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House lawmakers passed legislation on Friday that again proposes to change the tax treatment of certain partnership and LLC "carried interests" for investment fund managers, including venture capital, private equity, hedge and real estate funds. Under the version of the legislation proposed by the House, the changes to carried interest taxation would not commence until 2011. Senate consideration of the legislation is expected for next week.

Change to carried interest taxation likely deferred until 2011

A last-minute amendment to the House-passed legislation defers the proposed effective date for ordinary income treatment until 2011 (i.e., carried interest taxation would remain unaffected for 2010). Given that the House has been the driving force behind the legislation, it now appears unlikely that any final version of the legislation would be effective during 2010. Thus, under the revised House bill, ordinary tax rates would apply to 50% of carry allocations for 2011 and 2012, and would apply to 75% of carry allocations starting in 2013. The bill would also subject the same percentages of carry allocations to self-employment tax. The remaining portion of profit allocations not attributable to invested capital, along with 100% of profit allocations attributable to invested capital, would remain eligible for taxation at capital gain tax rates (and would not be subject to self-employment taxes). Both realized income and gain, as well as unrealized gain on assets distributed in kind and transfers of partnership interests would be affected. The bill contains certain anti-avoidance rules and significant penalties for violation.

Further deliberations

In order to become effective, the bill must also be passed in the Senate, where reports suggest it will likely face substantial opposition, or may undergo revisions. Senate consideration of the bill is expected for next week. In recent days, much attention has been focused on language that would treat as ordinary income a portion of the proceeds from the sale of a manager's equity interest in an investment services partnership and certain related entities. We will issue additional *Alerts* as developments warrant. If you have any questions about these developments, please contact your Cooley fund attorney or one of the attorneys listed above.

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