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STOP CARRYING THE INTEREST! A COMPARISON OF U.S. AND CHILEAN TAXATION OF PRIVATE EQUITY FUND MANAGERS UNDER INTERNATIONAL HUMAN RIGHTS LAW

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ABSTRACT

Why do we tax? How do we tax? Who should we tax? While asked by almost all of us, these questions are usually answered by a select few. Economists who work in theoretical realities, lawyers full of jargon, and legislators with competing interests all have different answers to those questions. Some might even have different answers depending on who is asking. Beyond the theory and the jargon, however, lies an underlying base of equity and fairness that drives all citizens to ask these questions. This Note will attempt to answer one small piece of these enormous questions by focusing on the taxation of private equity managers in the United States compared with that of Chile, arguing that, while the Chilean government has complied with what little international guidance there is on tax policy, the United States is violating international law by offering preferential treatment for high net-worth private equity managers.

I. INTRODUCTION

Why do we tax? How do we tax? Who should we tax? While asked by almost all of us, these questions are usually answered by a select few. Economists who work in theoretical realities, lawyers full of jargon, and legislators with competing interests all have different answers to those questions. Some might even have different answers depending on who is asking. Beyond the theory and the jargon, however, lies an underlying base of equity and fairness that drives all citizens to ask these questions. This Note will attempt to answer one small piece of these enormous questions by focusing on the taxation of private equity managers in the United States compared with that of Chile, arguing that, while the Chilean government has complied with what little international guidance there is on tax policy, the United States is violating international law by offering preferential treatment for high net-worth private equity managers.

II. BACKGROUND

A. WHY DO WE TAX? GUIDING PRINCIPLES

The answer to this question has two relatively simple components: budgetary and behavioral. In the immortal words of Tax Man Max: "For the things your town may need, for the things a country lacks, all good things take greenbacks."[1] At its most basic level, a government imposes taxes to raise revenue to provide services for its people. If that were the tax system's only purpose, there would be no need for tax attorneys or accountants. In addition to this budgetary component, governments manipulate the tax system to either incentivize or disincentivize behavior.[2] This component results in much of the complexity present in tax systems across the world. For example, in the United States, Congress rewards some behaviors via enhanced deductions and credits (i.e., charitable contributions, home ownership, marriage, and renewable energy to name a few).[3] Conversely, Congress seeks to disincentivize behaviors by disallowing deductions or imposing additional excise taxes (i.e., meals and entertainment, excess compensation, and fines and penalties). Both of these functions play a part in the argument explored in this Note.

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[1] PATRICK QUINN, TAX MAN MAX (Schoolhouse Rock 1995).
[2] Kevin Levingston, PwC, Guest Speaker at University of Georgia Tax Research and Policy Class (Nov. 2, 2022).
[3] *Id.*

B. HOW DO WE TAX? THEORETICAL UNDERPINNINGS

Economists have, for the last fifty years or so, relied on the slightly obscure criterion of Utilitarianism to shape tax policy.[4] This theory assumes that taxation schemes should "maximiz[e] overall well-being in society" by tailoring taxes to personal characteristics, or "tagging."[5] This tagging might be based on inherent characteristics like race, age, gender, and sexual orientation.[6] This theory could, for example, result in equal-earning taxpayers paying different taxes simply because one is younger than the other. Some scholars argue that this theory does not match reality; instead, they rely on the theory of "Equal Sacrifice," which aims to equalize each individual's tax burden relative to their ability to earn income. [7] This theory seems to better encapsulate the average citizen's beliefs about taxation, meaning each citizen should give what they can. Interestingly, Utilitarianism creates a system where "all property and individual abilities should be regarded as society's common resource."[8] On the other hand, Equal Sacrifice assumes that individuals have autonomy over their economic output, voluntarily agreeing to a society's taxation to receive public benefits.[9] Even though this theory seems to be more individualistic in nature, it can still result in a rather progressive tax schema. More importantly to this note, this theory seems to rest more squarely on principles of justice and equity than Utilitarianism.

Because questions of fairness so often arise when discussing tax policy, different regulatory, governing, and professional bodies often include this theme as a foundational principle. For example, the Association of International Certified Professional Accountants (AICPA) lists equity and fairness as one of its "guiding principles of good tax policy."[10] In terms of equity, the AICPA argues taxes should aim to achieve both vertical and horizontal equity.[11] Horizontal equity ensures that two similarly situated taxpayers should pay the same amount of tax.[12] In other words, two middle-class individuals with similar earnings should owe roughly the same amount. Vertical equity aims to capture differences in the ability to pay and requires

[4] Martha Lagace, *Why Do We Tax?*, WORKING KNOWLEDGE: BUS. RSCH. FOR BUS. LEADERS (Harv. Bus. Sch. Sep. 24, 2012) (https://hbswk.hbs.edu/item/why-do-we-tax).
[5] *Id.*
[6] Cremer et al., *Tagging and Income Taxation: Theory and an Application*, 2 AM. ECON. J.: ECON. POL'Y 31 (2010).
[7] Lagace, *supra* note 4.
[8] *Id.*
[9] *Id.*
[10] ASSOCIATION OF INTERNATIONAL CERTIFIED PROFESSIONAL ACCOUNTANTS [AICPA], GUIDING PRINCIPLE OF GOOD TAX POLICY: A FRAMEWORK FOR EVALUATING TAX PROPOSALS (2017).
[11] *Id.*
[12] *Id.*

those with higher disposable income to pay more.[13] Some might initially balk at that as representing equity, but a simple example will clear it up. Albus and Barty live in Atlanta, Georgia. Albus makes $20 a year while Barty makes $200. The City of Atlanta decides to implement a local sales tax of 10%. Both Albus and Barty show up at Kroger and buy $10 worth of groceries. Each is assessed $1 in sales tax. That represents 5% of Albus's income and only 0.5% of Barty's. Vertical equity seeks to eliminate regressive taxation schemes like this.

While the AICPA seeks to address both vertical and horizontal equity in tax schemes, other international bodies ignore one or both of those goals. For example, the OECD argues that taxes should be neutral, meaning that "taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation."[14] This represents horizontal equity but says nothing of a taxpayer's ability to pay. Until recently, the European Union (EU) has done very little to address fairness in its tax policy recommendations.[15] In 2018, after an outcry about tax evasion, the EU published its new platform called "A Fair Share."[16] Three pillars comprise the EU's agenda: transparency, effective taxation, and global good governance.[17] While these principles are no doubt important, they primarily address tax evasion. A system with tax evasion is not equitable, but principles of equity go further than avoiding crime. An equitable system eliminates *some* tax avoidance as well.

C. THE INTERNATIONAL TAX SYSTEM

As with much of international law, a quagmire of treaties, laws, and regulations comprise the relevant authorities on this subject. Broadly, this system "consists of rules that regulate the taxation of cross-border income."[18] The treatment of cross-border income inherently involves two jurisdictions, but laws governing international tax need not be bilateral in nature.[19] The international tax regime includes rules that arise out of multilateral, bilateral, and purely domestic deliberations.[20] Governing bodies attempt to regulate cross-border transactions in all of these ways. However, where other bodies of international law might rely on international conventions as a starting point,

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[13] *Id.*
[14] *Id.*
[15] European Commission, Directorate-General for Taxation and Customs Union, *A Fair Share: Taxation in the EU for the 21st Century* (2018), https://data.europa.eu/doi/10.2778/848353.
[16] *Id.*
[17] *Id.* at 4/5.
[18] PETER HONGLER, JUSTICE IN INTERNATIONAL TAX LAW: A NORMATIVE REVIEW OF THE INTERNATIONAL TAX REGIME 46 (IBFD Publications USA, Inc. 2019).
[19] *Id.* at 3.
[20] *Id.* at 45.

the United Nations (U.N.) has never held a tax convention. While organizations like the Tax Justice Network have been calling for this for years, the Committee of Experts report from the fifty-fourth session of the Conference of African Ministers of Finance, Planning, and Development just officially called upon the U.N. in June of 2022 to do just that.[21] The report calls for a convention "aimed at eliminating base erosion, profit shifting, tax evasion, including of capital gains tax, and other tax abuses."[22]

Because no convention has occurred yet, domestic laws can be compared to international human rights law for analysis. In fact, according to a U.N. report, "[t]axation is a key tool when tackling inequality and for generating the resources necessary for poverty reduction and the realization of human rights."[23] This U.N. report actually states an affirmative duty for states to secure the necessary resources to provide economic, social, and cultural rights for their citizens.[24] The Human Rights Council identifies at least seven rights that must be secured through a substantive taxation scheme: rights to equality, non-discrimination, self-determination, participation, accountability, transparency, and access to information.[25] By strengthening revenue-raising among member nations, states can widen the tax base, improve tax efficiency, tackle tax abuse, reassess corporate taxation, and broaden the financial sector's contribution.[26] Economic inequality is a massive driver for inequality of all kinds, and taxation schemes are just one piece of solving that puzzle.

