

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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CC:PSI:B03

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Date:

January 27, 2005

LEGEND

X =

Business =

State =

D1 =

Dear :

This letter responds to a letter, dated September 9, 2003, and subsequent correspondence submitted on behalf of X by X's authorized representatives, requesting a number of rulings under § 7704 of the Internal Revenue Code.

FACTS

According to the information submitted and representations made, X is a State limited liability company organized on D1 that operates a Business. X will not elect to be treated as an association under § 301.7701-3(c) of the Procedure and Administration regulations. Each unit of X represents an equal interest in X's capital and profits.

In order to facilitate the buying or selling of its membership units, X will establish a matching service (X's matching system) operated by an unrelated third party that is registered with the Securities and Exchange Commission (SEC) as an "alternative trading system" (the ATS) under Regulation ATS (Reg ATS), 17 CFR 242.300 through

17 CFR 242.303, promulgated by the Securities and Exchange Commission in 1998. The ATS will choose to be treated as a broker-dealer as provided by Reg ATS.

X's matching system will operate as follows. Buyers and sellers will access X's matching system through the internet and all offers to buy or sell will be anonymous. Only persons buying and selling for their own account may use the system, and each buyer and seller must represent that it is not acting as a broker or dealer for others.

X's matching system will operate on a quarterly basis, with quarters starting on January 1, April 1, July 1, and October 1. The first one month and 15 days of each quarter will constitute the sellers' posting period, where sellers may post offers to sell their partnership units. The first two months of each quarter will constitute the buyers' posting period, during which buyers may post offers to buy partnership units.

Sellers may submit offers to sell units at any time during the seller's posting period. All sellers must provide the number of partnership units offered for sale and must specify a minimum asking price. These offers to sell units will be posted to X's matching system and published to prospective buyers on the ATS's website maintained for X, beginning on the first day of the sellers' posting period. The seller's listed asking price will be firm and binding, meaning that its partnership units may be matched and settled with a buyer's posted bid that meets or exceeds the asking price without further agreement from the seller, subject to approval of X's board of managers. The seller's asking price may not be raised or lowered, but the offer to sell may be cancelled entirely by providing written notice to the matching system prior to matching.

Buyers may submit bids for partnership units at any time during the buyers' bid period. A buyer's posted bid will be firm and binding, meaning that such a bid will be matched with a seller's unit that has an asking price less than or equal to the bid without further action by the buyer, subject to approval of X's board of managers. Bids may be raised, but not lowered, prior to matching.

X's matching system will match sellers' offers to sell with buyers' offers to buy at 5 PM on the matching date, which will be the last day of the second month of the quarter. After the matches have been made for each quarter, the ATS will notify buyers and sellers of a match by sending them a "Sale Confirmation," which each must sign and return within fifteen days of the matching date. The exchange of the funds and X unit certificates will be handled through an independent escrow agent and a designated transfer agent. The buyer must remit full payment for the partnership units' purchase price within this fifteen-day time period to the escrow agent. The seller must submit his unit certificates to X's transfer agent.

After the signed sale confirmations, cash payments, and partnership unit certificates have been received by the respective parties, X's board of managers will decide whether or not to approve each matched transfer.

X's operating agreement provides that no transfer shall be recognized or effective without the board's approval, and that the board is not authorized to approve any transfer if the result of such approval would cause X to be treated as a publicly traded partnership within the meaning of § 7704(b). In particular, if the aggregate transfers submitted for approval in any quarter would exceed 2% of the total interests in partnership capital or profits for purposes of § 1.7704-1(j)(1) for that taxable year, then X's board will approve transfers only up to 2% of the total interests in the partnership, with priority given in order of price from highest to lowest, then for transfers at the same price, in the order the offers to sell were posted with X's matching system.

For transfers approved by X's board, the closing date will be the last day of each quarter. Any matched transfer that is not approved by X's board, because the transfer would exceed the 2% limit of § 1.7704-1(j) or for any other reason, despite being labeled a "firm offer," shall be null and void. Buyers and sellers whose orders had been matched but not approved, will have their payment and certificates returned to them, and, in order to effect a sale or purchase of a unit of X, must submit a new order to buy or to sell.

LAW AND ANALYSIS

Section 7704(a) provides that a publicly traded partnership shall be treated as a corporation.

Section 7704(b) provides that a publicly traded partnership means any partnership if (1) interests in such partnership are traded on an established securities market or (2) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Section 1.7704-1(a)(2)(i) provides that a partnership interest includes – (A) Any interest in the capital or profits of the partnership (including any 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).

Section 1.7704-1(d) provides, in part, that interests in a partnership are not traded on an established securities market within the meaning of § 1.7704-1(b)(5) and are not readily tradable on a secondary market or the substantial equivalent thereof within the meaning of § 1.7701-1(c) unless – (1) the partnership participates in the establishment of the market or the inclusion of its interests thereon; or (2) the partnership recognizes any transfers made on the market by – (i) redeeming the transferor partner (in the case of a redemption or repurchase by the partnership); or (ii) admitting the transferee as a partner or otherwise recognizing any rights of the transferee, such as a right of the transferee to receive partnership distributions (directly or indirectly) or to acquire an interest in the capital or profits of the partnership.

