H. R. 1935

To amend the Internal Revenue Code of 1986 to provide for the treatment of partnership interests held by partners providing services.

IN THE HOUSE OF REPRESENTATIVES

APRIL 2, 2009

Mr. LEVIN introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to provide for the treatment of partnership interests held by partners providing services.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. PARTNERSHIP INTERESTS TRANSFERRED IN CONNECTION WITH PERFORMANCE OF SERVICES.

(a) Modification to Election to Include Partnership Interest in Gross Income in Year of Transfer.—Subsection (e) of section 83 of the Internal Revenue Code of 1986 is amended by redesignating paragraph (2) as paragraph (3) and by striking paragraph (3) and inserting in lieu thereof the following paragraph:

"(3) In the case of a transfer of a partnership interest that results from the performance of services with respect to such partnership, the amount includible in gross income under this subsection shall—"
paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

“(4) PARTNERSHIP INTERESTS.—Except as provided by the Secretary, in the case of any transfer of an interest in a partnership in connection with the performance of services for (or on behalf of) such partnership—

“(A) the fair market value of such interest shall be treated for purposes of this section as being equal to the amount of the distribution which the partner would receive if the partnership sold (at the time of the transfer) all of its assets at fair market value and distributed the proceeds of such sale (reduced by the liabilities of the partnership) to its partners in liquidation of the partnership, and

“(B) the person receiving such interest shall be treated as having made the election under subsection (b)(1) unless such person makes an election under this paragraph to have such subsection not apply.”.

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 83(b) of such Code is amended by inserting “or subsection (c)(4)(B)” after “paragraph (1)”.
(c) Effective Date.—The amendments made by this section shall apply to interests in partnerships transferred after the date of the enactment of this Act.

SEC. 2. INCOME OF PARTNERS FOR PERFORMING INVESTMENT MANAGEMENT SERVICES TREATED AS ORDINARY INCOME RECEIVED FOR PERFORMANCE OF SERVICES.

(a) In General.—Part I of subchapter K of chapter 1 of the Internal Revenue Code of 1986 is amended by adding at the end the following new section:

“SEC. 710. SPECIAL RULES FOR PARTNERS PROVIDING INVESTMENT MANAGEMENT SERVICES TO PARTNERSHIP.

“(a) Treatment of Distributive Share of Partnership Items.—For purposes of this title, in the case of an investment services partnership interest—

“(1) In General.—Notwithstanding section 702(b)—

“(A) any net income with respect to such interest for any partnership taxable year shall be treated as ordinary income, and

“(B) any net loss with respect to such interest for such year, to the extent not disallowed under paragraph (2) for such year, shall be treated as an ordinary loss.
All items of income, gain, deduction, and loss which are taken into account in computing net income or net loss shall be treated as ordinary income or ordinary loss (as the case may be).

“(2) Treatment of losses.—

“(A) Limitation.—Any net loss with respect to such interest shall be allowed for any partnership taxable year only to the extent that such loss does not exceed the excess (if any) of—

“(i) the aggregate net income with respect to such interest for all prior partnership taxable years, over

“(ii) the aggregate net loss with respect to such interest not disallowed under this subparagraph for all prior partnership taxable years.

“(B) Carryforward.—Any net loss for any partnership taxable year which is not allowed by reason of subparagraph (A) shall be treated as an item of loss with respect to such partnership interest for the succeeding partnership taxable year.

“(C) Basis adjustment.—No adjustment to the basis of a partnership interest shall be
made on account of any net loss which is not
allowed by reason of subparagraph (A).

“(D) Prior partnership years.—Any
reference in this paragraph to prior partnership
taxable years shall only include prior partner-
ship taxable years to which this section applies.

“(3) Net income and loss.—For purposes of
this section—

“(A) Net income.—The term ‘net in-
come’ means, with respect to any investment
services partnership interest for any partner-
ship taxable year, the excess (if any) of—

“(i) all items of income and gain
taken into account by the holder of such
interest under section 702 with respect to
such interest for such year, over

“(ii) all items of deduction and loss so
taken into account.

