



Client Alert

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Temporary Tax Relief Act of 2007 Carried Interests in Investment Partnerships

In addition to providing some tax relief from the individual alternative minimum tax (“AMT”), the Temporary Tax Relief Act of 2007 (H.R. 3996) would, if enacted, provide for a major change in the tax treatment of carried interests when they are “investment services partnership interests.” The definition of such an interest is one held by a person who advises on the purchase or sale of “specified assets,” manages such assets or arranges financing for such assets. The definition of specified assets includes securities, real estate and commodities or any derivatives relating thereto.

In such a case, the distributive share of net income or gain of the partner, whatever its character, would be treated as ordinary income with respect to the carried interest (or portion of an interest that is a carried interest). The distributive share of net loss would be an ordinary loss. A sale of such an interest would also give rise to ordinary income or loss.

Similar treatment is provided for persons providing investment services if they hold a “disqualified interest” in any entity, other than a C corporation, the value of which is based on the income or gain of assets as to which investment services are performed.

A new 40% penalty would exist for understatement of income in connection with these investment services partnership interests and disqualified interests.

The effective date of the new provision would apply to taxable years ending after November 1, 2007. In the case of partnerships, the taxable year of which includes the effective date of November 1, 2007, the provision would apply to the lesser of the income for the entire year or the income allocable to the period from November 1 to the end of the year.

The House of Representatives is expected to pass the bill. There is no indication of where the Senate stands on it. The Administration, which would like to have an AMT patch, has said that the President will veto the bill if it contains the foregoing provision as well as others that the Administration believes to be counterproductive.

