AMENDMENT NO.__________ Calendar No._____

Purpose: In the nature of a substitute.

IN THE SENATE OF THE UNITED STATES—111th Cong., 2d Sess.

H.R. 4213

An Act to amend the Internal Revenue Code of 1986 to extend certain expiring provisions, and for other purposes.

Referred to the Committee on ________________ and
ordered to be printed

Ordered to lie on the table and to be printed

AMENDMENT IN THE NATURE OF A SUBSTITUTE intended
to be proposed by Mr. BAUCUS

Viz:

1 In lieu of the matter proposed to be inserted, insert
2 the following:

3 SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE;

4 TABLE OF CONTENTS.

5 (a) SHORT TITLE.—This Act may be cited as the
6 “American Jobs and Closing Tax Loopholes Act of 2010”.
7 (b) AMENDMENT OF 1986 CODE.—Except as other-
8 wise expressly provided, whenever in titles I, II, and IV
9 of this Act an amendment or repeal is expressed in terms
10 of an amendment to, or repeal of, a section or other provi-
(1) by striking “In the case of any information” and inserting the following:

“(A) IN GENERAL.—In the case of any information”; and

(2) by adding at the end the following:

“(B) APPLICATION TO FAILURES DUE TO REASONABLE CAUSE.—If the failure to furnish the information referred to in subparagraph (A) is due to reasonable cause and not willful neglect, subparagraph (A) shall apply only to the item or items related to such failure.”.

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in section 513 of the Hiring Incentives to Restore Employment Act.

Subtitle B—Personal Service Income Earned in Pass-thru Entities

SEC. 411. PARTNERSHIP INTERESTS TRANSFERRED IN CONNECTION WITH PERFORMANCE OF SERVICES.

(a) MODIFICATION TO ELECTION TO INCLUDE PARTNERSHIP INTEREST IN GROSS INCOME IN YEAR OF TRANSFER.—Subsection (c) of section 83 is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:
“(4) PARTNERSHIP INTERESTS.—Except as provided by the Secretary, in the case of any transfer of an interest in a partnership in connection with the provision of services to (or for the benefit of) such partnership—

“(A) the fair market value of such interest shall be treated for purposes of this section as being equal to the amount of the distribution which the partner would receive if the partnership sold (at the time of the transfer) all of its assets at fair market value and distributed the proceeds of such sale (reduced by the liabilities of the partnership) to its partners in liquidation of the partnership, and

“(B) the person receiving such interest shall be treated as having made the election under subsection (b)(1) unless such person makes an election under this paragraph to have such subsection not apply.”.

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 83(b) is amended by inserting “or subsection (e)(4)(B)” after “paragraph (1)”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to interests in partnerships transferred after the date of the enactment of this Act.
SEC. 412. INCOME OF PARTNERS FOR PERFORMING INVESTMENT MANAGEMENT SERVICES TREATED AS ORDINARY INCOME RECEIVED FOR PERFORMANCE OF SERVICES.

(a) In General.—Part I of subchapter K of chapter 1 is amended by adding at the end the following new section:

"SEC. 710. SPECIAL RULES FOR PARTNERS PROVIDING INVESTMENT MANAGEMENT SERVICES TO PARTNERSHIP.

"(a) Treatment of Distributive Share of Partnership Items.—For purposes of this title, in the case of an investment services partnership interest—

"(1) In General.—Notwithstanding section 702(b)—

"(A) any net income with respect to such interest for any partnership taxable year shall be treated as ordinary income, and

"(B) any net loss with respect to such interest for such year, to the extent not disallowed under paragraph (2) for such year, shall be treated as an ordinary loss.

All items of income, gain, deduction, and loss which are taken into account in computing net income or net loss shall be treated as ordinary income or ordinary loss (as the case may be)."
"(2) TREATMENT OF LOSSES.—

"(A) LIMITATION.—Any net loss with respect to such interest shall be allowed for any partnership taxable year only to the extent that such loss does not exceed the excess (if any) of—

"(i) the aggregate net income with respect to such interest for all prior partnership taxable years, over

"(ii) the aggregate net loss with respect to such interest not disallowed under this subparagraph for all prior partnership taxable years.

