

Tax | December 11, 2009

## Taxation of Carried Interests

On December 9 the House of Representatives passed the Tax Extenders Act of 2009 (H.R. 4213 or the “Act”) that would, among other things, tax carried interests at the rates applicable to ordinary income (rather than permitting capital gain treatment to apply, as is the case under current law). The House legislation would apply to net income earned in taxable years ending after December 31, 2009. It will be important to monitor action in the Senate, particularly with respect to effective dates, on any companion legislation.

The Act would require ordinary income treatment for any net income derived with respect to an “investment services partnership interest.” An investment services partnership interest is a partnership interest held by a person where it was reasonably expected that the partner or a person related to him would provide a substantial amount of any of broadly defined types of investment services to the partnership.

As a result of these changes, capital gains from a carried interest would lose their preferential 15% tax rate and instead be subject to the 35% ordinary income rate (currently in effect) plus any self employment taxes to which the service partner may be subject (as well as applicable state and local taxes).

Please feel free to contact any Shearman & Sterling LLP tax partner for further information.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this memorandum, you may contact your regular Shearman & Sterling contact person or any of the following:

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