

115TH CONGRESS  
2D SESSION

# H. R. 5514

To amend the Internal Revenue Code of 1986 to treat certain income with respect to partnership interests held in connection with the performance of services as ordinary income.

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## IN THE HOUSE OF REPRESENTATIVES

APRIL 13, 2018

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

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## A BILL

To amend the Internal Revenue Code of 1986 to treat certain income with respect to partnership interests held in connection with the performance of services as ordinary income.

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.**

4       This Act may be cited as the “Tax Fairness Act of  
5       2018”.

1 **SEC. 2. ORDINARY INCOME TREATMENT IN THE CASE OF**  
 2 **PARTNERSHIP INTERESTS HELD IN CONNEC-**  
 3 **TION WITH PERFORMANCE OF SERVICES.**

4 (a) IN GENERAL.—Section 1061 of the Internal Rev-  
 5 enue Code of 1986 is amended to read as follows:

6 **“SEC. 1061. PARTNERSHIP INTERESTS HELD IN CONNEC-**  
 7 **TION WITH PERFORMANCE OF SERVICES.**

8 “(a) IN GENERAL.—If one or more applicable part-  
 9 nership interests are held by a taxpayer at any time during  
 10 the taxable year, so much of—

11 “(1) the taxpayer’s net capital gain with respect  
 12 to such interests for such taxable year, as does not  
 13 exceed

14 “(2) the taxpayer’s recharacterization account  
 15 balance for such taxable year,  
 16 shall be treated as ordinary income.

17 “(b) NET CAPITAL GAIN.—

18 “(1) IN GENERAL.—For purposes of subsection  
 19 (a)(1), net capital gain shall be determined under  
 20 section 1222, except that such section shall be ap-  
 21 plied—

22 “(A) without regard to the recharacteriza-  
 23 tion of any item as ordinary income under this  
 24 section,

25 “(B) by only taking into account items of  
 26 gain and loss—

1 “(i) taken into account by the tax-  
2 payer under section 702 with respect to  
3 any applicable partnership interest,

4 “(ii) recognized by the taxpayer on  
5 the disposition of any such interest, or

6 “(iii) recognized by the taxpayer  
7 under paragraph (4) on a distribution of  
8 property with respect to such interest, and

9 “(C) in the case of a taxable year for  
10 which section 1231 gains (as defined in section  
11 1231(a)(3)(A)) exceed section 1231 losses (as  
12 defined in section 1231(a)(3)(B)), by treating  
13 property which is taken into account in deter-  
14 mining such gains and losses as capital assets  
15 held for more than 1 year.

16 “(2) ALLOCATION TO ITEMS OF GAIN.—The  
17 amount treated as ordinary income under subsection  
18 (a) shall be allocated ratably among the items of  
19 long-term capital gain taken into account in deter-  
20 mining net capital gain under paragraph (1).

21 “(3) RECOGNITION OF GAIN ON DISPOSITION  
22 OF APPLICABLE PARTNERSHIP INTERESTS.—Any  
23 gain on the disposition of any applicable partnership  
24 interest shall be recognized notwithstanding any  
25 other provision of this title.

1           “(4) RECOGNITION OF GAIN ON DISTRIBUTIONS  
2           OF PARTNERSHIP PROPERTY.—

3           “(A) IN GENERAL.—In the case of any dis-  
4           tribution of property by a partnership with re-  
5           spect to any applicable partnership interest, the  
6           partner receiving such property shall recognize  
7           gain equal to the excess (if any) of—

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

11                   “(ii) the adjusted basis of such prop-  
12                   erty in the hands of such partner (deter-  
13                   mined without regard to subparagraph  
14                   (B)).

15           “(B) ADJUSTMENT OF BASIS.—In the case  
16           of a distribution to which subparagraph (A) ap-  
17           plies, the basis of the distributed property in  
18           the hands of the distributee partner shall be the  
19           amount determined under subparagraph (A)(i).

20           “(c) RECHARACTERIZATION ACCOUNT BALANCE.—

21           “(1) IN GENERAL.—For purposes of this sec-  
22           tion, the term ‘recharacterization account balance’  
23           means, with respect to any taxpayer for any taxable  
24           year, the excess (if any) of—

25                   “(A) the sum of—

1 “(i) the taxpayer’s aggregate annual  
 2 recharacterization amounts with respect to  
 3 applicable partnership interests for such  
 4 taxable year, plus

5 “(ii) the taxpayer’s recharacterization  
 6 account balance for the taxable year pre-  
 7 ceding such taxable year, over

8 “(B) the sum of—

9 “(i) the taxpayer’s net ordinary in-  
 10 come with respect to applicable partnership  
 11 interests for such taxable year (determined  
 12 without regard to this section), plus

13 “(ii) the amount treated as ordinary  
 14 income of the taxpayer under this section  
 15 for the taxable year preceding such taxable  
 16 year.

