

112TH CONGRESS
2D SESSION

H. R. 4016

To amend the Internal Revenue Code of 1986 to provide for the proper tax treatment of personal service income earned in pass-thru entities.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 14, 2012

Mr. LEVIN (for himself and Mr. RANGEL) 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 proper tax treatment of personal service income earned in pass-thru entities.

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. SHORT TITLE; ETC.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Carried Interest Fairness Act of 2012”.

6 (b) AMENDMENT OF 1986 CODE.—Except as other-
7 wise expressly provided, whenever in this Act an amend-
8 ment or repeal is expressed in terms of an amendment
9 to, or repeal of, a section or other provision, the reference

1 shall be considered to be made to a section or other provi-
 2 sion of the Internal Revenue Code of 1986.

3 (c) TABLE OF CONTENTS.—The table of contents for
 4 this Act is as follows:

Sec. 1. Short title; etc.

Sec. 2. Partnership interests transferred in connection with performance of
 services.

Sec. 3. Special rules for partners providing investment management services to
 partnerships.

5 **SEC. 2. PARTNERSHIP INTERESTS TRANSFERRED IN CON-**
 6 **NECTION WITH PERFORMANCE OF SERVICES.**

7 (a) MODIFICATION TO ELECTION TO INCLUDE PART-
 8 NERSHIP INTEREST IN GROSS INCOME IN YEAR OF
 9 TRANSFER.—Subsection (c) of section 83 is amended by
 10 redesignating paragraph (4) as paragraph (5) and by in-
 11 serting after paragraph (3) the following new paragraph:

12 “(4) PARTNERSHIP INTERESTS.—Except as
 13 provided by the Secretary—

14 “(A) IN GENERAL.—In the case of any
 15 transfer of an interest in a partnership in con-
 16 nection with the provision of services to (or for
 17 the benefit of) such partnership—

18 “(i) the fair market value of such in-
 19 terest shall be treated for purposes of this
 20 section as being equal to the amount of the
 21 distribution which the partner would re-
 22 ceive if the partnership sold (at the time of
 23 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

“(ii) 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) ELECTION.—The election under subparagraph (A)(ii) shall be made under rules similar to the rules of subsection (b)(2).”.

(b) 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. 3. SPECIAL RULES FOR PARTNERS PROVIDING INVESTMENT MANAGEMENT SERVICES TO PARTNERSHIPS.

(a) IN GENERAL.—Part I of subchapter K of chapter 1 is amended by adding at the end the following new section:

1 **“SEC. 710. SPECIAL RULES FOR PARTNERS PROVIDING IN-**
2 **VESTMENT MANAGEMENT SERVICES TO**
3 **PARTNERSHIPS.**

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

7 “(1) IN GENERAL.—Notwithstanding section
8 702(b)—

9 “(A) an amount equal to the net capital
10 gain with respect to such interest for any part-
11 nership taxable year shall be treated as ordi-
12 nary income, and

13 “(B) subject to the limitation of paragraph
14 (2), an amount equal to the net capital loss
15 with respect to such interest for any partner-
16 ship taxable year shall be treated as an ordi-
17 nary loss.

18 “(2) RECHARACTERIZATION OF LOSSES LIM-
19 ITED TO RECHARACTERIZED GAINS.—The amount
20 treated as ordinary loss under paragraph (1)(B) for
21 any taxable year shall not exceed the excess (if any)
22 of—

23 “(A) the aggregate amount treated as ordi-
24 nary income under paragraph (1)(A) with re-
25 spect to the investment services partnership in-

1 terest for all preceding partnership taxable
2 years to which this section applies, over

3 “(B) the aggregate amount treated as or-
4 dinary loss under paragraph (1)(B) with re-
5 spect to such interest for all preceding partner-
6 ship taxable years to which this section applies.

7 “(3) ALLOCATION TO ITEMS OF GAIN AND
8 LOSS.—

9 “(A) NET CAPITAL GAIN.—The amount
10 treated as ordinary income under paragraph
11 (1)(A) shall be allocated ratably among the
12 items of long-term capital gain taken into ac-
13 count in determining such net capital gain.

14 “(B) NET CAPITAL LOSS.—The amount
15 treated as ordinary loss under paragraph (1)(B)
16 shall be allocated ratably among the items of
17 long-term capital loss and short-term capital
18 loss taken into account in determining such net
19 capital loss.

20 “(4) TERMS RELATING TO CAPITAL GAINS AND
21 LOSSES.—For purposes of this section—

22 “(A) IN GENERAL.—Net capital gain, long-
23 term capital gain, and long-term capital loss,
24 with respect to any investment services partner-
25 ship interest for any taxable year, shall be de-

1 terminated under section 1222, except that such
2 section shall be applied—

3 “(i) without regard to the recharacter-
4 ization of any item as ordinary income or
5 ordinary loss under this section,

6 “(ii) by only taking into account items
7 of gain and loss taken into account by the
8 holder of such interest under section 702
9 with respect to such interest for such tax-
10 able year, and

11 “(iii) by treating property which is
12 taken into account in determining gains
13 and losses to which section 1231 applies as
14 capital assets held for more than 1 year.

