

118TH CONGRESS
2D SESSION

S. 4123

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

APRIL 15, 2024

Ms. BALDWIN (for herself, Mr. MANCHIN, Mr. BROWN, Mr. WHITEHOUSE, Mr. VAN HOLLEN, Mr. MARKEY, Ms. WARREN, Ms. KLOBUCHAR, Mr. SANDERS, Mr. REED, Mr. KAINE, Mr. WELCH, Mr. BOOKER, Ms. HIRONO, and Mr. SCHATZ) 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 2024”.

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 AND DIVISIONS.—In the case of a
18 taxpayer which satisfies requirements similar to
19 the requirements of subparagraphs (A) and (B)
20 of paragraph (3), this paragraph and paragraph
21 (1)(A)(ii) shall not apply to the distribution of
22 a partnership interest if such distribution is in
23 connection with a contribution (or deemed con-
24 tribution) of any property of the partnership to

1 which section 721 applies pursuant to a trans-
2 action described in section 708(b)(2).

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

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

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

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

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

24 “(2) BUSINESSES TO WHICH THIS SECTION AP-
25 PLIES.—A trade or business is described in this

1 paragraph if such trade or business primarily in-
 2 volves the performance of any of the following serv-
 3 ices with respect to assets held (directly or indi-
 4 rectly) by one or more investment partnerships re-
 5 ferred to in paragraph (1):

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

9 “(B) Managing, acquiring, or disposing of
 10 any specified asset.

11 “(C) Arranging financing with respect to
 12 acquiring specified assets.

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

15 “(3) INVESTMENT PARTNERSHIP.—

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

21 “(i) substantially all of the assets of
 22 the partnership are specified assets (deter-
 23 mined without regard to any section 197
 24 intangible within the meaning of section
 25 197(d)), and

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

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

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

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

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

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

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

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

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

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

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

23 “(II) such interest shall be treat-
 24 ed as held by a person in connection
 25 with a trade or business during any

1 taxable year if such interest was so
2 held by such person during any 3 tax-
3 able years preceding such taxable
4 year, and

5 “(III) paragraph (5)(B) shall not
6 apply.

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

13 “(I) paragraph (1) or (9) of sec-
14 tion 267(b), or

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

21 “(D) ANTIABUSE RULES.—The Secretary
22 may issue regulations or other guidance which
23 prevent the avoidance of the purposes of sub-
24 paragraph (A), including regulations or other
25 guidance which treat convertible and contingent

1 debt (and other debt having the attributes of
2 equity) as a capital interest in the partnership.

3 “(E) CONTROLLED GROUPS OF ENTI-
4 TIES.—

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

18 “(ii) CONTROLLED GROUP OF ENTI-
19 TIES.—For purposes of clause (i), the term
20 ‘controlled group of entities’ means a con-
21 trolled group of corporations as defined in
22 section 1563(a)(1), applied without regard
23 to subsections (a)(4) and (b)(2) of section
24 1563. A partnership or any other entity
25 (other than a corporation) shall be treated

1 as a member of a controlled group of enti-
2 ties if such entity is controlled (within the
3 meaning of section 954(d)(3)) by members
4 of such group (including any entity treated
5 as a member of such group by reason of
6 this sentence).

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

13 “(4) SPECIFIED ASSET.—The term ‘specified
14 asset’ means securities (as defined in section
15 475(c)(2) without regard to the last sentence there-
16 of), real estate held for rental or investment, inter-
17 ests in partnerships, commodities (as defined in sec-
18 tion 475(e)(2)), cash or cash equivalents, or options
19 or derivative contracts with respect to any of the
20 foregoing.

21 “(5) RELATED PERSONS.—

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

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

6 “(d) EXCEPTION FOR CERTAIN CAPITAL INTER-
 7 ESTS.—

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

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

22 “(B) the allocations made to such other in-
 23 terests are significant compared to the alloca-
 24 tions made to such qualified capital interest.

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

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

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

17 “(C) ALLOCATIONS TO SERVICE PRO-
18 VIDERS’ QUALIFIED CAPITAL INTERESTS WHICH
19 ARE LESS THAN OTHER ALLOCATIONS.—Alloca-
20 tions shall not be treated as failing to meet the
21 requirement of paragraph (1)(A) merely be-
22 cause the allocations to the qualified capital in-
23 terest represent a lower return than the alloca-
24 tions made to the other qualified capital inter-
25 ests referred to in such paragraph.

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

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

24 “(5) EXCEPTION FOR NO-SELF-CHARGED
25 CARRY AND MANAGEMENT FEE PROVISIONS.—Ex-

cept as otherwise provided by the Secretary, an interest shall not fail to be treated as satisfying the requirement of paragraph (1)(A) merely because the allocations made by the partnership to such interest do not reflect the cost of services described in subsection (c)(2) which are provided (directly or indirectly) to the partnership by the holder of such interest (or a related person).

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

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

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

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

3 “(A) IN GENERAL.—The term ‘qualified
4 capital interest’ means so much of a partner’s
5 interest in the capital of the partnership as is
6 attributable to—

7 “(i) the fair market value of any
8 money or other property contributed to the
9 partnership in exchange for such interest
10 (determined without regard to section
11 752(a)),

12 “(ii) any amounts which have been in-
13 cluded in gross income under section 83
14 with respect to the transfer of such inter-
15 est, and

16 “(iii) the excess (if any) of—

17 “(I) any items of income and
18 gain taken into account under section
19 702 with respect to such interest, over

20 “(II) any items of deduction and
21 loss so taken into account.

22 “(B) ADJUSTMENT TO QUALIFIED CAPITAL
23 INTEREST.—

24 “(i) DISTRIBUTIONS AND LOSSES.—

25 The qualified capital interest shall be re-

duced by distributions from the partnership with respect to such interest and by the excess (if any) of the amount described in subparagraph (A)(iii)(II) over the amount described in subparagraph (A)(iii)(I).

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

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

“(8) TREATMENT OF CERTAIN LOANS.—

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

18 “(B) REDUCTION IN ALLOCATIONS TO
 19 QUALIFIED CAPITAL INTERESTS FOR LOANS
 20 FROM NONSERVICE-PROVIDING PARTNERS TO
 21 THE PARTNERSHIP.—For purposes of this sub-
 22 section, any loan or other advance to the part-
 23 nership made or guaranteed, directly or indi-
 24 rectly, by a partner not providing services de-
 25 scribed in subsection (c)(2) to the partnership

1 (or any person related to such partner) shall be
 2 taken into account in determining the qualified
 3 capital interests of the partners in the partner-
 4 ship.

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

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

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

17 “(i) such interest is an interest in a
 18 qualified family partnership,

19 “(ii) such interest is held by a natural
 20 person or by a trust with respect to which
 21 each beneficiary is a grantor or a person
 22 whose relationship to the grantor is de-
 23 scribed in section 267(b)(1), and

24 “(iii) all other interests in such quali-
 25 fied family partnership with respect to

1 which significant allocations are made
 2 (within the meaning of paragraph (1)(B)
 3 and in comparison to the allocations made
 4 to the interest described in clause (ii)) are
 5 held by persons who—

6 “(I) are related to the natural
 7 person or trust referred to in clause
 8 (ii), or

9 “(II) provide services described
 10 in subsection (c)(2).

11 “(C) QUALIFIED FAMILY PARTNERSHIP.—

12 For purposes of this paragraph, the term
 13 ‘qualified family partnership’ means any part-
 14 nership if—

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

17 “(I) specified family members,

18 “(II) any person closely related
 19 (within the meaning of subsection
 20 (c)(3)(C)(ii)) to a specified family
 21 member, or

22 “(III) any other person (not de-
 23 scribed in subclause (I) or (II)) if
 24 such interest is an investment services

1 partnership interest with respect to
 2 such person, and

3 “(ii) such partnership does not hold
 4 itself out to the public as an investment
 5 advisor.

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

13 “(i) the date of the establishment of
 14 the partnership,

15 “(ii) the earliest date that the com-
 16 mon ancestor holds a capital or profits in-
 17 terest in the partnership, or

18 “(iii) the date of the enactment of this
 19 section.

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

22 “(1) IN GENERAL.—If—

23 “(A) a person performs (directly or indi-
 24 rectly) investment management services for any

1 investment entity or special purpose acquisition
 2 company,

3 “(B) such person holds (directly or indi-
 4 rectly) a disqualified interest with respect to
 5 such entity or such company (as the case may
 6 be), 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 (other than a special pur-
16 pose acquisition company), and

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

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

21 “(i) a domestic C corporation, or

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

1 “(I) effectively connected with
2 the conduct of a trade or business in
3 the United States, or

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

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

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

15 “(E) SPECIAL PURPOSE ACQUISITION COM-
16 PANY.—The term ‘special purpose acquisition
17 company’ means any corporation that—

18 “(i) is formed for the purpose of ac-
19 quiring a privately held company,

20 “(ii) is publicly traded on an estab-
21 lished securities market or its interests are
22 readily tradable on a secondary market (or
23 the substantial equivalent thereof), and

24 “(iii) is required to report an acquisi-
25 tion under Item 2.01 or make a disclosure

1 under Item 5.06 of Form 8-K (or any suc-
2 cessor form) with the Securities and Ex-
3 change Commission.

