

permitted use level of polymaleic acid and its sodium salt to control mineral scale during the production of beet and cane sugar juice and liquor. FDA is also announcing its tentative decision to amend the specifications for the additives and to revise the analytical method for measuring those specifications. This action is in response to a petition filed by Ciba-Geigy, Inc.

DATES: Written comments by July 17, 1995.

ADDRESSES: Submit written comments to the Dockets Management Branch (HFA-305), Food and Drug Administration, rm. 1-23, 12420 Parklawn Dr., Rockville, MD 20857.

FOR FURTHER INFORMATION CONTACT: Vincent E. Zenger, Center for Food Safety and Applied Nutrition (HFS-206), Food and Drug Administration, 200 C St. SW., Washington, DC 20204, 202-418-3105.

SUPPLEMENTARY INFORMATION: In a notice published in the **Federal Register** of November 28, 1990 (55 FR 49426), FDA announced that a food additive petition (FAP 0A4226) had been filed by Ciba-Geigy Inc., proposing that § 173.45 *Polymaleic acid and its sodium salt* (21 CFR 173.45) be amended to provide for the safe use of polymaleic acid and its sodium salt to control mineral scale during the production of beet and cane sugar juice and liquor at higher levels than the maximum currently permitted under the regulation.

The petition also contained information on a new manufacturing process for polymaleic acid and its sodium salt which results in a lower weight-average molecular weight for the additives and number-average molecular weight than those currently permitted. The molecular weight determinations were based on an improved analytical method.

FDA has evaluated data in the petition (FAP 0A4226) and other relevant material. The agency concludes that the proposed increase in the food additive use level is safe, and that the regulations should be amended as set forth below. The agency tentatively concludes that the molecular weight specifications for the additives should be amended to allow for the use of products manufactured by the new technique, and that the molecular weight determinations of the additives are to be based on the improved analytical method entitled "Determinations of Molecular Weight Distribution of Poly(Maleic) Acid" submitted by Ciba-Geigy, Inc., and dated March 17, 1992, which is incorporated by reference in amended § 173.45(a). This replaces the previous method with

the same title but different date that was incorporated by reference in the current § 173.45(a).

In the filing notice for the petition, the agency gave notice of the intent to increase the permitted use levels of polymaleic acid and its sodium salt but did not anticipate amending the allowed molecular weight range for the additives or the method for determining the molecular weight. The amended specifications are not intended to place new restrictions on the currently approved products, but to allow use of products manufactured by a new method and to take into account an improved method of molecular weight determination. Therefore, because the agency did not give notice of this change, it is publishing this document as a tentative final rule to allow interested parties an opportunity to comment on the amended product specifications.

In accordance with § 171.1(h) (21 CFR 171.1(h)), the petition and the documents that FDA considered and relied upon in reaching its decision to approve the petition are available for inspection at the Center for Food Safety and Applied Nutrition by appointment with the information contact person listed above. As provided in 21 CFR 171.1(h), the agency will delete from the documents any materials that are not available for public disclosure before making the documents available for inspection.

The agency has carefully considered the potential environmental effects of this action. FDA has concluded that the action will not have a significant impact on the human environment, and that an environmental impact statement is not required. The agency's finding of no significant impact and the evidence supporting that finding, contained in an environmental assessment, may be seen in the Dockets Management Branch (address above) between 9 a.m. and 4 p.m., Monday through Friday.

List of Subjects in 21 CFR Part 173

Food additives, Incorporation by reference.

Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs and redelegated to the Director, Center for Food Safety and Applied Nutrition, it is proposed that 21 CFR part 173 is amended as follows:

PART 173—SECONDARY DIRECT FOOD ADDITIVES PERMITTED IN FOOD FOR HUMAN CONSUMPTION

1. The authority citation for 21 CFR part 173 continues to read as follows:

Authority: Secs. 201, 402, 409 of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321, 342, 348).

2. Section 173.45 is amended by revising paragraphs (a) and (c) to read as follows:

§ 173.45 Polymaleic acid and its sodium salt.

* * * * *

(a) The additives have a weight-average molecular weight in the range of 540 to 850 and a number-average molecular weight in the range of 520 to 650, calculated as the acid. Molecular weights shall be determined by a method entitled "Determination of Molecular Weight Distribution of Poly(Maleic) Acid", dated March 17, 1992, produced by Ciba-Geigy, Seven Skyline Rd., Hathorne, NY 10532-2188, which is incorporated by reference. Copies are available from the Division of Product Policy, Center for Food Safety and Applied Nutrition (HFS-205), Food and Drug Administration, 200 C St. SW., Washington, DC 20204, or available for inspection at the Office of the Federal Register, 800 North Capitol St. NW., suite 700, Washington, DC.

