WHITE & CASE

White & Case LLP
701 Thirteenth Street, NW
Washington, DC 20005

Tel +1 202 626 3600
Fax +1 202 639 9355
www.whitecase.com

Direct Dial + 202-626-3666 Direct Facsimile + 202-639-9355 lcarlisle@whitecase.com

April 13, 2010

John L. Buckley, Esq.
Chief Tax Counsel
House, Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Re: H.R. 4213 Carried Interest Provision

Dear John:

On behalf of the National Association of Publicly Traded Partnerships ("NAPTP"), we request that the three proposed modifications set forth in Attachment A be made to section 602(a) of H.R. 4213 entitled "Income of Partners Providing Investment Management Services to Partnerships." These proposals reflect concerns raised by NAPTP members in applying the proposed legislation to their existing structures. As we have discussed, natural resource publicly traded partnerships are engaged in active businesses and are not used to convert ordinary income into capital gain.

Modification I would narrow the definition of "specified asset" in the proposed legislation to exclude assets that do not give rise to capital gains. Modification II would limit the provision to individuals to eliminate the distortive effects of characterizing the income of intermediary pass-through entities as services income. Modification III would retain non-recognition treatment for restructuring transactions otherwise qualifying for such treatment to permit standard business restructurings to be conducted without tax.

In addition, we request that a technical correction be made to section 1402(a) of the "Health Care and Education Reconciliation Act of 2010," as described in Attachment B, to clarify that the rule requiring the bifurcation of gain realized from the disposition of a partnership interest will not apply to public investors in publicly traded partnerships.

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Thanks for your consideration. Please let me know if you have any questions with respect to these proposed modifications and technical correction.

Sincerely,

Linda E. Carlisle

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Attachment A

Proposal I.

Definition of "Specified Asset"

Purpose: Narrow the definition of specified assets to more accurately distinguish services relating to investment activities from services provided in an operating business.

Rationale: Many businesses structure their operations using subsidiary partnerships or corporations for a variety of business reasons. While in many cases the businesses could be structured without the use of subsidiary entities, there appears to be no reason to penalize a business for the manner in which it is structured. Instead of forcing the restructuring of businesses, it would be preferable to modify the definition of specified assets to target only those partnership interests and stock that are acquired as vehicles for generating capital gains for fund investors. Similarly, commodities held in inventory in the business (e.g., a retail sales business) or as hedges in the business do not present the capital gain conversion risk that is the target of the legislation and should not be treated as specified assets.

Proposed Legislative language:

In section 602(a) of the bill, modify section 710(c) by deleting the period at the end of the second sentence and adding at that point the following:

> ", provided that specified assets shall not include (i) any interest in an ordinary income partnership, provided no significant purpose in acquiring such partnership interest was to generate a return for investors from the disposition of such

partnership interest; (ii) any stock in a corporation substantially all of the income of which is reasonably expected to be ordinary income or section 1231 gain (as defined in section 1231(a)(3)), provided no significant purpose in acquiring such stock was to generate a return for investors from the disposition of such stock; (iii) any commodities held or used in activities described in section 7704(d)(1)(E); or (iv) any notional principal contract or other derivative held as hedges with respect to commodities described in clause (iii).

For purposes of this paragraph, the term 'ordinary income partnership' means a partnership (i) substantially all of the income of which is reasonably expected to be ordinary income or section 1231 gain (as defined in section 1231(a)(3)), and (ii) which is primarily engaged, directly or indirectly, in activities described in section 7704(d)(1)(E)."

Attachment A

Proposal II.

Limit Application to Individual Service Providers

Purpose: Limit the service providers that are subject to the provision to individuals.

Rationale: The target of the legislation is fund managers that convert compensation that would otherwise be taxed as ordinary income into capital gain income. Individuals are the only persons who actually provide services. Partnerships as pass-through entities are not subject to tax and corporations are subject to the same rate of tax on both ordinary income and capital gain. Accordingly, it makes little sense to attempt to address the issue of the conversion of services income into capital gains which is taxable at a lower rate by treating entities as holding carried interests. It is the treatment of the income of the individual service provider that needs to be addressed.

Treating intermediary entities as having service income distorts the effects of the provision, producing unfair results in many cases. For example, treating partnerships whose employees or partners provide services as holding carried interest results in more income being characterized as ordinary self-employment income than the amount that is actually attributable to the services. Moreover, as the Example below demonstrates, income of a public unit holder of a PTP could be subject to the carried interest recharacterization even though he or she provides no services and is merely a passive investor.