D. TAXATION SCHEMA: THE UNITED STATES V. CHILE

1. *United States*

The United States, as is the case with many countries, taxes different types of income differently. Absent a specific provision to the contrary, the United States government taxes "compensation earned for work performed" in this country irrespective of the time and place payments are made.[27] Generally, other sources of income, like capital gains and interest income, are

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[21] Conference of African Ministers of Finance, Planning and Economic Development, *Report of the Conference of African Ministers of Finance, Planning and Economic Development on its Work During the Fifty-Fourth Session of the Economic Commission for Africa*, U.N. Doc. E/ECA/CM/54/6 (June 1, 2022).
[22] *Id.* at 26.
[23] Magdalena Sepúlveda Carmona (Special Rapporteur on Extreme Poverty and Human Rights), *Rep. of the Special Rapporteur on Extreme Poverty and Human Rights*, Summary, U.N. Doc. A/HRC/26/28 (May 22, 2014).
[24] *Id.*
[25] *Id.* at 5-7.
[26] *Id.* at 14-17.
[27] *Individual – Income Determination*, PwC (Feb. 7, 2024), https://taxsummaries.pwc.com/united-states/individual/income-determination.

taxed, regardless of the source country.[28] This means that the United States is both a territorial-based and a credit-based international tax jurisdiction, meaning U.S. citizens are taxed on the income derived inside of the U.S. border as well as their worldwide income.[29] Note that the emphasis on worldwide income is called a credit-based system, so the U.S. tax law allows a credit for taxes paid to another country.[30] Relevant to this note, certain types of income are treated differently. For example, long-term capital gains mean "gains from the sale or exchange of a capital asset held for more than one year."[31] Capital assets are slightly more difficult to define as the Code defines it by exclusion.[32] In general, however, capital assets are assets a taxpayer holds for investment or personal use.[33] This definition excludes property such as cash and inventory.[34] Long-term capital gains are considered by many to be the best sort of income source because of the tax benefits associated with them. As demonstrated below, in the most recent tax year of 2022, tax rates for long-term capital gains and ordinary income vary enormously.

Ordinary Income

Tax Rate	For Single Filers	For Married Individuals Filing Joint Returns	For Heads of Households
10%	$0 to $10,275	$0 to $20,550	$0 to $14,650
12%	$10,275 to $41,775	$20,550 to $83,550	$14,650 to $55,900
22%	$41,775 to $89,075	$83,550 to $178,150	$55,900 to $89,050
24%	$89,075 to $170,050	$178,150 to $340,100	$89,050 to $170,050
32%	$170,050 to $215,950	$340,100 to $431,900	$170,050 to $215,950
35%	$215,950 to $539,900	$431,900 to $647,850	$215,950 to $539,900
37%	$539,900 or more	$647,850 or more	$539,900 or more

[28] *Id.*
[29] MISEY & SCHADEWALD, PRACTICAL GUIDE TO U.S. TAXATION OF INTERNATIONAL TRANSACTIONS ¶ 201.02 (12th ed. 2020).
[30] *Id.*
[31] I.R.C. § 1222.
[32] I.R.C. § 1221.
[33] *Id.*
[34] *Id.*

Capital Gains

Tax Rate	For Single Filers	For Married Individuals Filing Joint Returns	For Heads of Household
0%	$0 to $41,675	$0 to $83,350	$0 to $55,800
15%	$41,676 to $459,750	$83,351 to $517,200	$55,801 to $488,500
20%	$459,751 or more	$517,201 or more	$488,501 or more

*Both charts have been populated with numbers from the Tax Foundation.[35]

Beyond the general character of income, the United States Code has an entire subchapter dedicated to the taxation of partnerships, the entity most often used by private equity funds.[36] A partnership is an example of a flow-through entity, meaning the partnership itself is not "a separate and distinct entity for tax purposes."[37] This means that while income is determined at the partnership level, that income flows through and is taxable to each individual partner based on their ownership interest, represented by a capital account.[38] While subject to some default rules, this ownership interest is largely governed by the partnership agreement. This agreement allocates income, deductions, gains, and losses among partners, whose corresponding capital accounts change accordingly.[39] Contributions, income, and liabilities all increase a partner's capital account while distributions, losses, and debt relief all decrease the account.[40] In the case of a private equity fund, most income comes in the form of investment income or capital gains. Therefore, much of the income that flows through to the account's partners retains that character, allowing fund managers to greatly reduce their tax burden. By receiving most of their compensation in the form of capital gains, some of the wealthiest fund managers can take advantage of a seventeen-point gap in tax rates (the highest ordinary income tax rate less the highest capital gain tax rate), creating what many have referred to as a loophole protecting private equity fund managers.[41]

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[35] Erica York, *2022 Tax Brackets*, TAX FOUND. (Nov. 10, 2021), https://taxfoundation.org/2022-tax-brackets/.
[36] I.R.C. §§ 701-777.
[37] Michael R. Pieczonka, *The Largest Loophole in Federal Tax Law: Preferential Capital Gain Treatment for Private Equity and Hedge Fund Managers' Carried Interests*, 42 J. MARSHALL L. REV. 529, 538 (2009).
[38] I.R.C. § 701.
[39] ROBERT RICKETTS & LARRY TUNNEL, PRACTICAL GUIDE TO PARTNERSHIPS AND LLCS ¶¶ 904—905 (10th ed., 2019).
[40] *Id.*
[41] *See generally* Pieczonka, *supra* note 37; Maxwell Gawley, *Closing the Carried Interest Loophole and the Impacts on Venture Capital*, 68 DEPAUL L. REV. 671 (2019); Sarah

2. *Chile*

In Chile, the tax system varies significantly from that of the United States in some regards. However, some categories of income are taxed similarly, such as employment income. In Chile, employment income is taxed as ordinary income, and the government imposes this tax on a taxpayer's worldwide income.[42] In fact, most all forms of income in Chile are taxed under this "Overall Income Tax" scheme with a progressive tax.[43] Interestingly, when individuals receive earnings from entities domiciled in Chile, they can use the 22.5% First Category Tax paid by that entity as a tax credit for their own income.[44] Further, dependent workers pay taxes on work-related income.[45] This tax is called Second Category Tax and employers withhold it for their employees.[46] Therefore, the calculation of an individual's tax base depends on whether that individual is self-employed.[47] For an employee, taxable income consists of salary received minus withholdings paid by the employer and tax-exempt income.[48] For self-employed individuals, the Overall Income Tax scheme applies, so taxable income includes all income received throughout the year minus necessary expenses.[49]

At a corporate level, most Chilean companies must pay First Category Tax (22.5%).[50] This includes "corporations, stock companies, limited liability companies, limited liability individual enterprises," and other special cases.[51] Most of the rules surrounding these types of entities are beyond the scope of this Note, but there are myriad differences between this scheme and that of the United States.[52] For example, dividends, profits, and distributions from other Chilean companies are not subject to First Category Tax.[53] Additionally, numerous exceptions exist for companies that deal exclusively in the investment trade, including private equity funds themselves.[54]

Sutton Osborne, *Carried Away: Sun Capital, Politics, and the Potential for A New Spin on "Trade or Business" in Private Equity*, 45 CUMB. L. REV. 595 (2015).

[42] *Worldwide Tax Summaries – Chile*, PWC (February 8, 2024), https://taxsummaries.pwc.com/Chile.

[43] CLARO & CIA., ABOGADOS, LEXMUNDI'S GUIDE TO DOING BUSINESS IN CHILE ch. 5, at 36 (2023).

[44] *Id.*

[45] *Id.*

[46] *Id.*

[47] *Id.* at 22.

[48] *Id.*

[49] *Id.*

[50] *Id.*

[51] *Id.* at 37.

[52] *See generally* PwC, *supra* note 42; CLARO & CIA., *supra* note 43.

[53] PwC, *supra* note 27.

[54] CLARO & CIA., *supra* note 43, at 25.

Beyond ordinary income, Chile has an interesting system in place regarding capital gains. The treatment differs based on the type of taxpayer recognizing a gain and whether or not the shares on which a gain is recognized are "significantly traded on stock exchanges."[55] For non-traded shares purchased prior to January 31, 1984, Chile does not tax the gain as long as the "taxpayer is not customarily engaged in the purchase and sale of securities."[56] For shares purchased after that date, Chile imposes a tax of 22.5% so long as several conditions are met: (1) the taxpayer must have held the shares for more than one year; (2) the sale must not be between related parties; and (3) the seller does not customarily engage in the securities' trade.[57] If a gain does not fit into one of the categories described above, it is fully taxable, meaning Chile imposes the First Category Tax on sellers and the Overall Income Tax on Chilean resident individuals upon receiving a gain.[58] However, as with other types of income, the First Income Tax already paid by the investment entity triggers a credit against the Overall Income Tax calculation to avoid double taxation.[59]

Chile does not impose a capital gains tax for shares "significantly traded on stock exchanges," subject to several conditions.[60] First, the shares must be *sold* "(i) on a Chilean stock exchange authorized by the SVS; (ii) within the process of a public tender of shares . . . or (iii) as a result of the contribution of securities into a mutual fund under . . . Article 109 of the Income Tax Act . . . ."[61] Additionally, the shares of common stock must also have been *acquired*:

> (i) on a Chilean stock exchange, authorized by the SVS;
> (ii) within the process of a public tender of shares governed by Title XXV of the Chilean Securities Market Act;
> (iii) in an initial public offer of shares of common stock resulting from the formation of a corporation or a capital increase of the same;
> (iv) in an exchange of public offered securities convertible into shares; or

(v) as a result of the redemption of securities subject to the provisions of Article 109 of the ITL.[62]