15 “(B) NET CAPITAL LOSS.—The term ‘net
16 capital loss’ means the excess of the losses from
17 sales or exchanges of capital assets over the
18 gains from such sales or exchanges. Rules simi-
19 lar to the rules of clauses (i) through (iii) of
20 subparagraph (A) shall apply for purposes of
21 the preceding sentence.

22 “(5) SPECIAL RULES FOR DIVIDENDS.—

23 “(A) INDIVIDUALS.—Any dividend allo-
24 cated to any investment services partnership in-

1 terest shall not be treated as qualified dividend
2 income for purposes of section 1(h).

3 “(B) CORPORATIONS.—No deduction shall
4 be allowed under section 243 or 245 with re-
5 spect to any dividend allocated to any invest-
6 ment services partnership interest.

7 “(6) SPECIAL RULE FOR QUALIFIED SMALL
8 BUSINESS STOCK.—Section 1202 shall not apply to
9 any gain from the sale or exchange of qualified small
10 business stock (as defined in section 1202(c)) allo-
11 cated with respect to any investment services part-
12 nership interest.

13 “(b) DISPOSITIONS OF PARTNERSHIP INTERESTS.—

14 “(1) GAIN.—

15 “(A) IN GENERAL.—Any gain on the dis-
16 position of an investment services partnership
17 interest shall be—

18 “(i) treated as ordinary income, and

19 “(ii) recognized notwithstanding any
20 other provision of this subtitle.

21 “(B) GIFT AND TRANSFERS AT DEATH.—

22 In the case of a disposition of an investment
23 services partnership interest by gift or by rea-
24 son of death of the taxpayer—

25 “(i) subparagraph (A) shall not apply,

1 “(ii) such interest shall be treated as
2 an investment services partnership interest
3 in the hands of the person acquiring such
4 interest, and

5 “(iii) any amount that would have
6 been treated as ordinary income under this
7 subsection had the decedent sold such in-
8 terest immediately before death shall be
9 treated as an item of income in respect of
10 a decedent under section 691.

11 “(2) LOSS.—Any loss on the disposition of an
12 investment services partnership interest shall be
13 treated as an ordinary loss to the extent of the ex-
14 cess (if any) of—

15 “(A) the aggregate amount treated as ordi-
16 nary income under subsection (a) with respect
17 to such interest for all partnership taxable
18 years to which this section applies, over

19 “(B) the aggregate amount treated as or-
20 dinary loss under subsection (a) with respect to
21 such interest for all partnership taxable years
22 to which this section applies.

23 “(3) ELECTION WITH RESPECT TO CERTAIN EX-
24 CHANGES.—Paragraph (1)(A)(ii) shall not apply to
25 the contribution of an investment services partner-

1 ship interest to a partnership in exchange for an in-
2 terest in such partnership if—

3 “(A) the taxpayer makes an irrevocable
4 election to treat the partnership interest re-
5 ceived in the exchange as an investment serv-
6 ices partnership interest, and

7 “(B) the taxpayer agrees to comply with
8 such reporting and recordkeeping requirements
9 as the Secretary may prescribe.

10 “(4) DISTRIBUTIONS OF PARTNERSHIP PROP-
11 ERTY.—

12 “(A) IN GENERAL.—In the case of any dis-
13 tribution of property by a partnership with re-
14 spect to any investment services partnership in-
15 terest held by a partner, the partner receiving
16 such property shall recognize gain equal to the
17 excess (if any) of—

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

21 “(ii) the adjusted basis of such prop-
22 erty in the hands of such partner (deter-
23 mined without regard to subparagraph
24 (C)).

1 “(B) TREATMENT OF GAIN AS ORDINARY
2 INCOME.—Any gain recognized by such partner
3 under subparagraph (A) shall be treated as or-
4 dinary income to the same extent and in the
5 same manner as the increase in such partner’s
6 distributive share of the taxable income of the
7 partnership would be treated under subsection
8 (a) if, immediately prior to the distribution, the
9 partnership had sold the distributed property at
10 fair market value and all of the gain from such
11 disposition were allocated to such partner. For
12 purposes of applying subsection (a)(2), any gain
13 treated as ordinary income under this subpara-
14 graph shall be treated as an amount treated as
15 ordinary income under subsection (a)(1)(A).

16 “(C) ADJUSTMENT OF BASIS.—In the case
17 a distribution to which subparagraph (A) ap-
18 plies, the basis of the distributed property in
19 the hands of the distributee partner shall be the
20 fair market value of such property.