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(c) The additives are to be used so that the amount of either or both additives does not exceed 4 parts per million (calculated as the acid) by weight of the beet or cane sugar juice or liquor process stream.

Dated: April 19, 1995.

Fred R. Shank,

Director, Center for Food Safety and Applied Nutrition.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[PS-013-88]

RIN 1545-AL57

Certain Publicly Traded Partnerships Treated as Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the classification of certain publicly traded partnerships as corporations. These proposed regulations would provide guidance needed by taxpayers to comply with changes to the law made

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

financial instrument or contract described above. This provision applies only for purposes of determining when a transaction is treated as a transfer for purposes of section 7704(b) and does not apply in determining any other federal tax consequences of a transaction, including whether the transaction is a sale or exchange or whether the transferee is a partner of the partnership for any purpose other than section 7704(b).

The proposed regulations also provide that a transfer of an interest in a partnership is taken into account for purposes of section 7704(b) only if: (1) The partnership redeems the interest; (2) the transferee is admitted as a partner; or (3) the partnership otherwise recognizes any rights of the transferee, such as a right of the transferee to partnership distributions (directly or indirectly) or the right of the transferee to acquire an interest in the capital or profits of the partnership. For example, if a partner enters into a financial contract providing for a payment by the partner in an amount calculated by reference to the amount of partnership distributions, the financial contract is treated as an interest in the partnership and the entering into the contract is treated as a transfer of an interest for purposes of section 7704. The transfer is not taken into account, however, unless the partnership admits the transferee as a partner or otherwise recognizes the rights of the transferee to partnership distributions by, for example, making distributions directly to the transferee or to a third party on behalf of the transferee. This provision is intended to limit transfers for purposes of section 7704(b) to transfers that the partnership is aware of and has recognized, thereby preventing a partnership from becoming publicly traded without the knowledge or participation of the partnership.

Transfers That Do Not Create Public Trading

As discussed above, guidance issued in Notice 88-75 provided certain exclusions for purposes of section 7704(b)(2). The proposed regulations generally adopt these exclusions with certain modifications. The modifications are necessary to more appropriately implement congressional intent and to ensure that any partnership in which interests are subject to firm-quote trading is treated as a publicly traded partnership under section 7704. As in Notice 88-75, none of these exclusions apply in determining whether interests in a partnership are traded on an established securities market.

The proposed regulations adopt the exclusion in section II.A of Notice 88-75 for partnership interests issued in certain private placements with four modifications. First, the proposed regulations provide that the exclusion applies only for purposes of determining whether interests in a partnership are readily tradable on the substantial equivalent of a secondary market. Unlike Notice 88-75, this exclusion does not apply for purposes of determining whether the interests are readily tradable on a secondary market. As a result, a private placement partnership is treated as a publicly traded partnership if the interests in the partnership are readily tradable on a secondary market. This modification was made to ensure that, consistent with the purpose of section 7704(b), all partnerships, including private placement partnerships, are treated as publicly traded if interests in the partnership are subject to firm-quote trading.

Secondly, the proposed regulations provide that the private placement exclusion does not apply if the partnership has more than 50 partners at any time during its taxable year and the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in private transfers described in paragraph (d) of this section) exceeds 10 percent of the total interests in partnership capital or profits. This modification was made because transfers in excess of 10 percent indicate the existence of the type of market that section 7704(b) intended to treat as public trading. This modification does not apply to partnerships with 50 or fewer partners because such partnerships are unlikely to develop any public trading.

Thirdly, as in Notice 88-75, the private placement exclusion applies only if the partnership does not have more than 500 partners or the initial offering price of each unit of partnership interest is at least \$20,000. The proposed regulations clarify that a partnership satisfies the 500 partner requirement only if the partnership does not have more than 500 partners at any time during the taxable year of the partnership. Finally, the proposed regulations provide that the indirect ownership rule for determining the number of partners in a partnership does not apply to persons owning interests in a partnership through a regulated investment company (as defined in section 851) or a real estate investment trust (as defined in section 865).

