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USE (OR ABUSE) OF THE LIMITED PARTNERSHIP IN FINANCING REAL ESTATE VENTURES IN NEW MEXICO

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New Mexico's building boom, particularly in the Albuquerque area, has coincided with an increased local use of the limited partnership form of business association. Lawyers and laymen involved in the creation of these limited partnerships should be aware of the impact of both state and federal securities laws on such ventures; even the smallest limited partnership may be subject to the requirements of the Securities Act of the State of New Mexico (the "New Mexico Securities Act"). There is at present a distressing lack of such compliance demonstrated by the very few limited partnership filings on record in the office of the New Mexico Securities Commissioner.

The limited partnership is, like the corporation, a creature of statute and, in order to secure the benefits that this form of organization provides, the formalities of the statute must be satisfied. New Mexico has adopted the Uniform Limited Partnership Act, which provides that a limited partnership is formed if there has been substantial compliance in good faith with the requirements of the Act. To form a limited partnership, two or more persons must sign

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1. See Burks, Signs Point to Apartment Ocerbuild in Albuquerque, Albuquerque Journal, Jan. 7, 1973, at F-1, col. 1. There have been more than 100 real estate limited partnership certificates filed in the Bernalillo County Clerk's office since January 1, 1970.
3. There have been fewer than 15 real estate limited partnerships registered with the New Mexico Securities Commission since January 1, 1970. Interview with Andrew M. Swarthout, Commissioner of Securities, March 13, 1973 [hereinafter cited as Swarthout Interview].
and swear to a certificate setting forth, among other things, the name and place of residence of each general partner and limited partner (designated as such), and the amount of cash or other property contributed or to be contributed by each limited partner. The certificate must be recorded in the office of the county clerk of the county in which the limited partnership's principal place of business is located.

The limited partnership form of business association was originally imported to the United States from France in 1822 in order to provide an alternative to the corporate form which was then subject to confining limitations. As the various states competed in a race to make their corporation laws more flexible, the form declined in importance. Today, chiefly due to federal tax laws, the limited partnership form has experienced renewed popularity, especially in the area of real estate syndication. Inextricably related to the concept of the "tax shelter", its special attractiveness to real estate investment ventures is that an investor, as a limited partner, can combine the limited liability and passive role usually afforded the

7. A common practice in the area of real estate syndications is to name, in the subscription form or in the limited partnership agreement, one of the general partners as attorney in fact for the limited partners with the power to execute the certificate. It may be argued that an attorney cannot be empowered to swear on behalf of another person. Cf, Technical Advice Memorandum dated September 22, 1972, of the Internal Revenue Service, appearing in Practicing Law Institute, Real Estate Syndications at 529-34 (1973). It may also be argued that N.M. Stat. Ann. §70-1-6 (Repl. 1961) requires that any such power of attorney be acknowledged and recorded.

8. The New Mexico Supreme Court has held that the absence of the recording does not destroy the contractual relationship among the partners. See Hoefer v. Hall, 75 N.M. 751, 411 P.2d 230 (1965).

9. For a general history and analysis of the limited partnership form, see Crane & Bromberg, Partnership, § 26, at 143 (1968).


11. Limited partners of a duly organized limited partnership are not bound by the obligations of the partnership; however, a limited partner may lose such limited liability if he takes part in the control of the limited partnership's business. N.M. Stat. Ann §66-2-7 (Repl. 1972). Unfortunately, there is scant legal authority, in New Mexico as well as elsewhere, defining what powers or activities carry a limited partner across this crucial line. See Feld, The Control Test for Limited Partnerships, 82 Harv. L. Rev. 1471 (1969). It is not uncommon to provide in limited partnership agreements for the right on the part of the limited partners to remove a general partner in certain events or to approve the sale of substantially all of the limited partnership's assets or to require the dissolution of the limited partnership.

The State of California has a statute which attempts to provide the limited partner with some control:


(b) A limited partner shall not be deemed to take part in the control of the business by virtue of his possessing or exercising a power, specified in the certificate, to vote upon matters affecting the basic structure of the partnership, including the following matters or others of a similar nature:

(I) Election or removal of general partners.

(II) Termination of the partnership.
corporate stockholder with the flow-through tax treatment usually afforded the partner.

The purpose of this article is to outline the basic securities aspects of the real estate limited partnership ("RELP") that should be carefully considered before offering or selling interests in RELPs to investors. The article will also set forth the basic tax features of the limited partnership, principally insofar as such aspects are relevant to the information that should be disclosed to investors. Ignoring either the securities or the tax areas may result in significant harm to the participants in a RELP: noncompliance with the law of securities regulation may render general partners, their affiliates or others engaged in the organization of the RELP personally liable for the entire amount contributed by the limited partners; noncompliance with the tax laws may deprive the parties of the favorable tax treatment which served as a major inducement for their investment. In addition, this article proposes a series of basic disclosures which the authors consider should be made to investors in all RELPs, public or private.

The following three hypotheticals will serve as examples of how real estate syndications use the RELP and will suggest problems that are discussed in the substantive portions of the article:

(1) Builder-Developer Corporation ("BDC") is a Texas corporation engaged in the business of building and


13. The fact that this is a Texas corporation which will serve as the general partner makes it unlikely that the federal intrastate exemption would be available for an offering in New Mexico. See text as 268 infra.
developing apartment complexes throughout the South- west. As it has often done in the past with respect to other projects, BDC intends to finance the construction of its proposed major apartment complex on Montgomery Boulevard in Albuquerque, New Mexico, by obtaining a construction loan from a local bank in the amount of $2,500,000 and a "take-out" commitment for a permanent mortgage loan from a Connecticut insurance company. Since the construction loan proceeds will not cover the expected cost of construction (including a profit to BDC as the prime contractor), BDC hopes to raise additional funds (approximately $450,000) by the sale of an equity interest in the project to investors. It has employed for this purpose a licensed real estate broker, Rabbit Realty Co. ("Rabbit") who has suggested to BDC that BDC act as the sole general partner of a New Mexico limited partnership to be formed for the purpose of owning the apartment project. Rabbit would offer subscriptions for limited partnership interests in the proposed RELP to all of its clients, friends and relations, some of whom live in El Paso, Texas and at one of the local military bases. Rabbit estimates that it will be necessary to contact about 50 persons in connection with this offering, and if necessary it will place a classified advertisement in various New Mexico and El Paso newspapers. Rabbit proposes to charge its customary real estate brokerage fee in connection with sales actually consumated. BDC is already a general partner in a number of other RELPs

14. This may create an integration problem; see text at 269 infra; moreover, experience in other projects should be disclosed; see text at 279 infra.
15. It is important that this financing should be structured properly for tax purposes; see text at 260 infra.
16. Any profits to principals should be disclosed; see text at 277 infra.
17. Regulation A is a possible exemption for this project; see text at 272 infra.
18. Rabbit may be a securities broker-dealer; see text at 266 infra.
19. This may create a tax problem; see text at 259 infra.
20. This would make the federal intrastate exemption unavailable; see text at 269 infra.
21. This raises a potential problem regarding the availability of the federal intrastate exemption; see note 111 infra.
22. This creates a problem in that it will probably cause the New Mexico private placement exemption and the parallel federal exemption to be unavailable; see text at 273 and 269 infra.
23. Id.
24. This would make the federal intrastate exemption unavailable; see text at 268 infra.
25. Rabbit is probably a broker-dealer unless his business is exclusively intrastate; he is also a securities salesman under New Mexico law; see text at 266 and 267 infra.
organized in Texas and elsewhere which own and manage other projects constructed by BDC.26
(2) Shelter and Leverage are real estate brokers in Roswell, New Mexico. They propose to act as general partners in a RELP to be organized to purchase an existing office building27 in Roswell, and intend to offer28 subscriptions for limited partnership interests in such a RELP to a few local29 physicians who are clients of a Roswell accountant named C. P. Ayer.30 With the help of the accountant,31 they will make the investment presentation to such clients. Neither they nor the accountant will receive any special compensation relating to the offering of these interests.32
(3) Blind Pool Partners ("BPP") is a RELP organized by a major realty firm for the purpose of making a nationwide33 public offering of limited partnership interests by means of an underwritten offering registered with the Securities and Exchange Commission.34 BPP hopes to raise $25,000,000 with which it intends to acquire from time to time various tax-sheltered real estate investments, usually in the form of limited partnership interests in other