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

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

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

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

18 “(1) require such reporting and recordkeeping
19 by any person in such manner and at such time as
20 the Secretary may prescribe for purposes of enabling
21 the partnership to meet the requirements of section
22 6031 with respect to any item described in section
23 702(a)(9),

24 “(2) provide modifications to the application of
25 this section (including treating related persons as

1 not related to one another) to the extent such modi-
 2 fication is consistent with the purposes of this sec-
 3 tion,

4 “(3) prevent the avoidance of the purposes of
 5 this section (including through the use of qualified
 6 family partnerships), and

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

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

12 (b) APPLICATION OF SECTION 751 TO INDIRECT DIS-
 13 POSITIONS OF INVESTMENT SERVICES PARTNERSHIP IN-
 14 TERESTS.—

15 (1) IN GENERAL.—Subsection (a) of section
 16 751 is amended by striking “or” at the end of para-
 17 graph (1), by inserting “or” at the end of paragraph
 18 (2), and by inserting after paragraph (2) the fol-
 19 lowing new paragraph:

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

22 (2) CERTAIN DISTRIBUTIONS TREATED AS
 23 SALES OR EXCHANGES.—Subparagraph (A) of sec-
 24 tion 751(b)(1) is amended by striking “or” at the
 25 end of clause (i), by inserting “or” at the end of

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

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

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

8 (A) by striking “or” at the end of para-
 9 graph (1), by inserting “or” at the end of para-
 10 graph (2), and by inserting after paragraph (2)
 11 the following new paragraph:

12 “(3) an investment services partnership interest
 13 held by the partnership,” and

14 (B) by striking “partner.” and inserting
 15 “partner (other than a partnership in which it
 16 holds an investment services partnership inter-
 17 est).”.

18 (4) INVESTMENT SERVICES PARTNERSHIP IN-
 19 TERESTS; QUALIFIED CAPITAL INTERESTS.—Section
 20 751 is amended by adding at the end the following
 21 new subsection:

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

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

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

12 “(3) EXCEPTION FOR PUBLICLY TRADED PART-
 13 NERSHIPS.—Except as otherwise provided by the
 14 Secretary, in the case of an exchange of an interest
 15 in a publicly traded partnership (as defined in sec-
 16 tion 7704) to which subsection (a) applies—

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

20 “(B) such partnership shall be treated as
 21 owning its proportionate share of the property
 22 of any other partnership in which it is a part-
 23 ner.

24 “(4) RECOGNITION OF GAINS.—Any gain with
 25 respect to which subsection (a) applies by reason of

1 paragraph (3) thereof shall be recognized notwith-
 2 standing any other provision of this title.

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

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

11 “(7) VALUATION METHODS.—The Secretary
 12 shall prescribe regulations or other guidance which
 13 provide the acceptable methods for valuing invest-
 14 ment services partnership interests for purposes of
 15 this section.”.

16 (c) TREATMENT FOR PURPOSES OF SECTION
 17 7704.—Subsection (d) of section 7704 is amended by add-
 18 ing at the end the following new paragraph:

19 “(6) INCOME FROM CERTAIN CARRIED INTER-
 20 ESTS NOT QUALIFIED.—

21 “(A) IN GENERAL.—Specified carried in-
 22 terest income shall not be treated as qualifying
 23 income.

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

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

3 “(I) any item of income or gain
 4 allocated to an investment services
 5 partnership interest (as defined in
 6 section 710(c)) held by the partner-
 7 ship,

8 “(II) any gain on the disposition
 9 of an investment services partnership
 10 interest (as so defined) or a partner-
 11 ship interest to which (in the hands of
 12 the partnership) section 751 applies,
 13 and

14 “(III) any income or gain taken
 15 into account by the partnership under
 16 subsection (b)(4) or (e) of section
 17 710.

18 “(ii) EXCEPTION FOR QUALIFIED CAP-
 19 ITAL INTERESTS.—A rule similar to the
 20 rule of section 710(d) shall apply for pur-
 21 poses of clause (i).

22 “(C) COORDINATION WITH OTHER PROVI-
 23 SIONS.—Subparagraph (A) shall not apply to
 24 any item described in paragraph (1)(E) (or so

1 much of paragraph (1)(F) as relates to para-
2 graph (1)(E)).