Section 1.7704-1(b) provides, in part, that for purposes of § 7704(b) and § 1.7704-1, an established securities market consists of (1) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) (the 1934 Act); (2) a national securities exchange exempt from registration under section 6 of the 1934 Act 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 of the 1934 Act; (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.

Section 1.7704-1(c)(1) provides that for purposes of § 7704(b) and § 1.7704-1, interests in a partnership that are not traded on an established securities market are readily tradable on a secondary market or the substantial equivalent thereof if, taking into account all of the facts and circumstances, 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.

Section 1.7704-1(c)(2) provides that for purposes of § 1.7704-1(c)(1) interests in a partnership are readily tradable on a secondary market or the substantial equivalent thereof if (i) Interests in the partnership are regularly quoted by any person, such as a broker or dealer, making a market in the interests; (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; (iii) 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 (iv) Prospective buyers and sellers otherwise have the opportunity to buy, sell, or exchange interests in the partnership in a time frame and with the regularity and continuity that is comparable to that described in the other provisions of § 1.7704-1(c)(2).

Section 1.7704-1(c)(3) provides the fact that a transfer of a partnership interest is not within one or more of the safe harbors described in paragraph (e), (f), (g), (h), or (j) of this section is disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof.

Sections 1.7704-1(e), (f), (g) allow certain types of transfers of partnership interests to be disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof. These safe harbors are: transfers not involving trading (§ 1.7704-1(e)), redemption and repurchase agreements (§ 1.7704-1(f)), and qualified matching services (§ 1.7704-1(g)).

Section 1.7704-1(j) provides that interests in a partnership are not readily tradable on a secondary market or the substantial equivalent thereof if the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than transfers described in §§ 1.7704-1(e), (f), or (g)) does not exceed two percent of the total interests in partnership capital or profits.

Section 1.7704-1(k)(1)(i) provides that, except as otherwise provided in paragraph (k), the total interests in partnership capital and profits are determined by reference to all outstanding interests in the partnership. Section 1.7704-1(k)(2), (3), and (4) includes rules for determining the percentage interests in partnership capital or profits represented by partnership interests that are transferred.

Under Reg ATS, certain trading systems may, if eligible, choose to register as a national securities exchange under section 6 of the 1934 Act or to register as a broker-dealer and comply with additional requirements under Reg ATS. The ATS that will operate X's matching system has chosen to register as a broker-dealer rather than as a national securities exchange. In addition, buyers and sellers participating in X's matching system are not identified and must represent that they are acting for their own account and that they are not brokers or dealers acting for the accounts of others.

Accordingly, X's matching system as operated by the ATS does not meet the definition of an established securities market as defined in § 1.7704-1(b). However, we are not making a factual determination under § 1.7704-1(c)(2) as to whether or not the matching system is a secondary market or the substantial equivalent thereof. If the matching system is a secondary market or the substantial equivalent thereof, then transfers of interests of X that satisfy the safe harbor of § 1.7704-1(j) (or any of the other safe harbors) will not result in X being treated as a publicly traded partnership under § 7704.

CONCLUSIONS

Based on the facts submitted and the representations made, we rule as follows:

(1) X's matching system as operated by the ATS is not an established securities market within the meaning of § 1.7704-1(b).

(2) Units of X that are traded through X's matching system will not be treated as readily tradable on a secondary market or the substantial equivalent thereof solely by reason of being offered for purchase or sale and/or sold through X's matching system provided that (a) the total units of X transferred during the taxable year satisfy the requirements of § 1.7704-1(j), (b) X's matching system continues to operate in a manner consistent with the facts as represented, (c) the ATS does not register as a national securities exchange under section 6 of the 1934 Act, and (d) partnership interests in X (as defined for purposes of § 7704) are not otherwise traded on an established securities market as described in § 7704 and § 1.7704-1(b).

Except as specifically ruled upon above, we express or imply no opinion as to the federal tax consequences of the transactions described above under any other provision of the Internal Revenue Code. For example, we express or imply no opinion on whether X's matching system or any alternative trading system is an established financial market for purposes of § 1092 or § 1.1092(d)-1(b). Furthermore, we express or imply no opinion on whether units of X traded through X's matching system that exceed the 2% safe harbor described in § 1.7704-1(j) would be considered readily tradable on a secondary market or the substantial equivalent thereof.

Moreover, we express or imply no opinion as to whether an alternative trading system registered as a broker-dealer under Reg ATS is generally or in other circumstances may be treated an established securities market for purposes of § 7704.

This ruling is directed only to X. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,
/s/

Jeanne Sullivan
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes

cc: