

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3 PLR-115270-00

Date:

November 30, 2000

LEGEND:

X =

Y =

D =

Dear

This responds to your letter, dated September 15, 2000, and subsequent correspondence dated August 28, 2000, October 25, 2000, November 3, 2000, and November 16, 2000, submitted on behalf of X requesting a ruling under § 7704 of the Internal Revenue Code.

FACTS

X is a publicly traded partnership that is an electing 1987 partnership under § 7704(g). The interests in X are widely held and have been publicly traded on an established securities exchange since prior to December 17, 1987.

Since its inception, X has been engaged in the business of providing investment management and advisory services to individual and institutional clients. On D, X acquired the assets and business of Y, an S corporation. Y provides investment management and advisory services similar to the services provided by X; however, Y also provides a limited trade execution service to its investment clients that X does not.

Y execute trades for its smaller investment management clients as part of its investment management and advisory service. Y also uses its trade execution function to market its research through a “soft-dollar” brokerage service. Y’s soft-dollar brokerage service is a service through which Y provides investment

management and advisory services to customers with the understanding that the customers will compensate Y by using Y's trade execution service. Y charges its soft-dollar brokerage clients and some of its investment management clients a lump-sum fee for the investment management and trade execution services it provides.

X plans to integrate Y's investment management and advisory services into its own business, but it will operate Y's trade execution service through a wholly-owned limited liability company, which will be a disregarded entity for federal income tax purposes. The trade execution function is a new line of business for purposes of § 7704(g), and X has agreed treat the gross income from trade executions as being derived from a new line of business. X represents that the gross income attributable to the trade execution function is as follows: (1) the transaction based fees paid by X's investment management clients that pay separate fees for investment management and trade execution services; (2) the fair market value of the trade execution services rendered to investment management clients who pay X a single fee; and (3) the fair market value of the trade execution component of the soft-dollar brokerage services, determined in accordance with the principles of § 482, including trade execution transactions between independent unrelated parties.

X requests a ruling that its acquisition of Y, excluding Y's trade execution function, will not constitute a new line of business.

LAW AND ANALYSIS

Section 7704(a) provides that, except for partnerships with passive type income, a publicly traded partnership (PTP) is treated as a corporation.

Section 7704(b) defines a PTP as a partnership if interests in the partnership are either traded on an established securities market or are readily tradable on a secondary market.

Section 7704(g)(1) provides that § 7704(a) shall not apply to an electing 1987 partnership. Section 7704(g)(2) defines the term electing 1987 partnership as any PTP if (A) such partnership is an existing partnership (as defined in section 10211(c)(2) of the Revenue Reconciliation Act of 1987), (B) section 7704(a) has not applied (and without regard to § 7704(c)(1) would not have applied) to such partnership for all prior taxable years beginning after December 31, 1987, and before January 1, 1998, and (C) such partnership elects the application of § 7704(g) for its first taxable year beginning on or after December 31, 1997.

Section 7704(g)(2) also provides that a partnership which would otherwise be treated as an electing 1987 partnership will cease to be so treated (and the election under § 7704(g)(2)(C) shall cease to be in effect) as of the 1st day after December 31, 1997, on which there has been an addition of a substantial new line of business

with respect to the partnership.

Section 1.7704-2(b)(1) of the Income Tax Regulations defines the term “existing partnership” as any partnership if (i) the partnership was a publicly traded partnership (within the meaning of § 7704(b)) on December 17, 1987, and (ii) a registration statement indicating that the partnership was to be a publicly traded partnership was filed with the Securities and Exchange Commission (SEC) with respect to the partnership on or before December 17, 1987, or (iii) with respect to the partnership, an application was filed with a state regulatory commission on or before December 17, 1987, seeking permission to restructure a portion of a corporation as a publicly traded partnership.

Section 1.7704-2(b)(2) provides that a partnership will not qualify as an existing partnership after a new line of business is substantial.

Section 1.7704-2(c) provides that a new line of business is substantial as of the earlier of (i) the taxable year in which the partnership derives more than 15 percent of its gross income from that line of business, or (ii) the taxable year in which the partnership directly uses in that line of business more than 15 percent (by value) of its total assets.

Section 1.7704-2(d)(1) provides that a “new line of business” is any business activity of the partnership not closely related to a pre-existing business of the partnership to the extent that the activity generates income other than “qualifying income” within the meaning of § 7704 and the regulations thereunder.

Section 1.7704-2(d)(2) provides that a business activity is a pre-existing business of the partnership if (i) the partnership was actively engaged in the activity on or before December 17, 1987, or (ii) the partnership is actively engaged in the business activity that was specifically described as a proposed business activity of the partnership in a registration statement or amendment thereto filed on behalf of the partnership with the SEC on or before December 17, 1987.

Section 1.7704-2(d)(3) provides that all of the facts and circumstances determine whether a new business activity is closely related to a pre-existing business of the partnership. The following factors, among others, help to establish that a new business activity is closely related to a pre-existing business of the partnership and therefore is not a new line of business:

(i) The activity provides products or services very similar to products or services provided by the pre-existing business.

(ii) The activity markets products and services to the same class of customers as that of the pre-existing business.

(iii) The activity is of a type that is normally conducted in the same business location as the pre-existing business.

(iv) The activity requires the use of similar operating assets as those used in the pre-existing business.

(v) The activity's economic success depends on the success of the pre-existing business.

(vi) The activity is of a type that would normally be treated as a unit with the pre-existing business in the business, accounting records.

(vii) If the activity and the pre-existing business are regulated or licensed, they are regulated or licensed by the same or similar governmental authority.

(viii) The United States Bureau of the Census assigns the activity the same four-digit Industry Standard Identification Code ("Industry SIC Code") as the pre-existing business.

Interests in X have traded on an established securities market since prior to December 17, 1987. If X is a partnership, it was a publicly traded partnership within the meaning of § 7704(b) on December 17, 1987. X therefore qualifies as an "existing partnership" within the meaning of 1.7704-2(b)(1).

Analysis of the eight factors under section 1.7704-2(d) of the regulations, among others, to determine whether a "new line of business" exists indicates that the business activity of Y, excluding its trade execution function, involves a similar product, serves a similar class of customers, uses a similar business location, and uses similar operating assets as the pre-existing activity of X. Further, Y's activity is of a type that would normally be treated as a unit with X's pre-existing business in the business, accounting records, and Y's activity is regulated, to a substantial extent, by the same or similar governmental authority as X's pre-existing business.

CONCLUSION

The above analysis indicates that the business activity of Y, excluding its trade execution function, is closely related to the pre-existing business of X. Accordingly, X's acquisition of Y, excluding its trade execution function, will not constitute a new line of business. However, Y's trade execution function is a new line of business and if it becomes substantial, within the meaning of 1.7704-2(c), X's election under § 7704(g) shall cease to be in effect. The gross income attributable to the trade execution function may be determined under the method described above in the facts.

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X is a partnership for federal tax purposes.

This ruling is directed only to the taxpayer on whose behalf it was requested. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Under the power of attorney on file in this office, a copy of this letter is being sent to X and to the second authorized representative listed on the power of attorney.

Sincerely yours,
William P. O'Shea
Acting Deputy Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes