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Date:

December 20, 2004

X =

LP =

Trust =

State =

Year =

Dear :

This is in reply to a letter dated August 18, 2004, and subsequent correspondence, submitted on behalf of X and LP, by their authorized representative, requesting rulings regarding the classification of Trust as a partnership under § 301.7701-3(b)(1)(i) of the Procedure and Administration Regulations.

The information submitted states that LP is a State limited partnership. X is a corporation formed under the laws of State. LP is engaged in business as a venture capital fund. X, the sole general partner of LP, manages the business and affairs of LP. X's shareholders are the limited partners of LP. X owns a 1% interest in LP. Due to recent changes in the industry, in Year, the Board of Directors of X determined that it was in the best interests of X and LP to dissolve and wind down their affairs. Since that time, LP has not made any investments in new portfolio companies. However, LP continues to make investments in existing portfolio companies.

As part of the wind-down of LP and X, a portion of the cash held by LP will be used to pay its remaining known debts and other obligations. LP will transfer its portfolio company investments and a portion of its cash to Trust for the benefit of LP's

partners and X. The securities held by LP and the cash held by LP to pay for follow-on investments, on-going costs, and contingencies will be contributed to Trust. The beneficial interests in Trust and the balance of the cash, if any, will be distributed to the partners of LP in the same proportions as their interests in LP.

Following the transfer of LP's assets to Trust, X will liquidate and distribute its remaining assets, including its beneficial interests in Trust, to X's shareholders. Therefore, X's shareholders will become beneficiaries of Trust.

Trust will be managed by a trustee for the benefit of X's shareholders and LP's limited partners. Trust will engage a limited liability company controlled by certain of the current officers of X to act as the advisor to Trust. The advisor will: monitor Trust's investments in portfolio companies, including reviewing reports and attending meetings of the shareholders and boards of directors of such companies; make recommendations to the trustee concerning additional investments by Trust in portfolio companies, and the disposition by Trust of portfolio company investments; review and comment on all accounting and tax return information concerning Trust; and provide other advice to Trust upon the request of the trustee. The beneficiaries of Trust will appoint three persons to serve as beneficiary representatives.

Trust provides that the trust shall terminate at the earlier of (a) the distribution of all of the assets of the trust to the beneficiaries, or (b) seven years from the date of the inception of the trust. However, the beneficiaries of Trust may terminate Trust at any time.

Trust provides that to the extent that Trust has available cash, Trust may make additional investments in the debt or equity securities issued by existing portfolio companies. Trust provides that an existing portfolio company is a corporation, partnership, or limited liability company in which Trust holds securities.

Section 301.7701-4(d) provides that certain organizations which are commonly known as liquidating trusts are trusts for purposes of the Internal Revenue Code. An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose. A liquidating trust is treated as a trust for purposes of the Code because it is formed with the objective of liquidating particular assets and not as an organization having as its purpose the carrying on of a profit-making business which normally would be conducted through business organizations classified as corporations or partnerships. However, if the liquidation is unreasonably prolonged or if the liquidating purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust.

Section 301.7701-4(a) provides that in general, the term “trust” as used in the Internal Revenue Code refers to an arrangement created either by will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 301.7701-4(b) addresses “business trusts” and provides that there are other arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of beneficiaries, but which are not classified as trusts for purposes of the Internal Revenue Code because they are not simply arrangements to protect and conserve the property for the beneficiaries. These trusts, which are often known as business or commercial trusts, generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Internal Revenue Code. However, the fact that the corpus of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association or partnership. The fact that any organization is technically cast in the trust form, by conveying title to property to trustees for the benefit of persons designated as beneficiaries, will not change the real character of the organization if the organization is more properly classified as a business entity under § 301.7701-2.

Section 301.7701-2 provides that a business entity is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3) that is not properly classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code. A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership.

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Section 301.7701-3(b)(1)(i) provides that except as provided in § 301.7701-3(b)(3), unless the entity elects otherwise, a domestic eligible entity is a partnership if it has two or more members.

Section 704(a) provides that a partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in subchapter K, be determined by the partnership agreement.

Section 704(b) provides that a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if (1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or (2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

Section 708 provides that a partnership is considered to be continuing if it is not terminated. A partnership is terminated if (1) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership, or (2) within a 12-month period, there is sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Section 706(c)(1) provides that, except in the case of a termination of a partnership and except as provided in § 706(c)(2), the taxable year of a partnership does not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership.

Section 706(c)(2)(A)(i) provides that the taxable year of a partnership closes with respect to a partner who sells or exchanges the partner's entire interest in a partnership. Section 706(c)(2)(A)(ii) provides that the taxable year of a partnership closes with respect to a partner whose interest is liquidated, except that the taxable year of a partnership with respect to a partner who dies does not close prior to the end of the partnership's taxable year.

Section 752(a) provides that any increase in a partner's share of the partnership's liabilities is considered to be a contribution of money by the partner to the partnership.

Section 752(b) provides that any decrease in a partner's share of partnership's liabilities is considered to be a distribution of money by the partnership to the partner.

Section 1.752-1 provides rules for determining a partner's share of partnership liabilities.

Based on the information submitted and the representations made, we conclude that Trust is a business trust as described in § 301.7701-4(b) and not a trust under § 301.7701-4(a). We further conclude that, Trust will be classified for federal income tax purposes as a partnership under § 301.7701-3(b)(1)(i). Therefore, the beneficiaries of Trust are the partners for federal tax purposes and any income, gains,

losses, deductions, and credits realized by Trust will be allocated among the beneficiaries for federal tax purposes in the manner required by § 704. Because the business of LP will continue and because there is no sale or exchange of 50 percent or more of the total interest in partnership capital and profits, there will be no termination of LP as a partnership under § 708. Additionally, under these specific facts, the taxable year of LP does not close and Trust does not need to obtain a new taxpayer identification number.

Further, if there is no change in the partners' shares of liabilities under § 1.752-1, there will be no change to the adjusted basis of any partner's interest in LP or Trust and the partners will each have an adjusted basis with respect to each partner's beneficial interest in Trust equal to the adjusted basis of each partner's respective partnership interest in LP. However, if there is a change in the partners' shares of liabilities and such change causes a deemed contribution of money under § 752(a), then the adjusted basis of that partner's interest will be increased by the amount of such deemed contribution. If the change in the partners' shares of liabilities causes a deemed distribution of money under § 752(b), then the basis of that partner's interest will be reduced (but not below zero) by the amount of such deemed distribution, and gain will be recognized by that partner to the extent the deemed distribution exceeds the adjusted basis of that partner's interest in the partnership.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to X and LP's authorized representative.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Office of Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosures (2)