DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

August 30, 2002

Number: **200250013**
Release Date: 12/13/2002
POSTF-150151-01
UILC: 707.01-00; 701.01-00

CC:PSI:B01

MEMORANDUM FOR RICHARD H. GANNON

FROM: Associate Chief Counsel (Passthroughs & Special Industries)

SUBJECT: Disguised Sales Under Section 707

This memorandum responds to your request for assistance dated June 3, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

LEGEND

Partnership = .

V =

W =

X =

Y =

Z =

A =

B =

LLC =

Country	=
Year1	=
Year2	=
Year3	=
$a	=
$b	=
c%	=
d%	=
e%	=
$f	=
$g	=
h	=
i%	=
j%	=

ISSUES:

1. Whether the distribution of all of a partnership's operating assets to a e% partner in connection with the partner's withdrawal from the partnership constitutes a disguised sale of partnership property under section 707 under the circumstances set forth below.

2. Whether the transfer of a c% partnership interest by one member of a consolidated group to another member of the same group for the purpose of forestalling the dissolution of the partnership after the planned withdrawal of an unrelated e% partner should be disregarded.

3. Whether the transaction described below, taken as a whole, constituted a disguised sale of partnership interests to the withdrawing partner of the remaining partners' partnership interests.

4. Whether a promissory note acquired by the partnership constituted a "marketable security" as is defined under section 731(c) where the note was not actively traded, but where the investment banker arranging the note transaction stood ready to repurchase the note at a later time.

CONCLUSIONS:

1. The distribution of all of the partnership's operating assets to a withdrawing partner should, under the circumstances set forth below, be treated as a distribution of e% of the partnership assets to the withdrawing partner under section 731(b) in complete redemption of its interest, followed by a disguised sale of the remaining operating assets of the partnership to the redeemed partner in return for the assumption of the partnership's liabilities.

2. Because the distribution of the partnership's assets in redemption of the withdrawing partner is, in substance, equivalent to a distribution of marketable securities to the remaining partners, the transaction should be recast under § 1.731-2(h) as a distribution of the marketable securities to the remaining partners.

3. The transaction, taken as a whole, may be viewed as either a disguised sale of partnership interests or of partnership property; however, the better view is to treat the transaction as a disguised sale of partnership property.

4. The promissory note acquired by the partnership should meet the definition of marketable securities under section 731(c). While the note is not actively traded, it is readily convertible to cash under arrangements made in conjunction with the note's acquisition.

FACTS:

Partnership was formed in Year1 as a domestic partnership, owned equally by W and X. W and X are domestic state law corporations wholly-owned by domestic state law corporations Y and Z respectively.

By Year2, both W and X wished to liquidate their interests in Partnership. A prospective buyer, A, was located and the parties tentatively agreed to a basic price. The sale was executed through the following series of related transactions:[1]

1. In early Year3, Partnership borrowed $b (the "Year3 loan") from an unrelated third party lender in a loan guaranteed by Z. Under the terms of the loan, the lender agreed to release Partnership, W, and Y from any liability upon the contemplated

[1] In apparent anticipation of X's withdrawal or sale of its partnership interest, X and Z "monetized" their interest in Partnership by borrowing $a in Year2 against their interest in Partnership.

withdrawal of X from Partnership. As required by the loan agreement, Partnership used the loan proceeds to acquire a note issued by LLC, an unrelated state law limited liability company newly formed for the express purpose of issuing this note (the "Note"). In turn, LLC purchased units of participation in a trust securitizing bank credit card receivables. While both the units of participation purchased by LLC and the Note issued to Partnership were highly collateralized with blue chip assets, neither the units of participation nor the Note could be traded on the open market or otherwise sold except in a private transaction.

2. Shortly thereafter, W transferred a c% interest in Partnership to V, another Y subsidiary, in exchange for V stock. As a result, W and V purportedly became d% and c% partners of Partnership, with X remaining a e% partner. Neither the transfer of a partnership interest to V nor a transfer of W stock to V was recognized within Y's consolidated group. Similarly, no transfer of V shares to W was ever recorded on V's share register; nor was the issuance of new shares ever authorized by V's shareholder. Y continually represented itself as the sole shareholder of V after the purported admission of V as a partner. Finally, schedules accompanying Partnership's Year3 return fail to list V as a partner.

