U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

AUG 2 1989

89-14A
Sec. 401

Donald J. Myers, Esq.
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1200 - 18th Street, N.W.
Washington, DC 20036

Re: Identification Number: F-3844A

Dear Mr. Myers:

This responds to your letter of March 24, 1988, on behalf of the Real Estate Securities and Syndication Institute (RESSI), requesting an advisory opinion concerning the application of Department of Labor regulation section 29 CFR 2510.3-101 to publicly-offered limited partnerships. Your letter specifically concerns the "freely transferable" requirement of the "publicly-offered" exception contained in regulation section 29 CFR 2510.3-101(b)(2).

You represent that members of RESSI sponsor publicly-offered limited partnerships in which pension plans invest. The Omnibus Budget Reconciliation Act of 1987 (OBRA) made several changes to the Internal Revenue Code of 1986 (the Code) dealing with "publicly traded partnerships."

Specifically, OBRA added sections 469(k), 512(c)(2) and 7704 to the Code. For purposes of these sections, a "publicly traded partnership" is defined as a partnership whose interests (1) are traded on an established securities market or (2) are readily tradable on a secondary market or the substantial equivalent thereof.[1] With certain exceptions, Code section 7704 treats publicly traded partnerships as corporations for federal tax purposes. For publicly traded partnerships to which section 7704 does not apply [i.e., which are not treated as corporations under section 7704], there are tax consequences under section 469(k) and 512(c)(2) of the Code. Section 469(k)(1) of the Code generally provides that the passive loss rules of section 469 shall be applied separately with respect to items attributable to each publicly traded partnership. Section 512(c)(2) of the Code generally provides that income earned by tax-exempt investors (including plans) from an interest in a publicly traded partnership will be treated as gross income derived from an unrelated trade or business subject to the tax-exempt investor's share of partnership deductions.

[1] Sections 469(k)(2) and 7704(b) of the Code.

Internal Revenue Service Notice 88-75[2] (the Notice) provides that partnership interests will not be treated as readily tradable on a secondary market or the substantial equivalent thereof within the meaning of sections 469(d)(2) and 7704(b) of the Code if the conditions of any safe harbor contained in the Notice are satisfied. The safe harbors contained in the Notice, in relevant part, are:

> (1) Private Placement Safe Harbor
> Interests in a partnership will not be considered readily tradable on a secondary market or the substantial equivalent thereof if the partnership interests are not registered under the Securities Act of 1933 and either (a) the partnership has not more than 500 partners or (b) the initial offering price of each unit of partnership interest is at least $20,000.[3]
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> (2) Five Percent Safe Harbor
> Interests in a partnership will not be considered readily tradable on a secondary market or the substantial equivalent thereof if the sum of the interests in partnership capital or profits that are sold or otherwise disposed of during the partnership's taxable year does not exceed 5% of the total interests in partnership capital or profits.[4]

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[2] 1988-27 I.R.B. 29 (July 5, 1988).

[3] Because compliance with the second part of the Private Placement Safe Harbor would require that the minimum investment in the partnership exceed $10,000, we are not addressing the extent to which such compliance would affect the free transferability of the securities. See footnote 8, infra.

[4] For purposes of applying the 5% test, the following transfers of partnership interests (Excluded Transfers) are excluded:

(a) 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 Code section 732;
(b) transfers at death;
(c) transfers between family members;
(d) the issuance of partnership interests by the partnership;
(e) distributions from retirement plans qualified under section 401(a) of the Code;
(f) block transfers (i.e., transfers by a partner in one or more transactions during any thirty calendar day period of partnership interests representing in the aggregate more than 5 percent of the total interest in partnership capital or profits);
(g) partnership redemptions or repurchases that are exercisable only upon the death, complete disability or mental incompetence of the partner, or upon the retirement or complete termination of the performance of services of an individual who actively

(3) Two Percent Safe Harbor

Interests in a partnership will not be considered readily tradable on a secondary market or the substantial equivalent thereof if the sum of the interests in partnership capital or profits that are sold or otherwise disposed of during the partnerships taxable year does not exceed 2% of the total interest in partnership capital or profits. For purposes of this test, neither the Excluded Transfers nor the following transfers of partnership interests are taken into account: (1) certain matching service transfers[5]; and (2) certain redemptions of interests in open-end partnerships[6].