"(B) CARRYFORWARD.—Any net loss for any partnership taxable year which is not allowed by reason of subparagraph (A) shall be treated as an item of loss with respect to such partnership interest for the succeeding partnership taxable year.

"(C) BASIS ADJUSTMENT.—No adjustment to the basis of a partnership interest shall be made on account of any net loss which is not allowed by reason of subparagraph (A).

"(D) PRIOR PARTNERSHIP YEARS.—Any reference in this paragraph to prior partnership
taxable years shall only include prior partnership taxable years to which this section applies.

"(3) NET INCOME AND LOSS.—For purposes of this section—

"(A) NET INCOME.—The term ‘net income’ means, with respect to any investment services partnership interest for any partnership taxable year, the excess (if any) of—

"(i) all items of income and gain taken into account by the holder of such interest under section 702 with respect to such interest for such year, over

"(ii) all items of deduction and loss so taken into account.

"(B) NET LOSS.—The term ‘net loss’ means, with respect to such interest for such year, the excess (if any) of the amount described in subparagraph (A)(ii) over the amount described in subparagraph (A)(i).

"(4) SPECIAL RULE FOR DIVIDENDS.—Any dividend taken into account in determining net income or net loss for purposes of paragraph (1) shall not be treated as qualified dividend income for purposes of section 1(h).

"(b) DISPOSITIONS OF PARTNERSHIP INTERESTS.—
“(1) GAIN.—Any gain on the disposition of an investment services partnership interest shall be—

“(A) treated as ordinary income, and

“(B) recognized notwithstanding any other provision of this subtitle.

“(2) LOSS.—Any loss on the disposition of an investment services partnership interest shall be treated as an ordinary loss to the extent of the excess (if any) of—

“(A) the aggregate net income with respect to such interest for all partnership taxable years to which this section applies, over

“(B) the aggregate net loss with respect to such interest allowed under subsection (a)(2) for all partnership taxable years to which this section applies.

“(3) ELECTION WITH RESPECT TO CERTAIN EXCHANGES.—Paragraph (1)(B) shall not apply to the contribution of an investment services partnership interest to a partnership in exchange for an interest in such partnership if—

“(A) the taxpayer makes an irrevocable election to treat the partnership interest received in the exchange as an investment services partnership interest, and
“(B) the taxpayer agrees to comply with such reporting and recordkeeping requirements as the Secretary may prescribe.

“(4) DISPOSITION OF PORTION OF INTEREST.—In the case of any disposition of an investment services partnership interest, the amount of net loss which otherwise would have (but for subsection (a)(2)(C)) applied to reduce the basis of such interest shall be disregarded for purposes of this section for all succeeding partnership taxable years.

“(5) DISTRIBUTIONS OF PARTNERSHIP PROPERTY.—In the case of any distribution of property by a partnership with respect to any investment services partnership interest held by a partner—

“(A) the excess (if any) of—

“(i) the fair market value of such property at the time of such distribution, over

“(ii) the adjusted basis of such property in the hands of the partnership, shall be taken into account as an increase in such partner’s distributive share of the taxable income of the partnership (except to the extent such excess is otherwise taken into account in
determining the taxable income of the partnership),

"(B) such property shall be treated for purposes of subpart B of part II as money distributed to such partner in an amount equal to such fair market value, and

"(C) the basis of such property in the hands of such partner shall be such fair market value.

Subsection (b) of section 734 shall be applied without regard to the preceding sentence. In the case of a taxpayer which satisfies requirements similar to the requirements of subparagraphs (A) and (B) of paragraph (4), this paragraph and paragraph (1)(B) shall not apply to the distribution of a partnership interest if such distribution is in connection with a contribution (or deemed contribution) of any property of the partnership to which section 721 applies pursuant to a transaction described in paragraph (1)(B) or (2) of section 708(b).