The proposed regulations adopt, with two additions, the exclusion contained in section II.B of Notice 88-75 for transfers not involving trading (private transfers). Under the proposed regulations, private transfers include all of the transfers described in section II.B of Notice 88-75 plus: (1) distributions from an individual retirement account, and (2) transfers by one or more partners of interests representing more than 50 percent of the total interests in partnership capital and profits in one transaction or a series of related transactions. The proposed regulations also provide that a block transfer means the transfer by a partner in one or more transactions during any 30 calendar day period of partnership interests representing in the aggregate more than 2 percent of the total interests in partnership capital or profits, rather than 5 percent as in Notice 88-75.

In lieu of the 5 percent and 2 percent safe harbors contained in section II.C of Notice 88-75, the proposed regulations provide a more limited *de minimis* trading exclusion. The percentage safe harbors in Notice 88-75 applied in determining whether interests in a partnership were readily tradable on a secondary market or the substantial equivalent thereof. The Conference Report, however, gives no indication that a *de minimis* level of trading on a secondary market should be permitted, and the IRS and Treasury do not believe that a broad-based *de minimis* rule that allows firm-quote trading on a secondary market is appropriate. Furthermore, the percentage safe harbors contained in Notice 88-75 apparently have encouraged the type of firm-quote trading that Congress intended to prohibit by enacting section 7704.

Accordingly, the proposed regulations provide that interests in a partnership are not readily tradable on a substantial equivalent of a secondary market if the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership does not exceed 2 percent of the total interests in partnership capital or profits. All transfers of an interest in a partnership (including redemptions) are taken into account for purposes of this 2 percent rule, except for: (1) Private transfers; (2) transfers pursuant to redemption and repurchase agreements meeting certain requirements as specified in the regulations; and (3) transfers pursuant to a qualified matching service, discussed below. The 2 percent rule differs from the percentage safe harbors in Notice 88-75 because the 2 percent rule applies only for purposes of determining

whether interests in a partnership are readily tradable on the substantial equivalent of a secondary market. As a result, the 2 percent rule does not apply in determining whether interests are readily tradable on a secondary market and thus does not apply to partnerships with interests subject to firm quote trading.

The proposed regulations contain a qualified matching service exclusion similar to the matching service exclusion contained in section II.D of Notice 88-75. The proposed regulations, however, contain certain modifications designed to prevent a qualified matching service from operating as a secondary market or the substantial equivalent thereof. For example, the matching service can display only nonfirm quotes or nonbinding indications of interest and cannot provide firm quotes or two-sided quotes. The selling partner cannot enter into a binding agreement to sell an interest until the 15th calendar day after the date information regarding the offering of an interest for sale is made available to potential buyers, and closing of the sale cannot occur prior to the 30th calendar day after the first day that the seller can enter into a binding agreement to sell the interest. The matching service must obtain written representations from any subscribers that the subscribers and their customers will not act as market makers for any partnership interest listed on the matching service and that the subscriber, acting on its own account or on behalf of the same investor, will not enter offers for interests in the same partnership more than once in any 15 calendar day period.

As in Notice 88-75, this matching service exclusion does not apply if more than 10 percent of the total percentage interests in partnership capital or profits is transferred during the taxable year. For purposes of this 10 percent limitation, all transfers (other than private transfers) are considered, including transfers that do not take place on the matching service and transfers that are eligible for another exclusion under the proposed regulations. For example, if 1 percent of the total partnership interests in capital or profits is transferred on a nonqualified matching service, the amount of interests that can be transferred pursuant to a qualified matching service and still qualify for the matching service exclusion is reduced to 9 percent.

The proposed regulations clarify that certain activities will not prevent a matching service from qualifying for the exclusion. Under the proposed

regulations, a qualifying matching service may provide: (1) Prior pricing information, including information regarding resales of interests and actual prices paid for interests; (2) a description of the business of the partnership; and (3) financial and reporting information from the partnership's financial statements and reports. The operator of the matching service may also assist with the transfer documentation necessary to transfer the partnership interest. The operator may receive and deliver funds for completed transactions, and its fee may be a flat fee for use of the service, a fee based on completed transactions, or any combination thereof. While these activities may allow the operator of the matching service to assist in the completion of the transfer, the activities should not, by themselves, result in the type of activity that would cause the matching service to be a secondary market or the substantial equivalent thereof under section 7704(b)(2).