21 “(D) SPECIAL RULES WITH RESPECT TO
22 MERGERS, DIVISIONS, AND TECHNICAL TERMI-
23 NATIONS.—In the case of a taxpayer which sat-
24 isfies requirements similar to the requirements
25 of subparagraphs (A) and (B) of paragraph (3),

1 this paragraph and paragraph (1)(A)(ii) shall
2 not apply to the distribution of a partnership
3 interest if such distribution is in connection
4 with a contribution (or deemed contribution) of
5 any property of the partnership to which sec-
6 tion 721 applies pursuant to a transaction de-
7 scribed in paragraph (1)(B) or (2) of section
8 708(b).

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

11 “(1) IN GENERAL.—The term ‘investment serv-
12 ices partnership interest’ means any interest in an
13 investment partnership acquired or held by any per-
14 son in connection with the conduct of a trade or
15 business described in paragraph (2) by such person
16 (or any person related to such person). An interest
17 in an investment partnership held by any person—

18 “(A) shall not be treated as an investment
19 services partnership interest for any period be-
20 fore the first date on which it is so held in con-
21 nection with such a trade or business,

22 “(B) shall not cease to be an investment
23 services partnership interest merely because
24 such person holds such interest other than in
25 connection with such a trade or business, and

1 “(C) shall be treated as an investment
2 services partnership interest if acquired from a
3 related person in whose hands such interest was
4 an investment services partnership interest.

5 “(2) BUSINESSES TO WHICH THIS SECTION AP-
6 PLIES.—A trade or business is described in this
7 paragraph if such trade or business primarily in-
8 volves the performance of any of the following serv-
9 ices with respect to assets held (directly or indi-
10 rectly) by the investment partnership referred to in
11 paragraph (1):

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

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

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

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

21 “(3) INVESTMENT PARTNERSHIP.—

22 “(A) IN GENERAL.—The term ‘investment
23 partnership’ means any partnership if, at the
24 end of any calendar quarter ending after the
25 date of enactment of this section—

1 “(i) substantially all of the assets of
 2 the partnership are specified assets (deter-
 3 mined without regard to any section 197
 4 intangible within the meaning of section
 5 197(d)), and

6 “(ii) more than half of the capital of
 7 the partnership is attributable to qualified
 8 capital interests which (in the hands of the
 9 owners of such interests) constitute prop-
 10 erty not held in connection with a trade or
 11 business.

12 “(B) SPECIAL RULES FOR DETERMINING
 13 IF PROPERTY NOT HELD IN CONNECTION WITH
 14 TRADE OR BUSINESS.—Except as otherwise
 15 provided by the Secretary, for purposes of de-
 16 termining whether any interest in a partnership
 17 constitutes property not held in connection with
 18 a trade or business under subparagraph
 19 (A)(ii)—

20 “(i) any election under subsection (e)
 21 or (f) of section 475 shall be disregarded,
 22 and

23 “(ii) paragraph (5)(B) shall not apply.

24 “(C) ANTIABUSE RULES.—The Secretary
 25 may issue regulations or other guidance which

1 prevent the avoidance of the purposes of sub-
2 paragraph (A), including regulations or other
3 guidance which treat convertible and contingent
4 debt (and other debt having the attributes of
5 equity) as a capital interest in the partnership.

6 “(D) CONTROLLED GROUPS OF ENTI-
7 TIES.—

8 “(i) IN GENERAL.—In the case of a
9 controlled group of entities, if an interest
10 in the partnership received in exchange for
11 a contribution to the capital of the part-
12 nership by any member of such controlled
13 group would (in the hands of such mem-
14 ber) constitute property held in connection
15 with a trade or business, then any interest
16 in such partnership held by any member of
17 such group shall be treated for purposes of
18 subparagraph (A) as constituting (in the
19 hands of such member) property held in
20 connection with a trade or business.

21 “(ii) CONTROLLED GROUP OF ENTI-
22 TIES.—For purposes of clause (i), the term
23 ‘controlled group of entities’ means a con-
24 trolled group of corporations as defined in
25 section 1563(a)(1), applied without regard

1 to subsections (a)(4) and (b)(2) of section
2 1563. A partnership or any other entity
3 (other than a corporation) shall be treated
4 as a member of a controlled group of enti-
5 ties if such entity is controlled (within the
6 meaning of section 954(d)(3)) by members
7 of such group (including any entity treated
8 as a member of such group by reason of
9 this sentence).

10 “(E) SPECIAL RULE FOR CORPORA-
11 TIONS.—For purposes of this paragraph, in the
12 case of a corporation, the determination of
13 whether property is held in connection with a
14 trade or business shall be determined as if the
15 taxpayer were an individual.

16 “(4) SPECIFIED ASSET.—The term ‘specified
17 asset’ means securities (as defined in section
18 475(c)(2) without regard to the last sentence there-
19 of), real estate held for rental or investment, inter-
20 ests in partnerships, commodities (as defined in sec-
21 tion 475(e)(2)), cash or cash equivalents, or options
22 or derivative contracts with respect to any of the
23 foregoing.

24 “(5) RELATED PERSONS.—

1 “(A) IN GENERAL.—A person shall be
2 treated as related to another person if the rela-
3 tionship between such persons is described in
4 section 267(b) or 707(b).

