I

119TH CONGRESS
1ST SESSION

H. R. 2621

To amend the Internal Revenue Code of 1986 to establish deductions for cash tips, repeal the inclusion of social security benefits in gross income, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 3, 2025

Mr. COHEN (for himself and Mr. CARSON) 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 establish deductions for cash tips, repeal the inclusion of social security benefits in gross income, and for other purposes.

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

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Reward Each American's Labor And Make Every Rich Individual Contribute Again Act" or the "REAL AMERICA Act".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

SEC. 2. DEDUCTION FOR CASH TIPS.

(a) DEDUCTION ALLOWED.—

(1) IN GENERAL.—Part VII of subchapter B of chapter 1 is amended by redesignating section 224 as section 225 and by inserting after section 223 the following new section:

"SEC. 224. CASH TIPS.

"(a) IN GENERAL.—There shall be allowed as a deduction an amount equal to the cash tips received during the taxable year that are included on statements furnished to the employer pursuant to section 6053(a).

"(b) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

"(1) IN GENERAL.—No deduction shall be allowed by this section for any taxpayer if such taxpayer's modified adjusted gross income for the taxable year exceeds $450,000 ($900,000, in the case of a joint return).

"(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term 'modified adjusted gross income' means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.''.

(2) CLERICAL AMENDMENT.—The table of sections for part VII of subchapter B of chapter 1 is amended by redesignating the item relating to section 224 as relating to section 225 and by inserting after the item relating to section 223 the following new item:

''Sec. 224. Cash tips.''.

(b) DEDUCTION ALLOWED TO NON-ITEMIZERS.—Section 63(b) is amended by striking ''and'' at the end of paragraph (3), by striking the period at the end of paragraph (4) and inserting '', and'', and by adding at the end the following new paragraph:

''(5) the deduction provided in section 224.''.

(c) WITHHOLDING.—The Secretary of the Treasury (or the Secretary's delegate) shall modify the tables and procedures prescribed under section 3402(a) of the Internal Revenue Code of 1986 to take into account the deduction allowed under section 224 of such Code (as added by this Act).

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2025.

SEC. 3. REPEAL OF INCLUSION OF SOCIAL SECURITY BENEFITS IN GROSS INCOME.

(a) IN GENERAL.—Section 86 is amended by adding at the end the following new subsection:

"(g) TERMINATION.—This section shall not apply to any taxable year beginning after December 31, 2025.".

(b) SOCIAL SECURITY TRUST FUNDS HELD HARMLESS.—There are hereby appropriated (out of any money in the Treasury not otherwise appropriated) for each fiscal year to each fund under the Social Security Act (including the Federal Hospital Insurance Trust Fund) or the Railroad Retirement Act of 1974 an amount equal to the reduction in the transfers to such fund for such fiscal year by reason of section 86(g) of the Internal Revenue Code of 1986.

SEC. 4. DEDUCTION FOR QUALIFIED OVERTIME COMPENSATION.

(a) DEDUCTION ALLOWED.—

(1) IN GENERAL.—Part VII of subchapter B of chapter 1, as amended by the preceding provisions of this Act, is amended by redesignating section 225 as section 226 and by inserting after section 224 the following new section:

"SEC. 225. QUALIFIED OVERTIME COMPENSATION.

"(a) IN GENERAL.—There shall be allowed as a deduction an amount equal to the qualified overtime compensation received during the taxable year.

"(b) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

"(1) IN GENERAL.—No deduction shall be allowed by this section for any taxpayer if such taxpayer's modified adjusted gross income for the taxable year exceeds $450,000 ($900,000, in the case of a joint return).

"(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term 'modified adjusted gross income' means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

"(c) QUALIFIED OVERTIME COMPENSATION.—For purposes of this section, the term 'qualified overtime compensation' means overtime compensation that is paid to an individual as required under section 7 of the Fair Labor Standards Act of 1938 and is in excess of the regular rate (as used in such section) at which such individual is employed. Such term shall not include any amount deducted under section 224.".

(2) CLERICAL AMENDMENT.—The table of sections for part VII of subchapter B of chapter 1, as amended by the preceding provisions of this Act, is amended by redesignating the item relating to section 225 as relating to section 226 and by inserting after the item relating to section 224 the following new item:

"225. Qualified overtime compensation.".

