

115TH CONGRESS
1ST SESSION

S. 1020

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 SENATE OF THE UNITED STATES

MAY 3, 2017

Ms. BALDWIN (for herself, Mr. REED, Mr. KAINE, Mr. WHITEHOUSE, Mr. BLUMENTHAL, Mrs. FEINSTEIN, Mr. MANCHIN, Mrs. GILLIBRAND, Ms. WARREN, Mr. FRANKEN, Mr. MERKLEY, and Ms. HIRONO) introduced the following bill; which was read twice and referred to the Committee on Finance

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 2017”.

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

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

4 (c) TABLE OF CONTENTS.—The table of contents for
 5 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.

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

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

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

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

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

1 the transfer) all of its assets at fair market
 2 value and distributed the proceeds of such
 3 sale (reduced by the liabilities of the part-
 4 nership) to its partners in liquidation of
 5 the partnership, and

6 “(ii) the person receiving such interest
 7 shall be treated as having made the elec-
 8 tion under subsection (b)(1) unless such
 9 person makes an election under this para-
 10 graph to have such subsection not apply.

11 “(B) ELECTION.—The election under sub-
 12 paragraph (A)(ii) shall be made under rules
 13 similar to the rules of subsection (b)(2).”.

14 (b) EFFECTIVE DATE.—The amendments made by
 15 this section shall apply to interests in partnerships trans-
 16 ferred after the date of the enactment of this Act.

17 **SEC. 3. SPECIAL RULES FOR PARTNERS PROVIDING IN-**
 18 **VESTMENT MANAGEMENT SERVICES TO**
 19 **PARTNERSHIPS.**

20 (a) IN GENERAL.—Part I of subchapter K of chapter
 21 1 is amended by adding at the end the following new sec-
 22 tion:

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

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

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

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

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

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

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

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-

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

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

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

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

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

23 “(5) SPECIAL RULE FOR DIVIDENDS.—Any div-
24 idend allocated with respect to any investment serv-
25 ices partnership interest shall not be treated as

1 qualified dividend income for purposes of section
2 1(h).

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

9 “(b) DISPOSITIONS OF PARTNERSHIP INTERESTS.—

10 “(1) GAIN.—

11 “(A) IN GENERAL.—Any gain on the dis-
12 position of an investment services partnership
13 interest shall be—

14 “(i) treated as ordinary income, and

15 “(ii) recognized notwithstanding any
16 other provision of this subtitle.

17 “(B) GIFT AND TRANSFERS AT DEATH.—

18 In the case of a disposition of an investment
19 services partnership interest by gift or by rea-
20 son of death of the taxpayer—

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

22 “(ii) such interest shall be treated as
23 an investment services partnership interest
24 in the hands of the person acquiring such
25 interest, and

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

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

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

15 “(B) the aggregate amount treated as or-
 16 dinary loss under subsection (a) with respect to
 17 such interest for all partnership taxable years
 18 to which this section applies.

19 “(3) ELECTION WITH RESPECT TO CERTAIN EX-
 20 CHANGES.—Paragraph (1)(A)(ii) shall not apply to
 21 the contribution of an investment services partner-
 22 ship interest to a partnership in exchange for an in-
 23 terest in such partnership if—

24 “(A) the taxpayer makes an irrevocable
 25 election to treat the partnership interest re-

1 ceived in the exchange as an investment serv-
 2 ices partnership interest, and

3 “(B) the taxpayer agrees to comply with
 4 such reporting and recordkeeping requirements
 5 as the Secretary may prescribe.

6 “(4) DISTRIBUTIONS OF PARTNERSHIP PROP-
 7 PERTY.—

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

14 “(i) the fair market value of such
 15 property at the time of such distribution,
 16 over

17 “(ii) the adjusted basis of such prop-
 18 erty in the hands of such partner (deter-
 19 mined without regard to subparagraph
 20 (C)).

21 “(B) TREATMENT OF GAIN AS ORDINARY
 22 INCOME.—Any gain recognized by such partner
 23 under subparagraph (A) shall be treated as or-
 24 dinary income to the same extent and in the
 25 same manner as the increase in such partner’s

1 distributive share of the taxable income of the
2 partnership would be treated under subsection
3 (a) if, immediately prior to the distribution, the
4 partnership had sold the distributed property at
5 fair market value and all of the gain from such
6 disposition were allocated to such partner. For
7 purposes of applying subsection (a)(2), any gain
8 treated as ordinary income under this subpara-
9 graph shall be treated as an amount treated as
10 ordinary income under subsection (a)(1)(A).

