the Senate saw the introduction of bills that would reform the taxation of profit interests in the manner Fleischer proposed. Initially, the bills were received as relatively uncontroversial measures that would restore horizontal equity and intellectual integrity in the tax code. There were complaints regarding added complexity and drafting suggestions, as with any legislation designed to implement a general policy determination, but there were no significant protests against the substantive idea of somehow requiring the application of ordinary rates to the yield from profit interests.[84]

The efforts of Fleischer, Jones, and others; the media attention around the issue; and the seemingly obvious substantive policy case against the carried interest preference appeared to spell an end to decades of inertia. In the last two years of the George W. Bush presidency, Democrats were comfortably in charge of the House, under Nancy Pelosi's speakership, and narrowly controlled the Senate, with Chuck Schumer as Speaker.[85] Representative Sander Levin, Democrat from Michigan and brother of the influential Senator Carl Levin, had pioneered carried interest legislation in the House.[86] Surely, something—anything—would happen to make the billionaire hedge fund managers pay taxes like most of us.

Not so fast.

Nothing really happened, legislatively anyway. First, the attention paid to the issue awakened the forces of opposition. Jones writes: "As it became apparent, though, that fund managers were really on the verge of losing a substantial tax subsidy, both legislators and lobbyists resolved their free-rider and organizational problems and mobilized themselves in an ultimately successful effort to defeat the proposal."[87] And no one was more adept at resolving "organizational problems" than then-and-now Senate Majority Leader Schumer—he of the Manchin–Schumer Announcement.

Schumer, a Democrat—but a Democrat from New York, where Wall Street is—nominally opposed the carried interest loophole, as he seemingly had to, as a long-time critic of "regressive tax policies" and a card-carrying liberal politician.[88]

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83. *Fair and Equitable Tax Policy for America's Working Families: Hearing Before the Comm. On Ways and Means*, 110th Cong. 188–97 (2007) (statement of Victor Fleischer, Associate Professor of Law, University of Illinois College of Law).

84. Jones, *supra* note 42, at 875–76.

85. Charles Apple, *In Control*, THE SPOKESMAN-REVIEW, https://www.spokesman.com/stories/2020/jun/25/control-house-and-senate-1900/ [https://perma.cc/U7JZ-G4YN] (last visited Mar. 21, 2024).

86. Murphy, *supra* note 15.

87. Jones, *supra* note 42, at 876.

88. *Id.* at 879 n.123.

But behind the scenes, Schumer hatched a plan that would—*mirabile dictu!* —both preserve the *appearance* of opposing the preference while continuing the *reality* of doing nothing at all. As one of his home state newspapers, the *New York Post*, reported in August 2007:

> Charles Schumer has begun drafting legislation that would close a loophole that allows wealthy hedge-fund managers to get big portions of their earnings taxed at less than half the rate paid by ordinary taxpayers. But his effort could actually frustrate efforts to end the tax break. In a move critics say is designed to sink the bill, Schumer wants to make the changes also apply to oil and gas firms—which would then deploy their lobbying clout to fight the bill.[89]

Schumer's gambit worked, at least with one rather important audience member. George W. Bush, who had remained somewhat above the fray as the carried interest hearings played out down the street from the White House—but who would be predictably protective of oil and gas interests—came out against any carried interest legislation in the end. Bush was asked at a press conference in early August 2007 about his thoughts on the carried interest preference, and *Reuters* reported his response:

> "What ends up happening is that in trying to deal with one particular aspect of partnerships is that you end up affecting all partnerships," Bush said, adding that some small businesses have been organized as limited partnerships. "So we're very, very hesitant about trying to target one aspect of limited partnerships for fear of the spillover it'll have in affecting small business growth. So, we don't support that," Bush said.[90]

Democratic Senator Schumer had given Republican President Bush a sound talking point to deflect the seemingly realistic possibility of doing something about the 50-plus year boondoggle of carried interest. That, despite the fact that later developments—mainly the promulgation of I.R.C. § 1061, enacted as part of the TCJA ten years after the inertia of 2007—would curiously enough show how simple it was to isolate private equity and hedge funds in carried interest reform. Meanwhile, the *New York Times* reported that Schumer raised more than $1 million dollars from private equity funds for the Democratic Senate Campaign Committee, of which he was chair in 2007.[91]

And so in the end nothing at all had happened to curtail carried interest. Fleischer, who had been brimming with confidence and excitement during his

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89. *See* Geoff Earle, *Chuck Hedges His Bets*, N.Y. POST, Aug. 14, 2007 (News), at 3. For media reports regarding Senator Schumer and his opposition to efforts to reform the taxation of profit interests see Raymond Hernandez & Stephen Labaton, *In Opposing Tax Plan, Schumer Breaks with Party*, N.Y. TIMES, July 30, 2007, at A1; and Jenny Anderson, *For Schumer, the Double-Edged Sword of Cozying Up to Hedge Funds*, N.Y. TIMES, June 22, 2007, at C6. All discussed in Jones, *supra* note 42, at 879–80.

90. Kevin Drawbaugh, *Bush Says 'Hesitant' on Private Equity Tax Issue*, REUTERS (Aug. 9, 2007, 2:32 PM), https://www.reuters.com/article/bush-privateequity-idUSN0921911720070809 [https://perma.cc/9NJ8-83H3].

91. Jones, *supra* note 42, at 879 (citing Hernandez & Labaton, *supra* note 89).

September 2007 testimony before the House Ways and Means Committee,[92] was left depressed back among his academic peers in January 2008. As Jones writes:

> The preceding observation presented itself at the January 2008 Annual Meeting of the Association of American Law Schools, during which the intellectual father of the most attended to subchapter K legislative reform proposal since 1954, Professor Victor Fleischer, noted with palpable disgust and a gloomy visage that his thoroughly sensible efforts to reform the taxation of "profit interests" appeared doomed; not just politely declined with thanks, but repudiated in the most pejorative sense, as in the same sense as Senator Hillary Rodham Clinton's efforts to reform health care some fifteen years earlier.[93]

*Sic transit gloria mundi*, as they say, though we note that Fleischer, to his great credit, has kept up the battle, as we shall see. But so have the forces of inertia. We continue on the road to nothingness.

## II. A TOUCH OF THEORY: THE REVERSE MANCUR OLSON PHENOMENON, REDUX

Professor Jones presented his analysis of the ultimate legislative inaction on carried interest in an article, *Taxation of Profit Interests and the Reverse Mancur Olson Phenomenon*, published in 2007.[94] The title paid tribute to a law review article published the year prior by Professors Edward McCaffery and Linda Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*.[95] McCaffery and Cohen had coined the term "reverse Mancur Olson" to explain what they observed playing out in tax and other legislative lawmaking, particularly in regard to the still long-running debate over retaining or repealing the estate tax.[96]

Everyone knows the simple story of special interest politics by now. Mancur Olson taught it to us in formal terms almost 60 years ago.[97] Contrary to an intuitive fear of mob or majority rule, as manifested in Madison's *Federalist No. 10*,[98] Olson theorized that it was individuals with high stakes in legislative outcomes who would anticipate enough benefit to overcome organizational and free-rider

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92. Fleischer, *supra* note 60.

93. Jones, *supra* note 42, at 854–55.

94. *See generally id.* Note that Jones published *Taxation of Profit Interests and the Reverse Mancur Olson Phenomenon* after Fleischer published a draft version of *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*. *Compare* Jones, *supra* note 32. (published in the summer of 2008), *with* Fleischer, Working Paper, *supra* note 12 (published April 2008).

95. Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. REV. 1159 (2006). *See also* Edward J. McCaffery, *The Dirty Little Secret of (Estate) Tax Reform*, 65 STAN. L. REV. ONLINE 21 (2012).

96. McCaffery & Cohen, *supra* note 95, at 1172–79.

97. *See generally* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965).

98. *See generally* THE FEDERALIST NO. 10 (James Madison) (Clinton Rossiter ed., 1961).

problems and thereafter form special interest groups or "lobbies."[99] These groups then use their financial clout to influence legislation for their own selfish benefit at the expense of the overall public good.[100] Wealthy minorities—not electoral majorities—win. Under this "special interest model," legislators are passive participants, prey to private sector predators. Special interest groups are voracious and aggressive, dangling irresistible carrots before the eyes of legislators who inevitably succumb to the temptation and vote accordingly.

McCaffery and Cohen expanded on Olson's theories to account for the growing political savvy and cunning of politicians, particularly incumbents desperate for cash in their ever-increasingly expensive election campaigns.[101] Instead of passive legislators swept along by a tide not of their own making, McCaffery and Cohen explained that legislators often take a proactive role in the organization of special interest groups, accelerating their formation by plausible threats of narrowly tailored but costly legislative action and then extracting rents from those groups in exchange for benefitting them or holding them harmless. Where Olson saw bribery, McCaffery and Cohen see extortion.[102] The predators became the prey.

McCaffery and Cohen illustrated their "reverse Mancur Olson" theory—reverse because legislators come first, special interests second—with the still ongoing saga of the estate tax.[103] As but one manifestation of the phenomenon, the authors found that senators would "flip" back and forth on the relatively straightforward estate tax issue—voting on stand-alone bills to "kill the death tax" one day and against them the next. The result was that, at any moment in time, there were more than the 60 Senate votes needed to abolish the tax—and even enough votes to override President Bill Clinton's well-anticipated veto—*and* more than the 40 votes needed to retain the tax. These numbers do not sum to the 100 total senators—there were enough votes both to kill and not kill the tax—on account of the many Senators who "flipped" votes with no stated policy rationale. Because the spigots of campaign cash stayed fully open, enough senators "flipped" that votes to repeal the tax consistently stalled in the high 50s, never quite reaching the magical 60-vote threshold.[104]

Another example of the "shakedown" was the behavior of George W. Bush and his fellow Republicans, all of whom had sworn on the campaign trail in 2000 to "kill the death tax" as an "easy first step" after taking power over all three branches of the tax legislative machinery (presidency, Senate, House) in 2001.[105] Only they

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99. *See* OLSON, *supra* note 97, at 16–43.

100. *See id.*

101. McCaffery & Cohen, *supra* note 95, at 1167–68.

102. *See generally* Richard L. Doernberg & Fred S. McChesney, *Doing Good or Doing Well?: Congress and the Tax Reform Act of 1986*, 62 N.Y.U. L. REV. 891 (1987) [hereinafter Doernberg & McChesney, *Doing Good or Doing Well*]; Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913 (1987) [hereinafter Doernberg & McChesney, *On the Accelerating Rate*].

103. *See* McCaffery & Cohen, *supra* note 95, at 1233–35.

104. *Id.*

105.

did not do so. Instead, in Bush's signature tax cut, the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA")[106]—which required but 50 votes in the Senate as a "reconciliation" bill[107]—they opted for a gradual weakening followed by a reinstatement of the tax, as we discuss further below.[108] ("Sunset" provisions that require new rounds of voting to extend, as the TCJA will do, fit nicely into the reverse Mancur Olson game.)[109] All the while, money poured in—from wealthy families bent on eliminating the tax *and* from insurance companies, trust companies, and large nonprofits bent on keeping it.[110] Both the votes and the inertia on estate tax repeal have persisted to this day.[111]

McCaffery and Cohen noted several recurring features of the reverse Mancur Olson phenomenon, without specifying any formal model. Indeed, they emphasized that the game need not be, and likely is not generally, the product of careful *ex ante* planning and coordination.[112] Instead, McCaffery and Cohen found that legislators often "stumbled" into the situations, but then, recognizing the appeal for their own campaign war chests, proceed to "string the issue along":

> Congress may not have known what a good thing it had, in estate tax repeal/nonrepeal, for example, until history dumped the issue in its collective lap. But once it stumbled onto the example, like the proverbial drunken sailor, the conception predicts what it would—

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> On December 16, 2000, Speaker of the House Dennis Hastert was thus both speaking from a position of power and stating the then-reigning conventional wisdom when he said: "Because we had such success in passing bipartisan measures to end the marriage penalty and the death tax in this session of Congress, I believe that these two bills could quickly be enacted in the law at the beginning of next year. That is why I advocate that we start with these two bills in the 107th Congress."
>
> President-elect Bush showed no signs of disagreeing. By January 2001, the media was reporting the death of the estate tax as an "easy" first step in Bush's tax-cutting plans. On March 14, 2001, Representatives Dunn and Tanner, with 224 cosponsors, reintroduced H.R. 8, the Death Tax Elimination Act; within weeks, on April 4, the House overwhelmingly approved it by a vote of 274 to 154. The estate tax seemed dead at last. But a funny thing happened on the way to the wake. The Senate never voted on stand-alone death tax repeal. Not this time—not, that is, at the first point in the story when they could have actually done something final.

McCaffery & Cohen, *supra* note 95, at 1207–08 (citations omitted).

106. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38.