(b) DEDUCTION ALLOWED TO NON-ITEMIZERS.—Section 63(b), as amended by the preceding provisions of this Act, is amended by striking "and" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting ", and", and by adding at the end the following new paragraph:

"(6) the deduction provided in section 225.".

(c) REQUIREMENT TO INCLUDE OVERTIME COMPENSATION ON W–2.—Section 6051(a) 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) the total amount of qualified overtime compensation (as defined in section 225(b)).".

(d) WITHHOLDING.—The Secretary of the Treasury (or the Secretary's delegate) shall modify the tables and procedures prescribed under section 3402(a) of the Internal Revenue Code of 1986 to take into account the deduction allowed under section 225 of such Code (as added by this Act).

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2025.

SEC. 5. 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 (c) of section 83 is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

"(4) PARTNERSHIP INTERESTS.—Except as provided by the Secretary—

"(A) IN GENERAL.—In the case of any transfer of an interest in a partnership in connection with the provision of services to (or for the benefit of) such partnership—

"(i) 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

"(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. 6. 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:

"SEC. 710. SPECIAL RULES FOR PARTNERS PROVIDING INVESTMENT MANAGEMENT SERVICES TO PARTNERSHIPS.

"(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) an amount equal to the net capital gain with respect to such interest for any partnership taxable year shall be treated as ordinary income, and

"(B) subject to the limitation of paragraph (2), an amount equal to the net capital loss with respect to such interest for any partnership taxable year shall be treated as an ordinary loss.

"(2) RECHARACTERIZATION OF LOSSES LIMITED TO RECHARACTERIZED GAINS.—The amount treated as ordinary loss under paragraph (1)(B) for any taxable year shall not exceed the excess (if any) of—

"(A) the aggregate amount treated as ordinary income under paragraph (1)(A) with respect to the investment services partnership interest for all preceding partnership taxable years to which this section applies, over

"(B) the aggregate amount treated as ordinary loss under paragraph (1)(B) with respect to such interest for all preceding partnership taxable years to which this section applies.

"(3) ALLOCATION TO ITEMS OF GAIN AND LOSS.—

"(A) NET CAPITAL GAIN.—The amount treated as ordinary income under paragraph (1)(A) shall be allocated ratably among the items of long-term capital gain taken into account in determining such net capital gain.

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

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

"(A) IN GENERAL.—Net capital gain, long-term capital gain, and long-term capital loss, with respect to any investment services partnership interest for any taxable year, shall be determined under section 1222, except that such section shall be applied—

"(i) without regard to the recharacterization of any item as ordinary income or ordinary loss under this section,

"(ii) by only taking into account items of gain and loss taken into account by the holder of such interest under section 702 (other than subsection (a)(9) thereof) with respect to such interest for such taxable year, and

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

"(B) NET CAPITAL LOSS.—The term 'net capital loss' means the excess of the losses from sales or exchanges of capital assets over the gains from such sales or exchanges. Rules similar to the rules of clauses (i) through (iii) of subparagraph (A) shall apply for purposes of the preceding sentence.

"(5) SPECIAL RULE FOR DIVIDENDS.—Any dividend allocated with respect to any investment services partnership interest shall not be treated as qualified dividend income for purposes of section 1(h).

"(6) SPECIAL RULE FOR QUALIFIED SMALL BUSINESS STOCK.—Section 1202 shall not apply to any gain from the sale or exchange of qualified small business stock (as defined in section 1202(c)) allocated with respect to any investment services partnership interest.

"(b) DISPOSITIONS OF PARTNERSHIP INTERESTS.—

"(1) GAIN.—

"(A) IN GENERAL.—Any gain on the disposition of an investment services partnership interest shall be—

"(i) treated as ordinary income, and

"(ii) recognized notwithstanding any other provision of this subtitle.

"(B) GIFT AND TRANSFERS AT DEATH.—In the case of a disposition of an investment services partnership interest by gift or by reason of death of the taxpayer—

"(i) subparagraph (A) shall not apply,

"(ii) such interest shall be treated as an investment services partnership interest in the hands of the person acquiring such interest, and “(iii) any amount that would have been treated as ordinary income under this subsection had the decedent sold such interest immediately before death shall be treated as an item of income in respect of a decedent under section 691.