The proposed regulations adopt the exclusions for redemption and repurchase agreements contained in section II.E of Notice 88-75 with no significant modifications.

The IRS and Treasury request comments on the proposed regulations. In particular, comments are requested concerning: (1) Whether transitional relief is necessary for partnerships that qualified for an exclusion contained in Notice 88-75, but do not qualify for an exclusion contained in the proposed regulations and, if so, what type of relief would be appropriate; (2) whether further modifications to the private placement exclusion are necessary in light of developments in the securities laws since the issuance of Notice 88-75, including the issuance of Rule 144A (17 CFR 230.144A) and Regulation S (17 CFR 230.901); and (3) which members in a limited liability company or other entity that is treated as a partnership for federal tax purposes should be treated as general partners for purposes of determining the percentage interests in partnership capital or profits transferred during the taxable year of the partnership under paragraph (j)(1) of the proposed regulations.

Proposed Effective Date

These regulations are proposed to apply for taxable years of a partnership beginning on or after the date the final regulations are published in the **Federal Register**. The provisions of Notice 88-75 regarding the definition of readily tradable on a secondary market or the substantial equivalent thereof for purposes of section 7704(b) will

continue to apply until these regulations are effective.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for July 31, 1995, at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed (a signed original and eight (8) copies) by July 31, 1995.

A period of 10 minutes will be allotted for each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information: The principal author of these regulations is Christopher T. Kelley, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *.

Par. 2. Section 1.7704-1 is added to read as follows:

§ 1.7704-1 Publicly traded partnerships.

(a) *In general*—(1) *Publicly traded partnership.* A domestic or foreign partnership is a publicly traded partnership for purposes of section 7704(b) and this section if—

(i) Interests in the partnership are traded on an established securities market; or

(ii) Interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof.

(2) *Partnership interest*—(i) *In general.* For purposes of section 7704(b) and this section, an interest in a partnership includes—

(A) Any interest in the capital or profits of the partnership (including the right to partnership distributions); and

(B) 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).

(ii) *Exception for non-convertible debt.* For purposes of section 7704(b) and this section, an interest in a partnership does not include any financial instrument or contract that—

(A) Is treated as debt for federal tax purposes; and

(B) Is not convertible into or exchangeable for an interest in the capital or profits of the partnership and does not provide for a payment of equivalent value.

(iii) *Exception for tiered entities.* For purposes of section 7704(b) and this section, an interest in a partnership or a corporation (including a regulated investment company as defined in section 851 or a real estate investment trust as defined in section 856) that holds an interest in a partnership (lower-tier partnership) is not considered an interest in the lower-tier partnership.

(3) *Definition of transfer.* For purposes of section 7704(b) and this section, a transfer of an interest in a partnership means a transfer in any form, including a redemption by the partnership or the

entering into of a financial instrument or contract described in paragraph (a)(2)(i)(B) of this section.

(4) *Transfers taken into account.* For purposes of section 7704(b) and this section, a transfer of an interest in a partnership is taken into account only if—

(i) The transferee is admitted as a partner;

(ii) The partnership otherwise recognizes any rights of the transferee, such as a right of the transferee to partnership distributions (directly or indirectly) or the right of the transferee to acquire an interest in the capital or profits of the partnership; or

(iii) The partnership redeems or repurchases the interest.

(b) *Established securities market.* For purposes of section 7704(b) and this section, an established securities market includes—

(1) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(2) A national securities exchange exempt from registration under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) because of the limited volume of transactions;

(3) A foreign securities exchange that, under the law of the jurisdiction where it is organized, satisfies regulatory requirements that are analogous to the regulatory requirements under the Securities Exchange Act of 1934 described in paragraph (b)(1) or (2) of this section (such as the London International Financial Futures Exchange; the Marche a Terme International de France; the International Stock Exchange of the United Kingdom and the Republic of Ireland, Limited; the Frankfurt Stock Exchange; and the Tokyo Stock 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.

(c) *Readily tradable on a secondary market or the substantial equivalent thereof*—(1) *In general.* For purposes of section 7704(b) and this section, interests in a partnership that are not traded on an established securities market (within the meaning of section 7704(b) and paragraph (b) of this section) are readily tradable on a secondary market or the substantial equivalent thereof 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.

(2) *Secondary market.* For purposes of paragraph (c)(1) of this section, interests in a partnership are readily tradable on a secondary market if—(i) Interests in the partnership are regularly quoted by any person, such as a broker or dealer, making a market in the interests; or

(ii) 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.

(3) *Substantial equivalent of a secondary market.* For purposes of paragraph (c)(1) of this section, interests that are not readily tradable on a secondary market are readily tradable on the substantial equivalent of a secondary market if—

(i) 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 in the partnership; or

(ii) Prospective buyers and sellers have the opportunity to buy, sell, or exchange interests in the partnership in a time frame and with the regularity and continuity that the existence of a secondary market would provide.

(d) *Transfers not involving trading*—

(1) *In general.* For purposes of section 7704(b) and this section, the following transfers (*private transfers*) are disregarded in determining whether interests in a partnership are readily tradable on a secondary market or the substantial equivalent thereof—

(i) Transfers in which the basis of the partnership interest in the hands of the transferee is determined, in whole or in part, by reference to its basis in the hands of the transferor or is determined under section 732;

(ii) Transfers at death;

(iii) Transfers between members of a family (as defined in section 267(c)(4));

(iv) Transfers involving the issuance of interests by (or on behalf of) the partnership in exchange for cash, property, or services;

(v) Transfers involving distributions from a retirement plan qualified under section 401(a) or an individual retirement account;

(vi) Block transfers (as defined in paragraph (d)(2) of this section);

(vii) Transfers pursuant to a right under a redemption or repurchase agreement (as defined in paragraph (d)(3) of this section) that is exercisable only—

(A) Upon the death, disability, or mental incompetence of the partner; or
 (B) Upon the retirement or termination of the performance of services of an individual who actively participated in the management of, or performed services on a full-time basis for, the partnership;

(viii) Transfers pursuant to a closed end redemption plan (as defined in paragraph (d)(4) of this section); and

(ix) Transfers by one or more partners of interests representing more than 50 percent of the total interests in partnership capital and profits in one transaction or a series of related transactions.

(2) *Block transfers.* For purposes of paragraph (d)(1)(vi) of this section, a block transfer means the transfer by a partner in one or more transactions during any 30 calendar day period of partnership interests representing in the aggregate more than 2 percent of the total interests in partnership capital or profits.

(3) *Redemption or repurchase agreement.* For purposes of section 7704(b) and this section, a redemption or repurchase agreement means a plan of redemption or repurchase maintained by a partnership whereby the partners may tender their partnership interests for purchase by the partnership, another partner, or a person related to another partner (within the meaning of section 267(b) or section 707(b)(1)).

(4) *Closed end redemption plan.* For purposes of paragraph (d)(1)(viii) of this section, a redemption or repurchase agreement (as defined in paragraph (d)(3) of this section) is a closed end redemption plan if—

(i) The partnership does not issue any interest after the initial offering (other than the issuance of additional interests prior to August 5, 1988); and

(ii) No partner or person related to any partner (within the meaning of section 267(b) or 707(b)(1)) provides contemporaneous opportunities to acquire interests in similar or related partnerships which represent substantially identical investments.

(e) *Redemption and repurchase agreements.* For purposes of section 7704(b) and this section, the transfer of an interest in a partnership pursuant to a redemption or repurchase agreement (as defined in paragraph (d)(3) of this section) that is not described in paragraph (d)(1) (vii) or (viii) of this section is disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof only if—

(1) The redemption or repurchase agreement requires receipt of written

notification from the transferor partner by the partnership or a partner (or an agent thereof) at least 60 calendar days before the redemption or repurchase date of such partner's intention to exercise the redemption or repurchase right;

(2) Either—

(i) The redemption or repurchase agreement requires that the redemption or repurchase price not be established until at least 60 calendar days after receipt of such notification by the partnership or the partner; or

(ii) The redemption or repurchase price is established not more than 4 times during the partnership's taxable year; and

(3) The sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in private transfers described in paragraph (d) of this section) does not exceed 10 percent of the total interests in partnership capital or profits.

(f) *Qualified matching services—(1) In general.* For purposes of section 7704(b) and this section, the transfer of an interest in a partnership through a qualified matching service is disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof.

(2) *Requirements.* A matching service is a qualified matching service only if—

(i) The matching service consists of a computerized or printed listing system that lists customers' bid and/or ask prices in order to match partners who want to sell their interests in a partnership (the selling partner) with persons who want to buy those interests;

(ii) Matching occurs either by matching the list of interested buyers with the list of interested sellers or through a bid and ask process that allows interested buyers to bid on the listed interest;

(iii) The selling partner cannot enter into a binding agreement to sell the interest until the 15th calendar day after the date information regarding the offering of the interest for sale is made available to potential buyers and such time period is established by contemporaneous records maintained by the operator at a central location;

(iv) The closing of the sale effected by virtue of the matching service does not occur prior to the 30th calendar day after the first day that the selling partner can enter into a binding agreement to sell the interest (as specified in paragraph (f)(2)(iii) of this section) and such time period is established by

contemporaneous records maintained by the operator at a central location;

(v) The matching service displays only quotes that do not commit any person to buy or sell a partnership interest (nonfirm price quotes) or quotes that express interest in a partnership interest without an accompanying price (nonbinding indications of interest) and does not display quotes at which any person is committed to buy or sell a partnership interest (firm quotes) or two-sided quotes;

(vi) The operator of the matching service (or any person related to the operator within the meaning of section 267(b) or section 707(b)(1)) does not quote prices at which the operator (or a related person) stands ready to buy or sell partnership interests for itself or on behalf of others, make such quotes available to the public (or customers or subscribers), or buy or sell interests for itself or on behalf of others;

(vii) The matching service obtains written representations from any subscribers to the service that—

(A) The subscriber and its customers will not create or facilitate a secondary market (within the meaning of paragraph (c)(2) of this section) for any partnership interest listed on the matching service; and

(B) The subscriber, acting for its own account or on behalf of the same investor, will not enter offers for interests in the same partnership more than once in any 15 calendar day period;

(viii) The selling partner's information is removed from the matching service within 120 calendar days after the date information regarding the offering of the interest for sale is made available to potential buyers and, following any removal (other than removal by reason of a sale of any part of such interest) of the selling partner's information from the matching service, no interest in the partnership is entered into the matching service by the selling partner for at least 60 calendar days; and

(ix) The sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in private transfers described in paragraph (d) of this section) does not exceed 10 percent of the total interests in partnership capital or profits.

(3) *Closing.* For purposes of paragraph (f)(2)(iv) of this section, the closing of a sale occurs no later than the earlier of—

(i) The passage of title to the partnership interest;

(ii) The payment of the purchase price; or

(iii) The date, if any, that the operator of the matching service (or any person

related to the operator within the meaning of section 267(b) or section 707(b)(1) loans, advances, or otherwise arranged for funds to be available to the seller in anticipation of the payment of the purchase price.

(4) *Optional features.* A qualified matching service may be sponsored or operated by a partner of the partnership (either formally or informally), the underwriter that handled the issuance of the partnership interests, or an unrelated third party. In addition, a qualified matching service may offer the following features—

(i) The matching service may provide prior pricing information, including information regarding resales of interests and actual prices paid for interests; a description of the business of the partnership; financial and reporting information from the partnership's financial statements and reports; and information regarding material events involving the partnership, including special distributions, capital distributions, and refinancings or sales of significant portions of partnership assets;

(ii) The operator may assist with the transfer documentation necessary to transfer the partnership interest;

(iii) The operator may receive and deliver funds for completed transactions; and

(iv) The operator's fee may consist of a flat fee for use of the service, a fee based on completed transactions, or any combination thereof.

(g) *Private placements—(1) In general.* For purposes of section 7704(b) and this section, interests in a partnership are not readily tradable on the substantial equivalent of a secondary market if—

(i) All interests in the partnership were issued in a transaction (or transactions) that was not required to be registered under the Securities Act of 1933;

(ii) Either—

(A) The partnership does not have more than 500 partners at any time during the taxable year of the partnership; or

(B) The initial offering price of each unit of partnership interest is at least \$20,000 and the partnership agreement provides that no unit of partnership interest may be subdivided for resale into units smaller than a unit the initial offering price of which would have been at least \$20,000; and

(iii) If the partnership has more than 50 partners at any time during the taxable year of the partnership, the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in private

transfers described in paragraph (d) of this section) does not exceed 10 percent of the total interests in partnership capital or profits.

(2) *Number of partners.* For purposes of determining the number of partners under paragraph (g)(1) of this section—

(i) Each person indirectly owning an interest in the partnership through another partnership, a grantor trust, or an S corporation (but not through a regulated investment company, as defined in section 851, or a real estate investment trust, as defined in section 865) is treated as a partner; and

(ii) Partnerships are aggregated when they jointly operate one or more businesses, or the operations of the partnerships are interrelated, and a principal purpose for the use of multiple partnerships is to permit any of the partnerships to qualify for the rule provided under this paragraph (g).

