

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**Office of the Chief Financial Officer**

Natwar M. Gandhi  
Chief Financial Officer



**MEMORANDUM**

**TO:** The Honorable Linda W. Cropp  
Chairman, Council of the District of Columbia

**FROM:** Natwar M. Gandhi  
Chief Financial Officer

**DATE:** February 6, 2002

**SUBJECT:** Fiscal Impact Statement: "Portfolio Investment Fund  
Competitiveness Act of 2002"

**REFERENCE:** Bill Number 14-503 as Introduced

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**Conclusion**

Funds are not sufficient in the FY 2002 through FY 2005 budget and financial plan to implement the proposed legislation. **The provisions of the proposed legislation will result in a decrease of local General Fund revenue of \$1.13 million in the first year and \$3.50 million in FY 2002 through FY 2005.**

**Background**

The proposed legislation will exclude income classified as interest, dividends, capital gains and capital losses from taxation when it is earned by a partnership, limited partnership, limited liability company (LLC) or other unincorporated entity. The proposed legislation would be applied whether these earnings are through acquisition, holdings or disposal of assets in a portfolio, or part of a portfolio's investment income. Additionally, the proposed legislation would exclude share distributions of an investment portfolio from taxation in the case of a partnership, member partnership, LLC or other unincorporated association.

The proposed legislation is intended to exempt earnings from hedge funds management partnerships. According to industry representatives there are currently no hedge fund partnerships operating in the District however the OCFO is unable to verify this statement. Under current law, earnings from these types of funds would be recorded on the Unincorporated Franchise Tax return (DC Form D-30) and taxed at a rate of 9.75

percent. The proposed legislation moves the recordation of these earnings to a personal income tax return where they would be taxed at more marginal rates.

Some representatives in the investment management industry believe that the proposed legislation would make the District more attractive to hedge fund managers. They believe that implementing the proposed legislation would result in growth in hedge fund management in the District, and would provide indirect economic stimulus. However, provisions of the proposed legislation are not limited to hedge funds and would reduce local General Fund revenue in the District.

Currently the State of Maryland taxes partnerships but exempts the type of earnings that are the subject of the proposed legislation. The Commonwealth of Virginia does not tax partnerships.

### **Financial Plan Impact**

The District is unable to determine the number and size of hedge fund partnerships operating in the District. However, the proposed legislation will reduce local General Fund revenue by \$1.13 million in the first year of implementation because the bill provisions affect numerous unincorporated entities operating in the District who declare earnings subject to the franchise tax. The following table presents the estimated reductions in local General Fund revenue that would impact the FY 2002 through FY 2005 budget and financial plan.

<b>Estimated Reduction in Local General Fund Revenue</b>				
<b>(\$ in millions)</b>				
<b>FY 2002</b>	<b>FY 2003</b>	<b>FY 2004</b>	<b>FY 2005</b>	<b>4-Year Total</b>
<b>\$0.00</b>	<b>\$1.13</b>	<b>\$1.16</b>	<b>\$1.21</b>	<b>\$3.50</b>