“(B) Net loss.—The term ‘net loss’
means, with respect to such interest for such
year, the excess (if any) of the amount de-
dscribed in subparagraph (A)(ii) over the amount
described in subparagraph (A)(i).

“(b) Dispositions of partnership interests.—
“(1) **GAIN.**—Any gain on the disposition of an investment services partnership interest shall be treated as ordinary income and shall be recognized notwithstanding any other provision of this subtitle.

“(2) **LOSS.**—Any loss on the disposition of an investment services partnership interest shall be treated as an ordinary loss to the extent of the excess (if any) of—

“(A) the aggregate net income with respect to such interest for all partnership taxable years, over

“(B) the aggregate net loss with respect to such interest allowed under subsection (a)(2) for all partnership taxable years.

“(3) **DISPOSITION OF PORTION OF INTEREST.**—In the case of any disposition of an investment services partnership interest, the amount of net loss which otherwise would have (but for subsection (a)(2)(C)) applied to reduce the basis of such interest shall be disregarded for purposes of this section for all succeeding partnership taxable years.

“(4) **DISTRIBUTIONS OF PARTNERSHIP PROPERTY.**—In the case of any distribution of property by a partnership with respect to any investment services partnership interest held by a partner—
“(A) the excess (if any) of—

“(i) the fair market value of such property at the time of such distribution, over

“(ii) the adjusted basis of such property in the hands of the partnership,

shall be taken into account as an increase in such partner’s distributive share of the taxable income of the partnership (except to the extent such excess is otherwise taken into account in determining the taxable income of the partnership),

“(B) such property shall be treated for purposes of subpart B of part II as money distributed to such partner in an amount equal to such fair market value, and

“(C) the basis of such property in the hands of such partner shall be such fair market value.

Subsection (b) of section 734 shall be applied without regard to the preceding sentence.

“(5) APPLICATION OF SECTION 751.—In applying section 751(a), an investment services partnership interest shall be treated as an inventory item.
“(c) Investment Services Partnership Interest.—For purposes of this section—

“(1) In general.—The term ‘investment services partnership interest’ means any interest in a partnership which is held by any person if it was reasonably expected (at the time that such person acquired such interest) that such person (or any person related to such person) would provide (directly or indirectly) a substantial quantity of any of the following services:

“(A) Advising as to the advisability of investing in, purchasing, or selling any specified asset.

“(B) Managing, acquiring, or disposing of any specified asset.

“(C) Arranging financing with respect to acquiring specified assets.

“(D) Any activity in support of any service described in subparagraphs (A) through (C).

For purposes of this paragraph, the term ‘specified asset’ means securities (as defined in section 475(c)(2) without regard to the last sentence thereof), real estate held for rental or investment, interests in partnerships, commodities (as defined in sec-
tion 475(e)(2)), or options or derivative contracts with respect to any of the foregoing.

“(2) Exception for certain capital interests.—

“(A) In general.—In the case of any portion of an investment services partnership interest which is a qualified capital interest, all items of income, gain, loss, and deduction which are allocated to such qualified capital interest shall not be taken into account under subsection (a) if—

“(i) allocations of items are made by the partnership to such qualified capital interest in the same manner as such allocations are made to other qualified capital interests held by partners who do not provide any services described in paragraph (1) and who are not related to the partner holding the qualified capital interest, and

“(ii) the allocations made to such other interests are significant compared to the allocations made to such qualified capital interest.

“(B) Special rule for dispositions.—

In the case of any investment services partner-
ship interest any portion of which is a qualified
capital interest, subsection (b) shall not apply
to so much of any gain or loss as bears the
same proportion to the entire amount of such
gain or loss as—

“(i) the distributive share of gain or
loss that would have been allocable to the
qualified capital interest under subpara-
graph (A) if the partnership sold all of its
assets immediately before the disposition,
bears to

“(ii) the distributive share of gain or
loss that would have been so allocable to
the investment services partnership inter-
est of which such qualified capital interest
is a part.