(h) *Lack of actual trading—(1)*

General rule. For purposes of section 7704(b) and this section, interests in a partnership are not readily tradable on the substantial equivalent of a secondary market if the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in transfers described in paragraph (d), (e), or (f) of this section) does not exceed 2 percent of the total interests in partnership capital or profits.

(2) *Examples.* The following examples illustrate the rules of this paragraph (h).

Example 1. Calculation of percentage interest transferred. (i) ABC, a calendar year limited partnership formed in 1995, has 9,000 units of limited partnership interests outstanding at all times during 1996, representing in the aggregate 95 percent of the total interests in capital and profits of ABC.

(ii) During 1996, the following transactions occur with respect to the units of ABC's limited partnership interests—

(A) 800 units are sold through the use of a qualified matching service that meets the requirements of paragraph (f) of this section;

(B) 50 units are sold through the use of a matching service that does not meet the requirements of paragraph (f) of this section; and

(C) 500 units are transferred as a result of private transfers described in paragraph (d) of this section.

(iii) The private transfers of 500 units and the sale of 800 units through a qualified matching service are disregarded under paragraph (h)(1) of this section for purposes of applying the 2 percent rule. As a result, the total percentage interests in partnership capital and profits transferred for purposes of the 2 percent rule is .528 percent, determined by—

(A) Dividing the number of units sold through a matching service that did not meet the requirements of paragraph (f) of this section (50) by the total number of

outstanding limited partnership units (9,000); and

(B) Multiplying the result by the percentage of total interests represented by limited partnership units (95 percent) $([50/9,000] \times .95 = .528 \text{ percent})$.

Example 2. Application of the 2 percent rule. (i) ABC operates a service consisting of computerized video display screens on which subscribers view and publish quotes that do not commit any person to buy or sell a partnership interest and quotes that express interest in a partnership interest without an accompanying price. The ABC service does not provide two-sided quotes or quotes at which any person (including the operator of the service) is committed to buy or sell a partnership interest. Subscribers are limited to broker-dealers registered with the National Association of Securities Dealers.

(ii) The ABC service is not an established securities market for purposes of section 7704(b)(1) and this section because the service does not satisfy any of the definitions of an established securities market in paragraph (b) of this section. The ABC service also is not a secondary market because the service does not provide two-sided quotes or quotes at which any person (including the operator of the service) is committed to buy or sell a partnership interest. Therefore, partnerships whose interests are listed and transferred on the ABC service are not publicly traded for purposes of section 7704(b) and this section as a result of such listing or transfers if the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in transfers described in paragraph (d), (e), or (f)) does not exceed 2 percent of the total interests in partnership capital or profits. In addition, assuming the ABC service complies with the necessary requirements, the service may qualify as a matching service described in paragraph (f) of this section.

Example 3. Effect of firm quotes. Assume the same facts as in *Example 2*, except that, in addition to operating the matching service, ABC regularly quotes prices at which it stands ready to buy interests in certain partnerships listed on the service. As a result of the regular quotes, interests in the quoted partnerships are readily tradable on a secondary market under paragraph (c)(2) of this section. The quoted partnerships are therefore publicly traded partnerships for purposes of section 7704 and this section, regardless of whether the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership exceeds 2 percent of the total interests in partnership capital or profits.

(i) [Reserved].

(j) *Percentage interests in partnership capital or profits—(1) Interests considered—(i) General rule.* Except as otherwise provided in this paragraph (j), for purposes of this section, the total interests in partnership capital or profits are determined by reference to all outstanding interests in the partnership.

(ii) *Exceptions—(A) General partner with greater than 10 percent interest.* If

the general partners and any person related to the general partners (within the meaning of section 267(b) or section 707(b)(1)) own, in the aggregate, more than 10 percent of the outstanding interests in partnership capital or profits at any one time during the taxable year of the partnership, the total interests in partnership capital or profits are determined without reference to the interests owned by such persons.

(B) *Derivative interests.* Any partnership interests described in paragraph (a)(2)(ii) of this section are taken into account for purposes of determining the total interest in partnership capital or profits only as and to the extent that the transfer of the interest is taken into account under paragraph (a)(4) of this section.