3. Immediately thereafter, Partnership's partnership agreement was amended and restated in its entirety, both to formally recognize and admit V to the partnership and to provide that, upon the occurrence of specified conditions, X could withdraw from the partnership. The amended agreement provided that in redemption of X's interest in Partnership, X would receive all of Partnership's operating assets and liabilities, including the liability incurred to acquire the Note.[2] X withdrew from the partnership approximately h days after guaranteeing the Year3 loan. Following X's withdrawal, Partnership's sole remaining asset would be the Note received from LLC. The basic agreement between the parties stated that the value of Partnership's assets, net of Partnership's obligation to repay the loan from LLC, was $f.

4. Next, Z entered into an agreement with a domestic subsidiary of A whereby Z exchanged its X stock for newly issued non-voting stock of A's subsidiary, B. X remained a partner of Partnership immediately after this transaction. At this point, Z had terminated its direct interest in the historical Partnership business.

5. The next step called for the complete redemption of X by Partnership, with X receiving most of Partnership's assets, subject to all of Partnership's liabilities (including the Year3 loan). Partnership retained only cash and other liquid assets and the Note.

---

[2] Prior to X's withdrawal from Partnership, A, Z, and their respective affiliates entered into a series of transactions to facilitate the sale of Partnership's historic business. As part of these transactions, Partnership entered into separate agreements for the sale of its corporate subsidiaries to affiliates of A. The sales of Partnership's subsidiaries netted approximately $g.

The redemption of X increased the respective interests of W and V to i% and j%. Partnership, shorn of its operating assets and liabilities, owned the LLC Note.[3]

6. Contemporaneous with the withdrawal of X from Partnership, and as a condition of the transaction, Partnership, X, and Z entered into an agreement with the lenders in connection with the Year3 loan. Under the agreement, the lenders agreed to permit X to assume full liability for the Year3 loan and to permit the Year3 loan to be repaid on the date X assumed the liability. Pursuant to this agreement, the Year3 loan was repaid by X at the time X withdrew from Partnership with cash furnished by A or A's affiliate. Partnership asserts that it retains a basis in the Note equal to its cost and recognizes little or no gain in the following year when the Note is sold.

LAW AND ANALYSIS:

1. The Disguised Sale of Partnership Assets:

Section 707(a)(2)(B) provides that if (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and (iii) the transfers described in clauses (i) and (ii), when viewed together, are properly characterized as a sale or exchange of property, such transfers shall be treated either as occurring between the partnership and one who is not a partner, or as a transaction between two or more partners acting other than in their capacity as members of the partnership.

The legislative history of section 707(a)(2)(B) indicates that the provision was adopted as a result of Congress's concern that taxpayers were deferring or avoiding tax on sales of partnership property, including sales of partnership interests, by characterizing sales as contributions of property, including money, followed or preceded by a related partnership distribution. *See* S. Prt. No. 169, (Vol. I), 98th Cong., 2d Sess. 225 (1984) (hereinafter "S. Prt."); H.R. Rep. No. 432, (Pt. 2) 98th Cong., 2d Sess. 1218 (1984) (hereinafter "H.R. Rep."). Specifically, Congress was concerned about court decisions that allowed tax-free treatment in cases which were economically indistinguishable from sales of property to a partnership or another partner. *See* S. Prt. at 225; H.R. Rep. at 1218 (discussing *Jupiter Corp. v. United States*, No. 83-842 (Ct. Cl. 1983) and *Communications Satellite Corp. V. United States*, 223 Ct. Cl 253 (1980) both of which involved the disguised sale of a partnership interest). Congress believed that these transactions should be treated for tax purposes in a manner consistent with their underlying economic substance. *See* S. Prt. at 225; H.R. Rep. at 1218.

---

[3] Y asserts that Partnership remained in existence to engage in the lending business. However, Partnership in its continuing form had no employees and invested most of its cash in short term commercial paper until the following year, when it sold the Note and loaned the proceeds to Y to finance a new acquisition.

