

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.

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## 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

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## 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-

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

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

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

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

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

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

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

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

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

6                   “(ii) by only taking into account items  
7                   of gain and loss taken into account by the  
8                   holder of such interest under section 702  
9                   (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           ERTY.—

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) CONTRIBUTION 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

1 whose relationship to the grantor is de-  
2 scribed in section 267(b)(1), and

3 “(iii) all other interests in such quali-  
4 fied family partnership with respect to  
5 which significant allocations are made  
6 (within the meaning of paragraph (1)(B)  
7 and in comparison to the allocations made  
8 to the interest described in clause (ii)) are  
9 held by persons who—

10 “(I) are related to the natural  
11 person or trust referred to in clause  
12 (ii), or

13 “(II) provide services described  
14 in subsection (c)(2).

15 “(C) QUALIFIED FAMILY PARTNERSHIP.—

16 For purposes of this paragraph, the term  
17 ‘qualified family partnership’ means any part-  
18 nership if—

19 “(i) all of the capital and profits in-  
20 terests of such partnership are held by—

21 “(I) specified family members,

22 “(II) any person closely related  
23 (within the meaning of subsection  
24 (c)(3)(C)(ii)) to a specified family  
25 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          “(1) 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.

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