11 “(C) ADJUSTMENT OF BASIS.—In the case
12 a distribution to which subparagraph (A) ap-
13 plies, the basis of the distributed property in
14 the hands of the distributee partner shall be the
15 fair market value of such property.

16 “(D) SPECIAL RULES WITH RESPECT TO
17 MERGERS, DIVISIONS, AND TECHNICAL TERMI-
18 NATIONS.—In the case of a taxpayer which sat-
19 isfies requirements similar to the requirements
20 of subparagraphs (A) and (B) of paragraph (3),
21 this paragraph and paragraph (1)(A)(ii) shall
22 not apply to the distribution of a partnership
23 interest if such distribution is in connection
24 with a contribution (or deemed contribution) of
25 any property of the partnership to which sec-

1 tion 721 applies pursuant to a transaction de-
 2 scribed in paragraph (1)(B) or (2) of section
 3 708(b).

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

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

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

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

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

1 “(2) BUSINESSES TO WHICH THIS SECTION AP-
 2 PLIES.—A trade or business is described in this
 3 paragraph if such trade or business primarily in-
 4 volves the performance of any of the following serv-
 5 ices with respect to assets held (directly or indi-
 6 rectly) by one or more investment partnerships re-
 7 ferred to in paragraph (1):

8 “(A) Advising as to the advisability of in-
 9 vesting in, purchasing, or selling any specified
 10 asset.

11 “(B) Managing, acquiring, or disposing of
 12 any specified asset.

13 “(C) Arranging financing with respect to
 14 acquiring specified assets.

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

17 “(3) INVESTMENT PARTNERSHIP.—

18 “(A) IN GENERAL.—The term ‘investment
 19 partnership’ means any partnership if, at the
 20 end of any two consecutive calendar quarters
 21 ending after the date of enactment of this sec-
 22 tion—

23 “(i) substantially all of the assets of
 24 the partnership are specified assets (deter-
 25 mined without regard to any section 197

1 intangible within the meaning of section
2 197(d)), and

3 “(ii) less than 75 percent of the cap-
4 ital of the partnership is attributable to
5 qualified capital interests which constitute
6 property held in connection with a trade or
7 business of the owner of such interest.

8 “(B) LOOK-THROUGH OF CERTAIN WHOL-
9 LY OWNED ENTITIES FOR PURPOSES OF DETER-
10 MINING ASSETS OF THE PARTNERSHIP.—

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

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

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

21 “(ii) SPECIFIED ENTITY.—For pur-
22 poses of clause (i), the term ‘specified enti-
23 ty’ means, with respect to any partnership
24 (hereafter referred to as the upper-tier
25 partnership), any person which engages in

1 the same trade or business as the upper-
2 tier partnership and is—

3 “(I) a partnership all of the cap-
4 ital and profits interests of which are
5 held directly or indirectly by the
6 upper-tier partnership, or

7 “(II) a foreign corporation which
8 does not engage in a trade or business
9 in the United States and all of the
10 stock of which is held directly or indi-
11 rectly by the upper-tier partnership.

12 “(C) SPECIAL RULES FOR DETERMINING
13 IF PROPERTY HELD IN CONNECTION WITH
14 TRADE OR BUSINESS.—

15 “(i) IN GENERAL.—Except as other-
16 wise provided by the Secretary, solely for
17 purposes of determining whether any inter-
18 est in a partnership constitutes property
19 held in connection with a trade or business
20 under subparagraph (A)(ii)—

21 “(I) a trade or business of any
22 person closely related to the owner of
23 such interest shall be treated as a
24 trade or business of such owner,

1 “(II) such interest shall be treat-
 2 ed as held by a person in connection
 3 with a trade or business during any
 4 taxable year if such interest was so
 5 held by such person during any 3 tax-
 6 able years preceding such taxable
 7 year, and

8 “(III) paragraph (5)(B) shall not
 9 apply.

10 “(ii) CLOSELY RELATED PERSONS.—
 11 For purposes of clause (i)(I), a person
 12 shall be treated as closely related to an-
 13 other person if, taking into account the
 14 rules of section 267(c), the relationship be-
 15 tween such persons is described in—

16 “(I) paragraph (1) or (9) of sec-
 17 tion 267(b), or

18 “(II) section 267(b)(4), but solely
 19 in the case of a trust with respect to
 20 which each current beneficiary is the
 21 grantor or a person whose relationship
 22 to the grantor is described in para-
 23 graph (1) or (9) of section 267(b).