26. This may create a problem with the proposed RELP's tax status as a partnership; see text at 260 infra.
27. The use of an accelerated method of depreciation would be unavailable; see note 43 infra.
28. Shelter and Leverage might not be required to register as broker-dealers under federal law even absent an intrastate exemption; see text at 266 infra; they should register as securities salesmen under the New Mexico Securities Act; see text at 267 infra.
29. Even though this transaction may be exempt from federal registration because of the intrastate exemption, it will have to go through some process of registration in New Mexico unless it meets the standards of the 1973 amendments to the New Mexico Act; see text at 275 infra.
30. A discussion of the Investment Advisors Act of 1940, 15 U.S.C. §§80b-1 to -21 (hereinafter cited as the 1940 Act), is beyond the scope of this article. However, Ayer could find himself subject to the requirements of such Act as well as coming within the definition of investment advisor in N.M. Stat. Ann. §48-18-20.9 (Repl. 1966). However, since he is not receiving any special compensation, and is an accountant, it is unlikely that he would be so considered. See 1940 Act §202(a)(11). See generally Cook, SEC Considerations, in Practical Law Institute, Real Estate Syndications 101 (1973).
31. Ayer may be a broker-dealer. See text at 266 infra.
32. See note 30, supra.
33. In light of the recent adoption of the Rules for the Offer and Sale of Real Estate Programs of the Midwest Securities Commissioners Association [hereinafter cited as Midwest Guidelines], publicly offered RELPs, particularly those such as BPP which are considered non-specified property syndications, will have to meet the restrictive standards contained therein. See note 95 infra. Certain jurisdictions, most notably the State of New York, have prevented the offering of syndications unless a significant portion of the proceeds have been committed for the purchase of identifiable properties.
34. See text at 263 infra.
RELPS. The underwriters, who are members of the NASD, would like to emphasize in the sales literature the mutual fund nature of BPP.

SOME TAX ASPECTS OF RELPS

The following is a summary of some of the tax advantages and potential tax problems arising from the use of the RELP. A basic caveat in this area should always be kept in mind: No document should be signed, no expense incurred and no income earned at any stage of the RELP’s existence without careful consideration of the tax consequences of such document, expense or income.

A. Generally

The principal federal income tax benefits that may be available to participants in a RELP result because the RELP is not treated as a tax-paying entity. This causes both the gain and, more significantly, the losses of the venture to flow through to the partners; moreover, some RELPs may produce tax loss deductions in excess of cash risked; and in some cases, particularly in the early stages of a project, the investor may be entitled to receive tax-free cash distributions.

No federal income tax is paid by a partnership. Instead, each partner reports on his federal income tax return his distributive share of the income, gains, losses, deductions and credits of the partnership, whether or not any actual distribution is made to such partner. Each partner’s distributive share of losses of the partnership may be offset against such partner’s income from other sources to the extent of the tax basis of his interest in the partnership at the end of the taxable year. Each partner’s tax basis for his interest in the partnership is computed by taking into account his contributions to the partner-

35. BPP may be deemed to be an investment company within the meaning of the Investment Company Act of 1940, 15 U.S.C. §§80b-2-5 (1970). However, a discussion of such act is beyond the scope of this article. See Cook, supra note 30 at 98.

36. If the proposed guidelines on Tax Shelter Programs of the National Association of Securities Dealers, Inc. (NASD) are accepted, members of the NASD will not be able to participate in offerings of RELPs not meeting the revised standards. See note 85 infra.

It is understood that the staff of the Securities and Exchange Commission has been requiring that all sales literature used in connection with registered RELPs be submitted to the staff prior to use. Any such supplemental literature is subject to the antifraud provisions of the securities laws.

37. For more detailed and exhaustive recent treatments of this subject, see Willis, Partnership Taxation (1971); Shapiro, Tax Planning for Equity Financing by Real Estate Developers, 50 Taxes 530 (1972); Ben-Horin, Real Estate Syndications, Limited Partnerships, 24 U. So. Calif. 1972 Tax Institute 71; Aronsohn, ed., Advantages and Disadvantages of Various Ways of Holding Real Estate, 28 N.Y.U. Tax Inst. 145 (1970); Schwartz, How to Find Tax Shelter as a Limited Partner, 1 Real Estate Review 54 (1971).


ship\textsuperscript{41} plus, in certain cases, his pro-rata share of the mortgage liability.\textsuperscript{42} In a RELP, the major tax loss which is passed through to the partners, particularly in the early stages if accelerated depreciation\textsuperscript{43} is used, is the depreciation taken on the RELP’s buildings.\textsuperscript{44} This type of loss is extremely attractive since it is a “paper” loss and does not involve any out-of-pocket expenditures. The partnership is entitled to depreciate the entire cost of the improvements, even though such cost is financed by mortgages,\textsuperscript{45} which can therefore result in tax losses greater than the amount of cash invested.\textsuperscript{46} This is a key factor in inducing investors to purchase interests in RELPs.

To be effective as a vehicle for tax shelter,\textsuperscript{47} the RELP must be carefully structured to avoid its being taxed as an association,\textsuperscript{48} in

\begin{itemize}
\item \textsuperscript{41} Int. Rev. Code of 1954, §722.
\item \textsuperscript{42} Int. Rev. Code of 1954, §752; Treas. Reg. §1.752-1(e) (1960); See discussion at 260 infra.
\item \textsuperscript{43} Accelerated depreciation is a term used to indicate a method of accounting treatment which results in more rapid depreciation deductions than straight-line depreciation. The two most familiar methods of accelerated depreciation are the declining balance method [Treas. Reg. §1.167(b)-2 (1964)] and the sum of the years-digits method [Treas. Reg. §1.167(b)-3 (1960)]. The Tax Reform Act of 1969 imposed certain limitations on the use of these methods in connection with different types of buildings. With respect to new residential rental property, either the sum of the years-digits methods or the 200 percent declining balance methods may be used, Int. Rev. Code of 1954, §167(j)(2); with respect to used residential real property which has a useful life of at least 20 years to the new owner, the only accelerated method that can be used is the 125 percent declining balance method, Int. Rev. Code of 1954 §167(j) (5). With respect to new commercial or industrial property, the 150 percent declining balance method may be used, Int. Rev. Code of 1954 §167(j)(1); with respect to such property if not new, no form of accelerated depreciation may be used, Int. Rev. Code of 1954 §167(j)(4). In addition, if the property qualifies as low income rental housing, it may be possible to depreciate certain rehabilitation expenses over a five-year period, Int. Rev. Code of 1954 §167(k). See generally Kelley & Aronsohn, Real Estate Depreciation and Low-Income Housing, 23 Tax Lawyer 555 (1970); Grey, Real Estate Shelters and Tax Reform, 1 Real Estate Review 19 (1971); McKee, The Real Estate Tax Shelter: A Computerized Exposé, 57 Va. L. Rev. 521 (1971). As indicated above, the depreciation method which may be used depends on whether the property can be considered new; for tax purposes, the key factor is whether the owner can be deemed the first user, Int. Rev. Code of 1954 §167(c); Treas. Reg. §1.167-1(a)(2) (1960). This can sometimes be a problem if occupancy begins before the investors are officially admitted as limited partners. See Shapiro, supra note 37, at 532-533. See the discussion at note 159 infra as to the possibility of recapture of accelerated depreciation deductions in certain events.
\item \textsuperscript{44} Land is not depreciable, Treas. Reg. §1.167(a)(2) (1960).
\item \textsuperscript{45} Int. Rev. Code of 1954, §167(g); Crane v. Commissioner, 331 U.S. 1 (1947); See Perry, Limited Partnerships and Tax Shelters: The Crane Rule Goes Public, 27 Tax L. Rev. 525 (1972).
\item \textsuperscript{46} See McKee, supra note 43 for a discussion of the interplay between the depreciation deduction and the leverage obtained by using borrowed funds.
\item \textsuperscript{47} Despite the tax shelter nature of the RELP, it is important that the RELP, and perhaps the limited partners, have a profit objective. Under Int. Rev. Code of 1954 §183, any net losses attributable to an activity not engaged for profit may not be deducted from other gross income.
\item \textsuperscript{48} Int. Rev. Code of 1954, §7701(a)(2) excludes from the definition of the term partnership an entity which is a corporation. Int. Rev. Code of 1954, §7701(a)(3) includes within the definition of the term corporation an entity which is an association. The term association is not defined in the Int. Rev. Code of 1954, but is defined in Treas. Reg. §301.7701-2(a)(1) (1965).
\end{itemize}
which case the losses realized by the RELP would not be available to offset other income of the partners, and it would be subject to corporate tax. Moreover, in such cases, cash distributions to the partners may be taxed as dividends.49 For federal income tax purposes, an "association" is an organization that more nearly resembles a corporation than a partnership.50 In determining whether this is the case, consideration must be given to the following six corporate characteristics established by the Internal Revenue Service: a. centralized management; b. continuity of life; c. free transferability of interests; d. limited liability for investors; e. associates; and f. an objective to carry on business and divide the gain therefrom. An unincorporated organization will not be classified as an association unless such organization has more corporate than uncorporate characteristics.52 Because two of the above six characteristics (associates and objective to carry on business and divide the gain therefrom) are common to both corporations and limited partnerships, if it can be demonstrated that two of the remaining four corporate characteristics are absent, then the RELP will receive partnership tax treatment.53 In that case the organization would have at least as many partnership characteristics as corporate characteristics. It can generally be said that if a limited partnership is organized under a statute corresponding to the Uniform Limited Partnership Act, it will be taxed as a partnership rather than as an association.54 This is so because any partnership formed under such an act automatically lacks continuity of life.55 Furthermore, most limited partnership agreements provide that no substitution of limited partnership interests can be accomplished without the consent of the general partner, a provision usually considered sufficient to indicate

