

Verne, B. Michael

801.1(b)

From: [REDACTED]
Sent: Monday, June 11, 2007 8:43 AM
To: Verne, B. Michael
Subject: Control test for LP/LLC's 801.1(b)(1)(ii)

Mike,

I have been hearing questions regarding the control test for LP/LLC's.

Rule 801.1(b)(1)(ii) defines "control" as

(b) Control. The term control (as used in the terms control(s), controlling, controlled by and under common control with) means:

- (1) Either. (i) Holding 50 percent or more of the outstanding voting securities of an issuer or
 - (ii) In the case of an unincorporated entity, having the right to 50 percent or more of the profits of the entity, or having the right in the event of dissolution to 50 percent or more of the assets of the entity;
- or

Examples: 2. A statutory limited partnership agreement provides as follows: The general partner "A" is entitled to 50 percent of the partnership profits, "B" is entitled to 40 percent of the profits and "C" is entitled to 10 percent of the profits. Upon dissolution, "B" is entitled to 75 percent of the partnership assets and "C" is entitled to 25 percent of those assets. All limited and general partners are entitled to vote on the following matters: the dissolution of the partnership, the transfer of assets not in the ordinary course of business, any change in the nature of the business, and the removal of the general partner. The interest of each partner is evidenced by an ownership certificate that is transferable under the terms of the partnership agreement and is subject to the Securities Act of 1933. For purposes of these rules, control of this partnership is determined by subparagraph (1)(ii) of this paragraph. Although partnership interests may be securities and have some voting rights attached to them, they do not entitle the owner of that interest to vote for a corporate "director" or "an individual exercising similar functions" as required by §801.1(f)(1) below. Thus control of a partnership is not determined on the basis of either subparagraph (1)(i) or (2) of this paragraph. Consequently, "A" is deemed to control the partnership because of its right to 50 percent of the partnership's profits. "B" is also deemed to control the partnership because it is entitled to 75 percent of the partnership's assets upon dissolution.

The SBP says

If the right to profits is variable and the right to assets upon dissolution is fixed, the right to 50 percent or more of the assets upon dissolution will be deemed to confer control. Conversely, if the right to assets upon dissolution is variable and the right to profits is fixed, the right to 50 percent or more of the profits will be deemed to confer control. In a situation where both the right to profits and assets upon dissolution are variable, control will be determined by applying the formula for determining rights to assets upon dissolution to the total assets of the unincorporated entity at the time of the acquisition, as if the entity were being dissolved at that time.

Please let me know if the control test is an "or" test, that is if both the rights to profits and the rights to assets upon dissolution are determined and investor A has the right to 50% or more of the profits and investor B has the right to 50% or more of the assets upon dissolution would there be two UPE's, or

is the right to assets upon dissolution only relevant if the right to profits is variable that is once profit allocation is determined the right to assets upon dissolution is not relevant. The example in the SBP describes the result if both a right to profits and a right to assets are variable. Under the first scenario it would be possible to have 4 UPE's two 50% investors with the right to profits and two different 50% investors with the rights to assets upon dissolution (similar to a corporation with 4 UPE's). I would think those situations would be highly unusual.

As always your guidance is appreciated.
Many thanks

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Yes - if one partner has the right to 50% or more of the profits and another partner has the right to 50% or more of the assets on dissolution, there are two UPEs.

BW
6/11/07