Example: A service partner (SP) owns interests in publicly traded upper-tier partnership (UTP) consisting of $200x historic interests ($100x of value in carried interests and $100x of value in qualified capital interests) and $100x units purchased in the market (entirely qualified capital interests). The public owns $700x of publicly traded units. UTP owns interests in publicly traded lower tier-partnership (LTP) that are $100x of value in carried interests and $900x of value in qualified capital interests. Assume a 10% return on the value of all interests. UTP has income of $100x.

SP's income on her carried interests in UTP ($10x) should be recharacterized as ordinary income. If that is all that SP owned, then that is all of her income that would be subject to the provision. There is no reason to believe she should be treated as having any more ordinary self-employment income because she also invested capital in the structure. Accordingly, none of the income ($20x) on her qualified capital interests should be recharacterized as ordinary income.

Under the proposed legislation, all of the income ($10x) attributable to SP's carried interest is ordinary self-employment income, as is appropriate. In addition, because UTP is a service provider to LTP, $10x of UTP's $100x of income is also recharacterized as ordinary income; therefore, an additional $2x (10% of SP's $20x of income with respect to her qualified capital interests) will be characterized as ordinary self-employment income. This is a clearly inappropriate result. Moreover, the public unit holders of UTP are subject to the legislation on 10% ($7) of their $70 of income, even though they provide no services. In the aggregate, $19 of income will be treated as ordinary income under the provision, and $12 of that will be subject to self-employment taxes, when only $10 of income is actually attributable to a carried interest.

In contrast, consider the identical economic transaction structured as a single tier publicly traded partnership with a service partner who has carried interests in the partnership and also invests capital in the partnership by buying publicly traded units. Such a partner would be subject to the provision with respect to all of his income on the carried interests ($10 on the economic facts of the example above) but on none of his income on the public units, and the public unit holders would not be subject to the provision on any of their income. There is no justification for such sharply divergent outcomes for economically identical transactions.

The effect of treating the intermediate general partner entity as holding a carried interest is to multiply the amount of ordinary income and the amount of self-employment income generated by the exact same economic exchange of services and capital for profits. This distortion can be avoided, and the purposes of the legislation can be achieved, by treating only individuals, and not entities, as holding carried interests. The application of the provision by reference to an individual's direct or indirect ownership of a partnership interest and qualified contributed capital is sufficient to prevent an individual from avoiding the ordinary income consequences of receiving profits for services through an entity. All capital invested by the upper-tier partnership in the lower-tier partnership would be traced to capital invested by unit holders in the upper-tier partnership, none of the return allocable to qualified capital interests would be subject to the provision, and all of the return allocable to a carried interest held by an individual would be subject to the provision.

Proposed Legislative language:

In section 602(a) of the bill, modify the first sentence of section 710(c)(1) by inserting ", with respect to any individual," immediately after the word "means", substituting "such individual" for "any person" the first place it appears, and substituting "individual" for "person" each additional place it appears.

Attachment A

Proposal III.

Permit Nonrecognition Transactions with Carryover of Section 710 Treatment

Purpose: Permit the application of nonrecognition rules to gain on dispositions of carried interests to the extent that the carried interest rules can be applied to gain preserved in a partnership interest received in the transaction.

Rationale: The nonrecognition rules implement a variety of policies. Overriding those rules will lead to results that are contrary to those policies in many situations. In particular, many nonrecognition provisions are intended to permit businesses to be restructured without excessive tax costs. Nonrecognition rules should be preserved to the extent possible.

Proposed Legislative language:

In section 602(a) of the bill, modify section 710(b)(1) by adding the following immediately before the period at the end therof:

> ", provided however that this section shall not alter the amount or timing of gain recognition on such a disposition to the extent that such gain is preserved in a partnership interest immediately following such disposition and the holder of such partnership interest elects to treat such interest as an investment services partnership interest".

Attachment B

Technical Correction to H.R. 4872

Purpose: To clarify that the rule requiring a taxpayer to allocate gain on the disposition of a partnership interest for purposes of applying the unearned income Medicare contribution tax only applies to interests in a partnership which is not a passive activity partnership.

Rationale: All of the gain on the disposition of a passive activity interest partnership interest should be subject to the unearned income Medicare contribution tax, as clearly contemplated by Congress in the title of this subsection "Exception for Certain Active Interests in Partnerships and S Corporations.".

Proposed Legislative language:

In section 1402(a) of the legislation, insert the following clause at the end of the first clause in section 1411(b)(4):

"which is not a passive activity within the meaning of section 469".