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PRIVATE EQUITY

PRIVATE EQUITY BULLETIN
2016 U.S. PRESIDENTIAL ELECTION

Welcome to the second Dorsey Private Equity Bulletin. With the U.S. presidential election dominating recent headlines, this edition explores the impact of positions expressed by each of the two major party candidates. We have focused in particular on the impact on the tax treatment of executives in the U.S. PE industry, as well as certain key policy differences that may affect your portfolio companies that operate in the United States.

Should you have any queries on anything that we discuss in this bulletin or otherwise, please do not hesitate to get in touch with Eric, Fabrizio or Carsten. Please also let us know if you have any suggestions for topics you would like us to cover in future bulletins.

TAX IMPACT ON THE U.S. PE INDUSTRY

In short, a win by either Hillary Clinton or Donald Trump is likely to have similar repercussions on the tax treatment of carried interest. Both candidates have proposed to treat carried interest as ordinary income, rather than as capital gains, as is the case currently. This would seem to be one of the only tax policies that Clinton and Trump agree on, and many commentators believe that closing the "loophole" will gain bipartisan support through Congress. If the winning candidate is true to his/her word and manages to effect these changes, then this could increase pressure on the U.K. government to take further steps to remove the favourable tax treatment of carried interest currently enjoyed by the U.K. PE industry.

KEY POLICY CONSIDERATIONS

Tax Impact

Regardless of the outcome, portfolio companies that operate in the U.S., their customers and their employees will all be directly affected by the proposed tax plans put forward by the candidates, and, except for the treatment of carried interest, the candidates have contrasting tax plans. For example, whilst Trump proposes to reduce the number of personal tax brackets from seven to three and reduce the top tax bracket from 39.6% to 33%, Clinton intends to keep the current tax brackets, including the parameters of the top tax bracket. To incentivise long-term investment, Clinton is proposing to increase the capital gains tax on assets held between one and six years, although economists estimate that this alteration may lead people to realise their capital gains later, thereby reducing tax revenues. Additionally, Clinton intends to impose an "exit tax" on tax inversion mergers, in a bid to reduce the number of U.S. companies merging with international companies in lower tax jurisdictions as a method of reducing tax payments. In contrast, Trump's proposals are more explicitly business friendly. Trump's plan proposes to dramatically reduce corporate tax (from 35% to 15%), eliminate the corporate alternative minimum tax, and to allow firms engaged in manufacturing in the U.S. to choose between the full expensing of capital investment and the deductibility of interest paid. One point on which there has been some lack of clarity, but which will have a meaningful impact, is Trump's proposed treatment of pass-through businesses. These businesses, such as partnerships and limited liability companies, generally do not pay tax at the entity level but rather pass through their income to the owners of the business, who report such income and pay taxes on their individual tax returns. In Trump's original plan from September 2015, this type of income would be subject to a special 15% rate. Trump's most recent plan in September 2016 is less clear on this point, suggesting such income may be taxed at regular individual tax rates, which is currently the case. Additionally, with an estimated US$2 trillion currently held by U.S. companies overseas, Trump proposes allowing companies to repatriate earnings held overseas at a tax rate of 10% rather than at the current rate of 35%, as a means to promote reinvestment.

Foreign Trade

It is worth noting that, for the first time in the modern era in the U.S., the two major party candidates are both effectively considered anti-trade, albeit in different ways. Clinton supports the reauthorisation of the Export-Import Bank and believes the U.S. needs tougher enforcement of existing trade agreements. However, she has indicated that she intends to stop any trade deal that "kills jobs or holds down wages" in the U.S., including now opposing the controversial Trans-Pacific Partnership ("TPP," which, while Secretary of State, Clinton consistently promoted). Trump also opposes the TPP. However, the remainder of his trade policies are more explicitly anti-free trade than Clinton's. Trump has proposed steep tariffs on imported goods and has called for an immediate renegotiation of the terms of NAFTA, subject to the ultimatum that the U.S. would otherwise completely withdraw from NAFTA. The trade positions of both candidates are causing ripples of concern in the global economy and may ultimately impact raw manufacturing costs in the U.S. Trump's protectionist views, however, have the potential to cause a more significant shift away from globalisation in favour of isolationism.

Minimum Wage

Clinton proposes to raise the federal minimum wage in steps from US$7.25 per hour to US$12 per hour, whereas Trump intends to keep the minimum wage at its current level in order that the U.S. can compete with other manufacturing nations with lower cost bases. These differing policies will have a direct impact on manufacturing costs in the U.S.

Immigration

One of the most contested topics of this election is the subject of immigration. Clinton proposes to enact an immigration overhaul to create an easier pathway to citizenship in a bid to continue attracting "top talent" to the U.S. She intends to "staple" a green card to students studying science, technology, engineering and mathematics masters and PhDs from accredited institutions. This would enable international students, who often seek jobs in the financial sector, to move directly to green card status. On the other hand, Trump's hard stance on immigration, setting aside the headline-grabbing proposal to build a wall on the Mexican border, is manifested in his proposal to restrict immigrant visas. This would include H-1B working visas, which allow U.S. employers to temporarily employ foreign workers in specialty occupations. As such, this may dissuade international students and professionals from emigrating to the U.S. In addition, portfolio companies operating in the U.S. may find it more difficult to attract international talent or to relocate non-U.S. executives to the U.S. in order to help grow the business.

SPECIFIC INDUSTRY CONSIDERATIONS

Pharmaceuticals

Affordability of healthcare has been a key issue in this election campaign. Regardless of who emerges as the successful candidate, it is likely that the pharmaceutical industry will be impacted significantly. Both Trump and Clinton intend to leverage Medicare (the national social insurance program in the U.S.) to negotiate reductions in pharmaceutical prices. Clinton also intends to deny tax breaks for direct consumer advertising and to demand that drug companies invest in R&D in exchange for taxpayer support rather than relying on excessive profits. Both candidates intend to ease import restrictions on generic (i.e. unbranded) drugs in order to promote competition. However, Trump also supports repealing "Obamacare" and intends to decentralise the administration of Medicaid (the health insurance program for low-income Americans) and transfer control to the individual states. This is likely to reduce total federal healthcare funding and may therefore result in less expenditure on pharmaceutical drugs. In short, Trump plans to reform healthcare based on "free market principles" and easing regulations on overseas drug manufacturers.

Energy

Energy is a topic that neither candidate has prioritised in this election. However, it plays an integral role in distinguishing their respective manifestos. Whereas Clinton supports the Paris Agreement on combating climate change and opposes the Keystone XL pipeline project (an oil pipeline system in Canada and the U.S. that was rejected by Obama in 2015), Trump intends to cancel the Paris Agreement and renew the Keystone XL project. In a bid to increase the availability of renewable energy, Clinton plans to reduce the country's oil consumption by a third and install 500 million solar panels. Under her proposed US$60 billion Clean Energy Challenge, she promotes the transitioning and revitalization of communities historically tied to traditional energy sectors as part of an overall shift away from emphasis on fossil fuel production. In contrast, Trump proposes to revive the U.S. coal industry. The candidates' views overlap in their support of fracking, although recently Clinton has modified her views on this subject following her disapproval of Shell's proposed exploration activity in the Arctic.