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# Carried Interest

## What you Need to Know

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# Introduction to Carried Interest

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- Carried interest is a **share of profits** earned by General Partners (GPs) in private equity funds
- It is designed to **align fund managers' interests with those of investors**, ensuring that GPs are incentivized to achieve high returns

## Key Features of Carried Interest

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- **Performance-based:** To ensure performance alignment, GPs earn carried interest only if the fund meets a minimum return (hurdle rate)
- **Standard percentage:** Typically, carried interest is 20% of the fund's profits, creating a significant incentive
- **Tax treatment:** Taxed as long-term capital gains, benefiting from a lower tax rate compared to ordinary income

# How Carried Interest Works

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**Hurdle Rate:** Carried interest is earned if the fund exceeds a minimum return ensuring GPs are only rewarded based on fund performance

**Profit Sharing:** Typically, profits are split 80/20 between limited partners (LPs) and GPs once the hurdle rate is surpassed

**Vesting Period:** Often includes a vesting period, ensuring GPs remain committed to the fund's long-term performance

## Importance of Carried Interest

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- **Incentive Alignment:** Ensures that fund managers focus on achieving high returns for investors
- **Performance Motivation:** Encourages fund managers to strive for successful investment strategies
- **Risk and Reward:** Balances the risk taken by fund managers with the potential for substantial rewards

## Conclusion

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- Carried interest is **crucial for aligning the interests of fund managers with those of investors**, incentivizing high performance
- By **tying compensation to performance**, carried interest motivates fund managers to pursue **optimal investment strategies** and achieve outstanding results
- Its **preferential tax treatment** continues to spark debates and legislative scrutiny



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