51. The association regulations were promulgated by the Internal Revenue Service in 1960 and were strongly influenced by two cases, Morrissey v. Comm'r., 296 U.S. 344 (1933); United States v. Kintner, 216 F.2d 418 (9th Cir. 1954). See Fox, The Maximum Scope of the Association Concept, 25 Tax L. Rev. 311 (1970). For a comparison of the factors announced in Morrissey with the regulations as promulgated, and for a history of the application of such regulations to professional service organizations, see B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Stockholders ¶2.02 and 2.06 (3rd ed. 1971).
53. Id., Treas. Reg. §301.7701-3(b) (1960).
54. But see text at 259 infra.
55. N.M. Stat. Ann. §66-2-20 (Repl. 1972); Treas. Reg. § 301.7701-2(b)(3) (1965). This is so even if the remaining general partners have the right, as stated in the certificate, to continue the business of the RELP on the death of one of the general partners, Treas. Reg. §301.7701-3(b)(2) (1965), Example (2). In the Technical Advice Memorandum supra note 7, the writer took the position that the California limited partnership under consideration had continuity of life because the limited partners could, by less than unanimous vote, continue the RELP under certain circumstances.
that the partnership lacks free transferability of interest. Careful practitioners will also usually advise that the general partner retain a sufficient interest in the RELP’s profits (and partnership capital) to prevent it being said that the limited partners have substantially all of the interests in the RELP. This procedure will lessen the possibility of the RELP being found to have centralized management. Finally, if at least one of the individual general partners in the RELP is not a “dummy” for the limited partners, even if he has no substantial assets other than his interest in the RELP, then the RELP will also lack the corporate characteristics of limited liability.

B. RELPs With a Corporation as the Sole General Partner

It should be noted that the Internal Revenue Service has developed a special set of rules applicable to cases in which the sole general partner of a RELP is a corporation, even if the characteristics of continuity of life, limited transferability and centralized management are lacking. The Service has stated that it will not issue a favorable ruling unless the corporate general partner meets certain tests. While many practitioners question the validity of certain of these tests, nevertheless, it would appear to be unwise, particularly when offering interests to members of the public, to fail to comply with the specific “safe-harbor” tests required when a sole corporate general partner is used. At present, it is required that the sole corporate general partner have a net worth equal to at least 15% of the total partnership capital contributions, or $250,000, whichever is less, if the partnership capital is less than $2,500,000 (10% if partnership capital is equal to or greater than $2,500,000), and that all limited partners in the aggregate own directly or indirectly, not more than 20% of the

58. Treas. Reg. §301.7701-2(d)(1) and (2) (1965).
60. Although the policy speaks only in terms of a sole corporate general partner, presumably the rules could not be avoided through the use of two shell corporations as general partners. Moreover, there have been some indications that the net worth tests in the policy are being applied to individuals as well, see B. Bittker and J. Eustice, supra note 50 at ¶2.02 (1972 Supp.), and Feder, How Real Estate is Faring Under the Federal Income Tax, 2 Real Estate Rev. 49 (1972).
61. Indeed it is understood that the staff of the Securities and Exchange Commission is requiring that all RELPs registering under the 1933 Act receive a favorable ruling on this point.
62. In determining net worth, the current fair market value of the corporation’s asset is used, and the corporation’s interest in the RELP and any of its notes and accounts receivable from or payable to the RELP cannot be taken into account, 1972 Int. Rev. Bull. No. 2, at 26.
63. For purposes of determining such stock ownership, the attribution rules of Int. Rev. Code of 1954 §318 are applicable.
stock of the corporate general partner or any of its affiliates.\textsuperscript{64} Moreover, since the policy requires that the net worth test be met at all times, if the capitalization of the general partner corporation drops below the minimum (unless due to a temporary fluctuation in the value of the corporation's assets) the partnership would at once become an "association".\textsuperscript{65}

Quite significantly, these tests must be met for each separate limited partnership in which the corporation is the sole general partner.\textsuperscript{66} This means that the corporation cannot "use" the same minimum net worth\textsuperscript{67} to satisfy the requirements for more than one limited partnership.

C. Problems Concerning Tax Basis and Deductions

As stated above, a partner's distributive share of losses of the partnership can be used only to the extent of the tax basis of his partnership interest. If a RELP is structured properly, this tax basis can include a pro rata share (based on the partner's share of partnership profits)\textsuperscript{68} of the mortgage loan. Since the mortgage usually represents a large portion of the cost of the project, this can be quite significant. Normally a partner can include in the tax basis of his partnership interest a debt for which he has a personal liability and also liabilities to which partnership property is subject.\textsuperscript{69} In a limited partnership, a limited partner is permitted to take the mortgage liability into account only when no partner, including any general partner, is personally liable.\textsuperscript{70} This means that it is essential that the

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\item\textsuperscript{64} Moreover, the purchase of a limited partnership interest by a limited partner must not entail either a mandatory or a discretionary purchase or option to purchase any type of security of the corporate general partner or its affiliates. The purpose of this provision is not clear, see Fraser, \textit{supra} note 59.
\item\textsuperscript{65} In order to prevent such a conversion of status, it is customary in publicly offered RELPs to have the sole corporate general partner covenant to maintain the necessary net worth. The immediate tax effect of such a conversion is not clear, see B. Bittker & Eustice, \textit{supra} note 50 at 2. It has been suggested that the rationale behind the Service's policy with respect to sole corporate general partners is to prevent the sham use of the limited partnership vehicle, and that if the tests were not met, the I.R.S. would not seek to tax the RELP but instead would consider the general partner as the taxable entity and the limited partners as a class of stockholders of the general partner, see Fox, \textit{supra} note 51.
\item\textsuperscript{67} In determining the net worth of a corporation under these circumstances, any interest in, and notes and accounts receivable from and payable to, any limited partnership in which such corporation has an interest must be excluded, 1972 Int. Rev. Bull. No. 2, at 26.
\item\textsuperscript{68} Treas. Reg. §1.752-1(e) (1960).
\item\textsuperscript{69} Int. Rev. Code of 1954, §752(a); Treas. Reg. §1.752-1(e) (1960).
\item\textsuperscript{70} Treas. Reg. §1752-1(e) (1960). It is understood that the Treasury Department has been considering whether such rules should be changed. See Memorandum re Authority of the Treasury Department to Delete or Modify the Rule in §1.752-1(e) (1960) of the Income Tax Regulations which prescribe the Manner in which Non-Recourse Liabilities are Shared by Partners, contained in Practicing Law Institute, Real Estate Syndication 1973 (1973) at 437.
\end{itemize}
mortgage loan commitments and agreements, particularly the permanent mortgage, contain an exculpatory clause immunizing from personal liability each of the partners, including the general partners.