“(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 amount treated as ordinary income under subsection (a) with respect to such interest for all partnership taxable years to which this section applies, over

“(B) the aggregate amount treated as ordinary loss under subsection (a) with respect to such interest for all partnership taxable years to which this section applies.

“(3) ELECTION WITH RESPECT TO CERTAIN EXCHANGES.—Paragraph (1)(A)(ii) shall not apply to the contribution of an investment services partnership interest to a partnership in exchange for an interest in such partnership if—

“(A) the taxpayer makes an irrevocable election to treat the partnership interest received in the exchange as an investment services partnership interest, and

"(B) the taxpayer agrees to comply with such reporting and recordkeeping requirements as the Secretary may prescribe.

"(4) DISTRIBUTIONS OF PARTNERSHIP PROPERTY.—

"(A) IN GENERAL.—In the case of any distribution of property by a partnership with respect to any investment services partnership interest held by a partner, the partner receiving such property shall recognize gain equal to 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 such partner (determined without regard to subparagraph (C)).

"(B) TREATMENT OF GAIN AS ORDINARY INCOME.—Any gain recognized by such partner under subparagraph (A) shall be treated as ordinary income to the same extent and in the same manner as the increase in such partner's distributive share of the taxable income of the partnership would be treated under subsection (a) if, immediately prior to the distribution, the partnership had sold the distributed property at fair market value and all of the gain from such disposition were allocated to such partner. For purposes of applying subsection (a)(2), any gain treated as ordinary income under this subparagraph shall be treated as an amount treated as ordinary income under subsection (a)(1)(A).

"(C) ADJUSTMENT OF BASIS.—In the case of a distribution to which subparagraph (A) applies, the basis of the distributed property in the hands of the distributee partner shall be the fair market value of such property.

"(D) SPECIAL RULES WITH RESPECT TO MERGERS AND DIVISIONS.—In the case of a taxpayer which satisfies requirements similar to the requirements of subparagraphs (A) and (B) of paragraph (3), this paragraph and paragraph (1)(A)(ii) shall not apply to the distribution of a partnership interest if such distribution is in connection with a contribution (or deemed contribution) of any property of the partnership to which section 721 applies pursuant to a transaction described in section 708(b)(2).

"(c) INVESTMENT SERVICES PARTNERSHIP INTEREST.—For purposes of this section—

"(1) IN GENERAL.—The term 'investment services partnership interest' means any interest in an investment partnership acquired or held by any person in connection with the conduct of a trade or business described in paragraph (2) by such person (or any person related to such person). An interest in an investment partnership held by any person—

"(A) shall not be treated as an investment services partnership interest for any period before the first date on which it is so held in connection with such a trade or business,

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

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

"(2) BUSINESSES TO WHICH THIS SECTION APPLIES.—A trade or business is described in this paragraph if such trade or business primarily involves the performance of any of the following services with respect to assets held (directly or indirectly) by one or more investment partnerships referred to in paragraph (1):

"(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).

"(3) INVESTMENT PARTNERSHIP.—

"(A) IN GENERAL.—The term 'investment partnership' means any partnership if, at the end of any two consecutive calendar quarters ending after the date of enactment of this section—

"(i) substantially all of the assets of the partnership are specified assets (determined without regard to any section 197 intangible within the meaning of section 197(d)), and “(ii) less than 75 percent of the capital of the partnership is attributable to qualified capital interests which constitute property held in connection with a trade or business of the owner of such interest.

“(B) LOOK-THROUGH OF CERTAIN WHOLLY OWNED ENTITIES FOR PURPOSES OF DETERMINING ASSETS OF THE PARTNERSHIP.—

“(i) IN GENERAL.—For purposes of determining the assets of a partnership under subparagraph (A)(i)—

“(I) any interest in a specified entity shall not be treated as an asset of such partnership, and

“(II) such partnership shall be treated as holding its proportionate share of each of the assets of such specified entity.

“(ii) SPECIFIED ENTITY.—For purposes of clause (i), the term ‘specified entity’ means, with respect to any partnership (hereafter referred to as the upper-tier partnership), any person which engages in the same trade or business as the upper-tier partnership and is—

"(I) a partnership all of the capital and profits interests of which are held directly or indirectly by the upper-tier partnership, or

"(II) a foreign corporation which does not engage in a trade or business in the United States and all of the stock of which is held directly or indirectly by the upper-tier partnership.