“(C) QUALIFIED CAPITAL INTEREST.—For
purposes of this paragraph, the term ‘qualified
capital interest’ means so much of a partner’s
interest in the capital of the partnership as is
attributable to—

“(i) the fair market value of any
money or other property contributed to the
partnership in exchange for such interest,
“(ii) any amounts which have been included in gross income under section 83 with respect to the transfer of such interest, and

“(iii) the excess (if any) of—

“(I) any items of income and gain taken into account under section 702 with respect to such interest for taxable years to which this section applies, over

“(II) any items of deduction and loss so taken into account.

The qualified capital interest shall be reduced by distributions from the partnership to the partner and by the excess (if any) of the amount described in clause (iii)(II) over the amount described in clause (iii)(I).

“(D) TREATMENT OF CERTAIN LOANS.—

“(i) PROCEEDS OF PARTNERSHIP LOANS NOT TREATED AS QUALIFIED CAPITAL INTEREST OF SERVICE PROVIDING PARTNERS.—For purposes of this paragraph, an investment services partnership interest shall not be treated as a qualified capital interest to the extent that such in-
interest is acquired in connection with the
proceeds of any loan or other advance
made or guaranteed, directly or indirectly,
by any partner or the partnership (or any
person related to any such partner or the
partnership).

“(ii) Reduction in allocations to
qualified capital interests for
loans from nonservice providing
partners to the partnership.—For
purposes of this paragraph, any loan or
other advance to the partnership made or
guaranteed, directly or indirectly, by a
partner not providing services described in
paragraph (1) to the partnership (or any
person related to such partner) shall be
taken into account as invested capital of
such partner.

“(3) Related persons.—A person shall be
treated as related to another person if the relation-
ship between such persons would result in a dis-
allowance of losses under section 267 or 707(b).

“(d) Other income and gain in connection
with investment management services.—

“(1) In general.—If—
“(A) a person performs (directly or indirectly) investment management services for any entity,

“(B) such person holds a disqualified interest with respect to such entity, and

“(C) the value of such interest (or payments thereunder) is substantially related to the amount of income or gain (whether or not realized) from the assets with respect to which the investment management services are performed,

any income or gain with respect to such interest shall be treated as ordinary income. Rules similar to the rules of subsection (c)(2) shall apply where such interest was acquired on account of invested capital in such entity.

“(2) DEFINITIONS.—For purposes of this subsection—

“(A) DISQUALIFIED INTEREST.—

“(i) IN GENERAL.—The term ‘disqualified interest’ means, with respect to any entity—

“(I) any interest in such entity other than indebtedness,
“(II) convertible or contingent

debt of such entity,

“(III) any option or other right
to acquire property described in sub-
clause (I) or (II), and

“(IV) any derivative instrument
entered into (directly or indirectly)
with such entity or any investor in
such entity.

“(ii) EXCEPTIONS.—Such term shall
not include—

“(I) a partnership interest,

“(II) stock in a taxable corpora-
tion, and

“(III) except as provided by the
Secretary, stock in an S corporation.

“(B) TAXABLE CORPORATION.—The term
‘taxable corporation’ means—

“(i) a domestic C corporation, or

“(ii) a foreign corporation substan-
tially all of the income of which is—

“(I) effectively connected with
the conduct of a trade or business in
the United States, or
“(II) subject to a comprehensive foreign income tax (as defined in section 457A(d)(2)).

“(C) investment management services.—The term ‘investment management services’ means a substantial quantity of any of the services described in subsection (c)(1).

“(e) regulations.—The Secretary shall prescribe such regulations as are necessary or appropriate to carry out the purposes of this section, including regulations to—

“(1) provide modifications to the application of this section (including treating related persons as not related to one another) to the extent such modification is consistent with the purposes of this section,

“(2) prevent the avoidance of the purposes of this section, and

“(3) coordinate this section with the other provisions of this title.

“(f) cross reference.—For 40 percent no fault penalty on certain underpayments due to the avoidance of this section, see section 6662.”.