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

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

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

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

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

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

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

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

24 “(5) RELATED PERSONS.—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

20 “(iii) the excess (if any) of—

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

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

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

3 “(i) DISTRIBUTIONS AND LOSSES.—

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

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

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

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

4 “(8) TREATMENT OF CERTAIN LOANS.—

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

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

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

9 “(9) SPECIAL RULE FOR QUALIFIED FAMILY
 10 PARTNERSHIPS.—

11 “(A) IN GENERAL.—In the case of any
 12 specified family partnership interest, paragraph
 13 (1)(A) shall be applied without regard to the
 14 phrase ‘and who are not related to the partner
 15 holding the qualified capital interest’.

16 “(B) SPECIFIED FAMILY PARTNERSHIP IN-
 17 TEREST.—For purposes of this paragraph, the
 18 term ‘specified family partnership interest’
 19 means any investment services partnership in-
 20 terest if—

21 “(i) such interest is an interest in a
 22 qualified family partnership,

23 “(ii) such interest is held by a natural
 24 person or by a trust with respect to which
 25 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

1 “(III) any other person (not de-
 2 scribed in subclause (I) or (II)) if
 3 such interest is an investment services
 4 partnership interest with respect to
 5 such person, and

6 “(ii) such partnership does not hold
 7 itself out to the public as an investment
 8 advisor.

9 “(D) SPECIFIED FAMILY MEMBERS.—For
 10 purposes of subparagraph (C), individuals shall
 11 be treated as specified family members if such
 12 individuals would be treated as one person
 13 under the rules of section 1361(c)(1) if the ap-
 14 plicable date (within the meaning of subpara-
 15 graph (B)(iii) thereof) were the latest of—

16 “(i) the date of the establishment of
 17 the partnership,

18 “(ii) the earliest date that the com-
 19 mon ancestor holds a capital or profits in-
 20 terest in the partnership, or

21 “(iii) the date of the enactment of this
 22 section.

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

25 “(1) IN GENERAL.—If—

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

4 “(B) such person holds (directly or indi-
 5 rectly) a disqualified interest with respect to
 6 such entity, and

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

13 any income or gain with respect to such interest
 14 shall be treated as ordinary income. Rules similar to
 15 the rules of subsections (a)(5) and (d) shall apply
 16 for purposes of this subsection.

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

19 “(A) DISQUALIFIED INTEREST.—

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

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

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

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

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

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

12 “(I) a partnership interest,

13 “(II) except as provided by the
14 Secretary, any interest in a taxable
15 corporation, and

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

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

20 “(i) a domestic C corporation, or

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

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

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

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

8 “(D) INVESTMENT ENTITY.—The term ‘in-
 9 vestment entity’ means any entity which, if it
 10 were a partnership, would be an investment
 11 partnership.

12 “(f) EXCEPTION FOR DOMESTIC C CORPORATIONS.—
 13 Except as otherwise provided by the Secretary, in the case
 14 of a domestic C corporation—

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

20 “(2) subsection (e) shall not apply.

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

1 “(1) require such reporting and recordkeeping
 2 by any person in such manner and at such time as
 3 the Secretary may prescribe for purposes of enabling
 4 the partnership to meet the requirements of section
 5 6031 with respect to any item described in section
 6 702(a)(9),

7 “(2) provide modifications to the application of
 8 this section (including treating related persons as
 9 not related to one another) to the extent such modi-
 10 fication is consistent with the purposes of this sec-
 11 tion,

12 “(3) prevent the avoidance of the purposes of
 13 this section (including through the use of qualified
 14 family partnerships), and

15 “(4) coordinate this section with the other pro-
 16 visions of this title.

17 “(h) CROSS REFERENCE.—For 40 percent penalty on
 18 certain underpayments due to the avoidance of this sec-
 19 tion, see section 6662.”.

20 (b) APPLICATION OF SECTION 751 TO INDIRECT DIS-
 21 POSITIONS OF INVESTMENT SERVICES PARTNERSHIP IN-
 22 TERESTS.—

23 (1) IN GENERAL.—Subsection (a) of section
 24 751 is amended by striking “or” at the end of para-
 25 graph (1), by inserting “or” at the end of paragraph

1 (2), and by inserting after paragraph (2) the fol-
 2 lowing new paragraph:

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

5 (2) CERTAIN DISTRIBUTIONS TREATED AS
 6 SALES OR EXCHANGES.—Subparagraph (A) of sec-
 7 tion 751(b)(1) is amended by striking “or” at the
 8 end of clause (i), by inserting “or” at the end of
 9 clause (ii), and by inserting after clause (ii) the fol-
 10 lowing new clause:

11 “(iii) investment services partnership
 12 interests held by the partnership,”.