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participates in the management of the partnership or who performs services for the partnership on a full time basis; and

(h) partnership transfers pursuant to a closed-end redemption (i.e., a redemption plan of a partnership that does not issue any partnership interests after its initial offering provided that the general partner and certain persons related to the general partner do not provide contemporaneous opportunities to acquire interests in similar or related partnerships that represent substantially identical investments).

[5] In order to qualify as a matching service transfer which is excluded in applying the 2% safe harbor, the transfer must meet the following criteria:

(a) at least a 15 calendar day delay must occur between the date on which the operator of the matching service receives written confirmation from the listing customer that an interest in a partnership is available for sale (the contact date), and the earlier of (i) the date buyers are informed of the offering of such interest for sale or (ii) the day the listing customer is informed of the existence of outstanding bids to purchase the interests at a stated price;
(b) the closing of the sale must not occur prior to the 45th calendar day after the contact date;
(c) the listing customer's information must be removed from the matching service within 120 days after the contact date;
(d) following removal of the listing customer's information (except by reason of consummating a sale), the listing seller may not relist any interest in the partnership for at least 60 calendar days; and
(e) the sum of the percentage interests in partnership capital and profits transferred during the partnership's year (except Excluded Transfers) may not exceed 10% of the total outstanding interest in partnership capital or profits.

[6] In order to qualify as a redemption or repurchase of an open-end partnership interest that is excluded in applying the 2% safe harbor, the redemption must meet the following criteria:

(a) the redemption or repurchase agreement must require written notification at least 60 days before the exercise of the redemption or repurchase right by the partner;

You represent that, since the issuance of the Notice, many partnership agreements for publicly-offered partnerships have been drafted to provide the partnership with the ability to comply with the safe harbors set forth in the Notice or to otherwise avoid the adverse consequences of being classified as a publicly traded partnership under the Code.[7]

You state that some partnership agreement provisions may rely upon the general statutory language prohibiting secondary market transfers (as defined in the legislative history accompanying OBRA) and not refer explicitly to the safe harbors contained in the Notice. Based on the foregoing, you request an advisory opinion that restrictions on trading of limited partnership interests which are adopted to avoid the partnership being treated as a "publicly traded partnership" under sections 469(k), 512(c)(2) and 7704 of the Code are the type of restrictions described in regulation section 29 CFR 2510.3-101(b)(4)(iii). In effect, you request an opinion that such restrictions will not ordinarily affect a finding that the limited partnership interests are freely transferable where the minimum investment in the partnership is $10,000 or less.

Regulation section 29 CFR 2510.3-101 describes the circumstances under which the assets of an entity (such as a limited partnership) in which a plan invests will be considered to include plan

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(b) the redemption or repurchase agreement must provide that the redemption or the repurchase price not be established either (i) until at least 60 days after receipt of such notice or (ii) not more than four times during the partnership's taxable year; and

(c) the sum of the percentage interests in partnership capital or profits transferred during the partnership's year attributable to all interests transferred or redeemed during the year (except Excluded Transfers) may not exceed 10% of the total outstanding interest in partnership capital or profits.

[7] The following is an example you provided of such a provision:

No limited partner may transfer any units of beneficial ownership interests therein (whether by sale, assignment, exchange, repurchase or redemption), and any such purported transfer shall not be recognized by the partnership or be effective for any purpose, unless (i) despite such transfer, the general partners determine in their sole discretion that the partnership would be able to satisfy either of the 5% or 2% safe harbors contained in sections II.C.1. and II.C.2. of IRS Notice 88-75 (or other safe harbors from publicly traded partnership status adopted by the IRS) for the partnership's taxable year in which such transfer otherwise would be affective, or (ii) the partnership has received an opinion of counsel satisfactory to the general partners or a favorable IRS ruling that such transfer will not result in the partnership being classified as a publicly traded partnership for federal income tax purposes for such year.

assets for purposes of Subtitle A (definitional and coverage provisions) and Parts 1 and 4 (reporting and disclosure and fiduciary provisions) of Subtitle B of Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and for purposes of section 4975 of the Code (excise tax provisions relating to prohibited transactions).

Regulation section 29 CFR 2510.3-101(a)(2) provides:

> Generally, when a plan invests in another entity, the plan's assets include its investment, but do not, solely by reason of such investment, include any of the underlying assets of the entity. However, in the case of a plan's investment in an equity interest of an entity that is neither a publicly-offered security nor a security issued by an investment company registered under the Investment Company Act of 1940 its assets include both the equity interest and an undivided interest in each of the underlying assets of the entity, unless it is established that - (i) The entity is an operating company, or (ii) Equity participation in the entity by benefit plan investors is not significant.
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> Therefore, any person who exercises authority or control respecting the management or disposition of such underlying assets, and any person who provides investment advice with respect to such assets for a fee (direct or indirect), is a fiduciary of the investing plan.