(b) income from investment services partnership interests not treated as qualifying income of publicly traded partnerships.—Sub-
section (d) of section 7704 of such Code is amended by adding at the end the following new paragraph:

“(6) INCOME FROM INVESTMENT SERVICES PARTNERSHIP INTERESTS NOT QUALIFIED.—

“(A) IN GENERAL.—Items of income and gain shall not be treated as qualifying income if such items are treated as ordinary income by reason of the application of section 710 (relating to special rules for partners providing investment management services to partnership).

“(B) SPECIAL RULES FOR CERTAIN PARTNERSHIPS.—

“(i) CERTAIN PARTNERSHIPS OWNED BY REAL ESTATE INVESTMENT TRUSTS.—

Subparagraph (A) shall not apply in the case of a partnership which meets each of the following requirements:

“(I) Such partnership is treated as publicly traded under this section solely by reason of interests in such partnership being convertible into interests in a real estate investment trust which is publicly traded.

“(II) 50 percent or more of the capital and profits interests of such
partnership are owned, directly or indi-
directly, at all times during the tax-
able year by such real estate invest-
ment trust (determined with the ap-
plication of section 267(c)).

“(III) Such partnership meets
the requirements of paragraphs (2),
(3), and (4) of section 856(c).

“(ii) Certain partnerships own-
ing other publicly traded partner-
ships.—Subparagraph (A) shall not apply
in the case of a partnership which meets
each of the following requirements:

“(I) Substantially all of the as-
sets of such partnership consist of in-
terests in one or more other partner-
ships which are traded on an estab-
ished securities market.

“(II) Substantially all of the in-
come of such partnership is ordinary
income or section 1231 gain (as de-
fined in section 1231(a)(3)).

“(C) Transitional rule.—In the case of
a partnership in existence on the date of the en-
actment of this paragraph, subparagraph (A)

shall not apply to any taxable year of the part-
nership beginning before the date which is 10
years after the date of the enactment of this
paragraph.”.

(c) Imposition of Penalty on Underpay-
ments.—

(1) In General.—Subsection (b) of section
6662 of such Code is amended by inserting after
paragraph (5) the following new paragraph:

“(6) The application of subsection (d) of section
710 or the regulations prescribed under section
710(e) to prevent the avoidance of the purposes of
section 710.”.

(2) Amount of Penalty.—

(A) In General.—Section 6662 of such
Code is amended by adding at the end the fol-
lowing new subsection:

“(i) Increase in Penalty in Case of Property
Transferred for Investment Management Serv-
ices.—In the case of any portion of an underpayment to
which this section applies by reason of subsection (b)(6),
subsection (a) shall be applied with respect to such portion
by substituting ‘40 percent’ for ‘20 percent’.”.
(B) CONFORMING AMENDMENTS.—Subparagraph (B) of section 6662A(e)(2) of such Code is amended—

(i) by striking “section 6662(h)” and inserting “subsection (h) or (i) of section 6662”, and

(ii) by striking “GROSS VALUATION MISSTATED PENALTY” in the heading and inserting “CERTAIN INCREASED UNDERRATEMENT PENALTIES”.

(3) REASONABLE CAUSE EXCEPTION NOT APPLICABLE.—Subsection (c) of section 6664 of such Code is amended—

(A) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively,

(B) by striking “paragraph (2)” in paragraph (4), as so redesignated, and inserting “paragraph (3)”, and

(C) by inserting after paragraph (1) the following new paragraph:

“(2) EXCEPTION.—Paragraph (1) shall not apply to any portion of an underpayment to which this section applies by reason of subsection (b)(6).”.
(d) Income and Loss From Investment Services

Partnership Interests Taken Into Account in Determining Net Earning From Self-Employment.—

(1) Internal Revenue Code.—Section 1402(a) of such Code is amended by striking “and” at the end of paragraph (16), by striking the period at the end of paragraph (17) and inserting “; and”, and by inserting after paragraph (17) the following new paragraph:

“(18) notwithstanding the preceding provisions of this subsection, any amount treated as ordinary income or ordinary loss of any individual under section 710 shall be taken into account in determining the net earnings from self-employment of such individual.”.