5 “(B) ATTRIBUTION OF PARTNER SERV-
6 ICES.—Any service described in paragraph (2)
7 which is provided by a partner of a partnership
8 shall be treated as also provided by such part-
9 nership.

10 “(d) EXCEPTION FOR CERTAIN CAPITAL INTER-
11 ESTS.—

12 “(1) IN GENERAL.—In the case of any portion
13 of an investment services partnership interest which
14 is a qualified capital interest, all items of gain and
15 loss (and any dividends) which are allocated to such
16 qualified capital interest shall not be taken into ac-
17 count under subsection (a) if—

18 “(A) allocations of items are made by the
19 partnership to such qualified capital interest in
20 the same manner as such allocations are made
21 to other qualified capital interests held by part-
22 ners who do not provide any services described
23 in subsection (c)(2) and who are not related to
24 the partner holding the qualified capital inter-
25 est, and

1 “(B) the allocations made to such other in-
2 terests are significant compared to the alloca-
3 tions made to such qualified capital interest.

4 “(2) AUTHORITY TO PROVIDE EXCEPTIONS TO
5 ALLOCATION REQUIREMENTS.—To the extent pro-
6 vided by the Secretary in regulations or other guid-
7 ance—

8 “(A) ALLOCATIONS TO PORTION OF QUALI-
9 FIED CAPITAL INTEREST.—Paragraph (1) may
10 be applied separately with respect to a portion
11 of a qualified capital interest.

12 “(B) NO OR INSIGNIFICANT ALLOCATIONS
13 TO NONSERVICE PROVIDERS.—In any case in
14 which the requirements of paragraph (1)(B) are
15 not satisfied, items of gain and loss (and any
16 dividends) shall not be taken into account under
17 subsection (a) to the extent that such items are
18 properly allocable under such regulations or
19 other guidance to qualified capital interests.

20 “(C) ALLOCATIONS TO SERVICE PRO-
21 VIDERS’ QUALIFIED CAPITAL INTERESTS WHICH
22 ARE LESS THAN OTHER ALLOCATIONS.—Alloca-
23 tions shall not be treated as failing to meet the
24 requirement of paragraph (1)(A) merely be-
25 cause the allocations to the qualified capital in-

1 terest represent a lower return than the alloca-
2 tions made to the other qualified capital inter-
3 ests referred to in such paragraph.

4 “(3) SPECIAL RULE FOR CHANGES IN SERVICES
5 AND CAPITAL CONTRIBUTIONS.—In the case of an
6 interest in a partnership which was not an invest-
7 ment services partnership interest and which, by
8 reason of a change in the services with respect to as-
9 sets held (directly or indirectly) by the partnership
10 or by reason of a change in the capital contributions
11 to such partnership, becomes an investment services
12 partnership interest, the qualified capital interest of
13 the holder of such partnership interest immediately
14 after such change shall not, for purposes of this sub-
15 section, be less than the fair market value of such
16 interest (determined immediately before such
17 change).

18 “(4) SPECIAL RULE FOR TIERED PARTNER-
19 SHIPS.—Except as otherwise provided by the Sec-
20 retary, in the case of tiered partnerships, all items
21 which are allocated in a manner which meets the re-
22 quirements of paragraph (1) to qualified capital in-
23 terests in a lower-tier partnership shall retain such
24 character to the extent allocated on the basis of

1 qualified capital interests in any upper-tier partner-
 2 ship.

3 “(5) EXCEPTION FOR NO-SELF-CHARGED
 4 CARRY AND MANAGEMENT FEE PROVISIONS.—Ex-
 5 cept as otherwise provided by the Secretary, an in-
 6 terest shall not fail to be treated as satisfying the
 7 requirement of paragraph (1)(A) merely because the
 8 allocations made by the partnership to such interest
 9 do not reflect the cost of services described in sub-
 10 section (c)(2) which are provided (directly or indi-
 11 rectly) to the partnership by the holder of such in-
 12 terest (or a related person).

13 “(6) SPECIAL RULE FOR DISPOSITIONS.—In the
 14 case of any investment services partnership interest
 15 any portion of which is a qualified capital interest,
 16 subsection (b) shall not apply to so much of any
 17 gain or loss as bears the same proportion to the en-
 18 tire amount of such gain or loss as—

19 “(A) the distributive share of gain or loss
 20 that would have been allocated to the qualified
 21 capital interest (consistent with the require-
 22 ments of paragraph (1)) if the partnership had
 23 sold all of its assets at fair market value imme-
 24 diately before the disposition, bears to

1 “(B) the distributive share of gain or loss
2 that would have been so allocated to the invest-
3 ment services partnership interest of which such
4 qualified capital interest is a part.