107. Richard Kogan & David Reich, *Introduction to Budget "Reconciliation,"* CTR. ON BUDGET & POL'Y PRIORITIES, https://www.cbpp.org/research/federal-budget/introduction-to-budget-reconciliation [https://perma.cc/9D7B-WVDS] (May 6, 2022).

108. *See infra* Sections IV.C, D.

109. *See generally* Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*, 40 GA. L. REV. 335 (2006).

110. *See* McCaffery, *supra* note 95, at 23.

111. *See generally* Edward J. McCaffery, *Enough Insanity? A Call for a (More) Critical Tax Theory*, 20 PITT. TAX REV. 419 (2023).

112. McCaffery & Cohen, *supra* note 95, at 1166.

> and did—do. In general, the ex-ante rent-extraction technique predicts that Congress will generally avoid "ballot box" issues, preferring instead to devote its time to issues of high stakes to small groups. When it finds such issues, it will often string matters along. It will avoid sensible, good-faith compromises, and often produce laws unintelligible except as signals of its power to help, harm—or help to form—special-interest groups. Indeed, it is the "stringing along" or "milking" of issues lucrative from a campaign-contribution generating perspective that is our principal prediction and our most general finding.[113]

In the ongoing carried interest saga that we forefront here, Fleischer has played the unwitting role of bringing a lucrative cash cow issue to Congress; lawmakers have taken it from there, doing an excellent job of stringing matters along and ensuring that nothing gets done.

The most important conditions to play the game are that there be one or more small groups with high stakes in plausible legislative action or inaction. These are the Mancur Olson conditions, needed to prevent free-riding and overcome other costs of group formation, plus a plausibility condition to make the game rational and relevant. Wealthy families and the financial institutions that serve them played this role in the estate tax case; top fund managers are the star subjects (objects) of the carried interest capers. Indeed, given the massive stakes facing *individual* hedge fund managers, as noted above, it can take just one to make the game profitable for lawmakers—Donald Sussman of Paloma Funds *by himself* gave $21 million to Hillary Clinton in her 2016 presidential campaign.[114]

There also must be plausible legislative action, for who would pay without threat of pain or promise of benefit? Estate tax repeal became conceivable starting with the Family Heritage Preservation Act in 1994 (which led to the better-named Death Tax Elimination Act of 2000);[115] carried interest reform became quite possible starting with Fleischer's work, the 2007 hearings, and proposed legislation from Levin and others.

McCaffery and Cohen saw the importance of an issue having "two or more sides" to prevent all lawmakers from gathering on the one side where the money is and—heaven forbid—actually doing something (which would be a case of special interest capture, as seemed to have happened at the executive and IRS levels with carried interest). In the estate tax example, there was plenty of money on both sides of any vote, with wealthy families paying to kill the tax and large financial companies paying to keep it, such that there was money for all.[116] In the case of

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113. *Id.*

114. Matea Gold, *Hedge-fund Manager S. Donald Sussman Gave $21 Million to Pro-Clinton Super PAC Priorities USA*, WASH. POST (Oct. 20, 2016, 10:02 PM), https://www.washingtonpost.com/news/post-politics/wp/2016/10/20/hedge-fund-manager-s-donald-sussman-gave-21-million-to-pro-clinton-super-pac-priorities-usa [https://perma.cc/Y9UL-DC3A].

115. H.R. 2717, 103d Cong. (1993). The act was reintroduced as Death Tax Elimination Act of 2000, H.R. 8, 106th Cong. (2000) (failed to pass over veto). McCaffery & Cohen, *supra* note 95, at 1201–02

116. McCaffery & Cohen, *supra* note 95, at 1187–96.

carried interest, rather than two sides to receive the cash flow, closely divided government has played a pivotal role in maintaining the rationality of play: only Republicans played the game in 2017 and only Democrats played it in 2022. This fact made individual senators, such as Susan Collins in 2017 and Sinema in 2022, pivotally important and thus able to extract large contributions from the threatened group while preventing a super-majority of senators from being on the same side at the same time. If that ever happened, something might get done, lessening the group's need to keep paying.

Professor Jones demonstrated the reverse Mancur Olson strategy's presence in 2007 in the even-then drawn-out efforts to reform the taxation of carried interests. Jones noted the skill with which incumbents raised alarming prospects of disadvantageous legislative action against identified groups small enough but with sufficient incentive to overcome organizational barriers and free rider problems: a handful of *very* well-paid fund managers.[117] In the reverse Mancur Olson strategy, the predator becomes the prey. Members of Congress had fund managers right where they wanted them, facing the *possibility* of seeing a beneficial perk taken away. There was no reason to let them off the hook easily, and Schumer and friends did no such thing: they strung private equity interests along and continue to do so to this day.

In the end, Jones was rather more sanguine about the whole thing than McCaffery and Cohen had been, seeing the reverse Mancur Olson games as politics-as-usual. In a brief "Epilogue," Jones suggested that doing the right thing was just a matter of time: "Politics, after all, are ephemeral and fleeting; when political motivations subside or, more likely shift, underlying fundamentals will ultimately prevail if those fundamentals have been sufficiently defined."[118] But while politics may be fleeting, money and its allure endure.

Flash forward 15 years, and here we all are: *still* talking, and *still* not doing much, about carried interest. What is remarkable after all these years is the level of proficiency and ease with which the reverse Mancur Olson strategy now plays out in plain sight. The current case illustrates that the game, even in highly particular contexts such as carried interest or estate taxation, can go on for *decades*, playing out in public view, with no obvious end in sight. This is so because, absent some drastic change, it remains perfectly rational for all participants to keep playing: for politicians with power to *threaten* to repeal the carried interest preference, special interests to pay to avoid the threatened action, and the public not to do very much about the whole damn thing. We proceed with the story.

## III. REPUBLICANS GET TO DANCE: THE TCJA EPISODE

Barack Obama was elected in 2008 and entered office in 2009 with Democratic majorities in both the House and Senate, led by Pelosi and Schumer, respectively. Obama, who had cosponsored a bill to end carried interest in 2007,[119]

117. Jones, *supra* note 42, at 871–77.

118. *Id.* at 881.

119. Katy O'Donnell, *Clinton Was Late to Find Her Opposition to Carried Interest*, POLITICO: WRONGOMETER (Oct. 9, 2016, 10:33 PM), https://www.politico.com/blogs/2016-

could have ended the carried interest preference, *even by executive action*, such as by directing the IRS to re-examine and reverse its 1993 and related pronouncements.[120] But he did no such thing:

> Obama had asked Congress to end special treatment for "investment fund managers" in his first State of the Union address, and publicly the administration expressed confidence that the tax break was on the outs. But the White House never leaned on senators to include carried interest in a tax reform push, according to the New Yorker. And with the Republican minority filibustering every bill that passed to the floor, the industry had math—and time—on its side.[121]

Obama left the issue in the hands of Congress and potential legislative action—where the reverse Mancur Olson games could go on, and nothing could keep happening except for multiple votes and lots of cash flowing to lawmakers. The House passed a version of Levin's anti-carried-interest bill *four times* by 2010.[122] In the Senate, "[a]nother version of [carried interest] repeal came up for a vote in June 2010, and this time Democrats had 57 votes for passage—but Nebraska's Ben Nelson helped Republicans block it"[123]—a fact reminiscent of the many ultimately fruitless votes on estate tax repeal during Bush's presidency.[124] Again, nothing was happening.

Obama turned to the issue again in his second term, having spent much of his two-year honeymoon of Democratic control enacting the Affordable Care Act (a/k/a Obamacare).[125] Industry blogs from 2013 carried headlines such as "Obama pushes carried interest to the fore of U.S. tax policy debate."[126] By 2015, Obama was still adding his voice to the chorus of common sense calls to kill carried interest: "I will tell you that keeping this tax loophole, which leads to folk who are doing very well paying lower rates than their secretaries, is not helping the American economy."[127] The Carried Interest Tax Fairness Act of 2015 was introduced in both

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presidential-debate-fact-check/2016/10/clinton-was-late-to-find-her-opposition-to-carried-interest-229496 [https://perma.cc/B6B8-EDCZ].

120. *See* David Lebedoff, *Why Doesn't Obama End the Hedge Fund Tax Break*, SLATE (June 2, 2014, 4:00 PM), https://slate.com/business/2014/06/taxation-of-carried-interest-the-loophole-for-hedge-fund-managers-could-end-tomorrow.html [https://perma.cc/Q9GK-T4CJ].

121. Murphy, *supra* note 15.

122. *Id.*

123. *Id.*

124. McCaffery & Cohen, *supra* note 95, at 1165.

125. Sheryl Gay Stolberg & Robert Pear, *Obama Signs Healthcare Overhaul into Law, With a Flourish*, N.Y. TIMES (Mar. 23, 2010), https://www.nytimes.com/2010/03/24/health/policy/24health.html [https://perma.cc/32DV-YJ5U].

126. Gregory Mastel et al., *Obama Pushes Carried Interest to the Fore of U.S. Tax Policy Debate*, KELLEY DRYE: CLIENT ADVISORIES (Feb. 11, 2013), https://www.kelleydrye.com/News-Events/Publications/Client-Advisories/Obama-Pushes-Carried-Interest-to-the-Fore-of-U-S [https://perma.cc/2AQM-CAG5].

127. Hazel Bradford, *Obama Calls for End to Carried Interest*, PENSIONS & INVESTMENTS (Sept. 16, 2015, 1:00 AM), https://www.pionline.com/article/20150916/ONLINE/150919919/obama-calls-for-end-to-carried-interest [https://perma.cc/8GXA-CQGN].

the Senate and House with broad support.[128] (Essentially the same bill would be reintroduced in President Biden's first year, when Democrats were back in charge of the Senate, as the Carried Interest Tax Fairness Act of 2021.[129]) Fleischer himself, a modern day Plato in Syracuse, had left his academic perch and gone to work for the Senate Finance Committee as co-chief tax counsel under Democratic Senator Ron Wyden in 2016.[130]

Needless to say by now, nothing really happened.

It may have therefore seemed as though a restoration of horizontal equity was imminent. But during the 2016 campaign, Clinton took large sums of money from hedge fund managers, including a total of $21 million from Sussman of Paloma funds,[131] while still opposing the carried interest preference in public, as she had done only after she had declared herself a presidential candidate in 2007.[132] "It offends our values as a nation when an investment manager making $50 million can pay a lower tax rate on her earned income than a teacher making $50,000 pays on her income," Clinton had said in New Hampshire during her first presidential run.[133] Clinton even vowed during her 2016 presidential run to use her regulatory authority as President to end the break unilaterally, a move Obama never made.[134]

This all presented an opportunity for Trump to play the principled hero, tweaking Clinton—and Mitt Romney, the 2012 Republican nominee and prominent

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128. *See generally* S. 1686, 114th Cong. (2015); H.R. 2889, 114th Cong. (2015).

129. *See* S. 1598, 117th Cong. (2021).

130. Richard Rubin, *He Made 'Carried Interest' Famous. Now He's Going to Help Write the Law*, WALL ST. J. (July 20, 2016, 12:35 PM), https://www.wsj.com/articles/BL-REB-36224 [https://perma.cc/C65U-Y7AZ].

131. Kate Kelly, *The Big Hedge Funds are Betting Big on Hillary Clinton*, CNBC, https://www.cnbc.com/2016/09/21/the-big-hedge-funds-are-betting-big-on-hillary-clinton.html [https://perma.cc/QM5N-5JVL] (Sept. 21, 2016, 11:55 AM); John Carney & Anupreeta Das, *Hedge Fund Money Has Vastly Favored Clinton Over Trump*, WALL ST. J. (July 29, 2016), https://www.wsj.com/articles/hedge-fund-money-has-vastly-favored-clinton-over-trump-1469784601 [https://perma.cc/2P8G-25SU] ("Counting contributions from similar private investment funds, the data show seven financial firms alone have generated $47.6 million for groups working on Mrs. Clinton's behalf."); Matea Gold et al., *Clinton Blasts Wall Street, but Still Draws Millions in Contributions*, WASH. POST (Feb. 4, 2016, 11:49 AM), https://www.washingtonpost.com/politics/clinton-blasts-wall-street-but-still-draws-millions-in-contributions/2016/02/04/05e1be00-c9c2-11e5-ae11-57b6aeab993f_story.html [https://perma.cc/8QQ4-7VM8]; Matea Gold, *Hedge-fund Manager S. Donald Sussman Gave $21 Million to Pro-Clinton Super PAC Priorities USA*, WASH. POST (Oct. 20, 2016, 10:02 PM), https://www.washingtonpost.com/news/post-politics/wp/2016/10/20/hedge-fund-manager-s-donald-sussman-gave-21-million-to-pro-clinton-super-pac-priorities-usa/ [https://perma.cc/7QND-M5UH].

132. O'Donnell, *supra* note 119.

133. Dealbook, *Clinton Jumps into Carried-Interest Debate*, N.Y. TIMES (July 13, 2007, 3:49 PM), https://archive.nytimes.com/dealbook.nytimes.com/2007/07/13/clinton-calls-for-end-to-carried-interest-tax-break/ [https://perma.cc/ARX7-KA3N].