"(6) APPLICATION OF SECTION 751.—

"(A) IN GENERAL.—In applying section 751, an investment services partnership interest shall be treated as an inventory item.
“(B) Exception for certain dispositions of interests in a publicly traded partnership.—Except as provided by the Secretary, this paragraph shall not apply in the case of any disposition of an interest in a publicly traded partnership (as defined in section 7704) which is not an investment services partnership interest in the hands of the person disposing of such interest.

“(c) Investment Services Partnership Interest.—For purposes of this section—

“(1) In general.—The term ‘investment services partnership interest’ means any interest in a partnership which is held (directly or indirectly) by any person if it was reasonably expected (at the time that such person acquired such interest) that such person (or any person related to such person) would provide (directly or, to the extent provided by the Secretary, indirectly) a substantial quantity of any of the following services with respect to assets held (directly or indirectly) by the partnership:

“(A) Advising as to the advisability of investing in, purchasing, or selling any specified asset.
“(B) Managing, acquiring, or disposing of any specified asset.

“(C) Arranging financing with respect to acquiring specified assets.

“(D) Any activity in support of any service described in subparagraphs (A) through (C).

“(2) SPECIFIED ASSET.—The term ‘specified asset’ means securities (as defined in section 475(c)(2) without regard to the last sentence thereof), real estate held for rental or investment, interests in partnerships, commodities (as defined in section 475(e)(2)), or options or derivative contracts with respect to any of the foregoing.

“(3) EXCEPTION FOR FAMILY FARMS.—The term ‘specified asset’ shall not include any farm used for farming purposes if such farm is held by a partnership all of the interests in which are held (directly or indirectly) by members of the same family. Terms used in the preceding sentence which are also used in section 2032A shall have the same meaning as when used in such section.

“(4) RELATED PERSONS.—A person shall be treated as related to another person if the relationship between such persons is described in section 267 or 707(b).
“(d) Exception for Certain Capital Interests.—

“(1) In general.—In the case of any portion of an investment services partnership interest which is a qualified capital interest, all items of income, gain, loss, and deduction which are allocated to such qualified capital interest shall not be taken into account under subsection (a) if—

“(A) allocations of items are made by the partnership to such qualified capital interest in the same manner as such allocations are made to other qualified capital interests held by partners who do not provide any services described in subsection (c)(1) and who are not related to the partner holding the qualified capital interest, and

“(B) the allocations made to such other interests are significant compared to the allocations made to such qualified capital interest.

“(2) Authority to Provide Exceptions to Allocation Requirements.—To the extent provided by the Secretary in regulations or other guidance—

“(A) Allocations to Portion of Qualified Capital Interest.—Paragraph (1) may
be applied separately with respect to a portion
of a qualified capital interest.

"(B) NO OR INSIGNIFICANT ALLOCATIONS
TO NONSERVICE PROVIDERS.—In any case in
which the requirements of paragraph (1)(B) are
not satisfied, items of income, gain, loss, and
deduction shall not be taken into account under
subsection (a) to the extent that such items are
properly allocable under such regulations or
other guidance to qualified capital interests.

"(C) ALLOCATIONS TO SERVICE PRO-
VIDERS' QUALIFIED CAPITAL INTERESTS WHICH
ARE LESS THAN OTHER ALLOCATIONS.—Allocations
shall not be treated as failing to meet the
requirement of paragraph (1)(A) merely be-
cause the allocations to the qualified capital in-
terest represent a lower return than the alloca-
tions made to the other qualified capital inter-
ests referred to in such paragraph.

"(3) SPECIAL RULE FOR CHANGES IN SERV-
ICES.—In the case of an interest in a partnership
which is not an investment services partnership in-
terest and which, by reason of a change in the serv-
ices with respect to assets held (directly or indi-
rectly) by the partnership, would (without regard to
the reasonable expectation exception of subsection
(e)(1)) have become such an interest—

"(A) notwithstanding subsection (e)(1),
such interest shall be treated as an investment
services partnership interest as of the time of
such change, and

"(B) for purposes of this subsection, the
qualified capital interest of the holder of such
partnership interest immediately after such
change shall not be less than the fair market
value of such interest (determined immediately
before such change).