"(C) SPECIAL RULES FOR DETERMINING IF PROPERTY HELD IN CONNECTION WITH TRADE OR BUSINESS.—

"(i) IN GENERAL.—Except as otherwise provided by the Secretary, solely for purposes of determining whether any interest in a partnership constitutes property held in connection with a trade or business under subparagraph (A)(ii)—

"(I) a trade or business of any person closely related to the owner of such interest shall be treated as a trade or business of such owner,

"(II) such interest shall be treated as held by a person in connection with a trade or business during any taxable year if such interest was so held by such person during any 3 taxable years preceding such taxable year, and

"(III) paragraph (5)(B) shall not apply.

"(ii) CLOSELY RELATED PERSONS.—For purposes of clause (i)(I), a person shall be treated as closely related to another person if, taking into account the rules of section 267(c), the relationship between such persons is described in—

"(I) paragraph (1) or (9) of section 267(b), or

"(II) section 267(b)(4), but solely in the case of a trust with respect to which each current beneficiary is the grantor or a person whose relationship to the grantor is described in paragraph (1) or (9) of section 267(b).

"(D) ANTIABUSE RULES.—The Secretary may issue regulations or other guidance which prevent the avoidance of the purposes of subparagraph (A), including regulations or other guidance which treat convertible and contingent debt (and other debt having the attributes of equity) as a capital interest in the partnership.

"(E) CONTROLLED GROUPS OF ENTITIES.—

"(i) IN GENERAL.—In the case of a controlled group of entities, if an interest in the partnership received in exchange for a contribution to the capital of the partnership by any member of such controlled group would (in the hands of such member) constitute property held in connection with a trade or business, then any interest in such partnership held by any member of such group shall be treated for purposes of subparagraph (A) as constituting (in the hands of such member) property held in connection with a trade or business.

"(ii) CONTROLLED GROUP OF ENTITIES.—For purposes of clause (i), the term 'controlled group of entities' means a controlled group of corporations as defined in section 1563(a)(1), applied without regard to subsections (a)(4) and (b)(2) of section 1563. A partnership or any other entity (other than a corporation) shall be treated as a member of a controlled group of entities if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this sentence).

"(F) SPECIAL RULE FOR CORPORATIONS.—For purposes of this paragraph, in the case of a corporation, the determination of whether property is held in connection with a trade or business shall be determined as if the taxpayer were an individual.

"(4) SPECIFIED ASSET.—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 section 475(e)(2)), cash or cash equivalents, or options or derivative contracts with respect to any of the foregoing.

"(5) RELATED PERSONS.—

"(A) IN GENERAL.—A person shall be treated as related to another person if the relationship between such persons is described in section 267(b) or 707(b).

"(B) ATTRIBUTION OF PARTNER SERVICES.—Any service described in paragraph (2) which is provided by a partner of a partnership shall be treated as also provided by such partnership.

"(d) EXCEPTION FOR CERTAIN CAPITAL INTERESTS.—

"(1) IN GENERAL.—In the case of any portion of an investment services partnership interest which is a qualified capital interest, all items of gain and loss (and any dividends) which are allocated to such qualified capital interest shall not be taken into account under subsection (a) if—

"(A) 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 subsection (c)(2) and who are not related to the partner holding the qualified capital interest, and

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

"(2) AUTHORITY TO PROVIDE EXCEPTIONS TO ALLOCATION REQUIREMENTS.—To the extent provided by the Secretary in regulations or other guidance—

"(A) ALLOCATIONS TO PORTION OF QUALIFIED CAPITAL INTEREST.—Paragraph (1) may be applied separately with respect to a portion of a qualified capital interest.

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

"(C) ALLOCATIONS TO SERVICE PROVIDERS' QUALIFIED CAPITAL INTERESTS WHICH ARE LESS THAN OTHER ALLOCATIONS.—Allocations shall not be treated as failing to meet the requirement of paragraph (1)(A) merely because the allocations to the qualified capital interest represent a lower return than the allocations made to the other qualified capital interests referred to in such paragraph.

"(3) SPECIAL RULE FOR CHANGES IN SERVICES AND CAPITAL CONTRIBUTIONS.—In the case of an interest in a partnership which was not an investment services partnership interest and which, by reason of a change in the services with respect to assets held (directly or indirectly) by the partnership or by reason of a change in the capital contributions to such partnership, becomes an investment services partnership interest, the qualified capital interest of the holder of such partnership interest immediately after such change shall not, for purposes of this subsection, be less than the fair market value of such interest (determined immediately before such change).

