

Congress Moving Quickly toward Blended Tax Rate for Carried Interest

May 21, 2010

On May 20, 2010, The American Jobs and Closing Tax Loopholes Act of 2010 (H.R. 4213) was proposed in the House of Representatives. Included in this bill is a provision regarding the tax treatment of "carried interest."

Similar to prior versions of the "carried interest" legislation, the bill would treat tax items from carried interest as ordinary income or loss, but unlike prior versions, for individuals, the bill imposes a blended rate and provides for a phase-in period, as follows:

(1) Through 2012, 50 percent of an individual's tax items in respect of carried interest would be treated as ordinary income or loss, and

(2) For 2013 and thereafter, 75 percent of an individual's tax items in respect of carried interest would be treated as ordinary income or loss.

Of additional significance is the effective date for this bill. Although there were numerous unofficial reports that the bill would not apply until after December 31, 2010, the actual text of the bill generally provides that the carried interest provisions will be effective for tax items recognized in 2010. For 2010, however, tax items subject to these provisions would be equal to the lesser of (i) the net income of the applicable partnership for all of 2010 and (ii) the net income of the applicable partnership for 2010 determined by only taking into account tax items "attributable" to the portion of the partnership's taxable year after the date of enactment of the legislation.

It is uncertain whether there will be any modifications to the bill, either from the House or the Senate, prior to the anticipated House vote on Tuesday, May 25.

A more detailed alert on the substantive provisions related to the taxation of carried interest will follow if and when the terms of the proposed legislation are finalized.

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