134. Heidi M. Przybyla, *USA Today Interview: Clinton Says She'll Call Trump Unfit to Handle Economy*, USA TODAY, https://www.usatoday.com/story/news/politics/elections/2016/06/15/hillary-clinton-donald-trump-economy/85928334/ [https://perma.cc/A7EY-N4K6] (June 16, 2016, 12:30 AM).

private equity player[135]—for hypocrisy while railing against Wall Street, one of his favorite "drain the swamp" rhetorical targets.[136] And so he did.[137] Over and over, starting as far back as August 2015, when the *New York Times* hopefully reported that all Democratic candidates opposed the preference, Schumer had shown a new willingness to shut it down, and Fleischer was "fascinat[ed]" by the "renewed interest" in the "issue that had defined his career"[138]:

> Then came the Trump phenomenon. Last month, he said he would close the carried-interest loophole. "The hedge fund guys didn't build this country," Mr. Trump told John Dickerson on CBS's "Face the Nation." "These are guys that shift paper around and they get lucky." He continued: "The hedge fund guys are getting away with murder."[139]

After years of inertia under Bush and Obama, *The Times* was hopeful: "The Republican presidential candidate has done more to put a stake in the heart of the carried-interest tax loophole in the last month than the Obama administration has in the last six and a half years."[140]

Never one to make a point only once, Trump repeated his opposition to the carried interest break throughout the campaign. "We will eliminate the carried interest deduction and other special interest loopholes that have been so good for Wall Street investors, and for people like me, but unfair to American workers," was but one of Trump's pronouncements on point.[141] "They're paying nothing, and it's ridiculous. These are guys that shift paper around and they get lucky," was another.[142]

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135. Janet Novack, *Romney's Taxes: It's the Carried Interest, Stupid*, FORBES (Aug. 24, 2012, 6:03 PM), https://www.forbes.com/sites/janetnovack/2012/08/24/romneys-taxes-its-the-carried-interest-stupid/?sh=33fe78627a62 [https://perma.cc/X3GM-KLDT]; Charles Riley, *Romney's Confounding Position on Carried Interest*, CNN: MONEY (June 18, 2012, 7:17 AM), https://money.cnn.com/2012/06/18/news/economy/romney-carried-interest/index.htm [https://perma.cc/Q47T-2UFH].

136. Matea Gold & Tom Hamburger, *Trump's Convention Further Alienates Wall Street and its Money Players*, WASH. POST (July 19, 2016, 4:01 PM), https://www.washingtonpost.com/politics/trumps-convention-further-alienates-wall-street-and-its-money-players/2016/07/19/5872ade8-4dd2-11e6-a7d8-13d06b37f256_story.html [https://perma.cc/8B4Y-E8CW].

137. Kevin J. Delaney, *Hillary Clinton and Donald Trump Agree on One Thing: Hedge Fund Managers Should Pay More Taxes*, QUARTZ (Oct. 10, 2016), https://qz.com/805418/hillary-clinton-and-donald-trump-agree-on-one-thing-hedge-fund-managers-should-pay-more-taxes [https://perma.cc/W3T6-JBHR].

138. James B. Stewart, *Trump Lands a Blow Against Carried Interest Tax Loophole*, N.Y. TIMES (Sept. 17, 2015), https://www.nytimes.com/2015/09/18/business/with-trump-as-foe-carried-interest-tax-loophole-is-vulnerable.html [https://perma.cc/RRH3-PW46].

139. *Id.*

140. *Id.*

141. Louis Jacobson, *Despite Repeated Pledges to Get Rid of Carried Interest Tax Break, It Remains on the Books*, POLITIFACT (Dec. 20, 2017), https://www.politifact.com/truth-o-meter/promises/trumpometer/promise/1429/eliminate-carried-interest-loophole [https://perma.cc/WG6J-TGQQ].

142. Murphy, *supra* note 15.

This was a rare substantive political matter on which Trump and Clinton agreed, as the media liked to point out.[143] Surely, we were heading to . . . something. Except that—of course—nothing really happened.

### *A. The Puzzling Three-Year Patch*

Trump won. After his inauguration, Republicans controlled all three levers of legislation in 2017–18, and so they could, and did, enact tax policy unilaterally. After spending much of the first year of Trump's presidency trying and failing to repeal Obamacare,[144] the Grand Old Party turned to their old standby, tax cutting. House Ways and Means Committee Chairman Kevin Brady of Texas introduced a tax reduction bill on November 2, 2017.[145] Trump initially wanted to call the bill the "Cut Cut Cut Act"[146] but ultimately signed the more prosaically named Tax Cuts and Jobs Act of 2017 on December 22 (the TCJA was strung out until the last minute, prior to the end-of-year recess, in true reverse Mancur Olson fashion), hailed as his first—and ultimately his only—major legislative win.[147]

In addition to slashing the top corporate income tax rate from 35% to 21%, benefiting corporations and billionaires,[148] the TCJA delivered on Trump's promise to address the carried interest preference . . . sort of. New I.R.C. § 1061 changed the holding period for the long term capital gains rate under I.R.C. § 1222 for any "applicable partnership interest"[149] to three years.[150] Section 1061(a)'s remedial impact, however, was severely limited by the "special rule" in § 1061(b): "subsection (a) shall not apply to income or gain attributable to any asset not held for portfolio investment on behalf of third party investors."[151] The double negative in § 1061(b) ("shall *not* apply . . . to any asset *not* held for portfolio investment on behalf of third party investors") and the further special provisions for defining "applicable partnership interest" in § 1061(c) made abundantly clear that only hedge fund and private equity managers holding partnership interests would be affected by the new longer holding period. This work of legislative drafting gave the lie to the Schumer–Bush concern from 2007 about extending any attack on carried interest to

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143. Delaney, *supra* note 137.

144. Leigh Ann Caldwell, *Obamacare Repeal Fails: Three GOP Senators Rebel in 49-51 Vote*, NBC NEWS, https://www.nbcnews.com/politics/congress/senate-gop-effort-repeal-obamacare-fails-n787311 [https://perma.cc/5AFG-WQ36] (July 28, 2017, 9:14 AM).

145. H.R. 1, 115th Cong. (2017).

146. German Lopez, *Trump Apparently Wants to Name His Tax Reform Plan the "Cut Cut Cut Act,"* VOX (Nov. 1, 2017, 1:40 PM), https://www.vox.com/policy-and-politics/2017/11/1/16592690/trump-tax-cut-cut-cut-act [https://perma.cc/C29S-5F5V].

147. Jane C. Timm, *Trump Signs Tax Cut Bill, First Big Legislative Win*, NBC NEWS, https://www.nbcnews.com/politics/politics-news/trump-signs-tax-cut-bill-first-big-legislative-win-n832141 [https://perma.cc/F3PK-3HGW] (Dec. 22, 2017, 10:48 AM).

148. *TCJA by the Numbers, 2020*, INST. ON TAX'N & ECON. POL'Y (Aug. 28, 2019), https://itep.org/tcja-2020 [https://perma.cc/65CY-USBJ]; Galen Hendricks & Seth Hanlon, *The TCJA 2 Years Later: Corporations, Not Workers, Are the Big Winners*, CTR. FOR AM. PROGRESS (Dec. 19, 2019), https://www.americanprogress.org/article/tcja-2-years-later-corporations-not-workers-big-winners/ [https://perma.cc/4NJG-93EE].

149. I.R.C. § 1061(a).

150. I.R.C. § 1061(a)(2).

151. I.R.C. § 1061(b).

a wide range of interests, including real estate and oil and gas ones: Section 1061 only applied to private equity and hedge fund managers and of course *could* have been offered in 2007, had Schumer and others been so inclined. In any event, at least the TCJA curtailed the carried interest break, fulfilling Trump's campaign promises to end the "murder."

Or did it?

The trick this time was that few hedge fund managers would even try to sell in three years—and presumably none would do so after § 1061 became law. The *average* holding period of a carried interest position was 3.8 years in 2010 and had risen to 5.4 years by 2020, after the TCJA passed.[152] This was, in short, a limitation that applied to no one. The idea of a three-year holding period apparently originated with the American Investment Council ("AIC"), a private equity trade group.[153] Kevin Brady had added it to the inchoate TCJA prior to the Bill's introduction on the House floor.[154] As this carried interest cure became law, contemporary commentators were not impressed. Referring to the newly enacted § 1061, an informed legal academic put it simply:

> "It's laughable. Almost nobody will end up paying any additional tax. Tax planners have a million ways to Sunday to try to avoid it, some more legitimate than others, and the IRS is notoriously inept at auditing these types of issues," said Gregg Polsky, a former corporate tax lawyer who is now a professor at University of Georgia law school.[155]

The mainstream media, such as the *New York Times*, did not even bother to report on the three-year trick, simply noting instead that the TCJA preserved the carried interest loophole (this is a little surprising considering the press reporting on the Manchin–Schumer Announcement in the IRA, which only would have extended the holding period to five years, as we discuss below[156]):

> This week, as senior White House officials acclaimed passage of the tax overhaul in Congress, they also expressed one regret: failing to close the so-called carried interest "loophole" that benefits wealthy hedge fund managers and private equity executives. Despite Mr. Trump's vows to eliminate a tax rule that allows some rich business leaders to pay lower tax rates than their secretaries, the president in

152. *See Private Equity Holding Periods Reach All-Time High in 2020*, *supra* note 18.

153. Justin Elliott & Theodoric Meyer, *Susan Collins Backed Down from a Fight with Private Equity. Now They're Underwriting Her Reelection*, PROPUBLICA (Oct. 29, 2020, 12:00 PM), https://www.propublica.org/article/susan-collins-backed-down-from-a-fight-with-private-equity-now-theyre-underwriting-her-reelection [https://perma.cc/BKN4-HUAJ].

154. *Id.*

155. *Id.*

156. *See infra* Section IV.D.

> this case was no match for the powerful lobbyists protecting the status quo.[157]

What had happened? "I don't know what happened," Trump advisor Larry Kudlow, a bright man whom the paper credited with coming up with Trump's campaign plan, claimed to the *Times*.[158] The same article reported that Gary Cohn, formerly of Goldman–Sachs and at the time the director of Trump's National Economic Council, had said days after the TCJA was signed "that the administration tried more than two dozen times to eliminate the carried interest loophole and that, as recently as this week, Mr. Trump asked why it was not gone."[159] Treasury Secretary Steven Mnuchin found carried interest to be a "complicated issue" that represented "not much money,"[160] suggesting that the limited gains to the Treasury made it unimportant—although small dollars to the government are a direct function of the small groups with high stakes involved in reverse Mancur Olson plays. (A similar "not much money" attitude characterizes discussions of estate tax repeal or reform.) Everyone pointed to the usual special interest view; a contemporary headline in the *Times* read "Trump Promised to Kill Carried Interest. Lobbyists kept it Alive."[161] But as with earlier episodes of the carried interest capers and other reverse Mancur Olson plays, the "special interests made us do it" explanation is hardly sufficient. Questions and curiosities endure about Trump, TCJA, and carried interest.

The first curiosity is why Congress bothered doing anything at all. The "laughable" three-year patch of § 1061 did not trick the press even for a minute, as they easily saw through it. It thus scored no points with a public full of ordinary income taxpayers paying higher rates than hedge fund billionaires and awaiting an end to Wall Street's "getting away with murder." The three-year rule could be expected to bring in no revenue and to have little effect on managerial behavior, given the facts of the matter. The hedge fund industry itself viewed the whole saga as a win, although some worried, presciently enough, about the precedent that had been set by doing anything at all. The *Times* reported just after the TCJA's signing that while Mike Sommers, then the head of the AIC, "was generally pleased with the outcome of the tax bill . . . he said it was still disappointing that the term 'carried interest' is now being written in the tax code for the first time. This makes it more likely that future lawmakers will try to raise taxes on private equity funds."[162]

Indeed. Sommer's concern was a principal *point* of including § 1061: it was not to help Wall Street special interests, but to set the stage for continuing to shake them down. The reverse Mancur Olson phenomenon provides this reason for the apparent joke of § 1061. The three-year-non-fix was reminiscent of a move on the estate tax noted by McCaffery and Cohen in *Shakedown*.[163] Similarly controlling all

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157. Alan Rappeport, *Trump Promised to Kill Carried Interest. Lobbyists Kept it Alive*, N.Y. TIMES (Dec. 22, 2017), https://www.nytimes.com/2017/12/22/business/trump-carried-interest-lobbyists.html [https://perma.cc/2TT2-B3JH].