"(4) SPECIAL RULE FOR TIERED PARTNERSHIPS.—Except as otherwise provided by the Secretary, in the case of tiered partnerships, all items which are allocated in a manner which meets the requirements of paragraph (1) to qualified capital interests in a lower-tier partnership shall retain such character to the extent allocated on the basis of qualified capital interests in any upper-tier partnership.

"(5) EXCEPTION FOR NO-SELF-CHARGED CARRY AND MANAGEMENT FEE PROVISIONS.—Except as otherwise provided by the Secretary, an interest shall not fail to be treated as satisfying the requirement of paragraph (1)(A) merely because the allocations made by the partnership to such interest do not reflect the cost of services described in subsection (c)(2) which are provided (directly or indirectly) to the partnership by the holder of such interest (or a related person).

"(6) SPECIAL RULE FOR DISPOSITIONS.—In the case of any investment services partnership 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—

"(A) the distributive share of gain or loss that would have been allocated to the qualified capital interest (consistent with the requirements of paragraph (1)) if the partnership had sold all of its assets at fair market value immediately before the disposition, bears to

"(B) the distributive share of gain or loss that would have been so allocated to the investment services partnership interest of which such qualified capital interest is a part.

"(7) QUALIFIED CAPITAL INTEREST.—For purposes of this section—

"(A) IN GENERAL.—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 (determined without regard to section 752(a)),

"(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, over

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

"(B) ADJUSTMENT TO QUALIFIED CAPITAL INTEREST.—

"(i) DISTRIBUTIONS AND LOSSES.—The qualified capital interest shall be reduced by distributions from the partnership with respect to such interest and by the excess (if any) of the amount described in subparagraph (A)(iii)(II) over the amount described in subparagraph (A)(iii)(I).

"(ii) SPECIAL RULE FOR CONTRIBUTIONS OF PROPERTY.—In the case of any contribution of property described in subparagraph (A)(i) with respect to which the fair market value of such property is not equal to the adjusted basis of such property immediately before such contribution, proper adjustments shall be made to the qualified capital interest to take into account such difference consistent with such regulations or other guidance as the Secretary may provide.

"(C) MERGERS, CONSOLIDATIONS, ETC., DISREGARDED.—No increase or decrease in the qualified capital interest of any partner shall result from a merger, consolidation, or division described in section 708, or any similar transaction.

"(8) TREATMENT OF CERTAIN LOANS.—

"(A) PROCEEDS OF PARTNERSHIP LOANS NOT TREATED AS QUALIFIED CAPITAL INTEREST OF SERVICE PROVIDING PARTNERS.—For purposes of this subsection, an investment services partnership interest shall not be treated as a qualified capital interest to the extent that such interest is acquired in connection with the proceeds of any loan or other advance made or guaranteed, directly or indirectly, by any other partner or the partnership (or any person related to any such other partner or the partnership). The preceding sentence shall not apply to the extent the loan or other advance is repaid before the date of the enactment of this section unless such repayment is made with the proceeds of a loan or other advance described in the preceding sentence.

"(B) REDUCTION IN ALLOCATIONS TO QUALIFIED CAPITAL INTERESTS FOR LOANS FROM NONSERVICE-PROVIDING PARTNERS TO THE PARTNERSHIP.—For purposes of this subsection, any loan or other advance to the partnership made or guaranteed, directly or indirectly, by a partner not providing services described in subsection (c)(2) to the partnership (or any person related to such partner) shall be taken into account in determining the qualified capital interests of the partners in the partnership.

"(9) SPECIAL RULE FOR QUALIFIED FAMILY PARTNERSHIPS.—

"(A) IN GENERAL.—In the case of any specified family partnership interest, paragraph (1)(A) shall be applied without regard to the phrase 'and who are not related to the partner holding the qualified capital interest'.

"(B) SPECIFIED FAMILY PARTNERSHIP INTEREST.—For purposes of this paragraph, the term 'specified family partnership interest' means any investment services partnership interest if—

"(i) such interest is an interest in a qualified family partnership,

"(ii) such interest is held by a natural person or by a trust with respect to which each beneficiary is a grantor or a person whose relationship to the grantor is described in section 267(b)(1), and

"(iii) all other interests in such qualified family partnership with respect to which significant allocations are made (within the meaning of paragraph (1)(B) and in comparison to the allocations made to the interest described in clause (ii)) are held by persons who—

"(I) are related to the natural person or trust referred to in clause (ii), or

"(II) provide services described in subsection (c)(2).