5 “(7) QUALIFIED CAPITAL INTEREST.—For pur-
6 poses of this section—

7 “(A) IN GENERAL.—The term ‘qualified
8 capital interest’ means so much of a partner’s
9 interest in the capital of the partnership as is
10 attributable to—

11 “(i) the fair market value of any
12 money or other property contributed to the
13 partnership in exchange for such interest
14 (determined without regard to section
15 752(a)),

16 “(ii) any amounts which have been in-
17 cluded in gross income under section 83
18 with respect to the transfer of such inter-
19 est, and

20 “(iii) the excess (if any) of—

21 “(I) any items of income and
22 gain taken into account under section
23 702 with respect to such interest, over

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

1 “(B) ADJUSTMENT TO QUALIFIED CAPITAL
2 INTEREST.—

3 “(i) DISTRIBUTIONS AND LOSSES.—

4 The qualified capital interest shall be re-
5 duced by distributions from the partner-
6 ship with respect to such interest and by
7 the excess (if any) of the amount described
8 in subparagraph (A)(iii)(II) over the
9 amount described in subparagraph
10 (A)(iii)(I).

11 “(ii) SPECIAL RULE FOR CONTRIBU-
12 TIONS OF PROPERTY.—In the case of any
13 contribution of property described in sub-
14 paragraph (A)(i) with respect to which the
15 fair market value of such property is not
16 equal to the adjusted basis of such prop-
17 erty immediately before such contribution,
18 proper adjustments shall be made to the
19 qualified capital interest to take into ac-
20 count such difference consistent with such
21 regulations or other guidance as the Sec-
22 retary may provide.

23 “(C) TECHNICAL TERMINATIONS, ETC.,
24 DISREGARDED.—No increase or decrease in the
25 qualified capital interest of any partner shall re-

1 sult from a termination, merger, consolidation,
2 or division described in section 708, or any
3 similar transaction.

4 “(8) TREATMENT OF CERTAIN LOANS.—

5 “(A) PROCEEDS OF PARTNERSHIP LOANS
6 NOT TREATED AS QUALIFIED CAPITAL INTER-
7 EST OF SERVICE PROVIDING PARTNERS.—For
8 purposes of this subsection, an investment serv-
9 ices partnership interest shall not be treated as
10 a qualified capital interest to the extent that
11 such interest is acquired in connection with the
12 proceeds of any loan or other advance made or
13 guaranteed, directly or indirectly, by any other
14 partner or the partnership (or any person re-
15 lated to any such other partner or the partner-
16 ship). The preceding sentence shall not apply to
17 the extent the loan or other advance is repaid
18 before the date of the enactment of this section
19 unless such repayment is made with the pro-
20 ceeds of a loan or other advance described in
21 the preceding sentence.

22 “(B) REDUCTION IN ALLOCATIONS TO
23 QUALIFIED CAPITAL INTERESTS FOR LOANS
24 FROM NONSERVICE-PROVIDING PARTNERS TO
25 THE PARTNERSHIP.—For purposes of this sub-

1 section, any loan or other advance to the part-
 2 nership made or guaranteed, directly or indi-
 3 rectly, by a partner not providing services de-
 4 scribed in subsection (c)(2) to the partnership
 5 (or any person related to such partner) shall be
 6 taken into account in determining the qualified
 7 capital interests of the partners in the partner-
 8 ship.

9 “(e) OTHER INCOME AND GAIN IN CONNECTION
 10 WITH INVESTMENT MANAGEMENT SERVICES.—

11 “(1) IN GENERAL.—If—

12 “(A) a person performs (directly or indi-
 13 rectly) investment management services for any
 14 investment entity,

15 “(B) such person holds (directly or indi-
 16 rectly) a disqualified interest with respect to
 17 such entity, and

18 “(C) the value of such interest (or pay-
 19 ments thereunder) is substantially related to
 20 the amount of income or gain (whether or not
 21 realized) from the assets with respect to which
 22 the investment management services are per-
 23 formed,

24 any income or gain with respect to such interest
 25 shall be treated as ordinary income. Rules similar to

1 the rules of subsections (a)(5) and (d) shall apply
2 for purposes of this subsection.

3 “(2) DEFINITIONS.—For purposes of this sub-
4 section—

5 “(A) DISQUALIFIED INTEREST.—

6 “(i) IN GENERAL.—The term ‘dis-
7 qualified interest’ means, with respect to
8 any investment entity—

9 “(I) any interest in such entity
10 other than indebtedness,

11 “(II) convertible or contingent
12 debt of such entity,

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

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

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

22 “(I) a partnership interest,

23 “(II) except as provided by the
24 Secretary, any interest in a taxable
25 corporation, and

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

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

5 “(i) a domestic C corporation, or

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

8 “(I) effectively connected with
9 the conduct of a trade or business in
10 the United States, or

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

14 “(C) INVESTMENT MANAGEMENT SERV-
15 ICES.—The term ‘investment management serv-
16 ices’ means a substantial quantity of any of the
17 services described in subsection (c)(2).