Thus, under the regulation's look-through rule, the underlying assets of an entity in which a plan acquired an equity interest would include plan assets, unless one of the exceptions to the rule applies. One exception to the look-through rule is provided in the case of a plan's investment in "publicly-offered" securities. Regulation section 29 CFR 2510.3-101(b)(2) defines "publicly-offered security" as a security that is freely transferable, part of a class of securities that is widely held and either - (i) Part of a class of securities registered under section 12(b) or 12(g) of the Securities Exchange Act of 1934, or (ii) Sold to the plan as part of an offering of securities to the public pursuant to an effective registration statement under the Securities Act of 1933 and the class of securities of which such security is a part is registered under the Securities Exchange Act of 1934 within 120 days after the end of the fiscal year of the issuer during which the offering of such securities to the public occurred.

Regulation section 29 CFR 2510.3-101(b)(4) provides, in part, that if a security is part of an offering in which the minimum investment is $10,000 or less, certain factors described therein ordinarily will not, alone or in combination, affect a finding that such securities are "freely transferable".[8] One such factor described in regulation section 29 CFR 2510.3-101(b)(4)(iii) is

[8] We note that the preamble to regulation section 29 CFR 2510.3-101 provides that the existence of the kinds of restrictions on transfer that fit within one or more of the specific categories set forth in regulation section 29 CFR 2510.3-101(b)(4) would not necessarily result in a

any restriction on, or prohibition against, any transfer or assignment which would result in a reclassification of the entity for federal or state tax purposes or which would violate any state or federal statute, regulation, court order, judicial decree, or rule of law. In the preamble to regulation section 2510.3-101, the Department noted that it was adopting this provision to permit restrictions necessary to assure favorable treatment under federal or state tax law.[9] Accordingly, it is the Department's opinion that a restriction against a transfer which is drafted to avoid reclassification of a partnership as a publicly traded partnership under sections 469(k)(2) and 7704(b) of the Code would qualify as the type of restriction contemplated by regulation section 2510.3-101(b)(4)(iii).

We note, however, that regulation section 2510.3-101(b)(4) provides that whether a security is "freely transferable" is ultimately a factual question to be determined on the basis of all relevant facts and circumstances.[10] Moreover, section 2510.3-101(b)(4) states that "ordinarily" if a security is part of an offering containing any of the restrictions set forth in subsections (b)(4)(i) - (viii), such restrictions will not affect a finding that a security is freely transferable. Hence, section 2510.3-101(b)(4) merely establishes a presumption that securities will be considered freely transferable, notwithstanding the existence of the enumerated restrictions, where they are part of an offering in which the minimum investment is 10,000 or less. Accordingly, there may be circumstances where a restriction which qualifies under section 2510.3-101(b)(4)(iii) may affect a determination that a security is freely transferable. Thus, the Department is not prepared to rule that the example restriction set forth in footnote 7, above, or any other restriction placed on the transfer of limited partnership interests in order to assure compliance with one of the safe harbors contained in the Notice (or otherwise avoid reclassification of the partnership as a publicly traded partnership) would, in no case, affect a determination that the partnership interests are "freely transferable" under regulation section 2510.3-101.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, this letter is issued subject to the provisions of the procedure, including section 10 relating to the effect of

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determination that securities are not freely transferable, even where the minimum investment in the securities exceeds $10,000. However, the preamble states that the presumption that such restrictions do not affect the free transferability of the securities would not be available in these circumstances. See 51 Fed. Reg. 41262, 41268 (November 13, 1986).

[9] 51 Fed. Reg. 41262, 41268 (November 13, 1986).

[10] In particular, we note that the preamble to regulation section 2510.3-101 indicates that the Department intends that the publicly-offered exclusion in the regulation will only apply to securities which in fact provide a plan investor a reasonable opportunity to liquidate its investment. See 51 Fed. Reg. 41262, 41268 (November 13, 1986).

advisory opinions. This letter relates only to those issues that you expressly raised in your request.

Sincerely,

Robert J. Doyle
Director of Regulations and Interpretations