17 “(2) ANNUAL RECHARACTERIZATION  
 18 AMOUNT.—For purposes of this subsection—

19 “(A) IN GENERAL.—The term ‘annual re-  
 20 characterization amount’ means, with respect to  
 21 any applicable partnership interest for any  
 22 partnership taxable year, an amount equal to  
 23 the product of—

24 “(i) the specified rate determined  
 25 under subparagraph (B) for the calendar

1 year in which such taxable year begins,  
2 multiplied by

3 “(ii) the excess (if any) of—

4 “(I) an amount equal to the ap-  
5 plicable percentage of the partner-  
6 ship’s aggregate invested capital for  
7 such taxable year, over

8 “(II) the specified capital con-  
9 tribution of the partner with respect  
10 to the applicable partnership interest  
11 for such taxable year.

12 If a taxpayer holds an applicable partnership  
13 interest for less than the entire taxable year,  
14 the amount determined under the preceding  
15 sentence shall be ratably reduced.

16 “(B) SPECIFIED RATE.—For purposes of  
17 subparagraph (A), the term ‘specified rate’  
18 means, with respect to any calendar year, a per-  
19 centage equal to—

20 “(i) the Federal long-term rate deter-  
21 mined under section 1274(d)(1) for the  
22 last month of the calendar year, plus

23 “(ii) 10 percentage points.

24 “(C) APPLICABLE PERCENTAGE.—

1                   “(i) IN GENERAL.—The term ‘applica-  
2                   ble percentage’ means, with respect to any  
3                   applicable partnership interest, the highest  
4                   percentage of profits of the partnership  
5                   that could be allocated with respect to such  
6                   interest for the taxable year (consistent  
7                   with the partnership agreement and as-  
8                   suming such facts and circumstances with  
9                   respect to such taxable year as would re-  
10                  sult in such highest percentage).

11                  “(ii) SECRETARIAL AUTHORITY.—The  
12                  Secretary shall prescribe rules for the de-  
13                  termination of the applicable percentage in  
14                  cases in which the percentage of profits of  
15                  a partnership that are to be allocated with  
16                  respect to an applicable partnership inter-  
17                  est varies on the basis of the aggregate  
18                  amount of such profits. Such rules may  
19                  provide a percentage which may be used in  
20                  lieu of the highest percentage determined  
21                  under clause (i) in cases where such other  
22                  percentage is consistent with the purposes  
23                  of this section.

24                  “(D) AGGREGATE INVESTED CAPITAL.—

“(i) IN GENERAL.—The term ‘aggregate invested capital’ means, with respect to any taxable year, the average daily amount of invested capital of the partnership for such taxable year.

“(ii) INVESTED CAPITAL.—The term ‘invested capital’ means, with respect to any partnership as of any day, the total cumulative value, determined at the time of contribution, of all money or other property contributed to the partnership on or before such day.

“(iii) REDUCTION FOR LIQUIDATION OF PARTNERSHIP INTERESTS.—The invested capital of a partnership shall be reduced by the aggregate amount distributed in liquidation of interests in the partnership.

“(iv) TREATMENT OF CERTAIN INDEBTEDNESS AS INVESTED CAPITAL.—The following amounts shall be treated as invested capital:

“(I) PARTNER LOANS.—The aggregate value (determined as of the time of the loan) of money or other



1 property which a partner loans to the  
2 partnership.

3 “(II) INDEBTEDNESS ELIGIBLE  
4 TO SHARE IN EQUITY OF THE PART-  
5 NERSHIP.—The face amount of any  
6 convertible debt of the partnership or  
7 any debt obligation providing equity  
8 participation in the partnership.

9 “(E) SPECIFIED CAPITAL CONTRIBU-  
10 TION.—

11 “(i) IN GENERAL.—The term ‘speci-  
12 fied capital contribution’ means, with re-  
13 spect to any applicable partnership interest  
14 for any taxable year, the average daily  
15 amount of contributed capital with respect  
16 to such interest for such year.

17 “(ii) CONTRIBUTED CAPITAL.—The  
18 term ‘contributed capital’ means, with re-  
19 spect to applicable partnership interest as  
20 of any day, the excess (if any) of—

21 “(I) the total cumulative value,  
22 determined at the time of contribu-  
23 tion, of all money or other property  
24 contributed by the partner to the

1 partnership with respect to such inter-  
2 est as of such day, over

3 “(II) the total cumulative value,  
4 determined at the time of distribution,  
5 of all money or other property distrib-  
6 uted by the partnership to the partner  
7 with respect to such interest as of  
8 such day.

9 “(iii) TREATMENT OF RELATED  
10 PARTY BORROWINGS.—Any amount bor-  
11 rowed directly or indirectly from the part-  
12 nership or any other partner of the part-  
13 nership or any person related to such other  
14 partner or such partnership shall not be  
15 taken into account under this subpara-  
16 graph. For purposes of the preceding sen-  
17 tence, a person shall be treated as related  
18 to another person if the relationship be-  
19 tween such persons would be described in  
20 section 267(b) or 707(b) if such sections  
21 and section 267(f) were applied by sub-  
22 stituting ‘10 percent’ for ‘50 percent’ each  
23 place it appears.

24 “(F) MULTIPLE INTERESTS.—If at any  
25 time during a taxable year a taxpayer holds di-

1           rectly or indirectly more than 1 applicable part-  
2           nership interest in a single partnership, such in-  
3           terests shall be treated as 1 applicable partner-  
4           ship interest for purposes of applying this para-  
5           graph.

