

111TH CONGRESS
1ST SESSION

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.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. PARTNERSHIP INTERESTS TRANSFERRED IN**
4 **CONNECTION WITH PERFORMANCE OF SERV-**
5 **ICES.**

6 (a) MODIFICATION TO ELECTION TO INCLUDE PART-
7 NERSHIP INTEREST IN GROSS INCOME IN YEAR OF
8 TRANSFER.—Subsection (c) of section 83 of the Internal
9 Revenue Code of 1986 is amended by redesignating para-

1 graph (4) as paragraph (5) and by inserting after para-
2 graph (3) the following new paragraph:

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

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

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

22 (b) CONFORMING AMENDMENT.—Paragraph (2) of
23 section 83(b) of such Code is amended by inserting “or
24 subsection (c)(4)(B)” after “paragraph (1)”.

1 (c) EFFECTIVE DATE.—The amendments made by
 2 this section shall apply to interests in partnerships trans-
 3 ferred after the date of the enactment of this Act.

4 **SEC. 2. INCOME OF PARTNERS FOR PERFORMING INVEST-**
 5 **MENT MANAGEMENT SERVICES TREATED AS**
 6 **ORDINARY INCOME RECEIVED FOR PER-**
 7 **FORMANCE OF SERVICES.**

8 (a) IN GENERAL.—Part I of subchapter K of chapter
 9 1 of the Internal Revenue Code of 1986 is amended by
 10 adding at the end the following new section:

11 **“SEC. 710. SPECIAL RULES FOR PARTNERS PROVIDING IN-**
 12 **VESTMENT MANAGEMENT SERVICES TO**
 13 **PARTNERSHIP.**

14 “(a) TREATMENT OF DISTRIBUTIVE SHARE OF
 15 PARTNERSHIP ITEMS.—For purposes of this title, in the
 16 case of an investment services partnership interest—

17 “(1) IN GENERAL.—Notwithstanding section
 18 702(b)—

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

22 “(B) any net loss with respect to such in-
 23 terest for such year, to the extent not dis-
 24 allowed under paragraph (2) for such year,
 25 shall be treated as an ordinary loss.

1 All items of income, gain, deduction, and loss which
2 are taken into account in computing net income or
3 net loss shall be treated as ordinary income or ordi-
4 nary loss (as the case may be).

5 “(2) TREATMENT OF LOSSES.—

6 “(A) LIMITATION.—Any net loss with re-
7 spect to such interest shall be allowed for any
8 partnership taxable year only to the extent that
9 such loss does not exceed the excess (if any)
10 of—

11 “(i) the aggregate net income with re-
12 spect to such interest for all prior partner-
13 ship taxable years, over

14 “(ii) the aggregate net loss with re-
15 spect to such interest not disallowed under
16 this subparagraph for all prior partnership
17 taxable years.

18 “(B) CARRYFORWARD.—Any net loss for
19 any partnership taxable year which is not al-
20 lowed by reason of subparagraph (A) shall be
21 treated as an item of loss with respect to such
22 partnership interest for the succeeding partner-
23 ship taxable year.

24 “(C) BASIS ADJUSTMENT.—No adjustment
25 to the basis of a partnership interest shall be

1 made on account of any net loss which is not
2 allowed by reason of subparagraph (A).

3 “(D) PRIOR PARTNERSHIP YEARS.—Any
4 reference in this paragraph to prior partnership
5 taxable years shall only include prior partner-
6 ship taxable years to which this section applies.

7 “(3) NET INCOME AND LOSS.—For purposes of
8 this section—

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

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

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

19 “(B) NET LOSS.—The term ‘net loss’
20 means, with respect to such interest for such
21 year, the excess (if any) of the amount de-
22 scribed in subparagraph (A)(ii) over the amount
23 described in subparagraph (A)(i).

24 “(b) DISPOSITIONS OF PARTNERSHIP INTERESTS.—

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

5 “(2) LOSS.—Any loss on the disposition of an
 6 investment services partnership interest shall be
 7 treated as an ordinary loss to the extent of the ex-
 8 cess (if any) of—

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

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

15 “(3) DISPOSITION OF PORTION OF INTEREST.—
 16 In the case of any disposition of an investment serv-
 17 ices partnership interest, the amount of net loss
 18 which otherwise would have (but for subsection
 19 (a)(2)(C)) applied to reduce the basis of such inter-
 20 est shall be disregarded for purposes of this section
 21 for all succeeding partnership taxable years.