In the legislative history to section 707(a)(2)(B), Congress explained that pursuant to section 721, gain or loss is generally not recognized on the contribution of property to a partnership in return for a partnership interest, and pursuant to section 731, distributions of money from a partnership to a partner are generally tax-free to the extent of the adjusted basis of the recipient partner's interest in the partnership. *See* S. Prt. at 224; H.R. Rep. at 1217. Congress referred to Treasury regulations issued under sections 721 and 731 in its discussion of disguised sales. *See* S. Prt. at 224; H.R. Rep. at 1217. The regulations under section 721 provide that, if the transfer of property by a partner to a partnership results in the receipt by the partner of money or other consideration, including a promissory obligation fixed in amount and time for payment, the transaction will be treated as a sale or exchange rather than a contribution (§1.721-1(a)). *See* S. Prt. at 224; H.R. Rep. at 1217. These regulations require that the substance of the transaction, rather than its form, will govern in such cases. *See* S. Prt. at 224; H.R. Rep. at 1217. The regulations issued under section 731 provide that if a contribution of property is made to a partnership and (1) within a short time before or after such contribution other property is distributed to the contributing partner and the contributed property is retained by the partnership, or (2) within a short time after such contribution to the partnership, contributed property is distributed to another partner, tax free distribution treatment may not apply (§1.731-1(c)(3)). *See* S. Prt. at 225; H.R. Rep. at 1217-18. The regulations deny tax-free treatment if a purported distribution was, in fact, made to effect an exchange of property between two or more of the partners or between the partnership and a partner. *See* S. Prt. at 224-25; H.R. Rep. at 1217-18.

Congress expressed its concern that the regulations issued under sections 721 and 731 may not always prevent de facto sales of property to a partnership or another partner from being structured as a contribution to the partnership, followed or preceded by a tax-free distribution from the partnership. *See* S. Prt. at 225; H.R. Rep. at 1218. Congress specifically discussed case law that permitted results which were economically indistinguishable from a sale of all or part of the property despite the regulations described above and enacted section 707(a)(2)(B) to expressly prohibit such transactions. *See Jupiter Corp. v. United States*, No. 83-842 (Ct. Cl. 1983); *Communications Satellite Corp. v. United States*, 223 Ct. Cl. 253 (1980); S. Prt. at 225; H.R. Rep. at 1218.

The substance of the transactions described above is similar to the substance of the transactions cited by Congress as part of the reason for enacting section 707(a)(2)(B) to prohibit disguised sales of partnership property. When Partnership distributed to X the liability on the Year3 loan, Y and its subsidiaries no longer had an obligation to repay the borrowed funds. When Partnership distributed the Year3 loan and the Partnership's historic business in redemption of X's interest, a permanent shift in the equity ownership of Partnership and its historic business occurred. The transactions were in substance a sale of W's and V's (if V is recognized as a partner)[4]

---

[4] We are not convinced that the continuation of Partnership should be respected by the addition of V as a partner because there is no business purpose for V's admission to Partnership.

share of Partnership's business to X undertaken through related contributions to and distributions from Partnership, the kind of transaction that section 707(a)(2)(B) is intended to prevent. The above transactions should be recharacterized as a redemption of X's interest for e% of the Partnership's assets, followed by a sale between Partnership and X of the remainder of Partnership's historic business.

Recharacterizing a transfer of property to a partnership as a transaction between the partnership and one who is not a partner under section 707(a)(2)(B) requires that three elements be satisfied. First, there is a direct or indirect transfer of money or other property by a partner to the partnership. Second, there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner). Third, the transfers described by the first two elements, when viewed together, are properly characterized as a sale or exchange of property.

Section 1.707-6 provides rules for determining whether a transfer of property by a partnership to a partner and one or more transfers of money or other consideration by that partner to the partnership are treated as a sale of property, in whole or part, to the partner. Section 1.707-6(a) provides that rules similar to those set forth in § 1.707-3 apply in making this determination.

The first prong of the three-pronged test set forth in section 707(a)(2)(B) requires a direct or indirect transfer of money or other property by a partner to a partnership. In the present case, absent the application of the partnership nonrecognition provisions, a transfer of money by X to Partnership can be found through the transfer of the Year3 loan[5] from Partnership to X. The amount realized on a sale includes the assumption of liabilities by the transferee. Moreover, an affiliate of X paid off the Year3 loan at or about the same time as the purported redemption.

Second, there must be a related direct or indirect transfer of money or other property by the partnership to such partner or another partner. Partnership distributed most of its assets to Z's subsidiary, X, with Partnership retaining only cash and other liquid assets and the LLC Note. This distribution satisfies the second prong of the § 1.707-6 test.