E. PRIVATE EQUITY: STRUCTURE AND TAXATION

[55] *Id.* at 38.
[56] *Id.*
[57] *Id.*
[58] *Id.* at 36.
[59] *Id.* at 38.
[60] *Id.*
[61] *Id.*
[62] *Id.*

1. *Definitions and History*

At its most basic level, "private equity" describes much of what is important about the field. First, "private" means "[o]f, relating to, or involving an individual, as opposed to the public or the government," and when applied to a company, it means "not having shares that are freely available on an open market."[63] Equity, on the other hand, has a variety of meanings ranging from basic fairness to ownership interests.[64] For the purposes of this Note, "equity" means "an ownership interest in property, [especially] in a business."[65] Considering this, private equity "encompasses any investment in a private company." [66]

Historically, the concept of investing in a trade or business has existed for as long as humans have done business with each other. However, the true origin of private equity begins with J.P. Morgan's purchase of Carnegie Steel Company in 1901.[67] After World War II, the market began to expand when early venture capital firms formed in 1946.[68] Due to Cold War-Era government incentives for venture capital firms, the sector expanded in earnest, and the world of private equity has never looked back.[69] As time passed, the sector has adapted and now encompasses a wide range of investments, not just venture capital.[70] In this vein, private equity funds purchase public companies and make them private, but they also purchase private companies that are not otherwise readily available to investors.[71]

Therein lies one of the major benefits of private equity: accessibility to investors who otherwise would not have adequate capital to invest. This form also minimizes risk as a limited partnership, as discussed below. The private equity firm acts as the "actual owner of the portfolio company," and fund management administers the fund independently, allowing contributors to act as passive investors.[72] While private equity does create accessibility for those without large amounts of capital, a select few still hold the keys to the castle. In the United States, the primary funders of private equity are the following: public pension funds, endowments/foundations, funds-of-funds,[73] sovereign

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[63] *Private,* BLACK'S LAW DICTIONARY (11th ed. 2019).
[64] *Equity,* BLACK'S LAW DICTIONARY (11th ed. 2019).
[65] *Id.*
[66] Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, 37 DEL. J. CORP. L. 849, 859 (2013).
[67] Brandon Schumacher, *A New Development in Private Equity: The Rise and Progression of Special Purpose Acquisition Companies in Europe and Asia*, 40 NW. J. INT'L L. & BUS. 391, 394 (2020).
[68] *Id.*
[69] *Id.*
[70] *Id.* at 395.
[71] *Id.* at 395-96.
[72] *Id.* at 396.
[73] E. Napoletano & John Schmidt, *What Is a Fund of Funds?*, FORBES ADVISOR (Apr. 25, 2022, 9:46 AM), https://www.forbes.com/advisor/investing/what-is-fund-of-funds/ ("A

wealth funds, corporate pension funds, banks and other financial institutions, government agencies, insurance companies, wealth managers, family offices, and high-net-worth individuals.[74] Further, public pension plans, sovereign wealth funds, insurance companies, and private sector pension funds made up around 70% of the private equity world in 2019 based on capital invested.[75] In this way, most "regular" people do not have a seat at the table in any direct way.[76]

As time has passed, the private equity world has exploded in popularity. In fact, in 2015, "more than 2,000 private equity firms sought an estimated $700 billion of capital commitments from investors."[77] More recently, this sector has shown no signs of slowing down. According to a report by Deloitte in 2020, the market should expect "formidable growth" because of high returns, perceived low volatility, and increased access for retail investors.[78] If trends hold, institutional investors will continue to increase allocation to private capital, leading Deloitte to forecast global private equity assets under management to reach $5.8 trillion by 2025.[79] These numbers include all international private equity, but Deloitte clearly focuses on U.S. regulations and trends for a bellwether in its analysis.

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fund of funds is an investment vehicle that invests in mutual funds, exchange-traded funds (ETFs), or even hedge funds."). Here, average investors can buy shares in a fund that then invests in another entity, like a private equity fund. *Id*.

[74] Larry Jordan Rowe & Justin T. Kliger, *Private Equity in United States: Market and Regulatory Overview*, PRACTICAL LAW 1-500-5474 (database updated Jun. 1, 2023).

[75] *Id.* at 7-8.

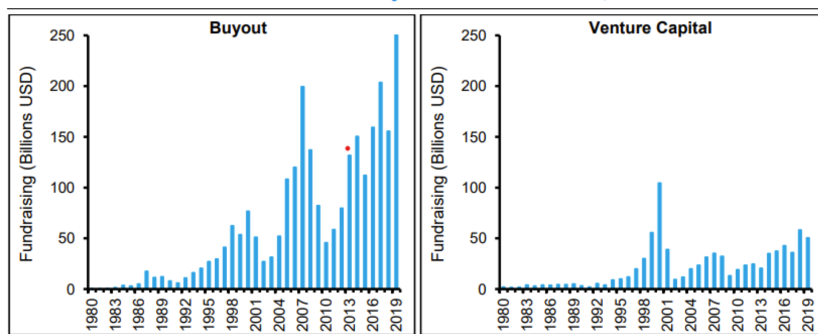
[76] Indirectly, retail investors can get involved in the private equity world through various entities like funds-of-funds and as a SPAC shareholder. *See* Napoletano & Schmidt, *supra* note 73; Rodrigues, *supra* note 66.

[77] *See* Schumacher, *supra* note 67.

[78] Patrick Henry et al., *The Growing Private Equity Market: How PE Firms can use Expertise, Technology, and Agility to Exceed Stakeholder Expectations*, DELOITTE INSIGHTS, at 2 (2020), https://www2.deloitte.com/us/en/insights/industry/financial-services/private-equity-industry-forecast.html.

[79] *Id.*

Exhibit 3: Investor Commitments to U.S. Buyout and Venture Funds, 1980-2019



Source: 2010 and 2020 NVCA Yearbooks and PitchBook.
Note: 1980-2005 buyout data includes commitments to mezzanine capital.

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Across the globe, private equity growth has increased exponentially as well. The majority of investment still stems from the United States and European markets, but regions across the world are on the rise.[80] In the past decade, for example, "the share of assets under management focused on the Asia-Pacific region has grown . . . 2.4 times faster than North America and 3.0 times faster than Europe."[81] Further, when considering global buyout-backed exit value by region in 2021, the rest of the world (meaning Africa, the Caribbean, South America, and the Middle East) performed 158% higher than its five-year average and posted an increase of 128% over 2020.[82] While business is booming in the United States, exciting opportunities for growth abound in historically untapped markets such as Latin America.

Like the rest of the world, Latin American markets can sometimes lack consistency, especially considering the political environment at the time.[83]

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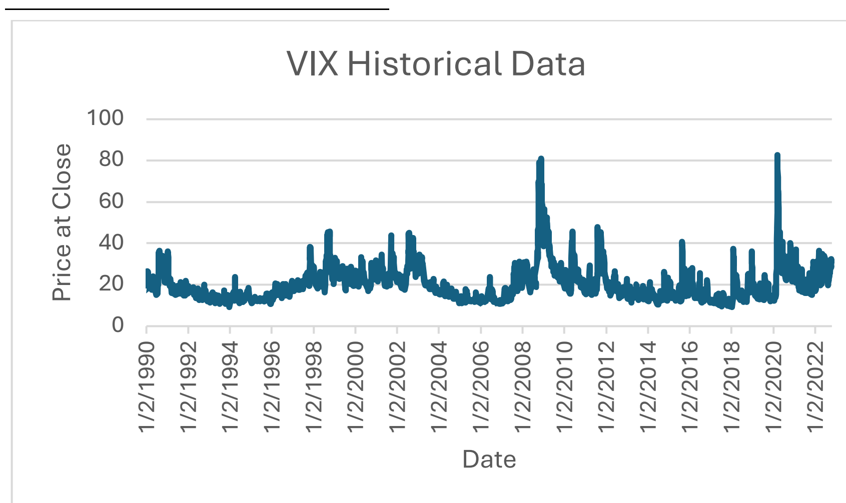
[80] Hugh MacArthur et al., *Global Private Equity Report 2022, BAIN & CO.,* at 27 (2022), https://www.bain.com/globalassets/noindex/2022/bain_report_global-private-equity-report-2022.pdf.
[81] *Id.*
[82] *Id.* at 16.
[83] For examples of market volatility, see John Jagerson & Wade Hansen, *The Market's Only Constant: Volatility*, INVESTORPLACE (May 20, 2022, 4:10 PM EDT), https://investorplace.com/tradingopportunities/2022/05/the-markets-only-constant-volatility/; Bank for International Settlements [BIS], *Financial Market Volatility: Measurement, Causes and Consequences*, Conference papers Vol. 1 (Mar. 1996), https://www.bis.org/publ/confp01.pdf; *Historical Data for Cboe VIX Index and Other Volatility Indices*, CBOE (last accessed Oct. 22, 2022), https://www.cboe.com/tradable_products/vix/vix_historical_data/.