Another way of accomplishing total exculpation is to have the mortgage loan executed by a nominee of the partnership and then transfer the property subject to the mortgage to the partnership. The use of a nominee may also be necessary to avoid usury problems. In many cases, a direct loan to the RELP by the construction lender or permanent mortgagee would run afoul of the usury laws. Therefore, a nominee corporation (or "straw") is used to take title to the real estate and to "borrow" the money from the lending institution. For tax purposes the nominee relationship should be carefully structured, documented and maintained so that the Internal Revenue Service does not claim that the corporation was the true owner of the property. It is therefore useful (a) to use as a straw a corporation whose corporate powers are limited to nominee activities and whose stock is owned by persons who have no beneficial interest in the property or in the RELP, (b) to enter into a formal nominee agreement between the straw and the RELP pursuant to which the straw agrees to act as such, disclaims any beneficial interest and receives a fee for its services, and (c) to establish an arrangement providing for the draw-down of the construction loan proceeds only on written instructions from the RELP.

Since the major attractiveness of the RELP is the ability to pass the tax deductions (primarily depreciation) to the high tax-bracket investors, it is customary to maximize such benefit by allocating to the limited partners as much of the partnership's tax losses as possible. The Internal Revenue Code permits any items of gain or loss to be allocated among the partners in accordance with the partnership

71. It is, of course, not always necessary to have total exculpation; partial exculpation may be sufficient, see Shapiro, supra note 37, at 532.
73. The maximum interest permitted in New Mexico with respect to collateralized loans, such as real estate mortgage loans, is 10 percent per annum computed upon the unpaid balance, N.M. Stat. Ann. §§50-6-16 (Repl. 1982).
76. Note that these tax safety rules may increase the risk that a court would pierce the corporate shield to the usury defense. In addition, some lenders may be unwilling or legally inhibited from lending money to a borrower which it knows to be a shell or straw. See Aronsohn, supra note 37 at 159-164; Real Estate Financing-Business and Legal Considerations 54 (McCord ed. 1968).
agreement, except that such allocation must have some economic substance and must not be motivated principally by tax avoidance purposes.

In connection with RELPs which are involved in the construction of new projects, one of the most important tax considerations to investors is the availability of the initial construction expenses, such as commitment fees, prepaid interest "points," FHA-related costs, architectural fees, etc., as tax deductions. It is to be noted that it is sometimes a difficult question which of such items are immediately deductible, amortizable or included as part of the depreciable base of the project. Assuming that an expense is immediately deductible, it often happens that the expense (for example, "points" paid to the construction lender) is incurred and paid by the developer or an affiliated entity prior to the admission of the limited partners to the partnership. If the partnership was organized at the time the expense was incurred and the expense was actually paid by the partnership, then it may be possible for investor limited partners who are admitted to the partnership during the calendar year to get the benefit of the deduction. Many times, however, because of poor planning or otherwise, the expense is paid directly by the developer and before the partnership is organized. In these cases, the deduction to limited partners is in great doubt and other procedures are established, the tax efficacy of which is not certain.

SECURITIES REGULATION AND THE RELP

Under the Securities Act of 1933 as well as state blue sky statutes, limited partnership interests in RELPs structured along

80. Int. Rev. Code of 1954, §706. This would require that a limited partnership be formed with an original limited partner with a provision in the agreement authorizing the admission of additional limited partners at a later date. See Treas. Reg. §1.706-1(b)(1)(ii) (1960); cf. Treas. Reg. §1.706-1(c)(4) (1960); Treas. Reg. §1.731-1(c)(3) (1960). Note that the rule applies to investors who purchase newly authorized limited partnership interests but not to investors who acquire their interests from existing limited partners, Treas. Reg. §1.706-1(c)(2)(ii) (1960). See Shapiro, supra note 37, at 533, 540, 541.
81. 15 U.S.C. §§77(a)-77(aa) (1970) [hereinafter cited as the 1933 Act]. It should be noted that the Real Estate Advisory Committee to the Securities and Exchange Commission has recommended that a permanent real estate advisory committee be established to advise the Commission on special regulation for real estate securities. The Committee has made summarized recommendations pending the establishment of the permanent committee. See BNA, Sec. Reg. & L.R. (Oct. 18, 1972).
the lines of the three hypotheticals set forth supra have been understood to come within the definition of "security." 33 Sales of limited partnership interests have thus met with administrative regulation at the federal 34 and state 35 levels and have also resulted in civil liability 36 for noncomplying sellers.

A. Registration Requirements

If limited partnership interests in RELPs are securities, then they must, in the absence of an applicable exemption, be registered prior to issuance, and be sold, again absent an exemption, only by licensed broker-dealers and salesmen of securities.

terms "certificate of interest or participation" [in any profit-sharing agreement], "investment contract", "any interest or instrument commonly known as a security", which terms are contained in all three such acts, cover limited partnership interests. It should be noted that Rule 3a-11-1 promulgated under the Securities Exchange Act of 1934, 15 U.S.C. §§78a-78(hh) (1970) [hereinafter cited as the 1934 Act] defines "equity security" to include any "limited partnership interest."

83. Limited partnership interests in RELPs formed under the Uniform Limited Partnership Act are always securities. By virtue of his statutory passivity and capital-contributing function, the limited partner is an investor who is more in need of the protection afforded by securities laws than his stockholder counterpart. For while the limited partner of even the smallest limited partnership may take an active role in the business only at the risk of losing his limited liability, the shareholder in a corporation is expected (and in some instances required by statute) to take part in major business decisions.

The argument has been made that so-called bona fide limited partnership interests are not securities in those cases where the partners have a right of delectus personae (the right to determine membership) and where the relationship among the limited and general partners is one of personal confidence. See Dahlquist, Regulation and Civil Liability Under the California Corporate Securities Act, 33 Calif. L. Rev. 343, 363 (1945); cf., Loss, Securities Regulation 504 (1961) 2550 (Supp. 1969). This distinction, if applied to investments in RELPs, would ignore economic realities. Limited partnership interests in RELPs clearly fall within the United States Supreme Court's test for determining what is a security set forth in S.E.C. v. Howey Company, 328 U.S. 293, 301 (1946): "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." For the proposition that a limited partnership interest is always a security, see Long, Partnership, Limited Partnership and Joint Venture Interests as Securities, 37 Mo. L. Rev. 581 (1972). Contra, e.g., Grabendike v. Adix, 335 Mich. 128, 55 N.W.2d 761 (1952); Lindemulder v. Sharp, 258 Mich. 679, 242 N.W. 807 (1932).


85. See, e.g., People v. Woodson, 78 Cal. App.2d 132, 177 F.2d 566 (1947); Curtis v. Johnson, 234 N.E.2d 568 (1968); Joint Release, supra note 84. Moreover, the present New Mexico Securities Commission considers limited partnership interest in RELPs to be securities. Swarthout interview, supra note 3.

1. Registration of Limited Partnership Interests Under the 1933 Act

Before a non-exempt offering of limited partnership interests can be made, Section 5 of the 1933 Act requires that a registration statement covering such interests must be in effect. The Division of Corporate Finance of the Securities and Exchange Commission (SEC) will review the registration statement of the RELP, which is normally made on Form S-11, prior to its effective date. Disclosures required in the process of registration are set forth in the instructions to Form S-11 as well as in the 1933 Act and the rules and releases promulgated thereunder. Additional regulation of the publicly-offered RELP may result from the proposals of the National Association of Securities Dealers, Inc. (NASD) regarding offerings in which its members are involved, and from the various rules of the applicable blue sky administrators.

Although each particular offering should be specifically analyzed by the attorneys for the RELP because of its own unique aspects, the authors of this article recommend that disclosures such as those set forth infra be regarded as providing the basic information that every investor should have before he makes his investment decision. This information is appropriate whether the offering is registered under federal and/or state law, or is made pursuant to exemptions from such registration.

