Statement of Senator Chuck Grassley (R-IA)
Introduction of Publicly Traded Partnership Bill
June 14, 2007

Mr. President, this legislation that Senator Baucus and I are introducing addresses an important issue – preserving the integrity of the tax code. Recent public offerings, effected and announced, by private equity and hedge fund management firms have raised serious tax concerns that if left unaddressed have the potential to fundamentally reduce the corporate tax base over the long run, leading other individuals and business taxpayers with a greater share of the nation's tax burden.

Congress enacted the publicly traded partnership rules in 1987 out of concern with erosion of the corporate tax base. Given the ease with which taxpayers can choose the type of entity for their business, an appropriate "bright line" to define entities that should be subject to a corporate level tax was considered to be those entities that are publicly traded. A hallmark of corporate status is access to public markets. Another concern was that the ability to be publicly traded without paying an entity level tax would create an unwarranted competitive advantage over publicly traded corporations.

These concerns – corporate tax base erosion and a tax-created competitive advantage – were not considered to be implicated in cases where the partnership's income is from passive investments, because investors could earn such income directly (e.g., interest) or because the income is already subject to a corporate level tax (e.g., dividends). The following key quote from the legislative history illustrates this point:

> In general, the purpose of distinguishing between passive-type income and other income is to distinguish those partnerships that are engaged in activities commonly considered as essentially no more than investments, and those activities more typically conducted in corporate form that are in the nature of active business activities.

The recent and proposed public offerings of private equity and hedge fund management firms claim to qualify for partnership tax treatment, even though virtually all of their income is derived from providing asset management and financial advisory services. This result is claimed to be accomplished by structuring service fees in a way that purports to characterize those fees as passive-type income. Whether or not these structures comply with the letter of the law, they are inconsistent with the purposes of the publicly traded partnership rules.

This legislation clarifies the purpose of the publicly traded partnership rules by denying the ability of an active financial advisory and asset management business to go public and avoid a corporate level tax on a significant amount of its income. Senator Baucus and I have asked Treasury for their views on these structures, how they plan to address this issue, and whether they think additional statutory changes are necessary to clarify the intent of the publicly traded partnership rules. If a change is necessary, this legislation will accomplish that change. If a change isn't necessary, this legislation does not alter the ability of Treasury and the Internal Revenue Service to issue guidance and enforce Congressional intent.

In his introductory remarks, Senator Baucus gave a technical description of this legislation and reasons for change, which reflects my understanding and intent in introducing this bill.