Despite this, however, the Association for Private Capital Investment in Latin America (LAVCA) reports a vibrant forecast for the region, relying mostly on the tech sector.[84] In fact, "[a]ccording to LAVCA statistics, private equity investment in Latin America totaled $29.4 billion" in 2021, which represents a 75% increase from 2020. Further, the "Pacific Alliance bloc, comprising Colombia, Chile, Peru[,] and Mexico . . . attracted . . . 43% of the capital invested in the region."[85] Even though both Colombia and Chile have experienced some recent political turmoil, "private equity funds remain optimistic," contributing to almost $16 billion in venture capital investments (more than Latin America has experienced in ten years).[86]

Despite having a relatively small domestic market, Chile still successfully attracts significant "Foreign Direct Investment (FDI)," specifically in the areas of mining, finance, energy, telecommunications, and chemical manufacturing.[87] The country boasts the sixth-largest GDP per capita compared to other countries in the Western Hemisphere, and its economic stability and prosperity have historically held firm.[88] Even as political administrations change, Chile seems to place economic prosperity at the forefront, attempting to promote an "entrepreneurship and investment



[84] Daniel Salazar Castellanos, *Private Equity Still Has Faith in Chile, But Outlook Cloudier in Colombia LAVCA Says*, BLOOMBERG LÍNEA (May 10, 2022) https://www.bloomberglinea.com/2022/05/10/private-equity-still-has-faith-in-chile-but-outlook-cloudier-in-colombia-lavca-says/.
[85] *Id.*
[86] *Id.*
[87] US Dep't of State, Bureau of Democracy, H.R. and Lab., 2021 Investment Climate Statements: Chile (2021).
[88] *Id.*

agenda."[89] These factors have combined to create a thriving environment for private equity.

2. Private Equity in the United States

Most private equity and hedge funds exist as limited partnerships.[90] Generally, they organize in Delaware because of its "well-developed statutory regime and . . . case law."[91] Limited partnerships must include at least one general partner and one limited partner.[92] Partner designations differ based on how much personal liability that person or entity assumes in the partnership's name.[93] Partnerships offer a plethora of tax benefits, but the main one comes from the principle of flow-through taxation.[94] This principle sees a partnership as a collection of individual partners instead of a standalone entity, and, as such, the income earned by the partnership flows through to each of the partners for them to report on their individual tax returns.[95] These factors incentivize many to organize as a partnership where a fund sponsor or manager fulfills the role of general partner, while investors act as limited partners.[96]

For many years, private equity funds operated with little to no regulation.[97] However, after the 2007-2008 financial crisis, Congress enacted the Dodd-Frank Act of 2010.[98] This law did away with an old exemption under which many private equity funds escaped regulation.[99] Now, investment advisers of private funds must register with the Securities and Exchange Commission (SEC) as long as the fund in question manages at least $150 million in assets.[100] Some exceptions exist, but most fund sponsors have some sort of filing obligation to the SEC or their applicable state regulatory authority.[101] Additionally, the partnership itself must register as an investment

[89] *See* Castellanos, *supra* note 84.
[90] Pieczonka, *supra* note 37, at 533.
[91] Rowe & Kliger, *supra* note 74.
[92] DEL. CODE ANN. tit. 6, § 17-101(11) (West, Westlaw through ch. 251 of the 152nd General Assembly (2023-2024)).
[93] DEL. CODE ANN. tit. 6, § 17-303(a) (West, Westlaw through ch. 251 of the 152nd General Assembly (2023-2024)).
[94] *See generally* Jerome R. Hellerstein et al., State Taxation ¶ 20.08 (3d ed. 2023), Westlaw.
[95] *Id.*
[96] Pieczonka, *supra* note 37, at 534.
[97] *See* Samuel Nadler, *Federal Fiduciary Duties and Private Equity: The Search for Workable Standards*, 2018 COLUM. BUS. L. REV. 254, 258.
[98] *Dodd-Frank Act*, HISTORY, https://www.history.com/topics/21st-century/dodd-frank-act (July 10, 2023).
[99] Nadler, *supra* note 97, at 261.
[100] *Id.* at 262.
[101] *See* 15 U.S.C. §§ 80b-3(b), 80b-3(a).

company because it "is engaged in investing or trading in securities."[102] However, private equity firms often use two exceptions to that requirement in order to avoid registration: (1) there are fewer than 100 owners or (2) all owners are qualified purchasers at the time of acquisition.[103]

In the fund world, general partners receive a myriad of sources of income from their work managing a fund's investment portfolio.[104] First, general partners might receive annual management fees taxed as ordinary income,[105] which are similar to a salary. Second, partners often receive "carried interest," which is essentially a portion of the appreciation in the fund's investments.[106] Third, general partners receive profit from their own capital investment in the fund.[107]

As explained, the United States government taxes ordinary income at higher rates than capital gains.[108] Because annual management fees, the first form of compensation mentioned above, are characterized as ordinary income, managers must pay a higher tax on those items.[109] Meanwhile, the appreciation of the funds' investments acts as long-term capital gains as long as the partnership holds on to those assets for one year.[110] Most agree that the actual appreciation in the managers' own investments, the third form of compensation explained above, should be taxed preferentially.[111] However, the appreciation of the collective "pot," or carried interest, still receives capital gains treatment.[112] This amount is often distributed to the managing partners in a manner similar to a salesman receiving commission in addition to his base salary.[113] This Note argues that this type of income should be taxed as ordinary income instead of receiving preferential treatment. While the case against carried interest is long and storied,[114] this Note argues that Congress's failure

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[102] Rowe & Kliger, *supra* note 74.
[103] *Id.*; *see generally* 15 U.S.C. § 80a-3(c) (2022).
[104] *See* Pieczonka, *supra* note 37, at 539.
[105] *Id.*
[106] *Id.* at 539-40.
[107] *Id.* at 540.
[108] *See generally* York, *supra* note 35.
[109] Pieczonka, *supra* note 37.
[110] *Id.* at 540.
[111] *Id.* at 546.
[112] *Id.* at 541.
[113] *Id.*
[114] *See generally* Valerie M. Hughes, *Flip This Company, but don't Leave its Pensioners out in the Cold: Sun Capital as a Call to Action to Change Taxation of Private Equity Funds,* 92 N.C. L. REV. 1322 (2014) (stating a call to action to change the incorrect interpretation of carried interest taxation); Jarrod Shobe, *Misaligned Interests in Private Equity,* 2016 B.Y.U. L. REV. 1435 (2016) (detailing political, media, and economic criticisms of carried interest); Libin Zhang, *Partnership Tax Reform and the Biden-Harris Tax Pledge*, 137 J. TAX'N 17 (2022) (describing the proposed plan by President Biden to eliminate the carried interest loophole for high-earning individuals). *But see*

to cure this deficiency violates international law as well as general principles of U.S. tax law.

3. *Chile's Private Equity*

Under Chilean law, private investment funds lack any "legal personality" of their own.[115] However, the fund itself must register with the Chilean tax authorities.[116] Although special rules govern international funds' presence in Chile, this Note focuses on domestic funds. Chilean private equity funds, or fondos de inversion privado [FIPs], serve as the main investment vehicle for groups entering the private equity space.[117] This type of entity has several benefits that are not available to public funds. First, the fund formation does not need prior approval of the Superintendencia de Valores y Seguros [SVS], the Chilean equivalent of the SEC. [118] Instead, as LAVCA explains:

> The only filing requirements for FIPS are (i) a resolution of the fund manager's board of directors approving the incorporation of the fund and (ii) the final version of the fund's bylaws. Upon filing the resolution and bylaws, the fund can obtain an identification number from the tax authorities and begin operations. FIPs are subject only to the rules contained in their internal regulations and are not subject to the oversight of the SVS.[119]

These entities cannot simply exist in space, however. A duly incorporated and registered corporation, or "Manager Company," must manage the fund, act as its legal representative, and liaise between the fund, which is not registered with the SVS, and the SVS itself.[120] Further, a year into the fund's existence, "neither the Manager Company nor its related parties may own equity representing more than 20% of the fund . . . and [] the fund must have at least four unrelated parties as investors."[121]

Importantly, investment funds are not subject to income tax in Chile.[122] This applies whether or not the fund registers with the SVS as a public or

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Osborne, *supra* note 41 (arguing that eliminating the carried interest tax break will have a net negative effect by decreasing investment).

[115] Amicorp, *Private Investment Funds ("FIP") of Chile*, AMINEWS (Aug. 5, 2016), https://www.amicorp.es/AmiNews/2016/august/the-chilean-private-investment-fund.php.

[116] *Id.*

[117] Constanza Rodriguez et al., Association for Private Capital Investment in Latin America [LAVCA], *Chile Private Equity Policy Overview* (Feb. 8, 2016).

[118] *Id.*

[119] *Id.*

[120] *Id.*

[121] *Id.*

[122] *Corporations: Venture Capital and Private Equity in Chile*, BROKERING ABOGADOS (Feb. 17, 2020), https://www.brokering.cl/venture-capital-and-private-equity-in-chile/.

private fund. Further, numerous benefits exist for foreign investors. First, if 80% of capital is invested in foreign assets, rents and earnings from those investments do not pay taxes in Chile, and if 90% is invested abroad, none of the investment is taxed in Chile.[123] Numerous incentives exist for domestic funds with domestic investors as well. For a natural person domiciled in Chile who pays Complementary Global Tax [IGC], Chile generally treats a distribution of fund profits to contributors as a dividend from local corporations.[124] As such, investors have the right to use any tax paid by the investment company as a credit, just as employees can deduct taxes paid by their employer on their behalf from their taxable income.[125] Further, the income retains its character upon distribution, so if it fell into any sort of tax-exempt exception, the investors would receive that benefit.[126]

As opposed to distributions of profits, funds also deliver income from the disposal or redemption of shares.[127] For natural persons, this type of income is also taxed under IGC by calculating the difference in selling price and basis. Depending on whether the fund meets relevant requirements, the profits obtained do not constitute income, called "ingresos no constitutivos de renta," or INR. As the name suggests, this type of income is not taxable to the recipient. However, Article 107, the relevant statute for these requirements, applies only to publicly traded companies or funds whose investments consist of publicly traded securities.[128] FIPs do not fall into this category.

FIPs still enjoy a variety of tax benefits, though. They are flow-through entities, similar to funds in the United States.[129] Therefore, the fund itself does not pay taxes.[130] However, once a contributing party receives profits from the fund, it triggers a taxable event. For those domiciled in Chile, the government imposes the Global Complementary Tax on the profits.[131] Although the investor cannot offset that income by taxes paid by the fund itself, because the

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[123] *Id.*

[124] *¿Que Son Los Fondos Mutuos?* [*What are Mutual Funds?*], ASOCIACIÓN ADMINISTRADORA DE FONDOS MUTUOS, https://www.aafm.cl/que-son-los-fondos-mutuos/.

[125] *Id.*

[126] *Id.*

[127] The legal rules that govern the FIPs, beyond their statutes and internal regulations, are Title VII of Law No. 18,815 on Investment Funds and what corresponds to them from the Investment Funds Regulations, contained in Supreme Decree No. 864 of 1989, from the Treasury.

[128] Law No. 18,815 tit. vii, art. 107, Octubre 2, 2022, DIARIO OFICIAL [D.O.] (Chile).

[129] Roberto Spencer, *Los Fondos de Inversión Privados* [*Private Investment Funds*], EDN ABOGADOS (Aug. 25, 2021), https://ednabogados.cl/2021/08/25/los-fondos-de-inversion-privados/.

[130] *Id.*

[131] *Id.*

fund did not pay any taxes, the taxpayer still has the right to a credit for any taxes paid by the entities in which the fund invested.[132]

III. ANALYSIS

A. THE PROBLEM AS IT STANDS

Both the United States and Chile have similar systems of private equity. Specifically, the United States and Chile both have a system where sponsors, or administrators, manage a fund in the private market where other investors can partake. However, the compensation and the resulting taxation in each system differs. In Chile, the amount paid to the administrators for their services is treated as a commission and, as such, is subject to a value-added tax of 19%, as explained later. The return on their own capital invested is taxed under normal Worldwide Income tax rates. In the United States, sponsors receive a variety of sources of income: commissions and fees are taxed at ordinary rates, return on their own capital is taxed at capital gains rates, and carried interest is also taxed at capital gains rates. In Chile, for private funds specifically, the tax regime is appropriate.[133] However, in the United States, the tax regime is wildly at odds with principles of taxation, equity, and international norms.

The carried interest debate in the United States is not new. Recently, Congress went further than before in attempting to eliminate the loophole, but one person blocked the effort: Kyrsten Sinema.[134] Americans voted Joe Biden into the Office of President in 2020, and with that mandate, Biden attempted to enact his Build Back Better agenda.[135] He faced blowback in Congress,

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[132] *Id.*

[133] For criticisms of Chile's *public* capital gains tax exemptions, see SEAN KENNEDY, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, OECD TAX POLICY REVIEWS: CHILE 2022. Further, see Chile's response in 2020 to address some of these shortfalls. *Chile: Corporate – Significant Developments*, PWC (Feb. 8, 2024), https://taxsummaries.pwc.com/chile/corporate/significant-developments#:~:text=Now%2C%20the%20capital%20gain%20obtained%20from%20the%20transfer,effective%20%28i.e.%2C%20when%20published%20in%20Chilean%20Official%20Gazette%29.

[134] Sahil Kapur, *Kyrsten Sinema Delivers a 'Gift to Private Equity' in Democrats Big Agenda Bill*, NBC NEWS (last updated Aug. 12, 2022, 9:00 AM EDT), https://www.nbcnews.com/politics/congress/kyrsten-sinema-delivers-gift-private-equity-democrats-big-agenda-bill-rcna42394.

[135] Joey Garrison & Ledyard King, *What's in the House-Passed Build Back Better Bill? Paid Leave, Universal Pre-K and More*, USA TODAY (last updated Nov. 19, 2021, 2:12 PM ET), https://www.usatoday.com/story/news/politics/2021/11/19/build-back-better-whats-house-passed-version-bidens-bill/8681429002/?gnt-cfr=1.

however, and Senator Joe Manchin seemingly hit the final nail in the coffin.[136] But behind the scenes, Manchin and Chuck Schumer, the Senate Majority Leader, quietly struck a deal on a pared-down version of the bill several months later.[137] The Inflation Reduction Act would have invested "more than $400 billion over 10 years, to be fully paid for by closing tax loopholes on the richest Americans and corporations."[138] Eliminating the loophole would have "produce[d] an estimated $14 billion in revenues from 2019 through 2028," according to the Congressional Budget Office.[139] However, Kyrsten Sinema refused to pass the bill with this provision, ostensibly due to it failing to be "what's best for Arizona."[140] However, Sinema received "at least $2 million from the securities and investment industry," leading some to believe her refusal to sign the bill has more to do with campaign finances than the welfare of Arizona.[141] While this problem is not new, it is especially important right now as Congress continues to polarize more and more. To begin the analysis of this problem, it is helpful to start with a discussion of the relevant law and standards.

B. SUMMARY OF THE LAW

1. *American Tax Code*

As previously discussed, the carried interest problem resides within the American tax code in Subchapter K. The partnership itself does not pay tax; only the partners do in their individual capacities.[142] § 702 sets out the general rules for the computation of each partner's income tax, dividing income

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[136] Ronn Blitzer, *Manchin Says He 'Cannot Vote' for Build Back Better: 'I've Done Everything Humanly Possible,'* FOX NEWS (Dec. 19, 2021, 9:23 AM EST), https://www.foxnews.com/politics/manchin-says-he-cannot-vote-for-build-back-better-ive-done-everything-humanly-possible.

[137] Anna Kaufman, *What is the Inflation Reduction Act of 2022? Answering Your Common Questions About the Bill*, USA TODAY (Dec. 12, 2022), https://news.yahoo.com/common-questions-inflation-reduction-act-100004450.html?fr=sycsrp_catchall.

[138] Kevin Breuninger, *Schumer, Manchin Announce Deal on Reconciliation Bill with Tax, Climate, Energy Provisions*, CNBC (last updated July 27, 2022, 6:48 PM EDT), https://www.cnbc.com/2022/07/27/manchin-announces-deal-with-schumer-on-reconciliation-bill-with-tax-climate-energy-provisions.html.

[139] CONG. BUDGET OFF., OPTIONS FOR REDUCING THE DEFICIT: 2019 TO 2028, 225 (Benjamin Plotinsky et al. eds., 2018).

[140] Kapur, *supra* note 134.

[141] Brian Schwartz, *How Wall Street Wood Sen. Kyrsten Sinema and Preserved Its Multibillion-Dollar Carried Interest Tax Break*, CNBC (last updated Aug. 9, 2022, 8:56 PM EDT), https://www.cnbc.com/2022/08/09/how-wall-street-wooed-sen-kyrsten-sinema-and-preserved-its-multi-billion-dollar-carried-interest-tax-break.html.

[142] I.R.C. § 701.

among different character classes.[143] Later, the Code specifies that certain different types of income must be separately stated, namely capital gain income.[144]

A fund's income comes from two primary sources: carried interest and management fees.[145] The general partner or sponsor typically receives the management fee as a sort of service fee from the limited partners in consideration of running the fund.[146] In this way, the income is ordinary revenue to the partnership as an entity. However, the partnership entity pays this fee to the general partner(s), and because it is a "payment[] made by a partnership to a partner for services," the payment constitutes a guaranteed payment. As such, the sponsor must include the payment "as ordinary income for his taxable year."[147] In contrast, carried interest represents "a percentage of the profits of the private equity fund."[148] Because the fund derives income from investment, it often arrives in the form of capital income to the partnership and partners, thereby substantially reducing tax rates.