2. Registration of Limited Partnership Interests Under the New Mexico Securities Act

The 1933 Act does not preempt regulation of RELPs by the states. Thus, not only is compliance with relevant state law

87. See National Ass'n of Securities Dealers, Inc., Tax Shelter Programs, proposed Art. III, Sec. 33 of Rules of Fair Practice and Proposed Regulations to be Adopted (May 9, 1972) [hereinafter cited as NASD Guidelines]. If the NASD Guidelines are adopted, they will prohibit members of the NASD from participating in the distribution of units of tax shelter programs to the public. The NASD Guidelines, which regulate the distribution of oil and gas programs and similar programs in addition to RELPs, contain substantive limitations such as the following: the sponsor (i.e., general partner) of the program must have a net worth of at least $100,000 or an amount equal to ten percent (10%) of the total value of all program offerings, public or private, sponsored by it during the current year, whichever is greater; no sponsor can sell his interest in a program without a comparable offer being made to the limited partners; no sponsor can sell any property owned by him to the RELP unless such is fully disclosed in the prospectus; the NASD member must be assured that the investor, after giving effect to all of his tax sheltered investments, is reasonably anticipated to be in the 50 percent federal income tax bracket and that he has a net worth of at least $50,000; the organization and offering expenses of the RELP must not exceed 12¼ percent of the cash receipts of the offering.

88. See note 97 infra.

89. See note 143 and accompanying text infra.

90. 1933 Act §18.
required, but, because the New Mexico Act requires that offerings be "fair, just and equitable," an offering registered under the 1933 Act could be barred from New Mexico. Moreover, even if an offering of limited partnership interests is exempt from federal registration requirements, a parallel state exemption may not be available. This latter fact makes observance of the New Mexico Securities Act of considerable importance, as transactions in RELPs exempt from federal regulation are in many instances not similarly exempt from the more restrictive New Mexico Act. For example, the present New Mexico Securities Commissioner has taken the position that, prior to the 1973 amendments to the New Mexico Securities Act, there was, for all practical purposes, no "private placement" exemption available for the issuance of limited partnership interests; consequently, all limited partnerships, regardless of their size, were obligated to go through the registration process.

New Mexico, unlike a few other jurisdictions, has no statute providing for special regulations for real estate syndications. Registration of limited partnership interests must therefore be accomplished by qualification (full-scale state regulation) or coordination (in cases involving concurrent federal registration). Both types of registration will involve disclosure of information similar to that required in SEC registration and will, in addition, be subject to New Mexico's "fair, just and equitable" requirements. Moreover, a RELP going through the registration process in New Mexico will be subject to additional regulation because of the recent adoption of the guidelines of the

92. For example, in view of the guidelines of the Midwest Association, the New Mexico Securities Commissioner could deny a permit to a RELP whose securities had been registered under the 1933 Act but that failed to meet the standards of the guidelines on the ground that an offering of the interests in such a RELP would not be "fair, just and equitable." See note 91 supra.
93. Swarthout Interview, supra note 3. RELPs with one general partner and as few as ten limited partners have registered by qualification. For example, see De Colores Limited Partnership, effective February 28, 1972; The New Mexico "T", effective April 4, 1972. However, Commissioner Swarthout acknowledged that the isolated sale exemption might be available to the creation of a RELP with one or two limited partners.
94. See e.g. N.J. Rev. Stat. 49:3-27 et seq. (Supp. 1970); N.Y. Gen Bus. Law §352(e) (McKinney 1968). The State of California regulates RELP offerings in two ways: The Real Estate Syndicate Act, Cal. Bus. & Prof. Code §§10250 et seq. (West Supp. 1972) deals with RELPs beneficially owned by no more than 100 persons and for which a registration statement under the 1933 Act has not been filed; the California Corporate Securities Law of 1968, Cal. Corp. Code §§25000 et seq. (West 1955) regulates RELP offerings that anticipate more than 100 beneficial owners.
Midwest Securities Commissioners Association, as New Mexico is a member of this Association.97

3. Broker-Dealer Registration Requirements

Section 3(a)(4) of the Securities Exchange Act of 193498 broadly defines a broker as any person, other than a bank, who is engaged in the business of effecting transactions in securities for the account of others. All persons, including general partners or officers of the corporate general partner, offering or selling units of RELPs such as those described in the introduction could be so deemed, because they are in fact effecting transactions in securities for the accounts of others: i.e., distributing limited partnership interests for the RELP. However, several recent interpretive letters of the staff of the Division of Corporate Finance of the SEC concluded that as long as they received no sales commissions for distributing limited partnership interests the staff would take no action on the failure to register as broker-dealers of general partners involved in the formation and operation of RELPs.99 It would seem that all other persons engaged in the business of effecting transactions in RELP interests (such as real estate brokers who are not general partners in the RELP whose interests are being distributed and who receive commissions on their sales) could come within the definition of “broker.” This has the following consequences:

a. No broker, other than one whose business is exclusively intrastate, may use the facilities of interstate commerce or the mails to effect any transaction in, or induce the purchase or sale of, such interests without being registered as a broker-dealer with the SEC pursuant to Section 15 of the 1934 Act.

b. The provisions of Sections 7 and 11(d) of the 1934 Act and Regulation T promulgated by the Federal Reserve Board relating to

97. See Midwest Securities Commissioners Ass’n Rules for the Offer and Sale of Real Estate Programs (adopted February, 1973) [hereinafter cited as Midwest Guidelines]. The Midwest Guidelines will have a significant impact on RELP offerings. While the securities administrator may, upon a showing of good cause, waive their application, the guidelines contain many substantive limitations on the structuring of a RELP, such as: the general partner (or officer of the corporate general partner) must have a minimum of four years experience (five in the case of a blind pool, i.e., non-specified property syndications offering); on low risk ventures the minimum investment must be $2,500 and, in those of high risk, $5,000; blind pool RELPs must have a minimum capitalization of $1,000,000 before commencing business; payment of a fee to the syndication upon acquisition, development or sale of the property by the RELP should not exceed 18 percent of the net proceeds of the offering. Moreover, the Midwest Guidelines also would require disclosures in addition to those which the authors of this article have set forth as the minimum basic disclosures, see text infra at 275.


99. Choice Communities, Inc., CCH Fed. Sec. L. Rep. ¶79,203 (1972); but cf. Hofheimer, Cartlir, Gottlieb & Gross, CCH Fed. Sec. L. Rep. ¶79,698 (1972). However, if such activities recurred on a regular basis, registration may be required.
the extensions of credit, and the arrangement thereof, by a broker are applicable. These provisions would prohibit the offer and sale of interests in RELPs required to be registered pursuant to Section 5 of the 1933 Act on installment terms inconsistent with such provisions.\textsuperscript{100}

c. The prohibitions under Section 15 of the 1934 Act specifically relating to the conduct of broker-dealers are applicable.\textsuperscript{101}

d. Any person who "controls" (within the meaning of Section 15 of the 1933 Act and Sections 15(b) and 20(a) of the 1934 Act and the rules and regulations thereunder) any other person who has committed violations of the 1933 Act or 1934 Act, or any person who has committed such violations "indirectly" (within the meaning of Section 20(b) of the 1934 Act) through any other person, may be subject to civil liability or administrative sanction by the SEC under those Acts.

e. Even assuming an exemption from federal broker-dealer regulations, the New Mexico Securities Act requires that persons acting as dealers or salesmen of non-exempt securities, except in exempt transactions, must register with the Securities Division.\textsuperscript{102} Accordingly, even though a general partner of a RELP who actively distributes limited partnership interests in that RELP may not come within the definition of "broker-dealer" under federal law, it would appear that he does come within the definition of "salesman" under the New Mexico Securities Act and must register as such.\textsuperscript{103}

It should be noted that the failure to comply with the provisions of the state and federal securities laws outlined above could result, under certain circumstances, not only in administrative action by the SEC or the New Mexico Securities Commission but also in civil actions for rescission by the purchasers of limited partnership interests.\textsuperscript{104}

\textbf{B. Exemptions from Section 5 of the 1933 Act}

Offerings of interests in RELPs are commonly made pursuant to one of the following three exemptions from the registration and

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\textbf{100.} 12 C.F.R. 220, 124, CCH Fed. Sec. L. Rep. \textsuperscript{122}. 282. Query: is this interpretation by the Federal Reserve Board applicable to \S\textsuperscript{111}(d) of the 1934 Act. \textit{See also} NASD Guidelines, \textit{supra} note 87, at 8.

\textbf{101.} Moreover, broker-dealers must maintain a minimum net capital and are subject to extensive reporting requirements.