Third, the transfers described in the first two parts of the test, when viewed together, must be properly characterized as a sale or exchange of property. Therefore, to satisfy the third requirement of section 707(a)(2)(B) it must be shown that the deemed contribution of cash by X to Partnership and the distribution by Partnership of its assets was in substance a sale or exchange of those Partnership assets to X. Section 1.707-6(a) provides that rules similar to those provided in §1.707-3 apply in determining whether a transfer of property by a partnership to a partner and one or more transfers of money or other consideration by that partner to the partnership are

[5] The Year3 loan was not a qualified liability because the proceeds of the borrowing (i.e., the Note) stayed with the partnership.

treated as a sale of property to the partnership. Section 1.707-3(c) provides that if within a two-year period a partner transfers money or other consideration to the partner (without regard to the order of the transfers), the transfers are presumed to be a sale of the property to the partnership unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

Because the assumption of the Year3 loan by X occurred contemporaneously with the transfer of assets from Partnership to X, the transfer is presumed to be a sale of the property from Partnership to X unless the facts and circumstances clearly do not constitute a sale.

The facts and circumstances to be considered in determining whether a transfer of property constitutes a sale include the following:

> (1) whether the transfer of property would have been made without the reciprocal transfer of money or other consideration,
>
> (2) whether the " the timing and amount of a subsequent transfer are determinable with reasonable certainty at the time of an earlier transfer," [6]
>
> (3) whether the "transferor has a legally enforceable right to the subsequent transfer,"[7]
>
> (4) whether "any person has made or is legally obligated to make contributions to the partnership in order to permit the partnership to make the transfer of money or other consideration,"[8]
>
> (5) whether "the partnership has incurred or is obligated to incur debt to acquire the money or other consideration necessary to permit it to make the transfer, taking into account the likelihood that the partnership will be able to incur that debt (considering such factors as whether any

---

[6] Treas. Reg. § 1.707-3(b)(2)(i).

[7] Treas. Reg. § 1.707-3(b)(2)(ii).

[8] Treas. Reg. § 1.707-3(b)(2)(iii).

> person has agreed to guarantee or otherwise assume personal liability for that debt),"[9]
>
> (6) whether "the partnership holds money or other liquid assets, beyond the reasonable needs of the business, that are expected to be available to make the transfer (taking into account the income that will be earned from those assets);"[10]
>
> (7) whether "partnership distributions, allocations or control of partnership operations is designed to effect an exchange of the burdens and benefits of ownership of property,"[11] and
>
> (8) whether "the transfer of money or other consideration by the partnership to the partner is disproportionately large in relationship to the partner's general and continuing interest in partnership profits."[12]

X's assumption of full liability for the Year3 loan was an express condition of its withdrawal from Partnership and its receipt of Partnership's business assets. The transfer of Partnership's business assets to X would not have been made without X's reciprocal assumption of liability for repayment of the Year3 loan.

X's assumption of Partnership's liabilities preceded and was a condition precedent to its receipt of Partnership's operating assets. At the time of its withdrawal, X's stock had already been transferred to B. The timing and amount of the second transfer was determinable at the time of the first transfer, thereby meeting the condition provided by § 1.707-3(b)(2)(i).

Partnership had "a legally enforceable right" to be relieved of all of its partnership liabilities at the time of X's withdrawal and receipt of Partnership's operating assets, as contemplated by § 1.707-3(b)(2)(ii). Moreover, X and Z were obligated to assume liability for the LLC Note as a condition of X's receipt of Partnership's operating assets. § 1.707-3(b)(2)(iii).

The partnership incurred liability for the LLC loan to acquire the money necessary to permit it to acquire the LLC Note, which remained in the partnership after

---

[9] Treas. Reg. § 1.707-3(b)(2)(vi).

[10] Treas. Reg. § 1.707-3(b)(2)(vii).

[11] Treas. Reg. § 1.707-3(b)(2)(viii).

[12] Treas. Reg. § 1.707-3(b)(2)(ix).

the withdrawal of X with the partnership's operating assets. § 1.707-3(b)(vi). X's withdrawal from the partnership, and its receipt of the partnership's operating assets, was premised on the separation of the valuable Note from the Year3 loan.

The acquisition of the Note by Partnership served no rational business purpose in light of Partnership's core business, and any liquid value it represented was far beyond the reasonable needs of Partnership's historic business. Its sole purpose was to facilitate the transfer of Partnership's operating assets to X without recognition of gain or loss by V and W.

The distribution of Partnership's operating assets to X, when coupled with the retention of the Note by Partnership and the withdrawal of X from the partnership, was designed to "effect an exchange of the burdens and benefits of ownership of property" as contemplated by § 1.707-3(b)(2)(viii). The transfer of money or other consideration to the partnership by X, represented by its agreement to assume full liability for the partnership's obligation to repay the Year3 loan, was "disproportionately large in relationship to the partner's general and continuing interest in partnership profits" which, as result of the transaction, was reduced to nothing. § 1.707-3(b)(2)(ix).