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *See generally* McCaffery & Cohen, *supra* note 95, at 1200–26.

three levers of relevant power and headed by a president who had repeatedly promised to "kill the death tax" while on the campaign trail, the Republicans passed their obligatory tax-cutting bill, EGTRRA, in 2001, also in the first year of Bush's presidency. And EGTRRA *did* kill the estate tax . . . sort of. Specifically, the law provided for a gradual weakening of the tax over its first nine years of operation—tax bills under the reconciliation format being "scored" over a ten-year window[164]—by raising the tax's exemption levels and lowering its rate. The tax went from an exemption (or "zero bracket") amount of $675,00 per person and a 55% rate prior to EGTRRA to a 45% rate and $3.5 million exemption by 2009.[165] And then, in 2010, the tax was to be repealed . . . only to be brought back to its pre EGTRRA level in 2011. Although a fortunate few billionaires like George Steinbrenner of New York Yankees fame were able to die in 2010,[166] what sense did the law make as enacted in 2001? As McCaffery and Cohen pointed out, the traditional special interest model could not explain the oddity, for the only special interest group that "won" in the legislation was comprised of those individuals who knew with certainty in 2001 that they would die in 2010—what came to be known as the "throw Momma from the train" year, after a contemporary film.[167] That was of course a null set. Just as § 1061 could hardly be said to have killed the carried interest preference, EGTRRA could not be said to have killed the estate tax; both bills left supporters of the principle that the sitting president had promised to enact bitterly disappointed.

Why do it then? McCaffery and Cohen pointed out that the curious EGTRRA provision showed that *Congress*—and a big part of the reverse Mancur Olson phenomenon is asserting *congressional* power over the subject matter—had *both* the willingness and ability to kill the estate tax, as it did in 2010, *and* the willingness and ability to bring it back, as it did in 2011.[168] The law as enacted virtually *guaranteed* more congressional votes on the issue and hence more bites at the campaign contribution apple.[169] In fact, over EGTRRA's decade, money flowed in—and continues to flow—as the perfectly predictable votes continued. And in the end, the estate tax did not die, after all.[170]

TCJA's three-year rule has similar effects, exactly as Sommers of the AIC anticipated. While § 1061 did little to nothing to change the carried interest preference, it nevertheless advanced the shakedown. It heightened the threat to rent seekers by demonstrating Congress's ability to legislate an end to the carried interest

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164. *See* Jeff Davis, *The Rule That Broke the Senate*, POLITICO MAG. (Oct. 15, 2017), https://www.politico.com/magazine/story/2017/10/15/how-budget-reconciliation-broke-congress-215706/ [https://perma.cc/XR4R-RQC9].

165. *Federal Estate and Gift Tax Rates, Exemptions, and Exclusions, 1916-2014*, TAX FOUND. (Feb. 4, 2014), https://taxfoundation.org/federal-estate-and-gift-tax-rates-exemptions-and-exclusions-1916-2014/ [https://perma.cc/KV9F-EGHK].

166. *How Steinbrenner Saved His Heirs a $600 Million Tax Bill*, WALL ST. J. (July 13, 2010, 2:11 PM), https://www.wsj.com/articles/BL-METROB-5928 [https://perma.cc/K3SK-77T9].

167. Paul Krugman, *Throwing Momma from the Train*, N.Y. TIMES: OPINION PAGES (Dec. 16, 2009, 6:36 PM), https://archive.nytimes.com/387rugman.blogs.nytimes.com/2009/12/16/throwing-momma-from-the-train/ [https://perma.cc/HX94-NUBA].

168. McCaffery & Cohen, *supra* note 95, at 1207–09.

169. *Id.*

170. *See* McCaffery, *supra* note 111, at 445–46.

loophole.[171] Indeed, changing a single word in I.R.C. § 1061(a)(2)—the word "three"—would do the trick.[172] But so long as there are rents to be extracted, why should Congress take that sensible approach?

### *B. Another Senator Goes Solo*

As it happens, it did not take long for legislators to see the opportunity to play the trick card. Less than a month, in fact.

It turns out that, as with Kyrsten Sinema and the Inflation Reduction Act, the TCJA had its own last-minute drama featuring a woman senator going solo. In late November, one day before a pivotal vote on the TCJA and after weeks of debating the bill, Senator Susan Collins, Republican of Maine, introduced a few amendments, including ones that might appeal to moderate and even Democratic voters, such as expanding the child-care credit,[173] retaining the itemized medical expense deduction,[174] and keeping up to $10,000 in itemized state and local tax deductions under I.R.C. § 164. To help offset the revenue cost for these last-minute changes, Collins offered an amendment to § 1061, extending the holding period for long-term capital gains treatment to eight years.[175] That might do *something*, and so it set off a flurry of concerned communications from Treasury Department officials.[176]

One curious aspect of Collins's effort was that it came so late: the Senate had been discussing and debating the TCJA for weeks,[177] so why wait for the last minute? No worries: on the day of the critical vote—*one day after offering the carried interest amendment*—Collins backed down, though not from her other amendments.[178] A *ProPublica* report from 2020 noted that Collins's "retreat was a significant victory for Senate Majority Leader Mitch McConnell. Collins put aside her opposition and voted for the bill, which passed 51–49."[179] Note that there were 52 Republican senators at the time; the retiring Senator Bob Corker of Tennessee voted against the Senate Bill, though he later "flipped" to support the final version of the TCJA.[180] The general slimness of the Republican majority, aided by Corker's

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171. *See* Jones, *supra* note 42, at 872–79 (regarding the role of threats in the reverse Mancur Olson process).

172. If the holding period specified in § 1061 is extended from three to ten years, for example, the longer holding period might deprive less patient fund managers and funds of the motivation to engage in the conversion at all. Of course, the simpler solution would be to simply state that profit shares received for investment management services shall be taxed as ordinary income.

173. *See* I.R.C. § 21.

174. *See* I.R.C. § 213.

175. Elliott & Meyer, *supra* note 153.

176. *Id.*

177. The TCJA was proposed on November 2, 2017. *Updated Details and Analysis of the 2017 House Tax Cuts and Jobs Act*, TAX FOUND. (Nov. 3, 2017), https://taxfoundation.org/research/all/federal/2017-tax-cuts-jobs-act-analysis [https://perma.cc/9Y9A-FCCP].

178. *Id.*

179. Elliott & Meyer, *supra* note 153.

180. Seung Min Kim, *Why Corker Flipped on the Tax Bill*, POLITICO, https://www.politico.com/story/2017/12/18/bob-corker-tax-bill-kickback-republicans-respond-302482 [https://perma.cc/JNE4-VKFD] (Dec. 18, 2017, 7:21 PM).

ambivalence, kept votes close enough to the margin such that every individual Republican senator, including Collins, had leverage to play the reverse Mancur Olson game. This was an aspect of the shakedown story noted by McCaffery and Cohen in the estate tax repeal version,[181] and it was also what the Manchin–Schumer Announcement in July 2022 did for Senator Sinema. The *ProPublica* article, examining the incident in hindsight, went on to note that "[Collins's] turnabout has been one of the mysteries surrounding the $1.5 trillion tax bill."[182] Collins herself claimed that lobbying had nothing to do with her 24-hour introduction-and-withdrawal turnabout, maintaining that she did not feel that the eight-year amendment could get 60 votes.[183] But why introduce it at all in that case? And why would it require 60 votes, while the revenue-costing amendments she simultaneously offered would not?[184] And why did Collins not check to see if any of the 48 Democratic senators, virtually all of whom supported the Manchin–Schumer Announcement a few years later, would have voted for an eight-year carried interest patch as a freestanding, non-germane amendment?[185]

What was going on? Of course, the answers can be found in money—money for Collins. *ProPublica* reporters uncovered that three years after the TCJA became law with a three-year, not eight-year, carried interest holding period, in a hotly contested re-election battle (after Collins had cast a deciding vote to confirm Supreme Court Justice Brett Kavanaugh),[186] private equity interests provided her with more than half a million dollars in campaign contributions: more than to any other senator.[187] Ken Griffin of Citadel gave $1.5 million to a super PAC backing Collins.[188] Steve Schwarzman, CEO of Blackrock, personally gave $2 million to a super PAC backing Collins and $20 million to a super PAC supporting her and other GOP senate candidates.[189] Why? "The failure of Collins' amendment likely saved

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181. *See generally* McCaffery & Cohen, *supra* note 95, at 1200–26.

182. Elliott & Meyer, *supra* note 153.

183. *Id.*

184. In other words, why did Collins assume that the carried interest amendment was not "germane," such that it only needed 50 votes to pass? *See* EMERITUS FLOYD M. RIDDICK, RIDDICK'S SENATE PROCEDURE: PRECEDENTS AND PRACTICES, S. Doc. No. 101-28, 854–61 (2d ed. 1992), https://www.govinfo.gov/content/pkg/GPO-RIDDICK-1992/pdf/GPO-RIDDICK-1992-66.pdf [https://perma.cc/U9HN-9V64] (stating procedure regarding germaneness of amendments).

185. In other words, either the carried interest amendment was germane to the TCJA, and so would have required 50 votes, *or* Collins could have sought 60 votes with Democratic support. Either way, she could have thought of this before introducing the amendment.

186. Kate Ackley, *Kavanaugh-Fueled Bounty Awaits Challenger to Sen. Susan Collins*, ROLL CALL (July 2, 2020, 5:00 AM), https://rollcall.com/2020/07/02/kavanaugh-fueled-bounty-awaits-challenger-to-sen-susan-collins/ [https://perma.cc/5LES-WDZM]; Tucker Higgins, *Susan Collins Struggles to Change the Subject from Brett Kavanaugh in Maine Senate Race*, CNBC: POLITICS, https://www.cnbc.com/2020/10/09/maine-senate-race-susan-collins-brett-kavanaugh-vote.html [https://perma.cc/PEJ6-SQP5] (Oct. 9, 2020, 12:56 PM).

187. Elliott & Meyer, *supra* note 153.

188. *Id.*

189. *Id.*

Schwarzman alone tens of millions of dollars in taxes, according to tax experts," as *ProPublica* noted.[190]

Collins won her reelection bid. The carried interest preference endured. Once again, nothing had happened.

### *C. The Strange Silence of Donald Trump*

Before leaving the TCJA and the Republican turn behind the wheel of carried interest inertia, there is a final set of curiosities to explore. In all the press reporting on the ultimate failure to do anything meaningful about the decades-old preference, there was one rather large dog curiously *not* barking. Why did Trump, who had accused hedge fund managers of "getting away with murder,"[191] not do *something* to make them pay *something* more than they were paying under the status quo?

As always, government officials such as Gary Cohn blamed special interests, invoking the standard Mancur Olson view.[192] But as throughout the carried interest capers, that simple explanation rings hollow. As the *Times* noted at the time about Cohn's whining: "Critics pounded on that explanation, saying that Mr. Trump could have done away with it had he publicly intervened. Unlike the other provisions Mr. Trump advocated, eliminating the carried interest loophole would have actually raised revenue for the Treasury."[193] Cohn's comments were especially puzzling given that, according to Cohn, the Trump Administration did not even *need* the congressional approval it had sought 25 times.[194] They too, like Obama before them, could have moved *by executive action* if they were that serious about it.[195]

Trump himself was critical to this round of the reverse Mancur Olson play all along: he generated fear, making an end to the carried interest preference plausible, given that Republicans are generally opposed to any measure resulting in higher taxes.[196] With Trump's campaign rhetoric making it possible, Wall Street had to pay to keep it from happening. In the end, Trump played the role of Schumer in 2007—making possible the end to carried interest without actually ending it.

Three aspects of the situation stand out as especially curious.

First, why leave all the negotiations over carried interest in the hands of Gary Cohn and Steven Mnuchin, two Wall Street players who would be predictably sympathetic to the break? Cohn had been at Goldman Sachs for 26 years before

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190. *Id.*
191. Rappeport, *supra* note 157.
192. *Id.*
193. *Id.*
194. *Id.*
195. Lebedoff, *supra* note 120.
196. Alicia Adamczyk, *Trump Is Really Starting to Scare Wall Street*, MONEY (Sept. 27, 2016), https://money.com/donald-trump-scare-wall-street/ [https://perma.cc/X53U-5VKC]; *How is the Trump Administration Impacting Private Equity?*, KSM: INSIGHTS (Oct. 19, 2017), https://www.ksmcpa.com/insights/how-is-the-trump-administration-impacting-private-equity/ [https://perma.cc/J4S8-D8DN].

joining Team Trump;[197] Mnuchin had run private equity funds before and raised $2.5 billion for his own private equity fund months after leaving the White House.[198] Regarding § 1061, Sommers of the AIC told the *Times* at the time: "What came out of this is what I would call the Mnuchin compromise. He wanted to make sure that we weren't discouraging the kind of investment that we provide. Secretary Mnuchin certainly would be an all-star on this in terms of our perspective."[199] Even beyond the "all-star" Mnuchin, the Trump Administration was full of just the type of hedge fund and private equity players whom Trump had accused of getting away with murder.[200] Why hire them in the first place? Why leave the wolves in charge of the henhouse?

Second, Cohn and others protested about how hard they had tried to persuade Congress to do something more meaningful than § 1061's three-year patch:

> "We would have cut carried interest," Cohn told Axios co-founder Mike Allen. "We probably tried 25 times." But he said the administration "hit opposition in that big white building with the dome at the other end of Pennsylvania Avenue every time we tried. It is just the reality of the political system."[201]

But why even bother walking down Pennsylvania Avenue 25 times? Like Obama before him, Trump could have ended the carried interest preference *by unilateral executive action*, such as by directing the IRS to reform its decades-old pronouncements, which had been issued regarding real estate.[202] In other contexts, such as his notorious Muslim ban,[203] Trump was not shy about asserting executive power, even beyond what the law might have allowed. *That* is "just the reality of the

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197. Kate Kelly, *Goldman's $285 Million Package for Gary Cohn Is Questioned*, N.Y. TIMES (Jan. 25, 2017), https://www.nytimes.com/2017/01/25/business/dealbook/goldman-sachs-gary-cohn-285-million-departure-package.html [https://perma.cc/N4LF-EK77].

198. Alan Rappeport, *Mnuchin's Private Equity Fund Raises $2.5 Billion*, N.Y. TIMES, https://www.nytimes.com/2021/09/20/us/politics/mnuchin-saudi-private-equity.html [https://perma.cc/AWM9-RLJH] (Oct. 28, 2021).

199. Rappeport, *supra* note 157.

200. Adam Lewis, *Untangling the Trump Administration's Private Equity Ties*, PITCHBOOK: NEWS & ANALYSIS (Mar. 27, 2017), https://pitchbook.com/news/articles/untangling-the-trump-administrations-private-equity-ties [https://perma.cc/45EA-9PQB]; Jane Mayer, *The Reclusive Hedge-Fund Tycoon Behind the Trump Presidency: How Robert Mercer Exploited America's Populist Insurgency*, NEW YORKER (Mar. 17, 2017), https://www.newyorker.com/magazine/2017/03/27/the-reclusive-hedge-fund-tycoon-behind-the-trump-presidency [https://perma.cc/XK6W-T7EZ]; Michelle Celarier, *Meet the Wall Street Titans Who Back Trump*, N.Y. MAGAZINE: INTELLIGENCER (June 22, 2016), https://nymag.com/intelligencer/2016/06/meet-the-wall-street-titans-who-back-trump.html [https://perma.cc/V698-944B].

201. Jacobson, *supra* note 141.

202. Lebedoff, *supra* note 120.

203. Mohammad Fadel, *Trump's Muslim Ban and its Constitutional Limits*, VERFASSUNGSBLOG (Feb. 4, 2017), https://verfassungsblog.de/trumps-muslim-ban-and-its-constitutional-limits/ [https://perma.cc/UA2W-WR5C]; Adam Liptak & Michael D. Shear, *Trump's Travel Ban is Upheld by Supreme Court*, N.Y. TIMES (June 26, 2018), https://www.nytimes.com/2018/06/26/us/politics/supreme-court-trump-travel-ban.html [https://perma.cc/E8YH-W2NA].

political system."[204] Why be cautious here? Why not even try to flex his solo executive power to stop the "murder" of the carried interest preference?[205]

Third, if executive action was too risky or possibly improper, why did Trump not at least tweet? *That* is something Trump showed an ability to do quite well, without needing any rhyme or reason at all, over 11,000 times during his presidency alone.[206] Why not at least remind people of his campaign pledge to end the "murder" of the carried interest break as the votes were coming due, with a simple use of his thumbs? That was a question that puzzled private equity interests themselves, as the TCJA action came down to the wire.[207] "We of course were concerned about an errant tweet from President Trump on this, or him doing something," Sommers told the *Times*.[208] This time, curiously, there was no tweet from on high.

Principle cannot answer any of these questions. Trump never said he had changed his mind, that he now supported the carried interest preference, that it was somehow "fair," or that murder was now acceptable. What can explain the curiosities? Money, money, everywhere, of course, and a desire not to kill the goose laying the golden eggs. Reverse Mancur Olson games are not meant to end.

Trump did his job of scaring Wall Street, and he left plenty of crumbs on the table to help his Republican co-conspirators in Congress grab cash to stay in power. Private equity, which had not needed to give much to Republicans—and which had historically supported Democrats, as noted above[209]—now opened their wallets for the GOP. *Fox Business* reported two days before the TCJA's signing that "[t]he $2.5 trillion private equity business, comprised of Wall Street behemoths Blackstone Group, Carlyle Group and KKR & Co., funneled massive amounts of campaign cash into the coffers of Republican leaders in the House and Senate as these same lawmakers voted for a tax bill that preserves the so-called carried interest loophole."[210] Records showed that the three private equity firms gave a combined $1.31 million to Republican lawmakers in the House and the Senate in 2017,

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204. Tae Kim, *Gary Cohn: We 'Tried 25 Times' to Cut Hedge Fund Loophole in Tax Reform Bill, but Failed*, CNBC: TAXES, https://www.cnbc.com/2017/12/20/cohn-tried-25-times-to-cut-hedge-fund-loophole-but-failed.html [https://perma.cc/A4TH-WZHE] (Dec. 20, 2017, 11:36 AM) (quoting Gary Cohn, Chief Economic Advisor during the Trump Administration).

205. Lebedoff, *supra* note 120.

206. Michael D. Shear et al., *How Trump Reshaped the Presidency in Over 11,000 Tweets*, N.Y. TIMES (Nov. 2, 2019), https://www.nytimes.com/interactive/2019/11/02/us/politics/trump-twitter-presidency.html [https://perma.cc/V4KW-RKQS]; *Trump's Tweets: Infamous, Offensive and Bizarre Posts by @realDonaldTrump*, SKY NEWS (LONDON) (Jan. 9, 2021, 3:32 PM), https://news.sky.com/story/trumps-tweets-infamous-offensive-and-bizarre-posts-by-atrealdonaldtrump-12182992 [https://perma.cc/W2M5-JD2G].

207. Rappeport, *supra* note 157.

208. *Id.*

209. *See supra* Section I.B.

210. *See* Brian Schwartz & Charlie Gasparino, *Money Talks: Blackstone, Carlyle, KKR Dial Up Donations to Key GOP Lawmakers as Tax Bill Protects Carried Interest Loophole*, FOX BUS., https://www.foxbusiness.com/politics/money-talks-blackstone-carlyle-kkr-dial-up-donations-to-key-gop-lawmakers-as-tax-bill-protects-carried-interest-loophole [https://perma.cc/26X5-AYDB] (Dec. 20, 2017, 5:44 PM).

compared to just $438,000 to Democrats.[211] Senate Majority Leader Mitch McConnell raked in $212,000 from Blackstone employees in 2017;[212] House Ways and Means Committee Chair Kevin Brady took in $428,325 in donations from the securities and investment industry in the same year.[213] BlackRock was also the top contributor to House Speaker Paul Ryan in the 2017–18 session.[214] And we have already noted Susan Collins's personal haul.[215]

Why would Trump, not generally known for his altruism, go along with these games? Aside from the fact that it is more fun to be a Republican president with Republican control of Congress, there is plenty of evidence that Trump himself was a significant object of private equity largesse.[216] Much of that money may never have materialized without the plausible threat to end private equity's murderous ways.

## IV. BACK TO THE PRESENT

We return now to where we started, the Summer of 2022 and the machinations around the Inflation Reduction Act. Joe Biden had predictably enough opposed the carried interest perk—on the campaign trail, in his annual budget proposals, his legislative initiatives, and his first State of the Union speech in March 2021: "I've proposed closing loopholes, so the very wealthy don't pay a lower tax rate than a teacher or a firefighter. What are we waiting for?"[217]

What are we waiting for, indeed. The TCJA had not *really* shut down the loophole, as we have just seen.[218] Nothing significant had been done about carried interest in the 15 years since Victor Fleischer and others had brought the issue to Washington and to broad attention—nothing other than to use the issue as a spur for many millions of dollars in campaign contributions flowing to politicians on both sides of the aisle.[219] In 2021, Democrats oversaw the presidency, House, and Senate.[220] It should have been easy to do *something*. After all, Biden, like Obama and Trump before him, could have taken meaningful action on his own by executive or regulatory action.[221] Yet again, there was talk of change; yet again, there were

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211. *Id.*

212. *Id.*

213. *Rep. Kevin Brady: Campaign Committee Fundraising, 2017-2018*, OPEN SECRETS, https://www.opensecrets.org/members-of-congress/kevin-brady/summary?cid=N00005883&cycle=2018&type=I [https://perma.cc/C4CF-D7ES] (last visited Mar. 23, 2024).

214. *Rep. Paul Ryan: Campaign Committee Fundraising, 2017-2018*, OPEN SECRETS, https://www.opensecrets.org/members-of-congress/summary?cid=N00004357 [https://perma.cc/6GG6-YXYA] (last visited Mar. 23, 2024).

215. *See* discussion *supra* Section III.B.

216. Lewis, *supra* note 200.

217. *See* Murphy, *supra* note 15; John Foley, *Breakingviews – Joe Biden Is Private Equity's Tax Boogeyman*, REUTERS (Oct. 26, 2020, 8:05 AM), https://www.reuters.com/article/us-usa-election-biden-breakingviews/breakingviews-joe-biden-is-private-equitys-tax-boogeyman-idUSKBN27B1XE [https://perma.cc/ME3A-8LLJ].

218. *Supra* Section III.A, B.

219. *See supra* Part III and accompanying text.

220. CONG. RSCH. SERV., R46705, MEMBERSHIP OF THE 117TH CONGRESS: A PROFILE 1 (Dec. 14, 2022).

221. Lebedoff, *supra* note 120.

proposals for change; yet again, nothing happened other than money flowing and the issue lingering for yet another day.

Here are four questions about this most recent round of the curious case of carried interest, answered in the light of the reverse Mancur Olson shakedown story.

### *A. Why Did This Take So Long?*

We do not, of course, mean "why has it taken so long to shut down the carried interest loophole?" Congress has *not* shut down the loophole, after all, and the current round did *nothing* to even mitigate the preference. Threatening and then delaying seemingly imminent action without acting—on even sensible tax proposals—is a central element of the reverse Mancur Olson phenomenon.[222] (Although, to be clear, Congress must *sometimes* act, to maintain the credibility of their threats, as well as to set the stage for the subsequent repeal of unfavorable tax treatment; we have here TCJA's "laughable" but symbolically important three-year rule.[223]) We have seen this dynamic play out with carried interest since the George W. Bush presidency, when it became plausible to shut down the preference.[224]

No, we mean here the more particular question of why the process of the Inflation Reduction Act's tax legislation, from the initial announcement of the $3.5 trillion BBB plan in October of 2021[225] to the presidential signing of the IRA on August 16, 2022,[226] took so long.

From a reverse Mancur Olson perspective, the answer is obvious: to maximize bites at the apple. Each time a potential iteration of a bill was *about* to be enacted, something happened to nix the deal and delay the matter.[227] Most often the

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222. *See generally* McCaffery & Cohen, *supra* note 95; Jones, *supra* note 42.

223. *See supra* Section III.A; *see also* McCaffery & Cohen, *supra* note 95.

224. *See* Fleischer, *Two and Twenty*, *supra* note 12, at 47–58; Jones, *supra* note 42, at 873–76, 881 ("As of the end of summer 2007, it became very apparent that efforts to reform the taxation of profit interests had died quietly, proving the triumph of politics over policy.").

225. *President Biden Announces the Build Back Better Framework*, WHITE HOUSE: BRIEFING ROOM (Oct. 28, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/10/28/president-biden-announces-the-build-back-better-framework/ [https://perma.cc/72Q3-YY75].

226. *Remarks by President Biden at Signing H.R. 5376, The Inflation Reduction Act of 2022*, WHITE HOUSE: BRIEFING ROOM (Aug. 16, 2022), https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/08/16/remarks-by-president-biden-at-signing-of-h-r-5376-the-inflation-reduction-act-of-2022/ [https://perma.cc/Y8ZS-NY9R].

227. *See* Jim Tankersley et al., *Social Policy Bill Will Add to Deficit, C.B.O. Says; Democrats Delay Vote*, N.Y. TIMES (Nov. 18, 2021), https://www.nytimes.com/2021/11/18/us/politics/cbo-biden-spending-bill.html [https://perma.cc/4X3X-SSMQ]; Lisa Friedman & Coral Davenport, *Manchin Rejects Landmark Legislation, Putting Biden's Climate Goals at Risk*, N.Y. TIMES (Dec. 19, 2021), https://www.nytimes.com/2021/12/19/climate/manchin-climate-build-back-better-bill.html?searchResultPosition=1 [https://perma.cc/RZV9-75TU]; Andrew Duehren et al., *Sinema's Opposition Stymies Democrats' Planned Tax-Rate Increases*, WALL ST. J.: POLITICS, https://www.wsj.com/articles/democrats-cut-programs-durations-to-lower-cost-of-social-policy-and-climate-plan-11634747582 [https://perma.cc/Q26M-HKFC] (Oct. 20, 2021, 7:54 PM); Richard Cowan, *Democrats at Odds Over Biden's $1.75 Trillion Social Spending Bill*, REUTERS: U.S. MARKETS (Dec. 15, 2021, 4:39 PM),

eleventh-hour drama involved Senators Manchin, Sinema, or both.[228] Manchin often commented on a desire to slow down and not rush the process.[229] As in other matters, the Senator from West Virginia got his way.

