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A legal update from Dechert's International and Domestic Tax Group

Proposed Tax Legislation Could Affect Blackstone IPO

Perhaps in reaction to the publicity on the riches being made from the Blackstone IPO, two U.S. senators have proposed legislation that would tax certain publicly traded partnerships (such as the one being taken public by Blackstone) as corporations.

On June 14, 2007, Senators Baucus and Grassley proposed a bill that would eliminate the "Qualifying Income Exception," which currently permits certain publicly traded partnerships to qualify as "flow-through" entities for federal income tax purposes, if the partnership were to derive any income from investment adviser and asset management services. Publicly traded partnerships, including certain partnerships that readily redeem interests from their partners, are taxed as corporations (not as "flow-through" entities) unless an exception, such as the Qualifying Income Exception, applies.

The Qualifying Income Exception currently applies to companies that derive 90% or more of their gross income from investments (including dividends, interest, and capital gains). The bill would deny a publicly traded partnership the benefit of the Qualifying Income Exception if the partnership derives *any* portion of its gross income, directly or indirectly, from investment adviser and asset management services.

The proposed legislation, if it becomes law, may significantly impact Blackstone's IPO because, as structured, Blackstone will be subject to corporate income tax following the IPO.

Current Law

Under section 7704 of the Internal Revenue Code of 1986, as amended (the "Code"), a partnership is a publicly traded partnership taxable as a corporation for U.S. tax purposes if:

- the interests in the partnership are traded on an established securities market, or
- the interests in the partnership are readily tradable on a secondary market, which could include partnerships that readily redeem interests from their partners.

In general, Section 7704(c) of the Code excepts publicly traded partnerships earning 90% or more of its gross income from interest, dividends, capital gains, rents, and certain other income (the "Qualifying Income Exception").

Proposed Legislation

The bill proposes to amend Section 7704(c) of the Code by providing that the Qualifying Income Exception shall not apply to any partnership which directly or indirectly has any item of income (including dividends or capital gains) directly or indirectly from either:

- services provided as an investment adviser as defined in Section 202 (a)(11) of the Investment Advisers Act of 1940 (the "Advisers Act"), or as a person associated with an investment adviser as defined in Section 202(a)(17) of the Advisers Act, or
- asset management services or services in connection with the management of assets with respect to which investment adviser services were provided.

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For purposes of determining whether the person providing the services is an investment adviser, it does not matter whether the person is required to register as an investment adviser under the Advisers Act.

Effective Date

The amendment to Section 7704 of the Code would apply only to taxable years of partnerships beginning on or after June 14, 2007. The provision would thus apply to a calendar year partnership starting in 2008.

A special transition rule extends the effective date of the amendment to apply only to taxable years beginning on or after June 14, 2012, for partnerships that were publicly traded partnerships as of June 14, 2007.

If you have any questions regarding this proposed bill, please contact any member of the International and Domestic Tax Group.

Practice group contacts

For more information, please contact one of the attorneys listed, or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/tax.

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