"(C) QUALIFIED FAMILY PARTNERSHIP.—For purposes of this paragraph, the term 'qualified family partnership' means any partnership if—

"(i) all of the capital and profits interests of such partnership are held by—

"(I) specified family members,

"(II) any person closely related (within the meaning of subsection (c)(3)(C)(ii)) to a specified family member, or

"(III) any other person (not described in subclause (I) or (II)) if such interest is an investment services partnership interest with respect to such person, and

"(ii) such partnership does not hold itself out to the public as an investment advisor.

"(D) SPECIFIED FAMILY MEMBERS.—For purposes of subparagraph (C), individuals shall be treated as specified family members if such individuals would be treated as one person under the rules of section 1361(c)(1) if the applicable date (within the meaning of subparagraph (B)(iii) thereof) were the latest of—

"(i) the date of the establishment of the partnership,

"(ii) the earliest date that the common ancestor holds a capital or profits interest in the partnership, or

"(iii) the date of the enactment of this section.

"(e) 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 investment entity or special purpose acquisition company,

"(B) such person holds (directly or indirectly) a disqualified interest with respect to such entity or such company (as the case may be), 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 subsections (a)(5) and (d) shall apply for purposes of this subsection.

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

"(A) DISQUALIFIED INTEREST.—

"(i) IN GENERAL.—The term 'disqualified interest' means, with respect to any investment 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 subclause (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) except as provided by the Secretary, any interest in a taxable corporation (other than a special purpose acquisition company), 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 substantially 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)(2).

"(D) INVESTMENT ENTITY.—The term 'investment entity' means any entity which, if it were a partnership, would be an investment partnership.

"(E) SPECIAL PURPOSE ACQUISITION COMPANY.—The term 'special purpose acquisition company' means any corporation that—

"(i) is formed for the purpose of acquiring a privately held company,

"(ii) is publicly traded on an established securities market or its interests are readily tradable on a secondary market (or the substantial equivalent thereof), and

"(iii) is required to report an acquisition under Item 2.01 or make a disclosure under Item 5.06 of Form 8-K (or any successor form) with the Securities and Exchange Commission.

"(f) EXCEPTION FOR DOMESTIC C CORPORATIONS.—Except as otherwise provided by the Secretary, in the case of a domestic C corporation (other than a special purpose acquisition company, as defined in subsection (e)(2)(E))—

"(1) subsections (a) and (b) shall not apply to any item allocated to such corporation with respect to any investment services partnership interest (or to any gain or loss with respect to the disposition of such an interest), and

"(2) subsection (e) shall not apply.

"(g) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as is necessary or appropriate to carry out the purposes of this section, including regulations or other guidance to—

"(1) require such reporting and recordkeeping by any person in such manner and at such time as the Secretary may prescribe for purposes of enabling the partnership to meet the requirements of section 6031 with respect to any item described in section 702(a)(9),

"(2) 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,

"(3) prevent the avoidance of the purposes of this section (including through the use of qualified family partnerships), and

"(4) coordinate this section with the other provisions of this title.

"(h) CROSS REFERENCE.—For 40 percent penalty on certain underpayments due to the avoidance of this section, see section 6662.".

(b) APPLICATION OF SECTION 751 TO INDIRECT DISPOSITIONS OF INVESTMENT SERVICES PARTNERSHIP INTERESTS.—

(1) IN GENERAL.—Subsection (a) of section 751 is amended by striking "or" at the end of paragraph (1), by inserting "or" at the end of paragraph (2), and by inserting after paragraph (2) the following new paragraph:

"(3) investment services partnership interests held by the partnership,".

(2) CERTAIN DISTRIBUTIONS TREATED AS SALES OR EXCHANGES.—Subparagraph (A) of section 751(b)(1) is amended by striking "or" at the end of clause (i), by inserting "or" at the end of

clause (ii), and by inserting after clause (ii) the following new clause:

"(iii) investment services partnership interests held by the partnership,".

