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## Levin Bill Would Tax Carried Interest as Ordinary Income

Congressional talk about taxing carried interest capital gains at ordinary income rates has finally taken a concrete form with Rep. Levin's introduction of a bill to add that concept to the Code. The proposal would tax any income from an "investment services partnership interest" at ordinary rates. Taxable gains from dispositions of such interests would be taxed at ordinary rates as well.

Investment services partnership interests are interests in a partnership held by persons who, in the active conduct of a business, provide a substantial quantity of advisory or management services to the partnership with respect to "specified assets." Specified assets generally consist of securities, real estate and commodities, as well as options and derivatives with respect to such assets.

There is an exception from ordinary income treatment for a "reasonable allocation" of partnership items to invested capital, but the allocation will not be treated as reasonable if it represents a disproportionate share of income otherwise allocated to invested capital.

The proposal is as noteworthy for what it leaves out as for what it includes. Clearly managers of traditional buyout funds, real estate funds, and hedge funds that rely on carried interest allocation (rather than fee deferrals) would be caught by the proposed legislation. It is probably the case that profits interests issued to employees in other kinds of businesses will still be eligible for capital gains treatment. Similarly, the proposal seems to leave room for sponsoring investors to receive a share of carry without adverse consequences, although some restructuring of traditional forms may be necessary. It is not clear whether this proposal is intended to impact the qualification of a publicly traded partnership receiving income from an investment services partnership interest, but presumably there will be further coordination of these efforts as the legislative process goes forward.

This is surely not the last word from Congress on this subject. And between this proposal, the Blackstone Bill and ongoing discussion of issues like UBTI blockers and limiting hedge fund fee deferral, there promises to be a great deal of legislative percolation before anything is finally decided. We will do our best to keep our clients and friends up to date on significant developments.

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