\textbf{103.} See Parnall and Tier, \textit{A Survey of the Securities Act of New Mexico}, 2 N.M. L. Rev. \textbf{1}, 25 (1972). Even though the general partners may be considered to be issuers under federal law, N.M. Stat. Ann. \S\textsuperscript{48-18-17(C)} (Repl. 1966) would expressly require such registration as it refers to "A partner \ldots of \ldots [an] issuer. \ldots" if he is engaged in the selling of the RELP interests.

\textbf{104.} \textit{See} 1933 Act, \textit{supra} note 81, at \S\S\textsuperscript{12(1)}; N.M. Stat. Ann. \S\textsuperscript{48-18-31} (Repl. 1966).
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prospectus requirements of the 1933 Act: (1) the "intrastate" exemption,\textsuperscript{105} (2) the "private placement" exemption\textsuperscript{106} and (3) the "Regulation A" exemption.\textsuperscript{107} It should be emphasized that even if a particular offering is exempt from the registration requirements, it is still subject to the antifraud provisions of the 1933 Act and the 1934 Act.

1. The Intrastate Exemption\textsuperscript{108}

Section 3(a)(11) of the Securities Act of 1933 exempts from the registration requirements of Section 5 of the Act:

any security which is part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory.

The SEC has stated that this exemption is designed to apply only to local financings of local businesses.\textsuperscript{109} Since this exemption is available only to issuers resident and doing business within the state in which the securities are being offered, the exemption should not be used unless all of the following are present:

 a. The RELP must be formed under the laws of the state.\textsuperscript{110}

\textsuperscript{105} 1933 Act \textit{supra} note 81, at §3(a)(11).
\textsuperscript{106} 1933 Act \textit{supra} note 81, at §4(2).
\textsuperscript{107} 1933 Act \textit{supra} note 81, at §3(b).
\textsuperscript{108} In Release No. 33-5349 CCH Fed. Sec. L. Rep. ¶79,168 the SEC proposed Rule 147 which is intended to provide objective standards for issuers who plan to use the intrastate exemption. While the proposed rule provides more certainty concerning the availability of the exemption, the standards themselves are generally as restrictive as the earlier positions taken by the SEC and the courts. The conditions that the proposed Rule imposes are:

(1) The issuer must be "a resident of" [defined in the proposed Rule] and "doing business within" [defined in the proposed Rule] the state or territory in which offers or sales are made. Note that if the issuer is a partnership, all the general partners must be residents of such state or territory;

(2) No "part of the issue" [defined in the proposed Rule] can be offered or sold to non-residents of such state or territory; and

(3) No part of the issue can be reoffered or resold to non-residents for a 12-month period from the date of the last sale of the issue. Note that for purposes of the proposed Rule, offerings of securities by separate and distinct business enterprises for separate and distinct purposes would not be deemed part of an issue solely because both issuers had the same general partner.

\textsuperscript{110} The general partners who are also considered issuers should also be residents of the state in which the securities are being offered and conducting their activities from that state. See American Plan Investment Corporation, CCH Fed. Sec. L. Rep. ¶78,044; see also Posner, \textit{Developments in Federal Securities Regulation}, 27 Bus. Lawyer 957, 976 (1972); but cf. SEC "no-action" letter re: Louisiana Motor Inns, cited in \textit{Prac. L. Inst. Real Estate Syndications}, 395 (1973).
b. All the limited partnership interests must be offered and sold to residents\textsuperscript{111} of the state. Thus, even if one nonresident were offered or acquired such an interest in a transaction deemed to be part of the initial offering the exemption would be lost. If the beneficial owners of the interests or any subparticipations thereof are nonresidents, the use of resident nominees would be ineffective, and the exemption would be lost. In addition, the interests cannot be sold to residents as conduits for resale to nonresidents. In this connection, any resale to a nonresident, within a short time after the initial sale, would be suspect.\textsuperscript{112}

c. The property owned by the RELP must be located in the state.\textsuperscript{113}

In any event, even if a transaction could be structured so that all of the aforementioned factors were present the intrastate exemption should not be relied upon if any one offering is part of an integrated series of offerings conducted by the principals in other states.\textsuperscript{114}

In the event that the intrastate exemption is available, there is no limit to the number of offerees or purchasers. However, the appropriate state (e.g., in our case, New Mexico) may regulate the offering.

2. The Private Placement Exemption.\textsuperscript{115}

Section 4(2) exempts from the registration requirements of Section 5 “transactions by an issuer not involving any public offering.” The

\textsuperscript{111} The term “resident” has been construed by the SEC to mean actual domicile. See Loss, supra note 83 at 598, 2603. See also proposed Rule 147 for a definition of the term. Military personnel stationed in the state are generally not considered to be residents for purposes of the exemption. Id.


\textsuperscript{113} The SEC has stated that where a real estate syndicate organized in State A sells interests in property acquired in a sale and leaseback arrangement with a corporation organized in State B, the exemption would not be available. It is not clear, however, whether the SEC meant to apply this statement to situations where the partnership is the financier-lessee or the borrower-lessee. See SEC Release No. 33-4434, supra note 112.

\textsuperscript{114} This would be done on the theory that such principals are in the business of developing, constructing and managing, for example, apartment units on a nationwide basis and that they obtain the necessary financing for its operations from public investors via a series of integrated offerings. Thus, the SEC has taken the position that the intrastate exemption should not be relied upon for offerings by each of a series of corporations organized in different states where there is in fact and purpose a single business enterprise or financial venture and that in the case of offerings of fractional undivided interests in separate oil or gas properties where the promoters must constantly find new participants for each new venture, it would appear to be appropriate to consider the entire series of offerings to determine the scope of the solicitation. See SEC Release No. 33-4434, supra note 112.

\textsuperscript{115} In Release No. 33-5336, CCH Fed. Sec. L. Rep. ¶79,108 (1972) the SEC proposed Rule 146, which is designed to provide more objective standards for determining the availability of the private placement exemption. While the proposed rule is nonexclusive (i.e., issuers may take
determination of whether an offering of securities falls within the nonpublic offering exemption of the 1933 Act is essentially a question of fact. Each of the following factors is relevant and must be considered: the number of offerees, their financial resources, investment sophistication, and relationship to each other and to the issuer; the number of units offered; the size of the offering; and the relationship to other offerings.

It should be noted that the integration theory, referred to in the discussion of the intrastate exemption, also is an important factor to be considered with respect to the private placement exemption. If the integration theory were applied to a series of private offerings of limited partnership interests in separate RELPs organized from time to time by the same principals, the entire series of offerings would be considered a single offering and the private offering exemption criteria (as discussed below) would be applied to all the offerings as an entirety. In this event, the number of offerees would be increased beyond normally acceptable limits and, if, for example, a single offeree in any one of the individual placements did not have the requisite sophistication, the entire series of offerings might fail to qualify under the private offering exemption.

the position that the exemption is available even in cases where they do not meet the rule's objective standards) the careful practitioner will be reluctant to advise a client of the availability of the exemption without coming within the rule's safe harbor standards. The standards set forth in Rule 146 are: (1) the issuer using the rule must file a report to the SEC after completion of the private placement; (2) there cannot be more than thirty-five (35) persons in any consecutive twelve-month period who purchase securities of the issuer in transactions pursuant to the rule; (3) The offer must be made only in a negotiated transaction (i.e., there must be no general advertising and the transaction must be carried out by direct communication between the issuer or any person acting on its behalf and the purchaser or its investment representative); (4) the offeree or his investment representative must have access to the same kind of information that the 1933 Act would make available in a registration statement; (5) the issuer must have reasonable grounds to believe that its offerees are sophisticated investors; and (6) the issuer must have reasonable grounds to believe that the purchasers are buying for investment and not for resale (and the issuer must take steps to protect against any resale).

116. See e.g. SEC v. Ralston Purina, 346 U.S. 119 (1953); Lively v. Hirschfeld, 440 F.2d 631 (10th Cir. 1971); SEC v. Continental Tobacco Company of South Carolina, Inc., 463 F.2d 137 (5th Cir. 1972); Gilligan, Will & Co. v. SEC, 267 F.2d 461 (2d Cir. 1959).