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

(A) by striking "or" at the end of paragraph (1), by inserting "or" at the end of paragraph (2), and by inserting after paragraph (2) the following new paragraph:

"(3) an investment services partnership interest held by the partnership,", and

(B) by striking "partner." and inserting "partner (other than a partnership in which it holds an investment services partnership interest).".

(4) INVESTMENT SERVICES PARTNERSHIP INTERESTS; QUALIFIED CAPITAL INTERESTS.—Section 751 is amended by adding at the end the following new subsection:

"(g) INVESTMENT SERVICES PARTNERSHIP INTERESTS.—For purposes of this section—

"(1) In general.—The term 'investment services partnership interest' has the meaning given such term by section 710(c).

"(2) Adjustments for qualified capital interests.—The amount to which subsection (a) applies by reason of paragraph (3) thereof shall not include so much of such amount as is attributable to any portion of the investment services partnership interest which is a qualified capital interest (determined under rules similar to the rules of section 710(d)).

"(3) Exception for publicly traded partnerships.—Except as otherwise provided by the Secretary, in the case of an exchange of an interest in a publicly traded partnership (as defined in section 7704) to which subsection (a) applies—

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

"(B) such partnership shall be treated as owning its proportionate share of the property of any other partnership in which it is a partner.

"(4) Recognition of gains.—Any gain with respect to which subsection (a) applies by reason of paragraph (3) thereof shall be recognized notwithstanding any other provision of this title.

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

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

"(7) VALUATION METHODS.—The Secretary shall prescribe regulations or other guidance which provide the acceptable methods for valuing investment services partnership interests for purposes of this section.".

(c) TREATMENT FOR PURPOSES OF SECTION 7704.—Subsection (d) of section 7704 is amended by adding at the end the following new paragraph:

"(6) INCOME FROM CERTAIN CARRIED INTERESTS NOT QUALIFIED.—

"(A) IN GENERAL.—Specified carried interest income shall not be treated as qualifying income.

"(B) SPECIFIED CARRIED INTEREST INCOME.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'specified carried interest income' means—

"(I) any item of income or gain allocated to an investment services partnership interest (as defined in section 710(c)) held by the partnership,

"(II) any gain on the disposition of an investment services partnership interest (as so defined) or a partnership interest to which (in the hands of the partnership) section 751 applies, and

"(III) any income or gain taken into account by the partnership under subsection (b)(4) or (e) of section 710.

"(ii) EXCEPTION FOR QUALIFIED CAPITAL INTERESTS.—A rule similar to the rule of section 710(d) shall apply for purposes of clause (i).

"(C) COORDINATION WITH OTHER PROVISIONS.—Subparagraph (A) shall not apply to any item described in paragraph (1)(E) (or so much of paragraph (1)(F) as relates to paragraph (1)(E)).

"(D) 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) Fifty percent or more of the capital and profits interests of such partnership are owned, directly or indirectly, at all times during the taxable year by such real estate investment trust (determined with the application of section 267(c)).

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

"(ii) CERTAIN PARTNERSHIPS OWNING OTHER PUBLICLY TRADED PARTNERSHIPS.—Subparagraph (A) shall not apply in the case of a partnership which meets each of the following requirements:

"(I) Substantially all of the assets of such partnership consist of interests in one or more publicly traded partnerships (determined without regard to subsection (b)(2)).

"(II) Substantially all of the income of such partnership is ordinary income or section 1231 gain (as defined in section 1231(a)(3)).

"(E) TRANSITIONAL RULE.—Subparagraph (A) shall not apply to any taxable year of the partnership beginning before the date which is 10 years after the date of the enactment of this paragraph.".

(d) IMPOSITION OF PENALTY ON UNDERPAYMENTS.—

(1) IN GENERAL.—Subsection (b) of section 6662 is amended by inserting after paragraph (10) the following new paragraph:

"(11) The application of section 710(e) or the regulations or other guidance prescribed under section 710(g) to prevent the avoidance of the purposes of section 710.".

(2) AMOUNT OF PENALTY.—

(A) IN GENERAL.—Section 6662 is amended by adding at the end the following new subsection:

"(m) INCREASE IN PENALTY IN CASE OF PROPERTY TRANSFERRED FOR INVESTMENT MANAGEMENT SERVICES.—In the case of any portion of an underpayment to which this section applies by reason of subsection (b)(10), subsection (a) shall be applied with respect to such portion by substituting '40 percent' for '20 percent'.".

