

by the Omnibus Budget Reconciliation Act of 1987. The regulations would affect the classification of certain partnerships for federal tax purposes.

DATES: Written comments must be received by July 31, 1995. Requests to speak (with outlines of oral comments) at a public hearing scheduled for July 31, 1995, at 10 a.m. must be received by July 31, 1995.

ADDRESSES: Send submissions to: CC:DOM:CORP:T:R (PS-013-88), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:T:R (PS-013-88), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. The public hearing has been scheduled to be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Christopher T. Kelley, (202) 622-3080; concerning submissions and the hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Introduction

This document proposes to add § 1.7704-1 to the Income Tax Regulations (26 CFR part 1) relating to the definition of a publicly traded partnership under section 7704(b) of the Internal Revenue Code (Code).

Background

Section 7704 was added to the Code by section 10211(a) of the Omnibus Budget Reconciliation Act of 1987 (Pub. L. 100-203), as amended by sections 2004(f)(1)-(5) of the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100-647). Section 7704(a) provides that a publicly traded partnership is treated as a corporation for federal tax purposes unless the partnership meets the 90 percent qualifying income test of section 7704(c) or qualifies as an existing partnership. The term *existing partnership* is defined in § 1.7704-2. Under section 7704(b), a partnership is a publicly traded partnership if interests in the partnership are traded on an established securities market or are readily tradable on a secondary market or the substantial equivalent thereof. Section 7704 applies to all domestic and foreign entities treated as partnerships under section 7701, including limited liability companies and other entities treated as partnerships for federal tax purposes.

No regulations have been issued regarding the circumstances under which interests in a partnership are treated as publicly traded under section 7704(b). Notice 8875, 1988-2 C.B. 386, however, provides guidance on the definition of a publicly traded partnership. Notice 88-75 provides that interests in a partnership are not treated as readily tradable on a secondary market or the substantial equivalent thereof for purposes of section 7704(b)(2) if the interests are: (1) issued in certain private placements; (2) transferred pursuant to transfers not involving trading; (3) traded in amounts that meet the requirements of a 5 percent or 2 percent safe harbor; (4) transferred through a matching service that meets certain requirements; or (5) transferred pursuant to a qualifying redemption or repurchase agreement. Notice 88-75 does not address when partnership interests are treated as traded on an established securities market for purposes of section 7704(b)(1).

Explanation of Provisions

Definitions

The proposed regulations define the terms *established securities market*, *secondary market*, and the *substantial equivalent of a secondary market* for purposes of section 7704(b). These definitions reflect congressional intent as articulated in the legislative history to section 7704. See H.R. Conf. Rep. No. 495, 100th Cong., 1st Sess. 947-50 (1987) (Conference Report).

Under the proposed regulations, an *established securities market* for purposes of section 7704(b)(1) includes: (1) A national securities exchange registered under the Securities Exchange Act of 1934; (2) a national securities exchange exempt from registration because of the limited volume of transactions; (3) a foreign securities exchange; (4) a regional or local exchange; and (5) an interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise.

Under the proposed regulations, interests in a partnership that are not traded on an *established securities market* are readily tradable on a *secondary market* or the *substantial equivalent of a secondary market* for purposes of section 7704(b)(2) if the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is comparable, economically, to trading on an *established securities market*. The proposed regulations further provide

that interests in a partnership are readily tradable on a *secondary market* if: (1) Interests in the partnership are regularly quoted by any person, such as a broker or dealer, making a market in the interest, or (2) any person regularly makes available to the public (including customers or subscribers) bid or offer quotes with respect to interests in the partnership and stands ready to effect buy or sell transactions at the quoted prices for itself or on behalf of others. This provision clarifies that a secondary market exists whenever interests in the partnership are subject to firm-quote trading.

The proposed regulations also provide that, if there is no secondary market, interests in a partnership are readily tradable on the *substantial equivalent of a secondary market* if: (1) The holder of an interest in the partnership has a readily available, regular, and ongoing opportunity to sell or exchange the interest through a public means of obtaining or providing information of offers to buy, sell, or exchange interests, or (2) prospective buyers and sellers have the opportunity to buy, sell, or exchange interests in a time frame and with the regularity and continuity that the existence of a secondary market would provide.

The proposed regulations define an interest in a partnership for purposes of section 7704(b) as any interest in the capital or profits of the partnership (including any right to partnership distributions) and any financial instrument or contract the value of which is determined in whole or in part by reference to the partnership (including the amount of partnership distributions, the value of partnership assets, or the results of partnership operations). This definition is intended to prevent the avoidance of section 7704(b) through the creation and transfer of interests other than traditional partnership interests, such as the creation and transfer of derivative partnership interests. The proposed regulations also provide several exceptions to the definition of an interest in the partnership. Under these exceptions, an interest in the partnership does not include non-convertible debt or an interest in a partnership or a corporation that holds an interest in a lower-tier partnership. For example, an interest in a regulated investment company that holds an interest in a partnership is not treated as an interest in the partnership.

The proposed regulations also define a transfer of an interest in a partnership to include a transfer in any form, including a redemption by the partnership or the entering into of a