Our evaluation of the facts set forth above in light of the criteria of § 1.707-3(b)(2) compels the conclusion that the transaction constitutes the receipt of e% of Partnership's operating assets in liquidation of X's partnership interest, and the simultaneous, disguised sale of Partnership's remaining operating assets in return for X's assumption of Partnership's liability for the Year3 loan. After agreeing that the value of Partnership was $f, the partnership incurred a liability of $b, and used that money to acquire the LLC Note.[13]

While the various steps discussed above were agreed to in a number of separate agreements, the agreements made specific reference to each other and the various steps were clearly designed to accomplish the goal of exchanging Partnership's operating assets for a discharge of Partnership's liabilities and the relinquishment of X's interest in Partnership.

Assuming Partnership had never obtained the Year3 loan and purchased the LLC Note, X should have been able to withdraw from Partnership taking e% of the partnership assets without the recognition of gain or loss on either the partnership or partner level. The Year3 loan, purchase of the Note, and subsequent assumption of liability on the transfer of W’s (and V’s) share of the operating assets for the Note was, in substance, indistinguishable from a sale of Partnership's remaining operating assets after the withdrawal of X and should be treated as such.

---

[13] Presumably, the value of Partnership reflected the amount by which the value of its assets exceeded the value of its liabilities and did not change as a result of the Year3 loan and purchase of the LLC Note.

X therefore satisfies all three of the criteria required to find a disguised sale of partnership assets to X under section 707. X transferred money to Partnership by assuming Partnership liabilities. X received all of the assets of Partnership, other than the LLC Note, in a related transfer. Finally these two steps, when viewed together, are properly characterized as a sale. Because the transfers occurred within two years of each other, they are presumed to constitute a sale. Examining the facts and circumstances surrounding the transfers fails to clearly establish that a sale did not occur. Thus Partnership realizes gain on this sale. The recognized gain is allocated to W (and V).

2. Application of § 1.731-2(h) Anti-Abuse Provision.

Section 1.731-2(h) provides an anti-abuse rule which states that section 731(c) must be applied in a manner consistent with the purpose of that section and with the substance of the underlying transaction.[14] Accordingly if a transaction's principal purpose is to achieve a tax result that is inconsistent with the purpose of section 731(c), the Commissioner can recast the transaction for Federal tax purposes. Whether a tax result is inconsistent with the purpose of section 731(c) must be determined based upon all facts and circumstances.

Section 1.731-2(h)(2) provides an example of circumstances in which a transaction achieves a tax result inconsistent with the purpose of section 731(c). Under the anti-abuse rule, a distribution of substantially all of the assets of a partnership other than marketable securities and money to some partners can be treated as a distribution of marketable securities to the remaining partners if the distribution of the other property and the withdrawal of the other partners is, in substance, equivalent to a distribution of the securities to the remaining partners.

In the present case, substantially all of the assets and liabilities of Partnership were distributed to X in redemption of X's interest. W claims to recognize no gain on the withdrawal of X because the LLC Note remains in Partnership. However, under § 1.731-2(h), because the distribution of Partnership's assets in redemption of X is, in substance, equivalent to a distribution of the Note to the remaining partners, the transaction should be recast as a distribution of the Note to W (and V).

3. Disguised Sale of Partnership Interest

Although the Service has not promulgated regulations for disguised sales of partnership interests under section 707(a)(2)(B) (Income Tax Regulation § 1.707-7 is

[14] Section 1.701-2 also provides an anti-abuse rule that determines whether the treatment of an item otherwise dictated by provisions of Subchapter K should be adjusted to conform to the intent of Subchapter K. However, use of the specific anti-abuse rule under section 731 is more appropriate in the present case. Thus we decline to address the section 701 anti-abuse rule at this time.

reserved), it may enforce section 707(a)(2)(B) in the context of a disguised sale of a partnership interest in the absence of regulations. *See* Pittway Corp. v. United States, 102 F.3d 932 (7th Cir. 1996) (holding that although the statute provides "to the extent provided in regulations", the plain language of the statute directs a single conclusion); Estate of Neuman, 106 T.C. 216 (1996) (holding that issuance of regulations contemplated under section 2663(2) is not a necessary precondition to the imposition of the generation-skipping transfer tax in the case); Rev. Rul. 91-47 (providing that Service would enforce section 108(e)(4) which applies "to the extent provided in regulations" despite fact that no regulations had been issued). Prior to the issuance of the regulations, the determination of whether a transaction is a disguised sale of a partnership interest under section 707(a)(2)(B) is to be made on the basis of the statute and its legislative history. *See* Notice 2001-64, 2001-41 I.R.B. 316 (October 9, 2001).