2. Chilean Tax Code

The Chilean Tax system, while taxing capital income at the same level of ordinary income, still does not raise significant revenue compared to the rest of the OECD.[149] The focus of that taxation also differs significantly from that of other countries in the OECD.[150] In Chile, although personal income tax rates are high, the government raises most of its revenue from value-added taxes (VATs) and corporate income taxes (CITs).[151] Governments impose VATs incrementally throughout the supply chain on the value added at each level, so they are a type of sales tax.[152] In this way, Chile relies less on personal income taxes and social security contributions to fund services.[153] This structure results in a relatively low level of funding available for social

[143] I.R.C. § 702(a).
[144] I.R.C. § 703(a)(1).
[145] 4D ROBERT L. HAIG, COM. LITIG. IN NEW YORK STATE COURTS: NEW YORK PRACTICE SERIES § 109:4 (5th ed., 2020)
[146] *Id.*
[147] Treas. Reg. § 1.707-1(c).
[148] Haig, *supra* note 140.
[149] SEAN KENNEDY, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, OECD TAX POLICY REVIEWS: CHILE 2022 21 (2022) ("[R]elative to the size of its economy [measured by GDP] Chile raises tax revenues of about 60% of the OECD average.").
[150] *Id.*
[151] *Id.*
[152] *Value-Added Tax (VAT)*, TAX FOUND., https://taxfoundation.org/business-taxes/value-added-tax/ (last visited Nov. 18, 2022).
[153] KENNEDY, *supra* note 149, at 22.

benefits due to a small tax base.[154] As a result, the OECD has actually recommended that Chile "rebalance[e] the tax mix . . . by increasing personal income tax revenues, including revenues from taxes on capital income."[155]

Chile does not have a domestic equivalent to the U.S. concept of carried interest. Instead, Chilean law creates a system where fund administrators can either receive compensation directly from the fund or from the other investors.[156] When receiving payments from the other investors, Chile designates that payment as commission, an amount that can only be paid out upon investment in or redemption of the fund interest.[157] Normally, payments charged by the administrator are subject to a value-added tax of 19%.[158] However, several exceptions exist for special funds related to housing and foreign investors.[159] Additionally, if the administrator immediately pays the amount back into the fund, that amount is not considered taxable income to the administrator.[160] Finally, the return on the administrator's own investment is treated as a capital gain, subject to the Global Complementary tax on the profits.[161]

3. U.S. Tax Standards

While the U.N. might seem like it promotes standards and passes resolutions covering every policy area, items covering taxation are conspicuously absent. Instead, for the last century, "international tax rules have been primarily determined by the OECD."[162]

4. OECD Tax Standards

Because the U.N. lacks any unified standards for taxation, we can look to other intergovernmental bodies as an alternative. Both Chile and the United States have memberships in the Organisation for Economic Co-operation and

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[154] *Id.* at 9. Further, "76% of Chileans that file tax returns are in the exempt bracket." *Id.* at 27. This means that a significant portion of the population in Chile pays no personal income tax.
[155] *Id.* at 27.
[156] Law No. 20712 art. 9, Diciembre 24, 2013, Biblioteca del Congreso Nacional de Chile [B.C.N.] (Chile).
[157] *Id.*
[158] *See* Decree No. 825 art. 2, Diciembre 27, 1974, Biblioteca del Congreso Nacional de Chile [B.C.N.] (Chile) (defining "service" as any action a person performs for another for which he receives a commission or any other type of payment). *Id.* art. 14.
[159] *Id.* art. 83.
[160] Law No. 20712, *supra* note 156 ("La remuneración aportada al fondo no constituirá renta para la administradora, para ningún efecto legal ni tributario.").
[161] Spencer, *supra* note 129.
[162] *U.N. Tax Convention*, TAX JUST. NETWORK, (last visited Nov. 20, 2022) https://taxjustice.net/topics/un-tax-convention/.

Development (OECD), and this body has published some standards around tax. Before examining those standards, however, it is important to acknowledge the limitations of the OECD as an organization first.

The OECD, in its words, "works to build better policies for better lives" through working with a variety of governmental and non-governmental actors.[163] These policies range from "fostering strong education" to "fighting international tax evasion," and the organization boasts of its ability to influence international standards.[164] However, its tax policy has garnered increased criticism in recent years.[165] Most recently, U.N. member states have asserted that national bodies lack an "inclusive forum for international tax cooperation," as OECD membership is limited to a small number of wealthier nations.[166] For years, the self-proclaimed G77, the world's group of lower-income countries, have bemoaned this system, arguing that attempts to allow non-members to participate have "been neither inclusive nor effective," and measures that do somehow make it into official proposals are rarely passed into law by the biggest players in the organization.[167]

In light of these criticisms, the OECD's tax policy must be analyzed carefully and in context. The OECD lays out five main standards, known as the Ottawa Taxation Framework Conditions, "that have traditionally guided the development of taxation systems."[168] These include neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility. Neutrality and fairness are the two standards that most clearly align with principles of equity. The OECD's discussion defines neutrality mainly by stating that all forms of business should be taxed in the same way in order to promote an "equal and neutral" tax scheme.[169] As for the fairness standard, the publication states, "[t]axation should produce the right amount of tax at the right time, while avoiding both double taxation and unintentional non-taxation."[170] Only

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[163] *About,* ORG. ECON. COOP. & DEV., https://www.oecd.org/about/ (last visited Nov. 19, 2022).
[164] *Id.*
[165] *See generally* Spencer Woodman, *Global Tax Proposal Gains Ground at U.N. as OECD Plan Falters*, INT'L CONSORTIUM OF INVESTIGATIVE JOURNALISTS (Oct. 18, 2022) (arguing that the OECD has failed to contain tax evasion); David Spencer & J.C. Sharman, *OECD Proposals on Harmful Tax Practices: A Status Report (Part 2)*, 17 J. INT'L TAX. 32, 60 (stating that while the OECD has made significant steps forward in its policy recommendations, the "actual implementation . . . has not yet progressed substantially…").
[166] *Id.*
[167] Irene Ovinji-Odida, *Forward to* TAX JUSTICE NETWORK, STATE OF TAX JUSTICE 2022: STOPGAP EDITION, 3 (Nov. 2022).
[168] OECD, *Fundamental Principles of Taxation, in* ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY 30 (2014).
[169] *Id.*
[170] *Id.* at 31.

after discussing these "foundational" principles does the OECD mention equity by name.[171]

The OECD explains that equity has two components – horizontal and vertical – and defines horizontal equity accordingly.[172] However, the organization then defines vertical equity as "a normative concept," asserting that it means different things to different people. Yet, it gives only one definition (that taxpayers with a higher ability to pay tax should pay more).[173] This lack of a strong definition is, at best, unhelpful and, at worst, inequitable. This section also expands on "inter-nation equity" in great detail, describing how each country should "receive[] an equitable share of tax revenues."[174] In some ways, this focus on cross-border gaps makes sense, as the OECD is a coalition of member states that are often engaged in trade with one another. However, it demonstrates the shortcomings of relying on the OECD to set equitable standards for taxation on the world stage. At its core, it represents a small group of wealthy countries and has a vested interest in maintaining its influence by keeping wealth within that group.

5. U.N. General Standards

After exhausting relevant guidance and authority, it is imperative to look at general U.N. standards that can relate to principles of taxation. First, the U.N. Charter devotes a chapter to "International Economic and Social Cooperation," and Articles 55 and 56 contain the most relevant portions. First, Article 55 states:

> With a view to the creation of conditions of stability and well-being which are necessary for peaceful and friendly relations among nations based on respect for the principle of equal rights and self-determination of peoples, the United Nations shall promote:
> - higher standards of living, full employment, and conditions of economic and social progress and development;
> - solutions of international economic, social, health, and related problems; and international cultural and educational cooperation; and
> - universal respect for, and observance of, human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion.[175]

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[171] *Id.*
[172] *Id.*
[173] *Id.*
[174] *Id.*
[175] U.N. Charter art. 55.

This Article lays out the foundation on which U.N. economic policy rests, citing stability, well-being, equality, and self-determination as necessary components of the world order.[176] Considering those principles, the U.N. commits to promoting solutions for international economic problems, but much of the provision speaks to social progress (i.e., health problems, educational cooperation, human rights, and fundamental freedoms).[177] Finally, in the immediately following provision, all member states pledge to take individual and collective action in cooperation with the U.N. in pursuit of those goals.[178]

As such, the U.N. and its member states explicitly acknowledge how economic and social rights are intertwined.[179] In fact, much of this Article does not address economic measures at all. Instead, it focuses on social metrics, implying a sort of proxy for economic well-being found in social progress. One cannot exist without the other. In this way, the U.N.'s stance on economic policy is one of equity, freedom, and progress.

Beyond the U.N. Charter, the United Nations has passed a variety of other provisions that touch on taxation, namely the International Covenant on Economic, Social and Cultural Rights (ICESCR). Throughout the ICESCR, the States parties covenant "to achieve the full realization" of rights enumerated throughout the document.[180] This means that each party agrees "to take steps . . . to the maximum of its available resources" to eventually realize these rights.[181] The covenant even states that economic steps and the adoption of legislative measures are "especially" and "particularly" important to this goal.[182] Chile signed this covenant in 1969, and its legislature ratified it in 1972.[183] On the other hand, the United States signed this covenant in 1977, but the U.S. Congress did not ratify it.[184] 172 states are full parties to this covenant, four are mere signatories, and twenty-two took no action.[185]

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[176] *Id.*
[177] *Id.*
[178] U.N. Charter art. 56.
[179] Mónica Pinto, *Introductory Note to the* INTERNATIONAL COVENANT ON ECONOMIC, SOCIAL AND CULTURAL RIGHTS (Nov. 2020).
[180] International Covenant on Economic, Social and Cultural Rights arts. 3, 11, 12, and 13, Dec. 16, 1966, 993 U.N.T.S. 3 (explaining that "the right to work," "the right of everyone to an adequate standard of living," "the right of everyone to the enjoyment of the highest attainable standard of physical and mental health," and "the right of everyone to education," among others, must be realized).
[181] *Id.* art. 2.
[182] *Id.*
[183] *International Covenant on Economic, Social and Cultural Rights* in *Status of Ratification Interactive Dashboard*, U.N. HUM. RTS. OFF. HIGH COMM'R, https://indicators.ohchr.org/ (last updated Nov. 3, 2022).
[184] *Id.*
[185] *Id.*