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

16 (A) by striking “or” at the end of para-
 17 graph (1), by inserting “or” at the end of para-
 18 graph (2), and by inserting after paragraph (2)
 19 the following new paragraph:

20 “(3) an investment services partnership interest
 21 held by the partnership,” and

22 (B) by striking “partner.” and inserting
 23 “partner (other than a partnership in which it
 24 holds an investment services partnership inter-
 25 est).”.

1 (4) INVESTMENT SERVICES PARTNERSHIP IN-
 2 TERESTS; QUALIFIED CAPITAL INTERESTS.—Section
 3 751 is amended by adding at the end the following
 4 new subsection:

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

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

10 “(2) ADJUSTMENTS FOR QUALIFIED CAPITAL
 11 INTERESTS.—The amount to which subsection (a)
 12 applies by reason of paragraph (3) thereof shall not
 13 include so much of such amount as is attributable
 14 to any portion of the investment services partnership
 15 interest which is a qualified capital interest (deter-
 16 mined under rules similar to the rules of section
 17 710(d)).

18 “(3) EXCEPTION FOR PUBLICLY TRADED PART-
 19 NERSHIPS.—Except as otherwise provided by the
 20 Secretary, in the case of an exchange of an interest
 21 in a publicly traded partnership (as defined in sec-
 22 tion 7704) to which subsection (a) applies—

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

1 “(B) such partnership shall be treated as
 2 owning its proportionate share of the property
 3 of any other partnership in which it is a part-
 4 ner.

5 “(4) RECOGNITION OF GAINS.—Any gain with
 6 respect to which subsection (a) applies by reason of
 7 paragraph (3) thereof shall be recognized notwith-
 8 standing any other provision of this title.

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

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

17 “(7) VALUATION METHODS.—The Secretary
 18 shall prescribe regulations or other guidance which
 19 provide the acceptable methods for valuing invest-
 20 ment services partnership interests for purposes of
 21 this section.”.

22 (c) TREATMENT FOR PURPOSES OF SECTION
 23 7704.—Subsection (d) of section 7704 is amended by add-
 24 ing at the end the following new paragraph:

1 “(6) INCOME FROM CERTAIN CARRIED INTER-
2 ESTS NOT QUALIFIED.—

3 “(A) IN GENERAL.—Specified carried in-
4 terest income shall not be treated as qualifying
5 income.

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

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

10 “(I) any item of income or gain
11 allocated to an investment services
12 partnership interest (as defined in
13 section 710(c)) held by the partner-
14 ship,

15 “(II) any gain on the disposition
16 of an investment services partnership
17 interest (as so defined) or a partner-
18 ship interest to which (in the hands of
19 the partnership) section 751 applies,
20 and

21 “(III) any income or gain taken
22 into account by the partnership under
23 subsection (b)(4) or (e) of section
24 710.

1 “(ii) EXCEPTION FOR QUALIFIED CAP-
 2 ITAL INTERESTS.—A rule similar to the
 3 rule of section 710(d) shall apply for pur-
 4 poses of clause (i).

5 “(C) COORDINATION WITH OTHER PROVI-
 6 SIONS.—Subparagraph (A) shall not apply to
 7 any item described in paragraph (1)(E) (or so
 8 much of paragraph (1)(F) as relates to para-
 9 graph (1)(E)).

10 “(D) SPECIAL RULES FOR CERTAIN PART-
 11 NERSHIPS.—

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

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

23 “(II) Fifty percent or more of
 24 the capital and profits interests of
 25 such partnership are owned, directly

1 or indirectly, at all times during the
 2 taxable year by such real estate in-
 3 vestment trust (determined with the
 4 application of section 267(c)).

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

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

13 “(I) Substantially all of the as-
 14 sets of such partnership consist of in-
 15 terests in one or more publicly traded
 16 partnerships (determined without re-
 17 gard to subsection (b)(2)).

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

22 “(E) TRANSITIONAL RULE.—Subpara-
 23 graph (A) shall not apply to any taxable year
 24 of the partnership beginning before the date

1 which is 10 years after the date of the enact-
2 ment of this paragraph.”.

3 (d) IMPOSITION OF PENALTY ON UNDERPAY-
4 MENTS.—

5 (1) IN GENERAL.—Subsection (b) of section
6 6662 is amended by inserting after paragraph (7)
7 the following new paragraph:

8 “(8) The application of section 710(e) or the
9 regulations or other guidance prescribed under sec-
10 tion 710(g) to prevent the avoidance of the purposes
11 of section 710.”.