22 “(4) DISTRIBUTIONS OF PARTNERSHIP PROP-
 23 ERTY.—In the case of any distribution of property
 24 by a partnership with respect to any investment
 25 services partnership interest held by a partner—

1 “(A) the excess (if any) of—

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

5 “(ii) the adjusted basis of such prop-
6 erty in the hands of the partnership,
7 shall be taken into account as an increase in
8 such partner’s distributive share of the taxable
9 income of the partnership (except to the extent
10 such excess is otherwise taken into account in
11 determining the taxable income of the partner-
12 ship),

13 “(B) such property shall be treated for
14 purposes of subpart B of part II as money dis-
15 tributed to such partner in an amount equal to
16 such fair market value, and

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

20 Subsection (b) of section 734 shall be applied with-
21 out regard to the preceding sentence.

22 “(5) APPLICATION OF SECTION 751.—In apply-
23 ing section 751(a), an investment services partner-
24 ship interest shall be treated as an inventory item.

1 “(c) INVESTMENT SERVICES PARTNERSHIP INTER-
2 EST.—For purposes of this section—

3 “(1) IN GENERAL.—The term ‘investment serv-
4 ices partnership interest’ means any interest in a
5 partnership which is held by any person if it was
6 reasonably expected (at the time that such person
7 acquired such interest) that such person (or any per-
8 son related to such person) would provide (directly
9 or indirectly) a substantial quantity of any of the
10 following services:

11 “(A) Advising as to the advisability of in-
12 vesting in, purchasing, or selling any specified
13 asset.

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

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

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

20 For purposes of this paragraph, the term ‘specified
21 asset’ means securities (as defined in section
22 475(c)(2) without regard to the last sentence there-
23 of), real estate held for rental or investment, inter-
24 ests 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-

1 ship interest any portion of which is a qualified
 2 capital interest, subsection (b) shall not apply
 3 to so much of any gain or loss as bears the
 4 same proportion to the entire amount of such
 5 gain or loss as—

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

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

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

22 “(i) the fair market value of any
 23 money or other property contributed to the
 24 partnership in exchange for such interest,

1 “(ii) any amounts which have been in-
2 cluded in gross income under section 83
3 with respect to the transfer of such inter-
4 est, and

5 “(iii) the excess (if any) of—

6 “(I) any items of income and
7 gain taken into account under section
8 702 with respect to such interest for
9 taxable years to which this section ap-
10 plies, over

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

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

18 “(D) TREATMENT OF CERTAIN LOANS.—

19 “(i) PROCEEDS OF PARTNERSHIP
20 LOANS NOT TREATED AS QUALIFIED CAP-
21 ITAL INTEREST OF SERVICE PROVIDING
22 PARTNERS.—For purposes of this para-
23 graph, an investment services partnership
24 interest shall not be treated as a qualified
25 capital interest to the extent that such in-

terest 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 relationship between such persons would result in a disallowance of losses under section 267 or 707(b).

“(d) OTHER INCOME AND GAIN IN CONNECTION WITH INVESTMENT MANAGEMENT SERVICES.—

“(1) IN GENERAL.—If—

1 “(A) a person performs (directly or indi-
2 rectly) investment management services for any
3 entity,

4 “(B) such person holds a disqualified in-
5 terest with respect to such entity, and

6 “(C) the value of such interest (or pay-
7 ments thereunder) is substantially related to
8 the amount of income or gain (whether or not
9 realized) from the assets with respect to which
10 the investment management services are per-
11 formed,

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

17 “(2) DEFINITIONS.—For purposes of this sub-
18 section—

19 “(A) DISQUALIFIED INTEREST.—

20 “(i) IN GENERAL.—The term ‘dis-
21 qualified interest’ means, with respect to
22 any entity—

23 “(I) any interest in such entity
24 other than indebtedness,

1 “(II) convertible or contingent
2 debt of such entity,

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

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

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

12 “(I) a partnership interest,

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

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

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

19 “(i) a domestic C corporation, or

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

22 “(I) effectively connected with
23 the conduct of a trade or business in
24 the United States, or

1 “(II) subject to a comprehensive
 2 foreign income tax (as defined in sec-
 3 tion 457A(d)(2)).

