

Amendment Offered by Mr. Levin of Michigan

This amendment would provide that carried interest compensation is taxed as ordinary income and excludes it from business income under Section 1004.

AMENDMENT

OFFERED BY MR. LEVIN OF MICHIGAN

Add at the end of title III the following:

1 **Subtitle J—Carried Interest**

2 **SEC. 3901. PARTNERSHIP INTERESTS TRANSFERRED IN**
3 **CONNECTION WITH PERFORMANCE OF SERV-**
4 **ICES.**

5 (a) MODIFICATION TO ELECTION TO INCLUDE PART-
6 **nership Interest in Gross Income in Year of**
7 **Transfer.**—Subsection (c) of section 83 is amended by
8 redesignating paragraph (4) as paragraph (5) and by in-
9 serting after paragraph (3) the following new paragraph:

10 “(4) PARTNERSHIP INTERESTS.—Except as
11 provided by the Secretary—

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

16 “(i) the fair market value of such in-
17 terest shall be treated for purposes of this
18 section as being equal to the amount of the
19 distribution which the partner would re-
20 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. 3902. 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(e)(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-