C. FINDING AN AFFIRMATIVE RIGHT FOR STATES TO ADEQUATELY TAX

According to a report of the Special Rapporteur on extreme poverty and human rights, the ICESCR creates a responsibility for states to raise adequate revenue via taxes.[186] The report states that this principle "should guide the State's decisions and priorities in generating, mobilizing and allocating resources in order to permit the realization of human rights."[187] The report further identifies tax as "a critical tool for realizing human rights and tackling inequality."[188] It sets out a three-part argument, stating first that taxation generates revenue for States' "realization of rights."[189] Second, taxation is a tool to "achiev[e] equality and tackl[e] discrimination."[190] Third, tax schema strengthens "governance and accountability."[191]

First, states must generate revenue in order to provide resources to their citizens. Without adequate resources, states cannot provide adequate standards of living, healthcare, education, and social security, leading the United Nations Educational, Scientific and Cultural Organization (UNESCO) to qualify tax systems as vital.[192] Many countries, however, do not "tap their tax bases sufficiently."[193] This results in a disproportionate impact on low-income populations, as "people living in poverty are particularly dependent on public services,"[194] as well as other marginalized groups like people with disabilities and women.[195]

This disproportionate impact leads to the report's second point: achieving equality and tackling discrimination. This point relies on a major function of taxation according to some progressive scholars: redistribution.[196] This principle posits that taxes are "part of the arsenal of measures" for states to use to reduce income inequality and address disparities in human rights,

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[186] Carmona, *supra* note 23, at ¶ 5.
[187] *Id.* ¶ 25.
[188] *Id.* at 10.
[189] *Id.* ¶ 36.
[190] *Id.*
[191] *Id.*
[192] *Id.* ¶ 43; UNESCO, 2013/4 Education for All Global Monitoring Report, – "Teaching and learning: achieving quality for all," p. 116.
[193] *Id.* ¶ 43 (citing UNESCO, *supra* note 192).
[194] *Id.* ¶ 44.
[195] *Id.* (stating "persons with disabilities are more likely to come into regular contact with health and social services, while women are more likely to be directly dependent on social protection and health systems for at least some period of their lives" and that women bear the burden of serving "as unpaid alternative care providers when public services are not adequately funded").
[196] Ignacio Saiz, *Resourcing Rights: Combating Tax Injustice from a Human Rights Perspective, in* 77 HUMAN RIGHTS AND PUBLIC FINANCE: BUDGETS AND THE PROMOTION OF ECONOMIC AND SOCIAL RIGHTS 82 (Aofie Nolan et al. eds., 2017).

placing an emphasis on discrimination against women.[197] States must raise adequate resources to provide for social services, of course, but states must also use the correct mix of tax policies to address inequalities.[198] For example, excessive taxation on goods and services paired with weak rates imposed on income, wealth, and property can bring about inequitable results.[199] However, every country is different, and both Chile and the United States have their own unique histories, challenges, and injustices.

The third and final area in which governments can use taxation to achieve greater equality is by strengthening governance and accountability.[200] According to the OECD, taxation is vital for governance and vice versa.[201] Taxation can increase state capacity, accountability, and responsiveness because states depend on taxpayers to accomplish their goals while taxpayers demand a greater say in tax policy in return.[202] For example, states that garner most of their revenues from exports like oil do not depend on their citizens to generate revenue. As such, governments have little incentive to promote economic development or negotiate with its citizens.[203] In furtherance of these goals, the OECD recommends making tax systems more transparent and simpler to encourage voluntary compliance in countries whose citizens do not trust their governments with their tax dollars.[204] In short, taxation is one of the most public-facing policies implemented by governments. Public confidence increases by creating a "sustainable base" of tax dollars, as does "the right of all persons to take part in the conduct of public affairs."[205] The report also highlights how growing income disparities and governments' subsequent inabilities or flat-out refusals to address them via the tax system serve to further polarize society.[206]

Under this application of the ICESCR, regarding tax policy, both the United States and Chile have a long way to go before fully realizing the rights enshrined in that document. However, in terms of the taxation of private fund managers, Chile is following this covenant while the U.S. is not.

While private investment funds in Chile exist as flow-through entities, meaning they are not subject to tax, the administrators of these funds are taxed

[197] *Id.*
[198] Carmona, *supra* note 23, at ¶ 47.
[199] *Id.*
[200] *Id.* ¶ 36.
[201] Organisation for Economic Co-operation and Development [OECD], *Factsheet on Taxation, State Building and Aid*, 1 (Mar. 2008), https://www.oecd.org/dac/accountable-effective-institutions/40456396.pdf.
[202] *Id.*
[203] *Id.* at 1-2.
[204] *Id.* at 2.
[205] Carmona, *supra* note 23, ¶ 52.
[206] *Id.* ¶ 53.

similarly to other service providers in Chile.[207] The service itself is subject to a value-added tax, while any return on administrators' own capital is taxed as ordinary income unless those stocks fall under some sort of exemption.[208] Additionally, an administrator's income or salary is further subject to regular income tax.[209] In this way, the fund managers' compensation is taxed as compensation, and their return of capital is taxed as return of capital. Because Chile, in name, taxes capital gains similarly to regular income, this scheme results in an adequate layer of taxation surrounding a private investment fund. In other words, there are no glaring loopholes.

This means that Chile is fulfilling the covenant it made in the ICESCR in this one instance. By creating a system in which private investment funds are adequately taxed, Chile is "generating revenue for the realization" of its citizens' rights.[210] In other words, if Chile has a deficit problem, revamping this part of its tax policy would not have a large effect on closing that gap. Additionally, by taxing these types of transactions, Chile achieves greater equality while "tackling inequality."[211] By taxing transactions that often involve sophisticated institutional investors and successful financial analysts, Chile can redistribute wealth to the population that sits below the poverty line.[212] Finally, Chile's robust taxation policy contributes to public confidence, strength of governance, and democratic accountability.[213] In fact, Chile's economic reforms have "contributed to steady growth, reduced poverty rates . . . and helped secure . . . [Chile's] commitment to democratic and representative government," according to some.[214]

Finally, Chile's system, in this one instance at least, seems to live up to the standards espoused by the OECD: "neutrality, efficiency, certainty and simplicity, effectiveness and fairness, . . . flexibility," and equity.[215] First, while the Chilean government treats the fund itself as a nontaxable entity, and thus has a different tax treatment, the administrator is treated neutrally – meaning they are taxed similarly to other service businesses.[216] Second,

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[207] *See* Decree Law No. 825 art. 2, Diciembre 27, 1974, Biblioteca del Congreso Nacional de Chile [B.C.N.] (Chile).
[208] *Id.*; Spencer, *supra* note 129.
[209] PwC, *supra* note 42.
[210] Carmona, *supra* note 23, at 2.
[211] *Id.*
[212] *See* Central Intelligence Agency [CIA], *Chile*, *in The World Factbook*, https://www.cia.gov/the-world-factbook/countries/chile/#economy (last updated Mar. 13, 2024) (stating the population below the poverty line in Chile is only 8.6%) [hereinafter CIA].
[213] Carmona, *supra* note 23, at 3.
[214] *See* CIA, *supra* note 212.
[215] OECD, *Fundamental Principles of Taxation, in* ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY 29, 30 (2014).
[216] Brokering Abogados, *supra* note 122.

compliance costs for the administrators themselves and for the government are minimized as this is a standard tax scheme that, for the most part, has not changed.[217] Similarly, the law surrounding private investment funds has not changed and is not under attack in Chile as of now; instead, Chile has reevaluated the way in which it exempts certain public stock sales from taxation.[218] Therefore, the law for this type of transaction is certain and simple. Fourth, this tax system does not overtax or undertax these transactions, especially compared to other businesses in Chile, so it is effective and fair.[219] Fifth, the guidance on this subject has been flexible, and it may have to continue doing so as fewer exemptions will soon exist for private funds' public counterparts.[220] Finally, this tax is equitable, both vertically and horizontally. In the vertical sense, other service-oriented businesses are taxed similarly (with VATs on the production or sale of services), and the only difference is between the tax treatment of public and private funds.[221] However, as stated previously, the tax schema of public funds seems to be changing to resemble that of private fund policy. Finally, on its face, it seems vertically equitable, meaning that wealthy administrators have to pay taxes on several levels of the transaction, thereby increasing their relative burden compared to a small business taxpayer, for example.[222]

The United States, on the other hand, does not have an adequate system of taxation in place to tax private equity managers. Most private equity funds are structured as limited partnerships, so the income the fund receives retains its character as it flows through to the partners.[223] This means that commissions charged to investors pass through to partners as ordinary income, and capital gains on managers' own investments pass through to partners as capital income.[224] However, private equity funds structure themselves so that much of their income enters the partnership as carried interest and thus receives preferential capital gain treatment.[225] In this way,

[217] For examples of how often other provisions of Chilean tax law change, *see* Ignacio Gepp, *Is There a Chilean Tax Policy?*, BLOOMBERG TAX (Feb. 25, 2022) https://news.bloomberglaw.com/tax-insights-and-commentary/is-there-a-chilean-tax-policy.
[218] PwC, *supra* note 133.
[219] SEAN KENNEDY, OECD, TAX POLICY REVIEWS: CHILE 2022, 21 (2022).
[220] *See* Eduardo Thomson, *Chile Moves to Reimpose Tax on Trading Profits After 20 Years*, BLOOMBERG, (Sept. 20, 2021) https://www.bloomberg.com/news/articles/2021-09-20/chile-moves-to-reimpose-tax-on-trading-profits-after-20-years?leadSource=uverify%20wall.
[221] Brokering Abogados, *supra* note 122.
[222] *Value-Added Tax (VAT)*, *supra* note 152.
[223] I.R.C. § 701.
[224] *Id.*
[225] Pieczonka, *supra* note 37.

the Internal Revenue Code treats a return of capital as a return of capital, but it treats compensation as a return of capital as well.