18 “(D) INVESTMENT ENTITY.—The term ‘in-
19 vestment entity’ means any entity which, if it
20 were a partnership, would be an investment
21 partnership.

22 “(f) REGULATIONS.—The Secretary shall prescribe
23 such regulations or other guidance as is necessary or ap-
24 propriate to carry out the purposes of this section, includ-
25 ing regulations or other guidance to—

1 “(1) provide modifications to the application of
2 this section (including treating related persons as
3 not related to one another) to the extent such modi-
4 fication is consistent with the purposes of this sec-
5 tion,

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

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

10 “(g) CROSS REFERENCE.—For 40 percent penalty on
11 certain underpayments due to the avoidance of this sec-
12 tion, see section 6662.”.

13 (b) APPLICATION OF SECTION 751 TO INDIRECT DIS-
14 POSITIONS OF INVESTMENT SERVICES PARTNERSHIP IN-
15 TERESTS.—

16 (1) IN GENERAL.—Subsection (a) of section
17 751 is amended by striking “or” at the end of para-
18 graph (1), by inserting “or” at the end of paragraph
19 (2), and by inserting after paragraph (2) the fol-
20 lowing new paragraph:

21 “(3) investment services partnership interests
22 held by the partnership,”.

23 (2) CERTAIN DISTRIBUTIONS TREATED AS
24 SALES OR EXCHANGES.—Subparagraph (A) of sec-
25 tion 751(b)(1) is amended by striking “or” at the

1 end of clause (i), by inserting “or” at the end of
 2 clause (ii), and by inserting after clause (ii) the fol-
 3 lowing new clause:

4 “(iii) investment services partnership
 5 interests held by the partnership,”.

6 (3) APPLICATION OF SPECIAL RULES IN THE
 7 CASE OF TIERED PARTNERSHIPS.—Subsection (f) of
 8 section 751 is amended—

9 (A) by striking “or” at the end of para-
 10 graph (1), by inserting “or” at the end of para-
 11 graph (2), and by inserting after paragraph (2)
 12 the following new paragraph:

13 “(3) an investment services partnership interest
 14 held by the partnership,” and

15 (B) by striking “partner.” and inserting
 16 “partner (other than a partnership in which it
 17 holds an investment services partnership inter-
 18 est).”.

19 (4) INVESTMENT SERVICES PARTNERSHIP IN-
 20 TERESTS; QUALIFIED CAPITAL INTERESTS.—Section
 21 751 is amended by adding at the end the following
 22 new subsection:

23 “(g) INVESTMENT SERVICES PARTNERSHIP INTER-
 24 ESTS.—For purposes of this section—

1 “(1) IN GENERAL.—The term ‘investment serv-
 2 ices partnership interest’ has the meaning given
 3 such term by section 710(c).

4 “(2) ADJUSTMENTS FOR QUALIFIED CAPITAL
 5 INTERESTS.—The amount to which subsection (a)
 6 applies by reason of paragraph (3) thereof shall not
 7 include so much of such amount as is attributable
 8 to any portion of the investment services partnership
 9 interest which is a qualified capital interest (deter-
 10 mined under rules similar to the rules of section
 11 710(d)).

12 “(3) EXCEPTION FOR PUBLICLY TRADED PART-
 13 NERSHIPS.—In the case of an exchange of an inter-
 14 est in a publicly traded partnership (as defined in
 15 section 7704) to which subsection (a) applies—

16 “(A) this section shall be applied without
 17 regard to subsections (a)(3), (b)(1)(A)(iii), and
 18 (f)(3), and

19 “(B) such partnership shall be treated as
 20 owning its proportionate share of the property
 21 of any other partnership in which it is a part-
 22 ner.

23 “(4) RECOGNITION OF GAINS.—Any gain with
 24 respect to which subsection (a) applies by reason of

1 paragraph (3) thereof shall be recognized notwith-
 2 standing any other provision of this title.

3 “(5) COORDINATION WITH INVENTORY
 4 ITEMS.—An investment services partnership interest
 5 held by the partnership shall not be treated as an
 6 inventory item of the partnership.

7 “(6) PREVENTION OF DOUBLE COUNTING.—
 8 Under regulations or other guidance prescribed by
 9 the Secretary, subsection (a)(3) shall not apply with
 10 respect to any amount to which section 710 applies.

11 “(7) VALUATION METHODS.—The Secretary
 12 shall prescribe regulations or other guidance which
 13 provide the acceptable methods for valuing invest-
 14 ment services partnership interests for purposes of
 15 this section.”.

16 (c) TREATMENT FOR PURPOSES OF SECTION
 17 7704.—Subsection (d) of section 7704 is amended by add-
 18 ing at the end the following new paragraph:

19 “(6) INCOME FROM CERTAIN CARRIED INTER-
 20 ESTS NOT QUALIFIED.—

21 “(A) IN GENERAL.—Specified carried in-
 22 terest income shall not be treated as qualifying
 23 income.