118. See Posner, Developments in Federal Securities Regulations, 27 Bus. Lawyer 957 (1972), for the recently developed proposition of the staff of the SEC that in the absence of financial interdependence, separate offerings to limited groups at different times with respect to separate projects financed by separate mortgages on separate sites would not be integrated solely because a common general partner is present. Separate offerings to limited groups at separate times to finance successive portions of a project . . . would not be integrated . . . citing Corp. Fin. Letter of Oct. 8, 1971, re: National Association of Home Builders. Mr. Posner indicates that it is not clear whether the same rules prevail with respect to integration of intrastate offerings. Cf., Corp. Fin. Letter of February 19, 1971, re: Presidential Realty Corp., CCH Fed. Sec. L. Rptr. ¶78,006.
The following are certain basic guidelines that should be considered in any private placement of securities issued in connection with a real estate syndication:

a. The group of persons to whom the securities are offered must be limited in number. In most cases, the number of offerees should be limited to no more than fifteen persons, all of whom have the financial position and real estate experience described in the next paragraph.

b. Offers should not be made to anyone in the absence of satisfactory knowledge that each such offeree is a sophisticated and knowledgeable investor and is able financially to incur the risks involved in the purchase of the securities being offered. Thus, appropriate standards should be established for minimum investment, net worth, annual income, liquidity, and real estate investment expertise on the part of prospective investors. The State of California, for example, has required that purchasers of publicly offered RELP securities be experienced in real estate matters and either have a net worth of at least $200,000, or have a net worth of at least $50,000 and be in the 50 percent tax bracket. Because of the nature of the investment in the great majority of RELPs, the suitability requirements would suggest it is advisable that investors be in the higher tax brackets.

c. At the time offers are made, the offeree should be

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119. In this regard, it has been asserted by members of the staff of the SEC that an offeree may include anyone who is asked about his general interest in the type of securities being offered. However, it is arguable that a distinction may be drawn between an offeree who is merely asked about his interest in real estate investments and an offeree who is given further facts. See Release No. 33-285, CCH Fed. Sec. L Rptr. ¶ 2741; see also, Practicing Law Institute, Annual Institute on Securities Regulation 27-28 (1970).

120. The number 15 has been chosen as this would be the maximum number of partners allowable in a RELP offering exempt from both New Mexico (after the effective date of the 1973 Amendments: see note 138 infra) and federal registration requirements. The offeror must always bear in mind that, even if proposed Rule 146 is adopted, there is no absolute number under federal law that will assure the availability of the private placement exemption. Thus the United States Supreme Court said, in SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953): "But the statute would seem to apply to a 'public offering' whether to few or many" and cited approvingly the dictum in Nash v. Lynde, [1929] A.C.158, 159: "The public . . . is of course a general word . . . Anything from two to infinity may serve . . . ."

121. Cal. Sec. Comm'n Rule 260. 140, 114, 1 CCH Blue Sky L Rptr. ¶ 8826 gives the commission the power to determine suitability standards with respect to particular offerings. Pursuant to this rule, the Commissioner has imposed the described minimum net worth and income standards.

122. See NASD Guidelines, supra note 87, at 21. See also Midwest Guidelines, supra note 97 at 8: "As a general rule, syndicates structured to give significant tax advantages should be sold only to persons in higher income tax brackets." See note 152, infra.
furnished with an offering brochure which fully describes both the advantages and the disadvantages of the offering by making the basic disclosures set forth infra.

d. Each purchaser must also represent that the securities being acquired by him are being acquired for his own account and for investment and not with a view to the distribution thereof. Moreover, the purchaser should represent that he understands the meaning of such representation.\textsuperscript{123} It would be desirable if the subscription form contained similar representations.

e. An accurate list must be maintained that identifies each offeree contacted (and each person contacted by any such offerees), the information furnished and the ultimate investment decision made.

3. The Regulation A Exemption.\textsuperscript{124}

If neither the intrastate nor private placement exemptions standards can be met, an offering of limited partnership interests may yet qualify for special treatment pursuant to Regulation A. Unlike the first two exemptions, an exemption under Regulation A involves what might be described as “mini-registration” with the appropriate regional office of the SEC and is available only if the amount of the offering does not exceed $500,000.\textsuperscript{125}

Although perfecting an exemption under Regulation A is generally less expensive and more expeditious than filing a full-scale registration statement with the Division of Corporate Finance in Washington, D.C., it should be approached with care. Not only should the required offering circular contain all of the basic disclosures as would a prospectus filed in compliance with Section 5 of the 1933 Act, but prior transactions of the principals should be carefully considered. If any of the principals (i.e., the general partners or affiliates of the general partners as well as the underwriter) have been the subject of censure for prior securities dealing, the exemption may be unavailable. Once again the concept of integration is important: If general partners or affiliates of a general partner have organized a limited

\textsuperscript{123} See Release No. 33-5226, CCH Fed. Sec. L. Rptr. \$78,483.

\textsuperscript{124} 1933 Act, supra note 81, at §3(b); Regulation A consists of Rules 251-263 and Forms 1-A through 6-A promulgated under the legislative authority of §3(b). See generally Loss, supra note 83, at 605-34, 2606-16.

\textsuperscript{125} Of particular interest to persons dealing with RELPs is Rule 254(d)(5) of Regulation A which excludes from the $500,000 ceiling “interest in any affiliated issuer organized to hold title to, lease, operate or improve other specific real property.” Thus organizers of RELP #1 could use the Regulation A exemption to raise $500,000 to build project A and then immediately raise another $500,000 with RELP #2 for project B. Without the language of Rule 254(d)(5), if the two RELPs had common general partners, this would not be possible.
partnership(s) under the intrastate exemption and later seek additional financing pursuant to the exemption afforded by Regulation A, the two or more offerings may be "integrated" and the earlier intrastate exemption destroyed.126

C. Exemptions from the Registration Requirements of the
New Mexico Securities Act

1. Before the 1973 Amendments

Offers and/or sales of limited partnership interests in RELPs such as those set forth in the hypotheticals, supra, are exempt from the registration requirements of the New Mexico Act only if they can be considered as "exempt transactions."127 Traditionally, the most commonly relied upon exemption from state registration requirements is the private placement exemption,128 which, prior to the 1973 amendments,129 was established in four separate subparagraphs of Section 48-18-22 of the Act.130 Two of these exempt transactions involving offers and/or sales to underwriters and institutional investors are not especially significant with respect to the three hypothetical transactions set forth supra; it is the isolated sale and the fifteen or less preorganization certificate exemptions upon which most organizers have relied. The significance of these two exemptions is magnified by the fact that the twenty-five or less security holder exemption of Section 48-18-22(J)131 is not available to transactions involving interests in limited partnerships.132

Contrary to many state securities acts, the isolated sale exemption of the New Mexico Act is available to issuers as well as non-issuers.133 It is understood by the present Commissioner of Securities to cover transactions involving only one or two offerees and never as many as

126. See Jennings & Marsh, Securities Regulation 575 (1972), see also Property Interest, Inc., CCH Fed. Sec. L. Rep. p 79,201, for the SEC's Division of Corp., Fin. Position that the offer and sale of $25,000,000 in promissory notes to be restricted to Texas residents may not be made without registration under the 1933 Act since a public offering of common stock, available out of state, to be made no less than six months after the notes offering begins might be considered a part of the same integrated scheme of financing.

127. It would appear that none of the three hypotheticals deals with an exempt security under N.M. Stat. Ann. § 48-18-21 (Repl. 1966). It is possible, however, that the limited partnership interests in the RELP described in the third hypothetical, if the securities were listed on a national stock exchange, could become exempt securities under N.M. Stat. Ann. § 48-18-21F (Repl. 1966).

128. See generally, for a discussion of this exemption, Loss, supra note 83, at 653, 697 and 2629-66; Jennings & Marsh, Securities Regulation 403-67 (1972).

129. See note 138 and accompanying text infra.


132. Swarthout Interview, note 3 supra. This is in keeping with the express language of the statute.

133. See Parnall & Ticer, supra note 103, at 37.
Thus, the isolated sale exemption would be available only to a very limited number of RELPs and should not be relied upon in setting up RELPs similar to the three hypothetical situations set out supra.