(B) CONFORMING AMENDMENT.—Subparagraph (B) of section 6662A(e)(2) is amended by striking "or (i)" and inserting ", (i), or (m)".

(3) SPECIAL RULES FOR APPLICATION OF REASONABLE CAUSE EXCEPTION.—Subsection (c) of section 6664 is amended—

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

(B) by striking "paragraph (3)" in paragraph (5)(A), as so redesignated, and inserting "paragraph (4)"; and

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

"(3) SPECIAL RULE FOR UNDERPAYMENTS ATTRIBUTABLE TO INVESTMENT MANAGEMENT SERVICES.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to any portion of an underpayment to which section 6662 applies by reason of subsection (b)(11) unless—

"(i) the relevant facts affecting the tax treatment of the item are adequately disclosed,

"(ii) there is or was substantial authority for such treatment, and

"(iii) the taxpayer reasonably believed that such treatment was more likely than not the proper treatment.

"(B) RULES RELATING TO REASONABLE BELIEF.—Rules similar to the rules of subsection (d)(4) shall apply for purposes of subparagraph (A)(iii).".

(e) INCOME AND LOSS FROM INVESTMENT SERVICES PARTNERSHIP INTERESTS TAKEN INTO ACCOUNT IN DETERMINING NET EARNINGS FROM SELF-EMPLOYMENT.—

(1) INTERNAL REVENUE CODE.—

(A) IN GENERAL.—Section 1402(a) 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, in the case of any individual engaged in the trade or business of providing services described in section 710(c)(2) with respect to any entity, investment services partnership income or loss (as defined in subsection (m)) of such individual with respect to such entity shall be taken into account in determining the net earnings from self-employment of such individual.".

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

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

"(1) IN GENERAL.—The term 'investment services partnership income or loss' means, with respect to any investment services partnership interest (as defined in section 710(c)) or disqualified interest (as defined in section 710(e)), the net of—

"(A) the amounts treated as ordinary income or ordinary loss under subsections (b) and (e) of section 710 with respect to such interest,

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

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

"(2) EXCEPTION FOR QUALIFIED CAPITAL INTERESTS.—A rule similar to the rule of section 710(d) shall apply for purposes of applying paragraph (1)(B).".

(2) SOCIAL SECURITY ACT.—Section 211(a) of the Social Security Act is amended by striking "and" at the end of paragraph (15), by striking the period at the end of paragraph (16) and inserting "; and", and by inserting after paragraph (16) the following new paragraph:

"(17) Notwithstanding the preceding provisions of this subsection, in the case of any individual engaged in the trade or business of providing services described in section 710(c)(2) of the Internal Revenue Code of 1986 with respect to any entity, investment services partnership income or loss (as defined in section 1402(m) of such Code) shall be taken into account in determining the net earnings from self-employment of such individual.".

(f) SEPARATE ACCOUNTING BY PARTNER.—Section 702(a) is amended by striking "and" at the end of paragraph (7), by striking the period at the end of paragraph (8) and inserting ", and", and by inserting after paragraph (8) the following:

"(9) any amount treated as ordinary income or loss under subsection (a), (b), or (e) of section 710.".

(g) CONFORMING AMENDMENTS.—

(1) Subsection (d) of section 731 is amended by inserting "section 710(b)(4) (relating to distributions of partnership property)," after "to the extent otherwise provided by".

(2) Section 741 is amended by inserting "or section 710 (relating to special rules for partners

providing investment management services to partnerships)'' before the period at the end.

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

(4)(A) Part IV of subchapter O of chapter 1 is amended by striking section 1061.

(B) The table of sections for part IV of subchapter O of chapter 1 is amended by striking the item relating to section 1061.

(h) 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 the date of the enactment of this Act.

(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 date of the enactment of this Act, the amount of the net capital gain referred to in such section shall be treated as being the lesser of the net capital gain for the entire partnership taxable year or the net capital gain deter-

mined 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.—

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

(B) INDIRECT DISPOSITIONS.—The amendments made by subsection (b) shall apply to transactions after the date of the enactment of this Act.

(4) OTHER INCOME AND GAIN IN CONNECTION WITH INVESTMENT MANAGEMENT SERVICES.—Section 710(e) of such Code (as added by this section) shall take effect on the date of the enactment of this Act.

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