24 “(B) SPECIFIED CARRIED INTEREST IN-
 25 COME.—For purposes of this paragraph—

1 “(i) IN GENERAL.—The term ‘speci-
2 fied carried interest income’ means—

3 “(I) any item of income or gain
4 allocated to an investment services
5 partnership interest (as defined in
6 section 710(c)) held by the partner-
7 ship,

8 “(II) any gain on the disposition
9 of an investment services partnership
10 interest (as so defined) or a partner-
11 ship interest to which (in the hands of
12 the partnership) section 751 applies,
13 and

14 “(III) any income or gain taken
15 into account by the partnership under
16 subsection (b)(4) or (e) of section
17 710.

18 “(ii) EXCEPTION FOR QUALIFIED CAP-
19 ITAL INTERESTS.—A rule similar to the
20 rule of section 710(d) shall apply for pur-
21 poses of clause (i).

22 “(C) COORDINATION WITH OTHER PROVI-
23 SIONS.—Subparagraph (A) shall not apply to
24 any item described in paragraph (1)(E) (or so

1 much of paragraph (1)(F) as relates to para-
2 graph (1)(E)).

3 “(D) SPECIAL RULES FOR CERTAIN PART-
4 NERSHIPS.—

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

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

10 “(I) Such partnership is treated
11 as publicly traded under this section
12 solely by reason of interests in such
13 partnership being convertible into in-
14 terests in a real estate investment
15 trust which is publicly traded.

16 “(II) Fifty percent or more of
17 the capital and profits interests of
18 such partnership are owned, directly
19 or indirectly, at all times during the
20 taxable year by such real estate in-
21 vestment trust (determined with the
22 application of section 267(c)).

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

1 “(ii) CERTAIN PARTNERSHIPS OWN-
 2 ING OTHER PUBLICLY TRADED PARTNER-
 3 SHIPS.—Subparagraph (A) shall not apply
 4 in the case of a partnership which meets
 5 each of the following requirements:

6 “(I) Substantially all of the as-
 7 sets of such partnership consist of in-
 8 terests in one or more publicly traded
 9 partnerships (determined without re-
 10 gard to subsection (b)(2)).

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

15 “(E) TRANSITIONAL RULE.—Subpara-
 16 graph (A) shall not apply to any taxable year
 17 of the partnership beginning before the date
 18 which is 10 years after the date of the enact-
 19 ment of this paragraph.”.

20 (d) IMPOSITION OF PENALTY ON UNDERPAY-
 21 MENTS.—

22 (1) IN GENERAL.—Subsection (b) of section
 23 6662 is amended by inserting after paragraph (7)
 24 the following new paragraph:

1 “(8) The application of section 710(e) or the
2 regulations or other guidance prescribed under sec-
3 tion 710(f) to prevent the avoidance of the purposes
4 of section 710.”.

5 (2) AMOUNT OF PENALTY.—

6 (A) IN GENERAL.—Section 6662 is amend-
7 ed by adding at the end the following new sub-
8 section:

9 “(k) INCREASE IN PENALTY IN CASE OF PROPERTY
10 TRANSFERRED FOR INVESTMENT MANAGEMENT SERV-
11 ICES.—In the case of any portion of an underpayment to
12 which this section applies by reason of subsection (b)(8),
13 subsection (a) shall be applied with respect to such portion
14 by substituting ‘40 percent’ for ‘20 percent’.”.

15 (B) CONFORMING AMENDMENT.—Subpara-
16 graph (B) of section 6662A(e)(2) is amended
17 by striking “or (i)” and inserting “, (i), or (k)”.

18 (3) SPECIAL RULES FOR APPLICATION OF REA-
19 SONABLE CAUSE EXCEPTION.—Subsection (c) of sec-
20 tion 6664 is amended—

21 (A) by redesignating paragraphs (3) and
22 (4) as paragraphs (4) and (5), respectively;

23 (B) by striking “paragraph (3)” in para-
24 graph (5)(A), as so redesignated, and inserting
25 “paragraph (4)”; and

1 (C) by inserting after paragraph (2) the
 2 following new paragraph:

3 “(3) SPECIAL RULE FOR UNDERPAYMENTS AT-
 4 TRIBUTABLE TO INVESTMENT MANAGEMENT SERV-
 5 ICES.—

6 “(A) IN GENERAL.—Paragraph (1) shall
 7 not apply to any portion of an underpayment to
 8 which section 6662 applies by reason of sub-
 9 section (b)(8) unless—

10 “(i) the relevant facts affecting the
 11 tax treatment of the item are adequately
 12 disclosed,

13 “(ii) there is or was substantial au-
 14 thority for such treatment, and

15 “(iii) the taxpayer reasonably believed
 16 that such treatment was more likely than
 17 not the proper treatment.

18 “(B) RULES RELATING TO REASONABLE
 19 BELIEF.—Rules similar to the rules of sub-
 20 section (d)(3) shall apply for purposes of sub-
 21 paragraph (A)(iii).”.