By preserving the carried interest loophole, the United States is not living up to the spirit of the U.N. Charter; further, its actions flatly violate the ICESCR. First, the United States is a founding member of the United Nations, and as such, it saw fit to include an entire chapter devoted to economic policy in the aftermath of a world war.[226] A provision therein states that the U.N. agrees to promote solutions to economic problems and international cooperation in addressing those problems.[227] The U.N. Charter places economic equality and prosperity as an indispensable step in achieving social progress, and the way a nation taxes its citizens is an indispensable part of a country's economic policy.[228] Therefore, when a state like the United States continues to allow such a glaring tax loophole for wealthy individuals, it fails to live up to the goals proclaimed in the U.N. Charter.

While missing the mark when it comes to the U.N. Charter is not an actionable offense, flatly breaking an international covenant rises to the level of an international violation. Even though the U.S. Congress has not ratified this document, almost every other country has done so, so international custom governs. By failing to adequately tax private equity fund managers, the United States is failing "to achieve the full realization" of rights enumerated throughout the document.[229] This is evident because the U.S. is not using the "maximum of its available resources" by undertaxing a portion of its population.[230] In this way, the U.S. fails the first mission of the Special Rapporteur's report: to generate revenue.[231] Additionally, by failing to correct this error, the U.S. is in a worse position to address systemic inequality through government action.[232] Finally, the U.S.'s lackluster taxation policy contributes to a lack of public confidence and a corresponding loss in strength of governance.[233] The United States has a long and storied history with the concept of taxation; but in 2019, about six in ten Americans doubted the tax

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[226] *See* U.N. Charter ch. ix.
[227] *Id.* art. 55.
[228] Pinto, *supra* note 179.
[229] International Covenant on Economic, Social and Cultural Rights arts. 3, 11, 12, and 13, Dec. 16, 1966, 993 U.N.T.S. 3, (explaining that "the right to work," "the right of everyone to an adequate standard of living," "the right of everyone to the enjoyment of the highest attainable standard of physical and mental health," and "the right of everyone to education," among others, must be realized).
[230] *Id.* art. 2.
[231] Carmona, *supra* note 23, at 20.
[232] *Id.*
[233] *Id.*

system's fairness.[234] This is evident, in part, from the American public's wide acceptance and approval of increasing taxes on the very rich.[235] While correcting this specific loophole likely would not correct all of this mistrust, it is an important step forward.

Additionally, the U.S.'s taxation schema surrounding carried interest receives low marks when compared to the OECD's standards.[236] While the current law is efficient, certain, and somewhat flexible, it is not neutral, simple, effective, fair, or equitable. Taxpayers and the I.R.S. both know the law surrounding this issue, and it is relatively cheap to administer that law in this specific context; however, partnership tax is one of the most complex areas of the Tax Code.[237] Further, the law on this point has consistently stayed the same despite many objections, so it has stayed certain.[238] Additionally, because this is partnership tax law, the rules are somewhat flexible, mirroring the flexibility of this business form.[239]

However, the current law is not neutral. While, in theory, all partnerships are being taxed in the same way, all service-oriented entities are not. For example, say two entities exist in a country where pet-sitting income receives preferential tax treatment. Snoopy & Woodstock L.P. is in the pet-sitting business, and it sells some dog food on the side. Therefore, the majority of its income is taxed preferentially while only a small portion is taxed under the ordinary rates. On the other hand, Charlie Brown L.P. is in the business of selling dog food while pet-sitting some on the side. The partnership pays ordinary taxes on dog food sales, which is the majority of the compensation, and receives preferential treatment on the pet-sitting income. When comparing these two entities, one receives preferential treatment for the main part of its business while the other does not. The difference is clear: this country wants to incentivize pet-sitting. However, in the process, it results in

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[234] NCC Staff, *On This Day: "No Taxation Without Representation!"*, NAT'L CONSTITUTIONAL CENTER (Oct. 7, 2022); Domestic Policy: Taxes, Environment, Health Care, PEW RESEARCH CENTER (Dec. 17, 2019).
[235] Howard Schneider & Chris Kahn, *Majority of Americans Favor Wealth Tax on Very Rich: Reuters/Ipsos Poll*, REUTERS (Jan. 10, 2020).
[236] OECD, *Fundamental Principles of Taxation, in* ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY 69, 90 (2014).
[237] *See* Brian T. Lovett, *Partnership Tax Preparation and Compliance*, LORMAN (2021), https://www.lorman.com/training/accounting/partnership-tax-preparation-and-compliance.
[238] *See* Alan Rappeport et al., *The Carried Interest Loophole Survives Another Political Battle,* N.Y.TIMES (Aug. 5, 2022), https://www.nytimes.com/2022/08/05/business/carried-interest-senate-bill.html#:~:text=A%20tax%20law%20passed%20by%20Republicans%20in%202017,years%20in%20order%20to%20enjoy%20preferential%20tax%20treatment.
[239] Julie McGinty, University of Georgia, Lecture at University of Georgia Partnership Tax Class (Nov. 8, 2022).

a biased system where pet-sitting firms can treat their ordinary business income as preferential income. Similarly, the United States' system incentivizes investment, but in the process, it allows for a gross perversion of the tax code's commitment to tax business income at a higher rate than capital gains income. When an entity's entire reason for being is centered on investment, it no longer should be able to treat that income preferentially.

Additionally, taxation of carried interest is neither simple nor effective. For one, a simple topic could be covered in far less than 10,000 words. Additionally, the law surrounding partnership taxation as a whole is extremely complicated and constantly changing; carried interest is no different, especially when one considers the wealth of authorities on this topic.[240] As for its effectiveness, the CBO projected a $14 billion increase in tax revenue if Congress were to eliminate the loophole.[241] Clearly, the Code is not taxing the right amount at the right time.

Finally, carried interest taxation as it stands today is neither equitable nor fair. In terms of vertical equity, this is a straightforward analysis. Private equity managers comprise some of the wealthiest people in the United States, partly because they are not required to pay more as their ability to pay increases.[242] Horizontal equity is essentially neutrality, which was addressed above. Finally, in terms of basic fairness, the current taxation of carried interest clearly falls short. This is most evident from the backlash Sinema received after refusing to approve the version of the Inflation Reduction Act that eliminated carried interest.[243] Essentially, the only reason this loophole still exists is because of the private equity lobby, while everyday average Americans disagree but hold no power to change the outcome.[244]

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[240] Lovett, *supra* note 237.

[241] CONG. BUDGET OFF., OPTIONS FOR REDUCING THE DEFICIT: 2019 TO 2028, 225 (Benjamin Plotinsky et al. eds., 2018).

[242] Greg Iacurci, *Carried Interest Provision Is Cut from Inflation Reduction Act. How This Tax Break Works, And How It Benefits High-Income Taxpayers*, CNBC (Aug. 8, 2022), https://www.cnbc.com/2022/08/08/what-carried-interest-is-and-how-it-benefits-high-income-taxpayers.html (stating that "managing partners' carried interest ranged from $10 million to $102 million, on average").

[243] Kyle Morris, *Progressive Groups Take Aim at Sinema Over Decision to Remove Carried Interest Tax Loophole from Manchin Bill,* FOX NEWS (Aug. 6, 2022, 3:52 PM), https://www.foxnews.com/politics/progressive-groups-take-aim-sinema-decision-remove-carried-interest-tax-loophole-manchin-bill.

[244] As of 2015, 68% of voters wanted to eliminate carried interest while 81% of small business owners also disapproved. *POLLING ON TAX FAIRNESS ISSUES (SMALL CAPS)*, AMERICANS FOR TAX FAIRNESS (Mar. 19, 2015), https://americansfortaxfairness.org/files/3.19.15-ATF-Polling-Questions-on-Tax-Fairness-Issues-Final.pdf.

IV. CONCLUSION & RECOMMENDATIONS

In summary, both the United States and Chile have extremely complex tax systems that change often and are the subject of much societal disagreement. While much of the structure of private equity remains the same throughout the two countries, such as treating the fund itself as a nontaxable entity, there are many differences. For one, Chilean private investment administrators' and American fund managers' compensation is taxed differently. Under U.S. law, carried interest is taxed as capital income in what many might call a loophole. In Chile, private investment fund administrators pay VAT on their services and income tax on the salary received from the administering company, thus achieving parity with other service professions. In the United States, on the other hand, fund managers' compensation is taxed at a preferential rate instead of at ordinary rates.

Because of these conditions, Chile has complied with the U.N. Charter and the ICESCR while the U.S. has fallen short. Although the United States has not ratified the ICESCR, it is compelled by international custom to follow its provisions. The United States should immediately enact a new provision in the tax code in order to eliminate the carried interest tax break. Additionally, because international guidance lags so far behind the issues of the day, the United Nations *must* host a tax convention. While admirable in its policy goals, the OECD has failed to make substantive changes while excluding G7 countries from the table. The time is now for substantive tax reform, and carried interest in the United States is a perfect place to start.