Committee Reports attending the 1984 enactment of § 707(a)(2)(B) refer to disguised sales of partnership interests stating

> In the case of disguised sales, the committee is concerned that taxpayers have deferred or avoided tax on sales of property (including partnership interests) by characterizing sales as contributions of property (including money) followed (or preceded) by a related partnership distribution. Although Treasury regulations provide that the substance of the transaction should govern, court decisions have allowed tax-free treatment in cases which are economically indistinguishable from sales of property to a partnership or another partner. The committee believes that these transactions should be treated in a manner consistent with their underlying economic substance.

Recharacterizing a transfer of property to a partnership as a transaction between two or more partners acting other than in their capacity as members of the partnership under section 707(a)(2)(B) requires that the same three elements be satisfied as described in Part 1 of this memo. First, there is a direct or indirect transfer of money or other property by a partner to the partnership. Second, there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner). Third, the transfers described by the first two elements, when viewed together, are properly characterized as a sale or exchange of property.

Because the transactions in the present case satisfy the three-pronged test of section 707(a)(2)(B), as discussed in Part 1 of this memo, the transfer of Partnership's historic business to X may constitute either a disguised sale of partnership property or a disguised sale of partnership interests from W (and V) to X.[15] While both arguments

---

[15] If the transaction is characterized as a sale of partnership interests from W (and V) to X, Rev. Rul. 99-6, 1999-6 I.R.B. 6, would apply to this transaction. That, is W (and V) would be treated as selling interests in Partnership to X, and X would be

should be raised as alternatives, the facts of this case establish more strongly that the transfer of Partnership's historic business to X constituted a disguised sale of partnership property.

4. Characterization of the N Note as a Non-Marketable Security.

Section 731(c) was enacted in 1994 to address concerns that, under prior law, taxpayers could exchange interests in appreciated assets for marketable securities and thereby avoid the immediate recognition of gain on distribution. According to the Committee Report on P.L. 103-465, this constituted a "virtual economic equivalent of the partner's share of the partnership's assets for cash." Section 731(c) generally treats marketable securities as money (in an amount equal to their fair market value) for purposes of determining the amount of gain recognized on a distribution from a partnership. Accordingly, subject to certain exceptions, a distributee partner will recognize gain to the extent the partner receives marketable securities whose fair market value, together with any money distributed, exceeds the partner's basis in the partnership interest prior to the distribution.

Section 731(c) provides that, for the purpose of section 731(a)(1), the term "money" includes marketable securities. Section 731(c)(2) defines marketable securities as property listed under section 731(c)(2)(B) and financial instruments and foreign currencies which are, as of the date of the distribution, actively traded (within the meaning of section 1092(d)(1). Section 731(c)(2)(B)(ii) provides that "marketable securities" includes any financial instrument which, pursuant to its terms or any other arrangement, is readily convertible into, or exchangeable for, money or marketable securities.

Under section 731(c), the term "marketable securities" consists primarily of securities that are actively traded and securities backed by marketable securities. In contrast, the Note issued by LLC was issued by a newly formed entity created for that very purpose, and was backed by units of participation in a trust that held credit card receivables issued by a major bank. None of these interests was actively traded, including the Note, units of participation, or credit card receivables. While the units of participation can not, by their terms, be sold without registration under federal securities laws, they are frequently the subject of private placements, representing a safe, conservative investment that is in frequent demand by financial institutions.

The Note was disposed of by the same investment banker that arranged for its creation over a year earlier. While the investment banker was apparently not bound to arrange for the resale of the Note, the investment banker is in the business of making private placements of this kind. Moreover, the bank generating the credit card receivables in question forms two or more credit card trusts of this kind each year, providing further proof that a market for these interests exists and justifying a finding

---

treated as purchasing W's (and V's) share of Partnership assets.

pursuant to section 731(c)(2)(B)(ii) that Y knew, at the time of the subject transaction, that it would be easy to later resell the Note.

Please call if you have any further questions.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

DAVID R. HAGLUND
Senior Technician Reviewer