22 (e) INCOME AND LOSS FROM INVESTMENT SERVICES
 23 PARTNERSHIP INTERESTS TAKEN INTO ACCOUNT IN DE-
 24 TERMINING NET EARNINGS FROM SELF-EMPLOYMENT.—

25 (1) INTERNAL REVENUE CODE.—

1 (A) IN GENERAL.—Section 1402(a) is
 2 amended by striking “and” at the end of para-
 3 graph (16), by striking the period at the end of
 4 paragraph (17) and inserting “; and”, and by
 5 inserting after paragraph (17) the following
 6 new paragraph:

7 “(18) notwithstanding the preceding provisions
 8 of this subsection, in the case of any individual en-
 9 gaged in the trade or business of providing services
 10 described in section 710(c)(2) with respect to any
 11 entity, investment services partnership income or
 12 loss (as defined in subsection (m)) of such individual
 13 with respect to such entity shall be taken into ac-
 14 count in determining the net earnings from self-em-
 15 ployment of such individual.”.

16 (B) INVESTMENT SERVICES PARTNERSHIP
 17 INCOME OR LOSS.—Section 1402 is amended by
 18 adding at the end the following new subsection:

19 “(m) INVESTMENT SERVICES PARTNERSHIP INCOME
 20 OR LOSS.—For purposes of subsection (a)—

21 “(1) IN GENERAL.—The term ‘investment serv-
 22 ices partnership income or loss’ means, with respect
 23 to any investment services partnership interest (as
 24 defined in section 710(c)) or disqualified interest (as
 25 defined in section 710(e)), the net of—

1 “(A) the amounts treated as ordinary in-
2 come or ordinary loss under subsections (b) and
3 (e) of section 710 with respect to such interest,

4 “(B) all items of income, gain, loss, and
5 deduction allocated to such interest, and

6 “(C) the amounts treated as realized from
7 the sale or exchange of property other than a
8 capital asset under section 751 with respect to
9 such interest.

10 “(2) EXCEPTION FOR QUALIFIED CAPITAL IN-
11 TERESTS.—A rule similar to the rule of section
12 710(d) shall apply for purposes of applying para-
13 graph (1)(B).”.

14 (2) SOCIAL SECURITY ACT.—Section 211(a) of
15 the Social Security Act is amended by striking
16 “and” at the end of paragraph (15), by striking the
17 period at the end of paragraph (16) and inserting “;
18 and”, and by inserting after paragraph (16) the fol-
19 lowing new paragraph:

20 “(17) Notwithstanding the preceding provisions
21 of this subsection, in the case of any individual en-
22 gaged in the trade or business of providing services
23 described in section 710(c)(2) of the Internal Rev-
24 enue Code of 1986 with respect to any entity, invest-
25 ment services partnership income or loss (as defined

1 in section 1402(m) of such Code) shall be taken into
 2 account in determining the net earnings from self-
 3 employment of such individual.”.

4 (f) CONFORMING AMENDMENTS.—

5 (1) Subsection (d) of section 731 is amended by
 6 inserting “section 710(b)(4) (relating to distribu-
 7 tions of partnership property),” after “to the extent
 8 otherwise provided by”.

9 (2) Section 741 is amended by inserting “or
 10 section 710 (relating to special rules for partners
 11 providing investment management services to part-
 12 nerships)” before the period at the end.

13 (3) The table of sections for part I of sub-
 14 chapter K of chapter 1 is amended by adding at the
 15 end the following new item:

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

16 (g) EFFECTIVE DATE.—

17 (1) IN GENERAL.—Except as otherwise pro-
 18 vided in this subsection, the amendments made by
 19 this section shall apply to taxable years ending after
 20 the date of the enactment of this Act.

21 (2) PARTNERSHIP TAXABLE YEARS WHICH IN-
 22 CLUDE EFFECTIVE DATE.—In applying section
 23 710(a) of the Internal Revenue Code of 1986 (as
 24 added by this section) in the case of any partnership

1 taxable year which includes the date of the enact-
2 ment of this Act, the amount of the net capital gain
3 referred to in such section shall be treated as being
4 the lesser of the net capital gain for the entire part-
5 nership taxable year or the net capital gain deter-
6 mined by only taking into account items attributable
7 to the portion of the partnership taxable year which
8 is after such date.

9 (3) DISPOSITIONS OF PARTNERSHIP INTER-
10 ESTS.—

11 (A) IN GENERAL.—Section 710(b) of such
12 Code (as added by this section) shall apply to
13 dispositions and distributions after the date of
14 the enactment of this Act.

15 (B) INDIRECT DISPOSITIONS.—The amend-
16 ments made by subsection (b) shall apply to
17 transactions after the date of the enactment of
18 this Act.

19 (4) OTHER INCOME AND GAIN IN CONNECTION
20 WITH INVESTMENT MANAGEMENT SERVICES.—Sec-
21 tion 710(e) of such Code (as added by this section)
22 shall take effect on the date of the enactment of this
23 Act.