12 (2) AMOUNT OF PENALTY.—

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

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

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

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

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

6 (B) by striking “paragraph (3)” in para-
 7 graph (5)(A), as so redesignated, and inserting
 8 “paragraph (4)”; and

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

11 “(3) SPECIAL RULE FOR UNDERPAYMENTS AT-
 12 TRIBUTABLE TO INVESTMENT MANAGEMENT SERV-
 13 ICES.—

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

18 “(i) the relevant facts affecting the
 19 tax treatment of the item are adequately
 20 disclosed,

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

23 “(iii) the taxpayer reasonably believed
 24 that such treatment was more likely than
 25 not the proper treatment.

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

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

8 (1) INTERNAL REVENUE CODE.—

9 (A) IN GENERAL.—Section 1402(a) is
 10 amended by striking “and” at the end of para-
 11 graph (16), by striking the period at the end of
 12 paragraph (17) and inserting “; and”, and by
 13 inserting after paragraph (17) the following
 14 new paragraph:

15 “(18) notwithstanding the preceding provisions
 16 of this subsection, in the case of any individual en-
 17 gaged in the trade or business of providing services
 18 described in section 710(c)(2) with respect to any
 19 entity, investment services partnership income or
 20 loss (as defined in subsection (m)) of such individual
 21 with respect to such entity shall be taken into ac-
 22 count in determining the net earnings from self-em-
 23 ployment of such individual.”.

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

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

6 “(1) IN GENERAL.—The term ‘investment serv-
 7 ices partnership income or loss’ means, with respect
 8 to any investment services partnership interest (as
 9 defined in section 710(c)) or disqualified interest (as
 10 defined in section 710(e)), the net of—

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

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

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

20 “(2) EXCEPTION FOR QUALIFIED CAPITAL IN-
 21 TERESTS.—A rule similar to the rule of section
 22 710(d) shall apply for purposes of applying para-
 23 graph (1)(B).”.

24 (2) SOCIAL SECURITY ACT.—Section 211(a) of
 25 the Social Security Act is amended by striking

1 “and” at the end of paragraph (15), by striking the
 2 period at the end of paragraph (16) and inserting “;
 3 and”, and by inserting after paragraph (16) the fol-
 4 lowing new paragraph:

5 “(17) Notwithstanding the preceding provisions
 6 of this subsection, in the case of any individual en-
 7 gaged in the trade or business of providing services
 8 described in section 710(c)(2) of the Internal Rev-
 9 enue Code of 1986 with respect to any entity, invest-
 10 ment services partnership income or loss (as defined
 11 in section 1402(m) of such Code) shall be taken into
 12 account in determining the net earnings from self-
 13 employment of such individual.”.

14 (f) SEPARATE ACCOUNTING BY PARTNER.—Section
 15 702(a) is amended by striking “and” at the end of para-
 16 graph (7), by striking the period at the end of paragraph
 17 (8) and inserting “, and”, and by inserting after para-
 18 graph (8) the following:

19 “(9) any amount treated as ordinary income or
 20 loss under subsection (a), (b), or (e) of section
 21 710.”.

22 (g) CONFORMING AMENDMENTS.—

23 (1) Subsection (d) of section 731 is amended by
 24 inserting “section 710(b)(4) (relating to distribu-

1 tions of partnership property),” after “to the extent
2 otherwise provided by”.

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

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

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

10 (h) EFFECTIVE DATE.—

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

15 (2) PARTNERSHIP TAXABLE YEARS WHICH IN-
16 CLUDE EFFECTIVE DATE.—In applying section
17 710(a) of the Internal Revenue Code of 1986 (as
18 added by this section) in the case of any partnership
19 taxable year which includes the date of the enact-
20 ment of this Act, the amount of the net capital gain
21 referred to in such section shall be treated as being
22 the lesser of the net capital gain for the entire part-
23 nership taxable year or the net capital gain deter-
24 mined by only taking into account items attributable

1 to the portion of the partnership taxable year which
2 is after such date.

3 (3) DISPOSITIONS OF PARTNERSHIP INTER-
4 ESTS.—

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

9 (B) INDIRECT DISPOSITIONS.—The amend-
10 ments made by subsection (b) shall apply to
11 transactions after the date of the enactment of
12 this Act.

13 (4) OTHER INCOME AND GAIN IN CONNECTION
14 WITH INVESTMENT MANAGEMENT SERVICES.—Sec-
15 tion 710(e) of such Code (as added by this section)
16 shall take effect on the date of the enactment of this
17 Act.

○