Through all this time, Manchin and Sinema were signaling, loudly and clearly, that they were *the* pivotal votes in deciding on any tax increase.[230] Special interests obviously knew this: the math of getting to 50 was simple enough. Manchin and Sinema reaped campaign contribution benefits throughout this entire period of *possible* tax increase legislation; "Sinema and Manchin Flush with Lobbyist Contributions as They Hold Up Biden Agenda," was but one telling headline.[231] By repeatedly stretching matters out—blocking one effort but keeping alive the possibility of another—Congress kept the bidding windows open.

The nature of the reverse Mancur Olson game suggests that special interests do not typically offer large sums at any one time for any one piece of tax legislation for several reasons. There is rarely an *ex ante* guarantee of how any vote will come out, and if there were, there would be no reason to pay for it, so some uncertainty will survive into each potential legislative action window, and repeated small bets will be rational.[232] Large contributions at single points in time are also more salient and likely to be noticed by others, including regulators, although the rise of altogether hidden "dark money" militates against this factor.[233] In any event, no Congress can deliver a credible long-term commitment that tax changes, even if enacted now, will endure and not be repealed by a subsequent Congress.[234] Thus, smaller, shorter-term deals keep being made, and the game of rent extraction through tax legislation is perpetual.[235] Like any good extortionist, Congress has learned how

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https://www.reuters.com/markets/us/bidens-175-trillion-social-spending-bill-faces-critical-year-end-test-2021-12-15/ [https://perma.cc/CNT6-L5TT].

228. *See infra* Section IV.B, C.

229. Tony Romm et al., *Manchin Calls for More Time to Review $1.75 Trillion Spending Package, Creating New Headaches for House Vote*, WASH. POST (Nov. 1, 2021, 3:53 PM), https://www.washingtonpost.com/us-policy/2021/11/01/manchin-biden-reconciliation-deal/ [https://perma.cc/TU96-LHLR].

230. *See, e.g.*, Emily Cochrane & Catie Edmondson, *Manchin Pulls Support from Biden's Social Policy Bill, Imperiling Its Passage*, N.Y. TIMES, https://www.nytimes.com/2021/12/19/us/politics/manchin-build-back-better.html [https://perma.cc/EM6E-6S4S] (Mar. 28, 2022); Jake Thomas, *How Kyrsten Sinema Could Deal a Blow to Manchin–Schumer Inflation Bill*, NEWSWEEK (July 27, 2022, 9:39 PM), https://www.newsweek.com/how-kyrsten-sinema-could-deal-blow-Manchin–Schumer-inflation-bill-1728594 [https://perma.cc/923G-GA67]; Alex Shephard, *Kyrsten Sinema's Joe Manchin Moment*, NEW REPUBLIC: POL. (July 28, 2022), https://newrepublic.com/article/167221/kyrsten-sinema-joe-manchin-moment-inflation-reduction-act [https://perma.cc/4ZUG-V3PH].

231. Matthias R. Lalisse, *Sinema and Manchin Flush with Lobbyist Contributions as They Hold Up Biden Agenda*, DATA FOR PROGRESS (Oct. 27, 2021), https://www.dataforprogress.org/blog/2021/10/27/sinema-and-manchin-flush-with-lobbyist-contributions [https://perma.cc/SQ4G-YE5G].

232. McCaffery & Cohen, *supra* note 95, at 1225.

233. *See* Edward J. McCaffery, *A Better Hope for Campaign Finance Reform*, 52 ARIZ. ST. L.J. 445, 445–46 (2020).

234. Doernberg & McChesney, *Doing Good or Doing Well*, *supra* note 102, at 897–98.

235. *Id.*

to keep the plausible threats coming, expecting constant "protection" payments to prevent or compel actual legislation.

Democrats, controlling all three branches of elected government (presidency, House, and Senate) from January 2021 until November 2022, had a monopoly over Congress's potent tax power for this entire period. With an even 50 senators needed, Manchin and Sinema could and did position themselves as the pivotal levers in the majority's use of its monopoly. Finding themselves in this position, there was no reason to use their power and end the leverage instantiated by the announcement of BBB in October 2021—until looming midterms in 2022 threatened the very existence of the Democrats' power. Then, and only then—in time for summer! —would Manchin act.

This is how we have seen the game work. Lawmakers continuously create or stumble upon the conditions for special interests to pay them to tax or not to tax them. Once they have these conditions, they perpetuate them. It's nice work if you have it and certain parties and players at certain times have it; these parties' and players' motive is to keep it for as long as they can. Manchin had the power to exercise, and he used it[236] until he had a week and a half left on the clock.

Which all leads us to another curious question: why leave even those days on the table?

The reverse Mancur Olson perspective provides an answer. Manchin did not leave any time on *his* clock. He simply bowed out like a tag team wrestler (for another metaphor) and let a different politician finish the match.

### *B. What About Sinema?*

Which brings us to the precise curiouser detail that began this piece: the seeming exclusion of Senator Sinema in the Manchin–Schumer Announcement of July 27, 2022.[237]

The recent round of reverse Mancur Olson games has helped to show that the phenomenon is not so much a precise script as a general playbook. Politicians opportunistically find and exploit occasions to cash in on their monopoly over the coercive power to tax. In the current case of tax legislation, a curious question is how Manchin and Schumer, two elderly white male Democratic senators, could so obviously snub a female colleague. These days people get "canceled" for such sins, yet Sinema herself voiced no displeasure,[238] and Schumer and Manchin faced little criticism from anyone, and certainly no consequences at all. Why?

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236. Burgess Everett & Marianne Levine, *Manchin's Latest Shocker: A $700B Deal*, POLITICO, https://www.politico.com/news/2022/07/27/Manchin–Schumer-senate-deal-energy-taxes-00048325 [https://perma.cc/QFH4-UTBE] (July 27, 2022, 7:32 PM).

237. *See* Zach Schonfeld, *Manchin Says Sinema Not Involved in Bill Talks Because He 'Didn't Think It Would Come to Fruition,'* THE HILL (July 31, 2022, 9:57 AM), https://thehill.com/homenews/sunday-talk-shows/3581454-manchin-says-sinema-not-involved-in-bill-talks-because-he-didnt-think-it-would-come-to-fruition/ [https://perma.cc/CWQ5-DD9R].

238. *See* Marianne Levine et al., *Silent Sinema Stresses Dems as They Race to Pass Manchin-blessed Deal*, POLITICO, https://www.politico.com/news/2022/07/28/democrats-climate-tax-health-care-bill-recess-00048459 [https://perma.cc/5C7T-YAS9] (July 28, 2022, 5:55 PM).

Again, from a reverse Mancur Olson perspective, the answer is obvious: Schumer and Manchin were doing Sinema a favor. By making *their* announcement on Wednesday, July 27, 2022, with the hard stop of Summer Recess looming the following week, Manchin and Schumer gave Sinema time of her own during which she could squeeze out whatever remaining tributes fund managers were willing to pay in the current round. Manchin had already extracted considerable contributions in part by helping oil and gas and mining interests,[239] not to mention blocking broader taxation of the wealthy.[240] Now it was Sinema's turn to play the game.

And so Manchin and Schumer passed the baton (for yet another metaphor) to Sinema for the last lap. Sinema took full advantage and had, by all accounts, a very nice week.[241] Continuing the curiosity of it all, while Sinema's week of shaking down the private equity crowd played out in very public view, we suspect that it will cost her few votes electorally. As we note below, the reverse Mancur Olson phenomenon is not even hidden anymore; in a sea of contentious issues, special interest tax legislation simply does not move many swing voters, if any.[242] Indeed, through her willingness to be the face that saved the carried interest preference, Sinema even gave cover to two men who have reaped their own millions from skilled use of the reverse Mancur Olson phenomenon: Senators Manchin and Schumer have been playing the game for a long time now. One can only laugh to keep from crying.

### *C. Why Was the Fix So Quick? The Bird in Hand*

As we focus on the end game of carried interest and the IRA, things get curiouser again. Manchin and Schumer had given Sinema ten days until the Summer Recess with their Announcement of July 27, 2022. The weekend—and travel plans!—loomed. The savvy Senator from Arizona did not need all this time. By Thursday, August 4, word came that Sinema would sign off on the law only if the carried interest provision was removed and other changes were made to sweeten the pot for private equity; Speaker Schumer lamented that he had "no choice" but to drop the carried interest provision.[243] Of course, this was the same Schumer who had himself sabotaged carried interest reform in 2007, at the start of our journey, when he

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239. Fredreka Schouten, *Joe Manchin, Who Just Torpedoed Democrats' Climate Agenda, Has Long Ties to Coal Industry*, CNN, https://www.cnn.com/2022/07/15/politics/joe-manchin-coal-financial-interests-climate/index.html [https://perma.cc/HF9S-2JH7] (July 15, 2022, 12:21 PM).

240. Tony Romm & Jeff Stein, *Manchin Says He Won't Support New Climate Spending or Tax Hikes on Wealthy*, WASH. POST, https://www.washingtonpost.com/us-policy/2022/07/14/manchin-climate-tax-bbb/ [https://perma.cc/K2Z2-T3JJ] (July 15, 2022, 11:53 AM).

241. *See Kyrsten Sinema's Donations from Investors Surged to Nearly $1 Million in the Year Before She Killed a Huge New Tax on Private Equity and Hedge Funds*, FORTUNE (Aug. 13, 2022, 7:03 AM), https://fortune.com/2022/08/13/sinema-wall-street-money-killing-tax-investors/ [https://perma.cc/T5DS-XCKZ].

242. *See* Editorial, *The Houdinis of Carried Interest*, WALL ST. J. (Aug. 7, 2022, 5:55 PM), https://www.wsj.com/articles/the-houdinis-of-carried-interest-schumer-sinema-manchin-private-equity-loophole-capital-gain-political-charade-11659895350 [https://perma.cc/YZ8G-ZMU2].

243. Breuninger, *supra* note 21.

presumably had plenty of choice.[244] Principled consistency is not an element of reverse Mancur Olson games.

As an aside, another curious dimension of the current shakedown play was the smallness of the fix needed. The carried interest provision in the initial Manchin–Schumer Announcement was "scored" at raising $14 billion over the ten-year scoring window.[245] This was a trivial amount in the coin of the realm: less than 2% of the IRA's projected $737 billion revenue increase;[246] Mnuchin had invoked the similar "smallness" of the issue in defending the TCJA's laughable solution to it.[247] We discuss in the next Section why this figure was so small. But first we note that the $14 billion "fix" of the carried interest loophole was sufficiently trivial that private equity interests may not have been willing to pay Sinema or anyone else all that much to avoid it; the proposed extension of the holding period to five years was not that threatening. No bother. Amid her very good week chatting with private equity pals, Sinema added a private equity carve-out to the 15% alternative minimum corporate tax that was a far more significant revenue-raiser in the IRA.[248] She also threw in added depreciation deductions to the new corporate tax.[249]

These rather predictable, last-minute changes following Sinema's solo turn at the wheels of power left the Manchin–Schumer proposal some $70 billion short of its announced revenue target. This, too, is a curious fact. Although the reconciliation process would have allowed Democrats to enact legislation that cost money, or added to the deficit,[250] Manchin had insisted that the IRA raises enough revenue to reduce the deficit by $300 billion over its ten-year scoring window.[251] Why? There was nothing magic about this number. Manchin and Schumer could have responded to Sinema's demands by removing the carried interest "reform" provisions and not replacing them, reducing deficit reduction to some $230 billion. They did not choose this path. Why not?

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244. *See supra* Section I.C.

245. Andrew Leahey, *Carried Interest Loophole Survives the Inflation Reduction Act*, BLOOMBERG TAX (Aug. 23, 2022, 1:45 AM), https://news.bloombergtax.com/tax-insights-and-commentary/carried-interest-loophole-survives-the-inflation-reduction-act [https://perma.cc/QS4G-UXGE].

246. Chelsey Cox, *Biden Signs Inflation Reduction Act into Law, Setting 15% Minimum Corporate Tax Rate*, CNBC, https://www.cnbc.com/2022/08/16/watch-live-biden-to-sign-inflation-reduction-act-into-law-setting-15percent-minimum-corporate-tax-rate.html [https://perma.cc/3QPD-SPVF] (Aug. 17, 2022, 9:17 AM).