4 “(C) INVESTMENT MANAGEMENT SERV-
 5 ICES.—The term ‘investment management serv-
 6 ices’ means a substantial quantity of any of the
 7 services described in subsection (c)(1).

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

11 “(1) provide modifications to the application of
 12 this section (including treating related persons as
 13 not related to one another) to the extent such modi-
 14 fication is consistent with the purposes of this sec-
 15 tion,

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

18 “(3) coordinate this section with the other pro-
 19 visions of this title.

20 “(f) CROSS REFERENCE.—For 40 percent no fault
 21 penalty on certain underpayments due to the avoidance
 22 of this section, see section 6662.”.

23 (b) INCOME FROM INVESTMENT SERVICES PART-
 24 NERSHIP INTERESTS NOT TREATED AS QUALIFYING IN-
 25 COME OF PUBLICLY TRADED PARTNERSHIPS.—Sub-

1 section (d) of section 7704 of such Code is amended by
2 adding at the end the following new paragraph:

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

5 “(A) IN GENERAL.—Items of income and
6 gain shall not be treated as qualifying income
7 if such items are treated as ordinary income by
8 reason of the application of section 710 (relat-
9 ing to special rules for partners providing in-
10 vestment management services to partnership).

11 “(B) SPECIAL RULES FOR CERTAIN PART-
12 NERSHIPS.—

13 “(i) CERTAIN PARTNERSHIPS OWNED
14 BY REAL ESTATE INVESTMENT TRUSTS.—
15 Subparagraph (A) shall not apply in the
16 case of a partnership which meets each of
17 the following requirements:

18 “(I) Such partnership is treated
19 as publicly traded under this section
20 solely by reason of interests in such
21 partnership being convertible into in-
22 terests in a real estate investment
23 trust which is publicly traded.

24 “(II) 50 percent or more of the
25 capital and profits interests of such

1 partnership are owned, directly or in-
2 directly, at all times during the tax-
3 able year by such real estate invest-
4 ment trust (determined with the ap-
5 plication of section 267(c)).

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

9 “(ii) CERTAIN PARTNERSHIPS OWN-
10 ING OTHER PUBLICLY TRADED PARTNER-
11 SHIPS.—Subparagraph (A) shall not apply
12 in the case of a partnership which meets
13 each of the following requirements:

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

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

23 “(C) TRANSITIONAL RULE.—In the case of
24 a partnership in existence on the date of the en-
25 actment of this paragraph, subparagraph (A)

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

5 (c) IMPOSITION OF PENALTY ON UNDERPAY-
 6 MENTS.—

7 (1) IN GENERAL.—Subsection (b) of section
 8 6662 of such Code is amended by inserting after
 9 paragraph (5) the following new paragraph:

10 “(6) The application of subsection (d) of section
 11 710 or the regulations prescribed under section
 12 710(e) to prevent the avoidance of the purposes of
 13 section 710.”.

14 (2) AMOUNT OF PENALTY.—

15 (A) IN GENERAL.—Section 6662 of such
 16 Code is amended by adding at the end the fol-
 17 lowing new subsection:

18 “(i) INCREASE IN PENALTY IN CASE OF PROPERTY
 19 TRANSFERRED FOR INVESTMENT MANAGEMENT SERV-
 20 ICES.—In the case of any portion of an underpayment to
 21 which this section applies by reason of subsection (b)(6),
 22 subsection (a) shall be applied with respect to such portion
 23 by substituting ‘40 percent’ for ‘20 percent’.”.

1 (B) CONFORMING AMENDMENTS.—Sub-
 2 paragraph (B) of section 6662A(e)(2) of such
 3 Code is amended—

4 (i) by striking “section 6662(h)” and
 5 inserting “subsection (h) or (i) of section
 6 6662”, and

7 (ii) by striking “GROSS VALUATION
 8 MISSTATEMENT PENALTY” in the heading
 9 and inserting “CERTAIN INCREASED UN-
 10 DERPAYMENT PENALTIES”.