(2) Social Security Act.—Section 211(a) of the Social Security Act is amended by inserting after paragraph (16) the following new paragraph:

“(17) Notwithstanding the preceding provisions of this subsection, any amount treated as ordinary income or ordinary loss of any individual under section 710 of the Internal Revenue Code of 1986 shall be taken into account in determining the net earnings from self-employment of such individual.”.

(e) Conforming Amendments.—
(1) Subsection (d) of section 731 of the Internal Revenue Code of 1986 is amended by inserting
“section 710(b)(4) (relating to distributions of partnership property),” after “to the extent otherwise provided by”.

(2) Section 741 of such Code is amended by inserting “or section 710 (relating to special rules for partners providing investment management services to partnership)” before the period at the end.

(3) The table of sections for part I of subchapter K of chapter 1 of such Code is amended by adding at the end the following new item:

“Sec. 710. Special rules for partners providing investment management services to partnership.”.

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years ending after ______.

(2) PARTNERSHIP TAXABLE YEARS WHICH INCLUDE EFFECTIVE DATE.—In applying section 710(a) of the Internal Revenue Code of 1986 (as added by this section) in the case of any partnership taxable year which includes ______, the amount of the net income referred to in such section shall be treated as being the lesser of the net income for the
entire partnership taxable year or the net income determined by only taking into account items attributable to the portion of the partnership taxable year which is after such date.

(3) Dispositions of Partnership Interests.—Section 710(b) of the Internal Revenue Code of 1986 (as added by this section) shall apply to dispositions and distributions after _____.

(4) Other income and gain in connection with investment management services.—Section 710(d) of such Code (as added by this section) shall take effect on _____.

(5) Publicly traded partnerships.—The amendment made by subsection (b) shall apply to taxable years beginning after _____.

SEC. 3. APPLICATION TO PARTNERSHIP INTERESTS AND TAX SHARING AGREEMENTS OF RULE TREATING CERTAIN GAIN ON SALES BETWEEN RELATED PERSONS AS ORDINARY INCOME.

(a) Partnership Interests.—

(1) In general.—Subsection (a) of section 1239 of the Internal Revenue Code of 1986 is amended to read as follows:

“(a) Treatment of Gain as Ordinary Income.—

In the case of a sale or exchange of property, directly or
indirectly, between related persons, any gain recognized to
the transferor shall be treated as ordinary income if—

“(1) such property is, in the hands of the trans-
ferree, of a character which is subject to the allow-
ance for depreciation provided in section 167, or

“(2) such property is an interest in a partner-
ship, but only to the extent of gain attributable to
unrealized appreciation in property which is of a
character subject to the allowance for depreciation
provided in section 167.”.

(2) Treatment of Amortizable Section 197
Intangibles as Depreciable Property.—Section
1239 of such Code is amended by adding at the end
the following new subsection:

“(f) Treatment of Amortizable Section 197 In-
tangibles as Depreciable Property.—For treatment
of amortizable section 197 intangibles as depreciable prop-
erty, see section 197(f)(7).”.

(b) Tax Sharing Agreements.—Section 1239 of
such Code (relating to gain from sale of depreciable prop-
erty between certain related taxpayers) is amended by
adding at the end the following new subsection:

“(f) Application to Tax Sharing Agree-
ments.—
“(1) IN GENERAL.—If there is a tax sharing agreement with respect to any sale or exchange, the transferee and the transferor shall be treated as related persons for purposes of this section.

“(2) TAX SHARING AGREEMENT.—For purposes of this subsection, the term ‘tax sharing agreement’ means any agreement which provides for the payment to the transferor of any amount which is determined by reference to any portion of the tax benefit realized by the transferee with respect to the depreciation (or amortization) of the property transferred.”.

(e) EFFECTIVE DATE.—The amendment made by this section shall apply to sales and exchanges after _____.