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## Baucus Releases Revised Carried Interest Legislation

On Tuesday, June 8, 2010, Senate Finance Committee Chair Max Baucus (D-Mont.) released a substitute amendment (the "Senate Amendment") to the *American Jobs and Closing Tax Loopholes Act of 2010*, which passed the House of Representatives on May 28 (the "House Bill"). The Senate began debate on the Senate Amendment today. The language of the Senate Amendment regarding the taxation of carried interest is similar to the language included in the House Bill,<sup>1</sup> with several notable differences.

**Carried Interest – Blended Rate.** Subject to the special rule discussed below relating to property held at least seven years, the Senate Amendment would treat 65% of carried interest as ordinary income and the remaining 35% as it is treated under current law (i.e., based on the underlying income of the fund in question). Until 2013, the percentages would be 50% and 50%. Gains from dispositions of carried interests would be subject to similar treatment and related rules would apply to distributions in kind to holders of carried interests. The House Bill includes similar rules, but would treat 75% of the applicable amounts as ordinary income and only 25% would be taxed as under current law after 2013.

**Special Blended Rate for Property Held at Least Seven Years.** The Senate Amendment includes a special blended rate that applies to gain from the disposition of any asset which is held at least seven years. In particular, for 2013 and after, with respect to gain from the sale or exchange of any fund asset held at least seven years, 55% of the carried interest income would be treated as ordinary income and the remaining 45% would be taxed as it is under current law, with the character determined by reference to the asset sold.

**Update on Effective Date.** Under the Senate Amendment, the carried interest legislation would apply to all taxable years beginning after December 31, 2010. This is consistent with the effective date provision in the House Bill, which was amended (after our earlier client alert on this issue) so that it would apply only after December 31, 2010.

<sup>1</sup> See our earlier client alert on the House Bill, *Baucus and Levin Release Revised Carried Interest Legislation*, at: <http://www.paulweiss.com/files/upload/21May10TB.pdf>

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**Gain on Enterprise Value and Sale of Other Businesses.** Although this may not have been the intent, the carried interest legislation (both the House Bill and the Senate Amendment) may apply to interests in other types of partnerships that are not the traditional private equity, hedge, venture capital and other similar funds that were the impetus for the legislation; for example, it may apply to the sale of an interest in a fund manager business (particularly a fund manager that holds MPI, fee waiver interests, or carried interest in a fund). But farther afield from investment funds, it may also apply to certain boutique investment banks organized as partnerships, partnership holding companies, and other businesses organized as partnerships that are operating business, but also buy or sell businesses. If the legislation were to apply, it could recharacterize gain attributable to going concern value and goodwill as ordinary income, even though those items have traditionally given rise to capital gain. There has been discussion about revising the legislation to address this point, but it is extremely uncertain whether that will happen.

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This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. If you have questions regarding the foregoing, please contact:

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