247. Rappeport, *supra* note 157.

248. *Here's What's in the Inflation Reduction Act, the Sweeping Health and Climate Bill Passed Sunday*, THE HILL (Aug. 08, 2022, 1:26 PM), https://thehill.com/homenews/3592694-heres-whats-in-the-inflation-reduction-act-the-sweeping-health-and-climate-bill-passed-sunday/ [https://perma.cc/54EQ-S9UA ].

249. *Id.*

250. *See* Kogan & Reich, *supra* note 107.

251. *See The Inflation Reduction Act Would Fight Inflation and Lower Costs for Americans*, JOINT ECON. COMM. DEMOCRATS (Aug. 12, 2022), https://www.jec.senate.gov/public/index.cfm/democrats/2022/8/the-inflation-reduction-act-would-fight-inflation-and-lower-costs-for-americans [https://perma.cc/FPH2-VG8X]; CONG. BUDGET OFF., SUMMARY: ESTIMATED BUDGETARY EFFECTS OF H.R. 5376, THE INFLATION REDUCTION ACT OF 2022.

From a reverse Mancur Olson perspective, the revenue constraints helped to make the game more real. There were costs to be paid, and it was plausible—for a few days—that fund managers would have to pay them. Simply reducing the revenue target at the last minute would undercut future threats needed to keep the campaign cash flowing.[252] Manchin's deficit reduction number helped set up a battle over which groups would pay it—those that did not pay enough *not* to pay it.

Still, the clock to Summer Recess was ticking, and the Democrats after Sinema's very good week now needed some $70 billion in revenue. Where could they get it? Fortunately, an answer came quickly enough: within a day.[253] (Things happen quickly in Congress when recesses loom.) The Democrats incorporated Senator Ron Wyden's previously introduced Stock Buyback Accountability Act into the IRA, adding a 1% tax on corporate stock buybacks (which presumably could be avoided by consummating stock buybacks before the law took effect).[254] As luck would have it, the stock buyback idea was scored at $72 billion, meeting Manchin's deficit reduction target and allowing Congress to make its summer flights out of town after approving the deal on Saturday, August 6.[255]

But this raises yet another curious question: where was the stock buyback provision *before* Sinema's very good week? This was seemingly a good revenue-raising idea, a piece of "sensible tax policy" with broad support—certainly, it garnered the support of the needed 50 Democrats within hours if not minutes of its ultimate proposal.[256] Why was it not part of the initial Manchin–Schumer Announcement? Why not have an $800 billion IRA, with nearly $400 billion of deficit reduction? Why was Congress seemingly willing to leave a good $70 billion revenue-raising idea on the shelf?

The answer, from a reverse Mancur Olson perspective, is that this is how the game works. In this round, the $70 billion on-the-shelf idea could and would be used as ballast to cover the last-minute exclusion of $70 billion of threatened taxes on private equity. It meant, all along, that Sinema had (at least) $70 billion to "give away" as she "negotiated" with the private equity special interests. This aspect of the current round suggests that Congress has motive to hold onto sensible revenue-

252. *See* McCaffery & Cohen, *supra* note 95, at 1164–72.

253. *See* Karl Evers-Hillstrom, *US Chamber Applauds Sinema, Attacks Stock Buyback Tax*, THE HILL (Aug. 5, 2022, 10:03 AM), https://thehill.com/business-a-lobbying/business-lobbying/3589503-us-chamber-applauds-sinema-attacks-stock-buyback-tax/ [https://perma.cc/8E5P-4QK3].

254. *Wyden Stock Buyback Legislation Passes Senate*, SENATE COMM. ON FIN.: CHAIRMAN'S NEWS (Aug. 7, 2022), https://www.finance.senate.gov/chairmans-news/wyden-stock-buyback-legislation-passes-senate [https://perma.cc/P4AJ-N4M8].

255. Ryan Lizza & Eugene Daniels, *How It Really Happened: The Inflation Reduction Act*, POLITICO, https://www.politico.com/newsletters/playbook/2022/08/08/how-it-really-happened-the-inflation-reduction-act-00050279 [https://perma.cc/3LFU-LFQ4] (Aug. 8, 2022, 6:21 PM).

256. Tal Axelrod, *Senate Democrats Pass Climate, Tax and Health Care Bill After Marathon Voting Session*, ABC NEWS (Aug. 7, 2022, 12:23 PM), https://abcnews.go.com/Politics/senate-democrats-pass-climate-tax-health-care-bill/story?id=88067862 [https://perma.cc/YU4S-HGA2] ("The Senate on Sunday passed the Inflation Reduction Act (IRA) along party lines, 51-50 . . . .").

raising ideas until they can be used to maximum effect in a shakedown scheme. In a parallel story, as the Tax Reform Act of 2012 was rounding into form as the "fiscal cliff fix" needed to close a $1.6 trillion budget shortfall, the expiration of President Obama's "payroll tax holiday" provided $1 trillion of the needed funds, limiting the tax increases on the rich to modest and largely symbolic reforms.[257]

### *D. Why Was the Fix So Small? Copying the Other Side of the Aisle*

We return finally to a curious question raised in the prior Section. Why was the fix to the longstanding carried interest preference in the initial Manchin–Schumer Announcement so small in its revenue impact ($14 billion over ten years) that Sinema could so easily get it removed? Recall that the Senator even had to sweeten the pot for private equity by demanding changes to the alternative corporate minimum tax as well—which she easily got.

The answer is because the Announcement did not really contain a fix or a closing of the carried interest loophole at all. The proposal was *only* to extend the holding period for carried profits interests to five, from three, years—at a time when the *average* holding period of carried interest before sale was already 5.4 years.[258] This was even less dramatic of a proposal than Susan Collins's one-day gambit during the TCJA round for an eight-year holding period.[259] (Presumably, eight was a bridge too far; going to five in the IRA would have left the stage set for going to seven or eight in the—inevitable—*next* round.) The IRA was never going to affect the average hedge fund manager at all. As the noble, Cassandra-like Fleischer tweeted on the day of the Manchin–Schumer Announcement:

> The Schumer-Manchin deal on carried interest isn't great. All it does is extend the holding period from 3 to 5 years, same as the House-passed BBB [Build Back Better].[260]

In yet another curious twist, recall that in 2017 it was *Republicans* who extended the carried interest holding period in new I.R.C. § 1061 to three years. At the time, of course, the move to three years was symbolic and easily avoidable—"laughable"—given the typical carried interest holding period and other loopholes planted in the law. But they set a useful precedent. In the current IRA round, Democrats followed the *precise* script that Republicans had followed less than five years before: after first threatening to close the carried interest loophole altogether, they rolled out a two-year extension of the holding period generating modest and merely projected revenue (the $14 billion).[261]

Note that, at the end of the day, this left all Republicans, and all but one Democrat, in favor of extending the carried interest holding period. But nothing

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257. *See* McCaffery, *Taxing Wealth Seriously*, *supra* note 24, at 349–52.

258. *See Private Equity Holding Periods Reach All-Time High in 2020*, *supra* note 18; Picchi, *supra* note 15; Sherri Snelson, *Fund Finance: Harnessing NAV Finance in New Ways*, JD SUPRA (Aug. 12, 2021), https://www.jdsupra.com/legalnews/fund-finance-harnessing-nav-finance-in-7929829/ [https://perma.cc/6C49-NB4F].

259. *See* discussion *supra* Section III.B.

260. Victor Fleischer (@vicfleischer), TWITTER (July 27, 2022, 7:05 PM), https://twitter.com/vicfleischer/status/1552475349421658113 [https://perma.cc/4AMA-LTJ5].

261. *See supra* Section III.A.

much happened. This curious aspect of the story is reminiscent of the estate tax saga that played out in the 1990s and first decade of the new millennium.[262] At many junctures, there were more than 60 senators who had voted to repeal the tax altogether.[263] The reverse Mancur Olson trick? More than the needed 60 senators never voted to repeal *at the same time*, with many senators simply "flipping" their votes to maintain legislative inertia.[264]

Republicans in 2017 did exactly what Democrats did in 2021–22 to the private equity crowd: shook them down. Throughout 2017, private equity was plausibly under the gun due to Trump's support for closing the carried interest loophole. Only the Republicans did not close the loophole in the end. They narrowed it, slightly, by extending the holding period from one to three years.[265] Wall Street paid, big time, for Republicans to back off from the stronger threat,[266] while politicians reserved the ability to take later bites at the apple. This is also an aspect of the reverse Mancur Olson play: to threaten or promise big action (like repeal of the estate tax) and then to deliver partial action (like raising the estate tax exemption level)—often with the partial action set to expire in the future, unless the price to keep it is paid—that keeps future shakedown possibilities alive.[267]

As it happened, those bites left in 2017 fell to the other side of the aisle. Democrats got the three-headed power in January 2021. How would they use it? In part by shaking down the private equity crowd exactly as Republicans had done. And so, the Manchin–Schumer Announcement threatened to extend the carried interest holding period from 3 to 5 years. Given the current average 5.4 year holding period, the five-year threat constituted another faux fix, such that Sinema needed to sweeten the pot to get enough players for the game. When the dust settled, Democrats had proposed exactly what Republicans had enacted—a largely meaningless two-year increase in the holding period for carried interests.

Note, by the way, that the carried interest card remains to be played: the next time someone has the power, Congress can propose a five- or ten- or twenty-year holding period and see what happens. As one headline put it, the carried interest loophole will outlast us all.[268]

Indeed, the minimal $14 billion price tag shows that the very particular game with carried interest may be reaching a point of diminishing returns, much as the estate tax situation has diminished in importance with its high exemption levels after decades of votes on the brink. No worries: The new 15% alternative corporate minimum tax happily (for lawmakers) creates fresh shakedown territory—some of which Sinema cashed in on during her very good week. Over the centuries,

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262. *See id.*

263. *See supra* Part II.

264. *See* McCaffery & Cohen, *supra* note 95, at 1189 n.88 tbl 2, 1194 n.102 tbl 3, 1197; McCaffery, *supra* note 95, at 23–24.

265. *See* discussion *supra* Section III.A.

266. *See* Schwartz & Gasparino, *supra* note 210.

267. McCaffery & Cohen, *supra* note 95, at 1177–79; McCaffery, *supra* note 95, at 23–25.

268. *See* Murphy, *supra* note 7.

politicians have shown much ingenuity in and passion for generating occasions to be paid.[269] It is only the window dressing details that change (eventually).

As with the story of the estate tax, the carried interest shakedown story is fully bipartisan, or better yet, nonpartisan. The reverse Mancur Olson story is a game played by those with power, who will typically be incumbents. When a party or a politician has power, they use it. None of this has much to do with principle. After the IRA was enacted, all but one senator had shown support for limiting the carried interest preference: all the Republicans in 2017 and all the Democrats except for Sinema in 2022. Yet the break endures, and its legislative "fixes," such as the TCJA provision, have been impotent. (Likewise, the estate tax is still here, although Republicans had many opportunities under George W. Bush and Donald Trump to kill it once and for all.[270]) The common thread? Politicians barely able to listen to the other side of the aisle are fully able to follow their campaign-cash-generating scripts to a "t." Everybody wants money.

## V. LESSONS TO BE LEARNED, AND CAN ANYTHING BE DONE?

There is nothing terribly surprising in the reverse Mancur Olson phenomenon. The whole story plays out from simple assumptions about rational behavior. Legislators are people. They need money: more and more all the time.[271] Tax (and other) laws can help or hurt small, well-funded groups that support or oppose changes. Congress has monopolistic control over the power to tax. At certain points in time, a party (Republicans in 2017, Democrats in 2021–22) or a politician (Collins, Manchin, Sinema) may have monopolistic power over Congress's monopolistic power to tax. Given all that, why would legislators *not* take advantage of their powers to maximize their opportunities to get paid for using, or not using, them?

The increasingly curious case of carried interest continues to illustrate the main idea. Senators Manchin and Schumer gave Senator Sinema a week to get paid to not tax private equity managers.[272] She took advantage. Democrats had already set her up for success by rolling out a small, incremental "fix" to the carried interest loophole: a tactic they copied precisely from Republicans, who had played the same game, with the same stakes, and the same parties, just five years before.[273] No one even bothered to point out the hypocrisy or talk much about any tax law principles involved. When Sinema predictably gave fund managers what they wanted, Democrats were ready within minutes to plug the holes with an idea that they had kept on the shelf the whole time. The IRA got signed, lawmakers got paid, and the carried interest break endured for another day and another round of shakedown

269. *See generally* Christine Perkins, *A History of Corruption in the United States*, HARV. L. TODAY (Sept. 23, 2020), https://hls.harvard.edu/today/a-history-of-corruption-in-the-united-states [https://perma.cc/4QNG-5SK6].

270. *See* McCaffery & Cohen, *supra* note 95, at 1213.