6           “(3) NET ORDINARY INCOME.—For purposes of  
7           this subsection, the net ordinary income with respect  
8           to applicable partnership interests for any taxable  
9           year is the excess (if any) of—

10                 “(A) the taxpayer’s distributive share of  
11                 items of income and gain under section 702  
12                 with respect to applicable partnership interests  
13                 for such taxable year (determined without re-  
14                 gard to any items of gain taken into account in  
15                 determining net capital gain under subsection  
16                 (b)(1)), over

17                 “(B) the taxpayer’s distributive share of  
18                 items of deduction and loss under section 702  
19                 with respect to such interests for such taxable  
20                 year (determined without regard to any items of  
21                 loss taken into account in determining net cap-  
22                 ital gain under subsection (b)(1)).

23           “(d) APPLICABLE PARTNERSHIP INTEREST.—For  
24           purposes of this section—

1           “(1) IN GENERAL.—The term ‘applicable part-  
2       nership interest’ means any interest in a partnership  
3       which, directly or indirectly, is transferred to (or is  
4       held by) the taxpayer in connection with the per-  
5       formance of services by the taxpayer, or any other  
6       person, in any applicable trade or business.

7           “(2) APPLICABLE TRADE OR BUSINESS.—

8               “(A) IN GENERAL.—The term ‘applicable  
9       trade or business’ means any trade or business  
10      conducted on a regular, continuous, and sub-  
11      stantial basis which, regardless of whether the  
12      activities are conducted in one or more entities,  
13      consists, in whole or in part, of—

14               “(i) raising or returning capital,

15               “(ii) investing in (or disposing of)  
16      trades or businesses (or identifying trades  
17      or businesses for such investing or disposi-  
18      tion), and

19               “(iii) developing such trades or busi-  
20      nesses.

21           “(B) TREATMENT OF RESEARCH AND EX-  
22      PERIMENTATION ACTIVITIES.—Any activity in-  
23      volving research or experimentation (within the  
24      meaning of section 469(c)(4)) shall be treated

1 as a trade or business for purposes of clauses  
2 (ii) and (iii) of subparagraph (A).

3 “(e) TRANSFER OF APPLICABLE PARTNERSHIP IN-  
4 TEREST TO RELATED PERSON.—

5 “(1) IN GENERAL.—If a taxpayer transfers any  
6 applicable partnership interest, directly or indirectly,  
7 to a person related to the taxpayer, the taxpayer  
8 shall include in gross income (as ordinary income) so  
9 much of the taxpayer’s recharacterization account  
10 balance for such taxable year as is allocable to such  
11 interest (determined in such manner as the Sec-  
12 retary may provide and reduced by any amount  
13 treated as ordinary income under subsection (a) with  
14 respect to the transfer of such interest).

15 “(2) RELATED PERSON.—For purposes of this  
16 paragraph, a person is related to the taxpayer if—

17 “(A) the person is a member of the tax-  
18 payer’s family within the meaning of section  
19 318(a)(1), or

20 “(B) the person performed a service within  
21 the current calendar year or the preceding three  
22 calendar years in any applicable trade or busi-  
23 ness in which or for which the taxpayer per-  
24 formed a service.

1       “(f) REPORTING BY ENTITY OF TAXPAYER’S AN-  
 2 NUAL RECHARACTERIZATION AMOUNT.—A partnership  
 3 shall report to the Secretary, and include with the infor-  
 4 mation required to be furnished under section 6031(b) to  
 5 each partner, the amount of the partner’s annual re-  
 6 characterization amount for the taxable year, if any. A  
 7 similar rule applies to any entity that receives a report  
 8 of an annual recharacterization amount for the taxable  
 9 year.

10       “(g) REGULATIONS.—The Secretary shall issue such  
 11 regulations or other guidance as necessary to carry out  
 12 this section, including regulations—

13               “(1) to prevent the abuse of the purposes of  
 14 this section, including through—

15                       “(A) the allocation of income to tax indif-  
 16 ferent parties, or

17                       “(B) a reduction in the invested capital of  
 18 the partnership (including attempts to under-  
 19 value contributed or loaned property),

20       “(2) which provide that partnership interests  
 21 shall not fail to be treated as transferred or held in  
 22 connection with the performance of services merely  
 23 because the taxpayer also made contributions to the  
 24 partnership,

1           “(3) which provide for the application of this  
2           section in cases where the taxpayer has more than  
3           1 applicable interest in a partnership, and

4           “(4) which provide for the application of this  
5           section in cases of tiered structures of entities.”.

6           (b) COORDINATION WITH SECTION 83.—Subsection  
7           (e) of section 83 is amended by striking “or” at the end  
8           of paragraph (4), by striking the period at the end of para-  
9           graph (5) and inserting “, or”, and by adding at the end  
10          the following new paragraph:

11           “(6) a transfer of a partnership interest to  
12          which section 1061 applies.”.

13          (c) EFFECTIVE DATE.—The amendments made by  
14          this section shall apply to taxable years beginning after  
15          December 31, 2017.

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