11 (3) REASONABLE CAUSE EXCEPTION NOT AP-
 12 PPLICABLE.—Subsection (c) of section 6664 of such
 13 Code is amended—

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

16 (B) by striking “paragraph (2)” in para-
 17 graph (4), as so redesignated, and inserting
 18 “paragraph (3)”, and

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

21 “(2) EXCEPTION.—Paragraph (1) shall not
 22 apply to any portion of an underpayment to which
 23 this section applies by reason of subsection (b)(6).”.

1 (d) INCOME AND LOSS FROM INVESTMENT SERVICES
2 PARTNERSHIP INTERESTS TAKEN INTO ACCOUNT IN DE-
3 TERMINING NET EARNING FROM SELF-EMPLOYMENT.—

4 (1) INTERNAL REVENUE CODE.—Section
5 1402(a) of such Code is amended by striking “and”
6 at the end of paragraph (16), by striking the period
7 at the end of paragraph (17) and inserting “; and”,
8 and by inserting after paragraph (17) the following
9 new paragraph:

10 “(18) notwithstanding the preceding provisions
11 of this subsection, any amount treated as ordinary
12 income or ordinary loss of any individual under sec-
13 tion 710 shall be taken into account in determining
14 the net earnings from self-employment of such indi-
15 vidual.”.

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

19 “(17) Notwithstanding the preceding provisions
20 of this subsection, any amount treated as ordinary
21 income or ordinary loss of any individual under sec-
22 tion 710 of the Internal Revenue Code of 1986 shall
23 be taken into account in determining the net earn-
24 ings from self-employment of such individual.”.

25 (e) CONFORMING AMENDMENTS.—

1 (1) Subsection (d) of section 731 of the Inter-
 2 nal Revenue Code of 1986 is amended by inserting
 3 “section 710(b)(4) (relating to distributions of part-
 4 nership property),” after “to the extent otherwise
 5 provided by”.

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

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

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

13 (f) EFFECTIVE DATE.—

14 (1) IN GENERAL.—Except as otherwise pro-
 15 vided in this subsection, the amendments made by
 16 this section shall apply to taxable years ending after
 17 _____.

18 (2) PARTNERSHIP TAXABLE YEARS WHICH IN-
 19 CLUDE EFFECTIVE DATE.—In applying section
 20 710(a) of the Internal Revenue Code of 1986 (as
 21 added by this section) in the case of any partnership
 22 taxable year which includes _____, the amount of
 23 the net income referred to in such section shall be
 24 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

1 indirectly, between related persons, any gain recognized to
 2 the transferor shall be treated as ordinary income if—

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

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

11 (2) TREATMENT OF AMORTIZABLE SECTION 197
 12 INTANGIBLES AS DEPRECIABLE PROPERTY.—Section
 13 1239 of such Code is amended by adding at the end
 14 the following new subsection:

15 “(f) TREATMENT OF AMORTIZABLE SECTION 197 IN-
 16 TANGIBLES AS DEPRECIABLE PROPERTY.—For treatment
 17 of amortizable section 197 intangibles as depreciable prop-
 18 erty, see section 197(f)(7).”.

19 (b) TAX SHARING AGREEMENTS.—Section 1239 of
 20 such Code (relating to gain from sale of depreciable prop-
 21 erty between certain related taxpayers) is amended by
 22 adding at the end the following new subsection:

23 “(f) APPLICATION TO TAX SHARING AGREE-
 24 MENTS.—

1 “(1) IN GENERAL.—If there is a tax sharing
2 agreement with respect to any sale or exchange, the
3 transferee and the transferor shall be treated as re-
4 lated persons for purposes of this section.

5 “(2) TAX SHARING AGREEMENT.—For purposes
6 of this subsection, the term ‘tax sharing agreement’
7 means any agreement which provides for the pay-
8 ment to the transferor of any amount which is deter-
9 mined by reference to any portion of the tax benefit
10 realized by the transferee with respect to the depre-
11 ciation (or amortization) of the property trans-
12 ferred.”.

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

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