271. Taylor Giorno, *"Midterm Spending Spree": Cost of 2022 Federal Election Tops $8.9 Billion, a New Midterm Record*, OPEN SECRETS (Feb. 7, 2023, 3:57 PM), https://www.opensecrets.org/news/2023/02/midterms-spending-spree-cost-of-2022-federal-elections-tops-8-9-billion-a-new-midterm-record/ [https://perma.cc/T2LA-Y5RV].

272. *See supra* Section IV.B.

273. *See supra* Parts III & IV.

games. Congress pulled it all off while making their flights out of town—again. And they left the stage well set for yet another round of the same game.

What is striking, and worth pausing over, is the openness with which the game was played this time. The press easily called it out.[274] This strongly suggests that playing the reverse Mancur Olson game has low political salience: shaming has no effect on behavior. Senator Sinema barely hid what she was doing and made only minimal efforts to defend herself on principle.[275]

And why not? Sinema is highly unlikely to face serious electoral consequences specifically for her actions vis-á-vis the IRA. What voter, otherwise inclined to vote for Senator Sinema, will not do so *strictly because* of her stance on the carried interest preference? As the general reporting revealed, the public is not terribly well informed about carried interest in the first place—the extension of the holding period to five years from three was repeatedly described as "closing" the loophole, which is hardly the case. Complexity becomes a tool that provides cover for unprincipled legislation. To truly "matter" at any ballot box, the carried interest story must be a pivotal issue for a pivotal voter in an election:[276] a very long longshot indeed. Senator Sinema is far more likely to benefit from the millions she raised from private equity interests than she is to be harmed by any voter she alienated. It is fully, perfectly rational for her to play the game. After all, Sinema in 2022 was following in the shoes of Schumer, Obama, Trump, Collins, Biden and others who expressed concern over the "murder" of capital interest preferences, all while managing to get nothing done, even when they had the power to end the game.

And therein lies the rub. We have reached the point where nothing seems to stop the games. The game is fully rational, for legislators, special interests, and the public, and so it will predictably endure until it is somehow *not* rational to go on. But in the meantime, there are costs.

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274. *See Kyrsten Sinema's Donations from Investors Surged to Nearly $1 Million in the Year Before She Killed a Huge New Tax on Private Equity and Hedge Funds*, *supra* note 241; *The Houdinis of Carried Interest*, *supra* note 242; Brian Slodysko, *Sinema Received Nearly $1 Million from Wall Street While Killing Tax Hike on Investors*, PBS NEWS HOUR (Aug. 13, 2022), https://www.pbs.org/newshour/politics/sinema-received-nearly-1-million-from-wall-street-while-killing-tax-hike-on-investors [https://perma.cc/N7FS-Q5VB]; Hailey Fuchs, *Sinema Rakes in Pharma and Finance Cash Amid Reconciliation Negotiations*, POLITICO, https://www.politico.com/news/2021/10/15/sinema-campaign-money-pharma-finance-516110 [https://perma.cc/A9RL-NMVY] (Oct. 15, 2021, 9:29 PM).

275. *See Kyrsten Sinema's Donations from Investors Surged to Nearly $1 Million in the Year Before She Killed a Huge New Tax on Private Equity and Hedge Funds*, *supra* note 241; Sahil Kapur, *Kyrsten Sinema Delivers a 'Gift to Private Equity' in Democrats' Big Agenda Bill*, NBC NEWS, https://www.nbcnews.com/politics/congress/kyrsten-sinema-delivers-gift-private-equity-democrats-big-agenda-bill-rcna42394 [https://perma.cc/7BNK-GYL7] (Aug. 12, 2022, 6:00 AM); Andrew Ross Sorkin et al., *A Tax Loophole's Powerful Defender*, N.Y. TIMES (Aug. 5, 2022), https://www.nytimes.com/2022/08/05/business/dealbook/sinema-tax-loophole-carried-interest.html [https://perma.cc/4842-PZXK].

276. *See generally* Andrew Gelman et al., *Empirically Evaluating the Electoral College*, *in* RETHINKING THE VOTE: THE POLITICS AND PROSPECTS OF AMERICAN ELECTION REFORM (Ann N. Crigler et al. eds., 2012).

### *A. Bad Laws: Rent Endures*

At the heart of the reverse Mancur Olson phenomenon is a principal–agent problem. Lawmakers in a representative democracy are supposed to work as agents for the people as principal. But under a reverse Mancur Olson setup, the agents go off on their own. Tax policy is distorted: principle takes a back seat to extortionist games. Professor Jones, in 2007, thought it would be just a matter of time before politics could recede, and principle could emerge to effect sensible reform.[277] But the *decades* of antics on both the estate tax and the carried interest preference suggest the problems run deep and will be difficult to change.

Indeed, although we emphasize again that Congress need not—and generally seems not to—plan the whole thing out with Herculean acts of foresight, note that the reverse Mancur Olson phenomenon suggests that a rational lawmaker would *start* the game by creating rent extraction possibilities. Congress could enact an onerous estate tax to get paid for weakening it or a carried interest preference to be paid for perpetuating it. Whereas an ideal lawmaker acting for the people might aim to reduce unearned rents from government action as much as possible, to turn the proceeds over to the general welfare, the reverse Mancur Olson player will want to *create* areas of rent . . . to be able to get some of the goodies for themself. A necessary element of a successful shakedown scheme is something worthwhile to shake down.

Thus, the gift and estate tax endures, albeit on life support and of concern only to the smallest fraction of Americans: those still ready, willing, and able to pay for a shot at outright repeal.[278] How can this status quo fit with principle? Those opposed to estate taxation are disappointed that there still is, nominally, a gift and estate tax; the shakedown would cease if ever the tax were truly killed. But those who desire a *stronger* tax are disappointed, too; the tax has been continually weakened, under Presidents Bush, Obama, and Trump, to the point where "only morons pay it," in the words of Trump's economic advisor Gary Cohn.[279] The only enduring "winners"[280] are the financiers who get paid to help their clients avoid being morons, and the politicians who keep getting paid to keep the game going.[281] In what should surprise no reader at this point, the TCJA's doubling of the estate tax exemption is set to sunset after 2025,[282] guaranteeing more votes, and more cash, on the issue from the small group with high stakes who even care.

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277. Jones, *supra* note 14, at 681, 711.

278. *See generally* McCaffery, *supra* note 111; McCaffery, *supra* note 95.

279. Robert Frank, *'Only Morons Pay the Estate Tax,' Says White House's Gary Cohn*, CNBC: ECONOMY, https://www.cnbc.com/2017/08/29/only-morons-pay-the-estate-tax-says-white-houses-gary-cohn.html [https://perma.cc/3546-8879] (Aug. 30, 2017, 9:45 AM).

280. *Id.*

281. McCaffery, *supra* note 111, at 444–46.

282. *Federal Estate and Gift Tax Exemption Will Sunset After 2025: How to Prepare Now*, CHERRY BEKAERT: GUIDANCE (June 15, 2023), https://www.cbh.com/guide/articles/estate-and-gift-tax-exemption-sunset-2025-how-to-prepare [https://perma.cc/BF9E-T9PA].

Similarly, the carried interest preference endures, at its laughable three-year holding period, waiting for another round of votes and money. If past is prelude, we can expect the next move to be an extension to five years, as the IRA *almost* reached. That would allow plenty more bites at the apple, which is the whole point of the reverse Mancur Olson play. It is not *just* that the shakedown games produce bad, unprincipled laws like EGTRRA's out-year repeal of the estate tax or the TCJA's laughable three-year holding period. It is that the *particular* bad laws that the game encourages preserve economic rents for legislators to extract. Victor Fleischer's sensible proposals do not become law—they persist as possibilities for politicians to get paid *not* to adopt.

### *B. The Stasis of the Status Quo: Incumbents Win*

Still, many will not care much. There might be little sympathy for the wealthy special interests who are being "extorted" in our view and little understanding of the technical aspects of tax "loopholes" that most Americans simply presume persist for the rich in any event.[283] But this blithe dismissal of concern misses what we consider the biggest problem of the reverse Mancur Olson phenomenon: the way it keeps money—lots of money—in our politics.

As long as there are good reasons for the wealthy to pay—as long as the perceived benefits/harms of government action/inaction exceed the costs of campaign contributions—massive amounts of money will stay in politics. Incumbents will have great advantages, as abundant evidence shows that they do.[284] According to data from *OpenSecrets* for the 2021–22 election cycle, 28 incumbent senators running for reelection raised an average of $29,663,644; nearly *fourteen times* the average of 183 challengers, $2,129,872.[285] Further, the incumbent cash was nearly *eight times* the average raised in *open* races, $3,769,989.[286] Similar numbers played out in the House, with averages of $2,855,968 for the 405 incumbents running for reelection; $307,857 for their challengers; and $600,753 for an open seat.[287] Whatever the causes and effects, this massive cash advantage for incumbents goes hand-in-hand with a massive electoral advantage. In 2021–22, *all* 28 senators running for reelection won, a 100% success rate; the House incumbent success rate was 94.5%.[288] And 2021–22 was hardly an outlier in these results.[289]

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283. *See* Juliana Menasce Horowitz et al., *Most Americans Say There Is Too Much Economic Inequality in the U.S., but Fewer Than Half Call It a Top Priority: Trends in Income and Wealth Inequality*, PEW. RSCH. CTR. (Jan. 9, 2020), https://www.pewresearch.org/social-trends/2020/01/09/trends-in-income-and-wealth-inequality/ [https://perma.cc/P22K-FJFS] ("The richest are getting richer faster").

284. *Elections Overview: Incumbent Advantage*, OPEN SECRETS, https://www.opensecrets.org/elections-overview/incumbent-advantage (last visited July 30, 2023); *See generally* Alexander Fouirnaies & Andrew B. Hall, *The Financial Incumbency Advantage: Causes and Consequences*, 76 J. OF POL. 711 (2014).

285. *Elections Overview: Incumbent Advantage*, *supra* note 284.

286. *Id.*

287. *Id.*

288. *Elections Overview: Reelection Rates over the Years*, OPEN SECRETS, https://www.opensecrets.org/elections-overview/reelection-rates [https://perma.cc/DML4-T588] (last visited Mar. 10, 2024).

289. *Id.*

And where did all that money for incumbents, of *both* parties, come from, and why? See generally above: it is the tale we have told of private equity's shakedown and similar transactions. Stories such as the saga of carried interest nonreform show incumbents of both parties—Bush, Schumer, Trump, McConnell, Collins, Obama, Biden, Manchin, Sinema—acting with great skill to keep the cash flowing while doing nothing at all of substance. As some casual observers blame partisanship for gridlock and inertia, we find a perfectly rational nonpartisan game of rent extraction helps explain why so little gets done—and why narrow partisan majorities persist. Follow the money, as they say.

## CONCLUSION

### *What Is to Be Done?*

Sadly, this is where our present work must come to an end. Like Old Testament prophets, we have a clearer vision of the problem than we have hope for any specific solution. We have learned that pointing out the shakedown scheme and asking the sinners to repent does not quite work. Writing law review articles laying bare the machinations of lawmakers does not change much. Nor does complaining about money in politics seem to do great good. Money and politics seem inevitably joined at the hip, and we are just helping to point out how it all goes down.

But if we do not have magic answers now, we can at least ask better questions. If America is going to effectively eliminate the pernicious influence of cash in our electoral politics, scholars and good-government reformers must redirect their gaze and consider not so much the content of the laws under consideration, or even who is contributing funds to enact them or not, but *why* they are doing so, and what role politicians are playing in setting up and perpetuating these conditions. We must better watch the watch dogs. Perhaps this leads to substantive changes in tax law, to simplify it and make it less vulnerable to politically infra-marginal manipulation. Or perhaps we need to consider the tax legislative process to make it less vulnerable to shakedown schemes, as by using different voting rules or subjecting legislative proposals to independent review. Budgeting and scoring rules, like sunset provisions, also shape opportunities for rent extraction and should be examined in this light. Perhaps legislative term limits, and limits on the portability of extra campaign cash, are part of the answer. Time and space preclude a fuller exploration of any of these possibilities here; there is much to consider and reconsider if we use our creative capacities. One lesson we hope to have conveyed is that we must all learn to think outside the box of the simple special interest theory of politics, for the boxes we have already constructed keep massive sums of money in politics. We need new boxes.

If we are going to get money out of our politics, we must get the *reasons* that money is in politics out of our politics. As long as a complex set of tax laws allows opportunities for lawmakers to use their taxing power to fundraise,[290] the

290. We note as a fact too good to be ignored here that Senator Sinema teaches a course at Arizona State University—on fundraising. *See* Ken Klippenstein, *Krysten Sinema is Literally Teaching a Course on Fundraising*, THE INTERCEPT (Oct. 8, 2021, 12:35 PM), https://theintercept.com/2021/10/08/kyrsten-sinema-fundraising-course-asu/ [https://perma.cc/AVG7-FB62]. Sight unseen, we recommend the class.

games will go on, however curiouser they have already become. As they say, the more things change . . . .