"(4) SPECIAL RULE FOR TIERED PARTNER-
SHIPS.—Except as otherwise provided by the Sec-
retary, in the case of tiered partnerships, all items
which are allocated in a manner which meets the re-
quirements of paragraph (1) to qualified capital in-
terests in a lower-tier partnership shall retain such
character to the extent allocated on the basis of
qualified capital interests in any upper-tier partner-
ship.

"(5) EXCEPTION FOR NO-SELF-CHARGED
CARRY AND MANAGEMENT FEE PROVISIONS.—Ex-
cept as otherwise provided by the Secretary, an in-
terest shall not fail to be treated as satisfying the
requirement of paragraph (1)(A) merely because the allocations made by the partnership to such interest do not reflect the cost of services described in subsection (c)(1) which are provided (directly or indirectly) to the partnership by the holder of such interest (or a related person).

“(6) Special rule for dispositions.—In the case of any investment services partnership interest any portion of which is a qualified capital interest, subsection (b) shall not apply to so much of any gain or loss as bears the same proportion to the entire amount of such gain or loss as—

“(A) the distributive share of gain or loss that would have been allocated to the qualified capital interest (consistent with the requirements of paragraph (1)) if the partnership had sold all of its assets at fair market value immediately before the disposition, bears to

“(B) the distributive share of gain or loss that would have been so allocated to the investment services partnership interest of which such qualified capital interest is a part.

“(7) Qualified capital interest.—For purposes of this subsection—
“(A) IN GENERAL.—The term ‘qualified capital interest’ means so much of a partner’s interest in the capital of the partnership as is attributable to—

“(i) the fair market value of any money or other property contributed to the partnership in exchange for such interest (determined without regard to section 752(a)),

“(ii) any amounts which have been included in gross income under section 83 with respect to the transfer of such interest, and

“(iii) the excess (if any) of—

“(I) any items of income and gain taken into account under section 702 with respect to such interest, over

“(II) any items of deduction and loss so taken into account.

“(B) ADJUSTMENT TO QUALIFIED CAPITAL INTEREST.—

“(i) DISTRIBUTIONS AND LOSSES.—

The qualified capital interest shall be reduced by distributions from the partnership with respect to such interest and by

...
the excess (if any) of the amount described
in subparagraph (A)(iii)(II) over the
amount described in subparagraph
(A)(iii)(I).

"(ii) SPECIAL RULE FOR CONTRIBUTIONS OF PROPERTY.—In the case of any
contribution of property described in sub-
paragraph (A)(i) with respect to which the
fair market value of such property is not
equal to the adjusted basis of such prop-
erty immediately before such contribution,
proper adjustments shall be made to the
qualified capital interest to take into ac-
count such difference consistent with such
regulations or other guidance as the Sec-
retary may provide.

"(8) TREATMENT OF CERTAIN LOANS.—

"(A) PROCEEDS OF PARTNERSHIP LOANS
NOT TREATED AS QUALIFIED CAPITAL INTER-
EST OF SERVICE PROVIDING PARTNERS.—For
purposes of this subsection, an investment serv-
ices partnership interest shall not be treated as
a qualified capital interest to the extent that
such interest is acquired in connection with the
proceeds of any loan or other advance made or
guaranteed, directly or indirectly, by any other partner or the partnership (or any person related to any such other partner or the partnership).

"(B) REDUCTION IN ALLOCATIONS TO QUALIFIED CAPITAL INTERESTS FOR LOANS FROM NONSERVICE- PROVIDING PARTNERS TO THE PARTNERSHIP.—For purposes of this subsection, any loan or other advance to the partnership made or guaranteed, directly or indirectly, by a partner not providing services described in subsection (c)(1) to the partnership (or any person related to such partner) shall be taken into account in determining the qualified capital interests of the partners in the partnership.

"(e) OTHER INCOME AND GAIN IN CONNECTION WITH INVESTMENT MANAGEMENT SERVICES.—

"(1) IN GENERAL.—If—

"(A) a person performs (directly or indirectly) investment management services for any entity,

"(B) such person holds (directly or indirectly) a disqualified interest with respect to such entity, and
“(C) the value of such interest (or payments thereunder) is substantially related to the amount of income or gain (whether or not realized) from the assets with respect to which the investment management services are performed,

any income or gain with respect to such interest shall be treated as ordinary income. Rules similar to the rules of subsections (a)(4) and (d) shall apply for purposes of this subsection.

“(2) DEFINITIONS.—For purposes of this subsection—

“(A) DISQUALIFIED INTEREST.—

“(i) IN GENERAL.—The term ‘disqualified interest’ means, with respect to any entity—

“(I) any interest in such entity other than indebtedness,

“(II) convertible or contingent debt of such entity,

“(III) any option or other right to acquire property described in sub-clause (I) or (II), and

“(IV) any derivative instrument entered into (directly or indirectly)
with such entity or any investor in such entity.

"(ii) EXCEPTIONS.—Such term shall not include—

"(I) a partnership interest,

"(II) except as provided by the Secretary, any interest in a taxable corporation, and

"(III) except as provided by the Secretary, stock in an S corporation.

"(B) TAXABLE CORPORATION.—The term ‘taxable corporation’ means—

"(i) a domestic C corporation, or

"(ii) a foreign corporation substantially all of the income of which is—

"(I) effectively connected with the conduct of a trade or business in the United States, or

"(II) subject to a comprehensive foreign income tax (as defined in section 457A(d)(2)).

"(C) INVESTMENT MANAGEMENT SERVICES.—The term ‘investment management services’ means a substantial quantity of any of the services described in subsection (c)(1).
“(f) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as is necessary or appropriate to carry out the purposes of this section, including regulations or other guidance to—

“(1) provide modifications to the application of this section (including treating related persons as not related to one another) to the extent such modification is consistent with the purposes of this section,

“(2) prevent the avoidance of the purposes of this section, and

“(3) coordinate this section with the other provisions of this title.

“(g) SPECIAL RULES FOR INDIVIDUALS.—In the case of an individual—

“(1) IN GENERAL.—Subsection (a)(1) shall apply only to the applicable percentage of the net income or net loss referred to in such subsection.

“(2) DISPOSITIONS, ETC.—The amount which (but for this paragraph) would be treated as ordinary income by reason of subsection (b) or (e) shall be the applicable percentage of such amount.

“(3) PRO RATA ALLOCATION TO ITEMS.—For purposes of applying subsections (a) and (e), the aggregate amount treated as ordinary income for any
such taxable year shall be allocated ratably among
the items of income, gain, loss, and deduction taken
into account in determining such amount.

“(4) **SPECIAL RULE FOR RECOGNITION OF**
**GAIN.**—Gain which (but for this section) would not
be recognized shall be recognized by reason of sub-
section (b) only to the extent that such gain is treat-
ed as ordinary income after application of paragraph
(2).

“(5) **COORDINATION WITH LIMITATION ON**
**LOSSES.**—For purposes of applying paragraph (2) of
subsection (a) with respect to any net loss for any
taxable year—

“(A) such paragraph shall only apply with
respect to the applicable percentage of such net
loss for such taxable year,

“(B) in the case of a prior partnership tax-
able year referred to in clause (i) or (ii) of sub-
paragraph (A) of such paragraph, only the ap-
pllicable percentage (as in effect for such prior
taxable year) of net income or net loss for such
prior partnership taxable year shall be taken
into account, and
“(C) any net loss carried forward to the succeeding partnership taxable year under sub-paragraph (B) of such paragraph shall—
“(i) be taken into account in such succeeding year without reduction under this subsection, and
“(ii) in lieu of being taken into account as an item of loss in such succeeding year, shall be taken into account—
“(I) as an increase in net loss or as a reduction in net income (including below zero), as the case may be, and
“(II) after any reduction in the amount of such net loss or net income under this subsection.

A rule similar to the rule of the preceding sentence shall apply for purposes of subsection (b)(2)(A).

“(6) COORDINATION WITH TREATMENT OF DIVIDENDS.—Subsection (a)(4) shall only apply to the applicable percentage of dividends described therein.

“(7) APPLICABLE PERCENTAGE.—For purposes of this subsection—
“(A) IN GENERAL.—Except as provided in subparagraph (B), the term ‘applicable percentage’ means 75 percent.

“(B) EXCEPTIONS FOR SALES OF INTERESTS AND ASSETS HELD AT LEAST 5 YEARS.—

“(i) IN GENERAL.—The applicable percentage shall be 50 percent with respect to—

“(I) any net income or net loss under subsection (a)(1), or any income or gain under subsection (e) which is properly allocable to gain or loss from the sale or exchange of any asset which has been held at least 5 years, and

“(II) to the extent provided under clause (ii), gain or loss under subsection (b) on the disposition of an investment services partnership interest or gain under subsection (e) with respect to a disqualified interest, but only if such interest has been held for at least 5 years.

“(ii) LOOK THROUGH IN THE CASE OF DISPOSITION OF INTEREST.—Except as
provided by the Secretary, in the case of a
disposition of an interest in an entity de-
scribed in clause (i)(II), clause (i) shall be
applied only to the portion of the gain or
loss attributable to the assets of such enti-
ty which have been held for at least 5
years, unless substantially all of such as-
sets have been held for at least 5 years. In
the case of tiered entities, the preceding
sentence shall be applied by reference to
the assets of such entities rather than to an
interest in such entities.

"(iii) SPECIAL RULE FOR SECTION 197
INTANGIBLE GAIN OF MANAGEMENT ENT-
ITIES.—

"(I) IN GENERAL.—In the case
of the disposition of an investment
services partnership interest in a man-
agement entity which has been held
for at least 5 years, any section 197
intangible gain with respect to such
interest shall be treated as gain from
an asset held for at least 5 years. In
the case of tiered management enti-
ties, the holding period requirement
under the preceding sentence shall apply with respect to interests in each such management entity.

"(II) VALUATION BURDEN ON THE TAXPAYER.—This clause shall not apply to any gain from the disposition of an investment services partnership interest unless the taxpayer establishes (in such manner as the Secretary shall provide) the amount of the section 197 intangible gain with respect to such disposition.

"(C) MANAGEMENT ENTITY.—For purposes of this paragraph, the term ‘management entity’ means a partnership the principal activity of which is providing the services described in subsection (c) with respect to assets held (directly or indirectly) by such partnership.

"(D) SECTION 197 INTANGIBLE GAIN.—For purposes of this paragraph—

"(i) IN GENERAL.—The term ‘section 197 intangible gain’ means, with respect to any management entity, gain recognized on the disposition of an investment services partnership interest in such entity which is
attributable to any section 197 intangible (within the meaning of section 197(d)).

“(ii) VALUE OF INVESTMENT SERVICES PARTNERSHIP INTEREST DISREGARDED.—Except as provided by the Secretary, no portion of the value of an investment services partnership interest (other than the interest being disposed of) shall be taken into account in determining section 197 intangible gain.

