

House Passes Bill That Would Reduce Capital Gains Treatment for Carried Interests

By **Kenneth E. Werner**

On May 28, 2010, the House of Representatives passed H.R. 4213, the “American Jobs, Closing Tax Loopholes and Preventing Outsourcing Act of 2010.” This bill would extend a number of expiring tax provisions. As one of the revenue offsets for these extensions, the bill would generally prevent a portion of any income with respect to carried interests in investment partnerships held by service providers to such partnerships (“investment service partnership interests”) from being characterized as capital gains. Instead, such portion (50% for tax years beginning before January 1, 2013 and 75% thereafter) would be treated as ordinary income.

Any gain on the disposition of an investment services partnership interest would be treated similarly; i.e., a portion of such gain would be characterized as ordinary income.

These recharacterization provisions would not apply to “qualified capital interests” (the portion of a partner’s interest in a partnership attributable to contributions made by such partner or ordinary income taken into account by such partner) that are treated no better than interests held by other non-service providing partners (although waiver of fees and carried interest charges with respect to capital of service providing partners won’t cause such interests not to be qualified capital interests).

The term ‘investment services partnership interest’ means any interest in a partnership which is held by any person if it was reasonably expected that such person (or any person related to such person) would provide a substantial quantity of any services in the

nature of advising as to investing in, purchasing, or selling any specified asset, managing, acquiring, or disposing of any specified asset, arranging financing with respect to acquiring specified assets, or any activities in support of the foregoing. The term “specified asset” means securities, real estate held for rental or investment, partnership interests, commodities, or options or derivative contracts with respect to any of the foregoing.

These changes in the law would be effective for partnership tax years ending after the date of enactment (for tax years which include the date of enactment, e.g., calendar year 2010 for calendar year partnerships, only the lesser of the taxable income for the entire year, or the taxable income for the portion of the year after the date of enactment would be affected).

Please let us know if you would like a copy of the bill, or wish to discuss its implications.

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If you have any questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or one of the persons listed below.

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Memorandum

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“...the bill would generally prevent a portion of any income with respect to carried interests in investment partnerships held by service providers to such partnerships...from being characterized as capital gains.”

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