3 “(D) SPECIAL RULES FOR CERTAIN PART-
4 NERSHIPS.—

5 “(i) CERTAIN PARTNERSHIPS OWNED
6 BY REAL ESTATE INVESTMENT TRUSTS.—

7 Subparagraph (A) shall not apply in the
8 case of a partnership which meets each of
9 the following requirements:

10 “(I) Such partnership is treated
11 as publicly traded under this section
12 solely by reason of interests in such
13 partnership being convertible into in-
14 terests in a real estate investment
15 trust which is publicly traded.

16 “(II) Fifty percent or more of
17 the capital and profits interests of
18 such partnership are owned, directly
19 or indirectly, at all times during the
20 taxable year by such real estate in-
21 vestment trust (determined with the
22 application of section 267(c)).

23 “(III) Such partnership meets
24 the requirements of paragraphs (2),
25 (3), and (4) of section 856(c).

1 “(ii) CERTAIN PARTNERSHIPS OWN-
 2 ING OTHER PUBLICLY TRADED PARTNER-
 3 SHIPS.—Subparagraph (A) shall not apply
 4 in the case of a partnership which meets
 5 each of the following requirements:

6 “(I) Substantially all of the as-
 7 sets of such partnership consist of in-
 8 terests in one or more publicly traded
 9 partnerships (determined without re-
 10 gard to subsection (b)(2)).

11 “(II) Substantially all of the in-
 12 come of such partnership is ordinary
 13 income or section 1231 gain (as de-
 14 fined in section 1231(a)(3)).

15 “(E) TRANSITIONAL RULE.—Subpara-
 16 graph (A) shall not apply to any taxable year
 17 of the partnership beginning before the date
 18 which is 10 years after the date of the enact-
 19 ment of this paragraph.”.

20 (d) IMPOSITION OF PENALTY ON UNDERPAY-
 21 MENTS.—

22 (1) IN GENERAL.—Subsection (b) of section
 23 6662 is amended by inserting after paragraph (10)
 24 the following new paragraph:

1 “(11) The application of section 710(e) or the
2 regulations or other guidance prescribed under sec-
3 tion 710(g) to prevent the avoidance of the purposes
4 of section 710.”.

5 (2) AMOUNT OF PENALTY.—

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

9 “(m) INCREASE IN PENALTY IN CASE OF PROPERTY
10 TRANSFERRED FOR INVESTMENT MANAGEMENT SERV-
11 ICES.—In the case of any portion of an underpayment to
12 which this section applies by reason of subsection (b)(10),
13 subsection (a) shall be applied with respect to such portion
14 by substituting ‘40 percent’ for ‘20 percent’.”.

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

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

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

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

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

6 “(3) SPECIAL RULE FOR UNDERPAYMENTS AT-
 7 TRIBUTABLE TO INVESTMENT MANAGEMENT SERV-
 8 ICES.—

9 “(A) IN GENERAL.—Paragraph (1) shall
 10 not apply to any portion of an underpayment to
 11 which section 6662 applies by reason of sub-
 12 section (b)(11) unless—

13 “(i) the relevant facts affecting the
 14 tax treatment of the item are adequately
 15 disclosed,

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

18 “(iii) the taxpayer reasonably believed
 19 that such treatment was more likely than
 20 not the proper treatment.

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

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

4 (1) INTERNAL REVENUE CODE.—

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

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

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

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

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

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

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

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

15 “(2) EXCEPTION FOR QUALIFIED CAPITAL IN-
 16 TERESTS.—A rule similar to the rule of section
 17 710(d) shall apply for purposes of applying para-
 18 graph (1)(B).”.

19 (2) SOCIAL SECURITY ACT.—Section 211(a) of
 20 the Social Security Act is amended by striking
 21 “and” at the end of paragraph (15), by striking the
 22 period at the end of paragraph (16) and inserting “;
 23 and”, and by inserting after paragraph (16) the fol-
 24 lowing new paragraph:

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

10 (f) SEPARATE ACCOUNTING BY PARTNER.—Section
 11 702(a) is amended by striking “and” at the end of para-
 12 graph (7), by striking the period at the end of paragraph
 13 (8) and inserting “, and”, and by inserting after para-
 14 graph (8) the following:

15 “(9) any amount treated as ordinary income or
 16 loss under subsection (a), (b), or (e) of section
 17 710.”.

18 (g) CONFORMING AMENDMENTS.—

19 (1) Subsection (d) of section 731 is amended by
 20 inserting “section 710(b)(4) (relating to distribu-
 21 tions of partnership property),” after “to the extent
 22 otherwise provided by”.

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

1 providing investment management services to part-
 2 nerships)” before the period at the end.

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

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

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

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

11 (h) EFFECTIVE DATE.—

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

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

1 mined by only taking into account items attributable
 2 to the portion of the partnership taxable year which
 3 is after such date.

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

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

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

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

○