112TH CONGRESS  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
shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) Table of Contents.—The table of contents for 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.

SEC. 2. 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. 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:

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“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) Reclassification 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 in-
terest 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 de-
terminated 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 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 RULES FOR DIVIDENDS.—

“(A) INDIVIDUALS.—Any dividend allocated to any investment services partnership in-
terest shall not be treated as qualified dividend
income for purposes of section 1(h).

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

“(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)) allo-
cated with respect to any investment services part-
nership interest.

“(b) DISPOSITIONS OF PARTNERSHIP INTERESTS.—

“(1) GAIN.—

“(A) IN GENERAL.—Any gain on the dis-
position 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 rea-
on 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 in-
terest 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 ex-
cess (if any) of—
“(A) the aggregate amount treated as ordi-

ary 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 or-
dinary 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 ex-
changes.—Paragraph (1)(A)(ii) shall not apply to
the contribution of an investment services partner-
ship 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 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, divisions, and technical terminations.—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 paragraph (1)(B) or (2) of section 708(b).

“(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 the investment partnership 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 calendar quarter 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) more than half of the capital of the partnership is attributable to qualified capital interests which (in the hands of the owners of such interests) constitute property not held in connection with a trade or business.

“(B) Special rules for determining if property not held in connection with trade or business.—Except as otherwise provided by the Secretary, for purposes of determining whether any interest in a partnership constitutes property not held in connection with a trade or business under subparagraph (A)(ii)—

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

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

“(C) 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.

“(D) 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 part-
nership by any member of such controlled
group would (in the hands of such mem-
ber) 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 con-
trolled 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).

“(E) 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(e)(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) **ATRIBUTION 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 (e)(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 in-
terest 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) Technical terminations, etc., disregarded.—No increase or decrease in the qualified capital interest of any partner shall re-
(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 sub-
section, 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.

“(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,

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

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

any income or gain with respect to such interest shall be treated as ordinary income. Rules similar to
the rules of 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, 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.

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

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

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

“(g) 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 fol-
lowing 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 para-
graph (1), by inserting “or” at the end of para-
graph (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 inter-
est).”.

(4) Investment services partnership in-
terests; qualified capital interests.—Section
751 is amended by adding at the end the following
new subsection:

“(g) Investment Services Partnership Inter-
est.—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.—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.”.

(e) 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 para-

graph (1)(E)).

“(D) Special rules for certain part-

nerships.—

“(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 in-
terests 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 in-
vestment 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 (7) the following new paragraph:
“(8) The application of section 710(e) or the
regulations or other guidance prescribed under sec-
tion 710(f) to prevent the avoidance of the purposes
of section 710.”.

(2) AMOUNT OF PENALTY.—

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

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

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

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

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

(B) by striking “paragraph (3)” in para-
graph (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)(8) 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)(3) 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(e)) 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) 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:

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

(g) 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 determined by only taking into account items attributable to the portion of the partnership taxable year which is after such date.

(3) Dispositions of partnership interests.—

(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.