“(iii) LIMITATION.—For purposes of clause (i), gain from the disposition of an investment services partnership interest shall in no event be treated as attributable to a section 197 intangible (within the meaning of section 197(d)) if such gain would be included in the amount of the distribution which the partner disposing of such interest would receive if the partnership sold (at the time of the disposition) all of its assets at fair market value and distributed the proceeds of such sale (reduced by the liabilities of the partnership) to its partners in liquidation of the partnership.
“(iv) REGULATIONS.—The Secretary shall prescribe regulations or guidance which provide—

“(I) the acceptable valuation methods for purposes of this subparagraph, except that such methods shall not include any valuation method which is inconsistent with the method used by the taxpayer for other purposes (including reporting asset valuations to partners or marketing the partnership or any lower-tier partnership to prospective partners) if such inconsistent valuation method would result in a greater amount of section 197 intangible gain than would result under the valuation method used by the taxpayer for such other purposes,

“(II) circumstances under which valuations are sufficiently independent to provide an accurate determination of fair market value, and

“(III) any information required to be furnished to the Secretary by
the parties to the disposition with respect to such valuation.

"(h) CROSS REFERENCE.—For 40 percent penalty on certain underpayments due to the avoidance of this section, see section 6662."

(b) TREATMENT FOR PURPOSES OF SECTION 7704.—Subsection (d) of section 7704 is amended by adding at the end the following new paragraph:

"(6) INCOME FROM INVESTMENT SERVICES PARTNERSHIP INTERESTS NOT QUALIFIED.—

"(A) IN GENERAL.—Items of income and gain shall not be treated as qualifying income if such items are treated as ordinary income by reason of the application of section 710 (relating to special rules for partners providing investment management services to partnership).

The preceding sentence shall not apply to any item described in paragraph (1)(E) (or so much of paragraph (1)(F) as relates to paragraph (1)(E)).

"(B) SPECIAL RULES FOR CERTAIN PARTNERSHIPS.—

"(i) CERTAIN PARTNERSHIPS OWNED BY REAL ESTATE INVESTMENT TRUSTS.—

Subparagraph (A) shall not apply in the
case of a partnership which meets each of
the following requirements:

“(I) Such partnership is treated
as publicly traded under this section
solely by reason of interests in such
partnership being convertible into in-
terests in a real estate investment
trust which is publicly traded.

“(II) 50 percent or more of the
capital and profits interests of such
partnership are owned, directly or in-
directly, at all times during the tax-
able year by such real estate invest-
ment trust (determined with the ap-
lication of section 267(e)).

“(III) Such partnership meets
the requirements of paragraphs (2),
(3), and (4) of section 856(c).

“(ii) CERTAIN PARTNERSHIPS OWN-
ing other publicly traded partner-
ships.—Subparagraph (A) shall not apply
in the case of a partnership which meets
each of the following requirements:

“(I) Substantially all of the as-
sets of such partnership consist of in-
interests in one or more publicly traded partnerships (determined without regard to subsection (b)(2)).

"(II) Substantially all of the income of such partnership is ordinary income or section 1231 gain (as defined in section 1231(a)(3))."

"(C) TRANSITIONAL RULE.—Subparagraph (A) shall not apply to any taxable year of the partnership beginning before the date which is 10 years after the date of the enactment of this paragraph."

(c) IMPOSITION OF PENALTY ON UNDERPAYMENTS.—

(1) IN GENERAL.—Subsection (b) of section 6662 is amended by inserting after paragraph (7) the following new paragraph:

"(8) The application of subsection (e) of section 710, the regulations or other guidance prescribed under section 710(f) to prevent the avoidance of the purposes of section 710, or the regulations or other guidance prescribed under section 710(g)(7)(D)(iv)."

(2) AMOUNT OF PENALTY.—
(A) IN GENERAL.—Section 6662 is amended by adding at the end the following new subsection:

"(k) INCREASE IN PENALTY IN CASE OF PROPERTY TRANSFERRED FOR INVESTMENT MANAGEMENT SERVICES.—In the case of any portion of an underpayment to which this section applies by reason of subsection (b)(8), subsection (a) shall be applied with respect to such portion by substituting ‘40 percent’ for ‘20 percent’.

(B) CONFORMING AMENDMENT.—Subparagraph (B) of section 6662A(e)(2) is amended by striking “or (i)” and inserting “, (i), or (k)”.