(2) *Monthly determination.* For purposes of this section, except in the case of block transfers (as defined in paragraph (d)(2) of this section), the percentage interests in partnership capital or profits represented by partnership interests that are transferred during a taxable year of the partnership is equal to the sum of the percentage interests transferred for each calendar month during the taxable year of the partnership in which a transfer of a partnership interest occurs (other than a private transfer as described in paragraph (d) of this section). The percentage interests in capital or profits of interests transferred during a calendar month is determined by reference to the partnership interests outstanding during that month.

(3) *Monthly conventions.* For purposes of paragraph (j)(2) of this section, a partnership may use any reasonable convention in determining the interests outstanding for a month, provided the convention is consistently used by the partnership from month to month during a taxable year and from year to year. Reasonable conventions include, but are not limited to, a determination by reference to the interests outstanding at the beginning of the month, on the 15th day of the month, or at the end of the month.

(4) *Block transfers.* For purposes of paragraph (d)(2) of this section (defining block transfers), the partnership must determine the percentage interests in capital or profits for each transfer of an interest during the 30 calendar day period by reference to the partnership interests outstanding immediately prior to such transfer.

(5) *Example.* The following example illustrates the rules of this paragraph (j).

Example. Conventions. (i) ABC limited partnership, a calendar year partnership formed in 1995, has 1,000 units of limited partnership interests outstanding on January

1, 1996, representing in the aggregate 95 percent of the total interests in capital and profits of ABC. The remaining 5 percent is held by the general partner.

(ii) The following transfers take place during 1996—

(A) On January 15, 10 units of limited partnership interests are sold in a transaction that is not a private transfer;

(B) On July 10, 1,000 additional units of limited partnership interests are issued by the partnership (the general partner's percentage interest is unchanged); and

(C) On July 20, 15 units of limited partnership interests are sold in a transaction that is not a private transfer.

(iii) For purposes of determining the sum of the percentage interests in partnership capital or profits transferred, ABC chooses to use the end of the month convention. The percentage interests in partnership capital and profits transferred during January is .95 percent ($[(15/2,000) \times .95]$). ABC is not required to make determinations for the other months during the year because no transfers of partnership interests occurred during such months. ABC may qualify for the 2 percent rule for its 1996 taxable year because less than 2 percent (.95 percent + .7125 percent = 1.6625 percent) of its total interests in partnership capital and profits was transferred during that year.

(iv) If ABC had chosen to use the beginning of the month convention, the interests in capital or profits sold during July would have been 1.425 percent ($[(15/1,000) \times .95]$) and ABC would not have satisfied the 2 percent rule for its 1996 taxable year because 2.375 percent (.95 + 1.425) of ABC's interests in partnership capital and profits was transferred during that year.

(k) *Effective date.* This section applies for taxable years of a partnership beginning on or after the date final regulations are published in the **Federal Register**.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

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26 CFR Part 1

[FI-21-95]

RIN 1545-AT46

Definition of Personal Property for Purposes of the Straddle Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the definition of personal property for purposes of the straddle rules. This action is necessary to reflect changes in the law made by the Tax Reform Act of 1984. The regulations provide guidance to persons who enter into straddle transactions.

DATES: Written comments must be received by July 31, 1995. Requests to appear and outlines of topics to be discussed at the public hearing scheduled for August 30, 1995, must be submitted by August 9, 1995.

ADDRESSES: Send submissions to: CC:DOM:CORP:T:R (FI-21-95), 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 (FI-21-95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. A public hearing has been scheduled for Wednesday, August 30, 1995, at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Robert B. Williams, (202) 622-3960; concerning submissions and the hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 1092(d) of the Internal Revenue Code provides definitions and special rules relating to straddles. Under section 1092(d)(3)(B)(i)(II), an ownership interest in stock, which generally is not treated as personal property subject to the straddle rules, may be personal property if it is part of a straddle at least one of the offsetting positions of which is, under regulations, a position with respect to substantially similar or related property (other than stock). On March 20, 1995, the IRS published final regulations (§ 1.1092(d)-2) under section 1092(d)(3)(B). Those regulations generally apply the rules of § 1.246-5 to determine whether an offsetting position is a position with respect to substantially similar or related property (other than stock) within the meaning of section 1092(d)(3)(B)(i)(II).

Explanation of Provisions

The proposed regulations clarify the definition of the term "personal property" under section 1092(d)(1) as it applies to stock. The proposed