(3) SPECIAL RULES FOR APPLICATION OF REASONABLE CAUSE EXCEPTION.—Subsection (c) of section 6664 is amended—

(A) by redesignating paragraphs (3) and (4) as paragraphs (4) and (5), respectively;

(B) by striking “paragraph (3)” in paragraph (5)(A), as so redesignated, and inserting “paragraph (4)”;

(C) by inserting after paragraph (2) the following new paragraph:

"(3) SPECIAL RULE FOR UNDERPAYMENTS ATTRIBUTABLE TO INVESTMENT MANAGEMENT SERVICES.—
“(A) In general.—Paragraph (1) shall not apply to any portion of an underpayment to which section 6662 applies by reason of subsection (b)(8) unless—

“(i) the relevant facts affecting the tax treatment of the item are adequately disclosed,

“(ii) there is or was substantial authority for such treatment, and

“(iii) the taxpayer reasonably believed that such treatment was more likely than not the proper treatment.

“(B) Rules relating to reasonable belief.—Rules similar to the rules of subsection (d)(3) shall apply for purposes of subparagraph (A)(iii).”.

(d) Income and loss from investment services partnership interests taken into account in determining net earnings from self-employment.—

(1) Internal revenue code.—Section 1402(a) is amended by striking “and” at the end of paragraph (16), by striking the period at the end of paragraph (17) and inserting “; and”, and by inserting after paragraph (17) the following new paragraph:
“(18) notwithstanding the preceding provisions of this subsection, in the case of any individual engaged in the trade or business of providing services described in section 710(c)(1) with respect to any entity, any amount treated as ordinary income or ordinary loss of such individual under section 710 with respect to such entity shall be taken into account in determining the net earnings from self-employment of such individual.”.

(2) Social Security Act.—Section 211(a) of the Social Security Act is amended by striking “and” at the end of paragraph (15), by striking the period at the end of paragraph (16) and inserting “; and”, and by inserting after paragraph (16) the following new paragraph:

“(17) Notwithstanding the preceding provisions of this subsection, in the case of any individual engaged in the trade or business of providing services described in section 710(c)(1) of the Internal Revenue Code of 1986 with respect to any entity, any amount treated as ordinary income or ordinary loss of such individual under section 710 of such Code with respect to such entity shall be taken into account in determining the net earnings from self-employment of such individual.”.
(e) CONFORMING AMENDMENTS.—

(1) Subsection (d) of section 731 is amended by inserting "section 710(b)(4) (relating to distributions of partnership property)," after "to the extent otherwise provided by".

(2) Section 741 is amended by inserting "or section 710 (relating to special rules for partners providing investment management services to partnership)" before the period at the end.

(3) The table of sections for part I of subchapter K of chapter 1 is amended by adding at the end the following new item:

"Sec. 710. Special rules for partners providing investment management services to partnership."

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years ending after December 31, 2010.

(2) PARTNERSHIP TAXABLE YEARS WHICH INCLUDE EFFECTIVE DATE.—In applying section 710(a) of the Internal Revenue Code of 1986 (as added by this section) in the case of any partnership taxable year which includes December 31, 2010, the amount of the net income referred to in such section shall be treated as being the lesser of the net income
for the entire partnership taxable year or the net income determined by only taking into account items attributable to the portion of the partnership taxable year which is after such date.

(3) Dispositions of Partnership Interests.—Section 710(b) of the Internal Revenue Code of 1986 (as added by this section) shall apply to dispositions and distributions after December 31, 2010.

(4) Other Income and Gain in Connection with Investment Management Services.—Section 710(e) of such Code (as added by this section) shall take effect on December 31, 2010.

SEC. 413. EMPLOYMENT TAX TREATMENT OF PROFESSIONAL SERVICE BUSINESSES.

(a) In General.—Section 1402 is amended by adding at the end the following new subsection:

“(m) Special Rules for Professional Service Businesses.—

“(1) Shareholders Providing Services to Disqualified S Corporations.—

“(A) In General.—In the case of any disqualified S corporation, each shareholder of such disqualified S corporation who provides substantial services with respect to the professional service business referred to in subpara-