It is arguable that the fifteen or less preorganization certificate exemption is available to issuers where: (1) the number of limited partners does not exceed fifteen, (2) there are no commissions paid for sales, and (3) payments made by the partners are held in escrow, presumably until the existence of the limited partnership formally begins. While it is possible to read the words “preorganization certificate” and “subscription” as words of art applicable only to subscriptions for the shares of a corporation, the limited partnership interests could be considered as subscriptions or preorganization certificates if the certificate of limited partnership for the RELP had not been filed before the limited partner (subscriber) paid his money into an escrow account. Since there is nothing further to be issued to the limited partner (in contrast to the case of a corporation where a subscriber would receive shares after the formation of the corporation, which issuance requires an exemption) after he signs and pays, the funds could be released by the escrow agent to the RELP upon compliance with the terms of the escrow (i.e., obtaining the necessary funds, filing of the certificate of limited partnership, etc.).

The difficulty with this argument is that it is contrary to the draftsmen’s comments to the following similar exemption provided by the Uniform Act:

The following transactions are exempted from Sections 301 and 403 . . .

(10) any offer or sale of a preorganization certificate or subscription if (A) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective subscriber, (B) the number of subscribers does not exceed ten, and (C) no payment is made by any subscriber; . . . 136

The commentators take the position that this exemption is merely a technical exemption delaying registration until payment is actually made. That is, only gratis preorganization certificates or subscriptions may be distributed to not more than ten persons; after the distribution of such certificates, another exemption must be found prior to the issuance of shares in exchange for the consideration that is

134. Swarthout Interview, note 3 supra.
136. Uniform Act, supra note 82, at §402(b)(10).
then due from the subscriber. This reasoning applied to the New Mexico Act’s exemption would render the exemption of little value in the case of RELPs. Even though the original placement of limited partnership preorganization interests to fifteen persons would be exempt, there could be no release of the escrow money to the RELP without an additional exemption or registration. The present Commissioner of Securities does not view this exemption as available to limited partnerships.

2. The 1973 Amendments

The New Mexico Securities Act has been amended effective June 15, 1973. The amendment most relevant to the RELP is the addition of a private placement exemption expressly dealing with limited partnerships:

any offer or sale of limited partnership interests in a limited partnership organized under the laws of this state [is exempt from the registration requirement of the Act] if:

(1) the number of limited partners will not at any time, either as a result of a subsequent transfer of a limited partnership interest or otherwise, exceed fifteen partners; and

(2) no general partner of the limited partnership, and no affiliate of any general partner has been involved directly or indirectly in any manner in any limited partnership for which a notice of claim of exemption under this subsection has been filed during the preceding twelve-month period. As used in this subsection, “affiliate” means a person who, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, another person.

It should be noted that, as in the case of the exemption for a private placement of corporate securities, this exemption must be perfected by filing a notice of exemption with the New Mexico Securities Commissioner. Moreover, the anti-fraud provisions of the New Mexico Securities Act would still apply.

D. Basic Disclosures to Investors in RELPs

One of the major abuses associated with the RELP has been the tendency to emphasize its tax aspects while ignoring the quality of the real estate investments. Interests in RELPs should be offered or sold only to persons having an appreciation of the business risks of the

venture as well as the tax implications of their investment. In today's post-Texas Gulf Sulphur investment world, disclosure of the material facts concerning a transaction in securities is required, whether or not the transaction is exempt from registration. The rash of litigation under Rule 10b-5 and other federal and state securities regulations and statutes should serve to point out the potential liability to those who become involved in securities transactions and either inaccurately disclose material facts or fail to disclose them. Because federal and state securities regulations are directed at inaccurate disclosure and failure to disclose as well as registration, purchasers of interests in RELPs registered under the 1933 Securities Act, or the New Mexico Securities Act, or exempt from registration thereunder, are legally entitled to accurate and complete information. While not taking the position that failure to do so would necessarily lead to liability, the authors consider that the disclosure document, whether in the form of a 1933 Act prospectus, a Regulation A offering circular, a New Mexico intrastate prospectus or a private placement circular should contain the minimum basic disclosures set forth below. Notations are made after those disclosures (such as projections) that the SEC does not allow with respect to interests registered under the 1933 Securities Act or exempt pursuant to Regulation A.

1. **Risk Factors**

a. If the RELP has been recently organized or the RELP's property has not yet been developed and operated (as is usually the case), this fact should be specifically brought to the attention of the potential investor. The status of the construction of any buildings owned or operated or to be owned or operated by the RELP and the rental status of such buildings, if relevant, should be stated.

b. If any economic benefits have been described either in the circular or prospectus (or orally) as being obtainable from the purchase of limited partnership interests, it should

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144. Proposed Rule 146(e) would condition the availability of the private offering exemption on each offeree's (or his investment representative's) access to the same kind of information that would be available in the form of a registration statement filed under the 1933 Act. Access to information is also required by the tests set forth in SEC v. Ralston Purina Co. 316 U.S. 119 (1953). However, there is some authority for the proposition that a well-prepared offering circular might not suffice for these purposes: see Continental Tobacco Company of South Carolina, Inc., 463 F.2d 237 (1972).
be made clear that such benefits are based upon the correctness of various projections\textsuperscript{145} that may or may not be correct. The investor should be warned that if such projections are incorrect, the results of the operations may be substantially different from those described. A statement should be made concerning the impossibility of predicting future income, expenses and contingencies and that no assurances can be given that any of the potential benefits of the RELP will in fact be realized by investors.

c. From a competitive viewpoint, the effect should be indicated of present and planned similar projects on the rentals and occupancy of the project.

d. It should be noted that not all RELPs are successful; that they are subject to risks inherent in real estate investments; and that the success of any particular project depends on many factors, such as local and national economic conditions, rent stabilization laws, population shifts, natural hazards, environmental regulation, management capability and the availability of suitable financing, some of which are beyond the control of management.

e. Transactions between the RELP and the general partners or their affiliates and any other conflicts of interests, present or potential, that the general partners of their affiliates may have with respect to the project should be described.\textsuperscript{146}

f. Reference should be made to the compensation paid and to be paid to the general partners or their affiliates.\textsuperscript{147}

g. The investor should be warned if the transferability of

\textsuperscript{145} In Release 33-5362 (Feb. 3, 1973), the SEC has indicated a willingness to permit projections in registered offerings not involving tax shelter programs: BNA, Sec. Reg. & L.R. Feb. 7, 1973:

The SEC plans to adopt rules to define the circumstances under which a projection wouldn’t be considered a misleading statement of material fact to prevent liability for those estimates. It is said such a rule will probably underscore the concept that a projection is neither a promise that it will be achieved nor per se misleading if not achieved. In addition, the SEC has indicated that a separate release covering tax shelter projections would be issued soon.

\textsuperscript{146} In this connection, the SEC has been requiring, with respect to offerings registered under the 1933 Act, information as to possible interests in adjoining properties, formation of other partnerships and lack of independent representation by counsel and accountants, see e.g., Prospectus dated October 31, 1972 CNA-Larwin Realty Funds.

\textsuperscript{147} The SEC has recently been requiring, as the first risk factor, with respect to offerings registered under the 1933 Act, a chart (known informally as the "Levenson Chart") which sets forth in tabular form all fees and other compensation to be received by the general partners and their affiliates. In addition, the SEC has required a boxed-in statement immediately following such chart setting forth the aggregate gross compensation of all forms to be paid to such persons.
such interests is restricted by terms of the partnership agreement and also, in the case of nonregistered offerings, by the fact that various state and federal securities regulations inhibit future transferability. In addition, the "tax shelter" concept which may make the offering attractive to the original investor may also result in a very limited resale market for the investment. In this connection, reference should be made to the suitability requirements for investors with respect to the tax aspects of the RELP.

h. A cross-reference should be made to the tax risks involved, including the adverse tax consequences of a sale of or a foreclosure on the property.

i. The method of distribution of income of the RELP should be noted, especially if such distributions are within the discretion of the general partners. It should also be noted that distributions are not guaranteed.

j. It should be noted that the general partners have broad authority over the management of the RELP, and that the limited partners have little or none.\textsuperscript{148}

2. Organizational Structure of the RELP

This section of the prospectus or circular should state that the rights and obligations of the parties are governed by the certificate and agreement of limited partnership of the RELP as well as the Partnership Law of the State of New Mexico. The agreement and the certificate should be attached to the circular or prospectus. The principal terms of such certificate and agreement should be set forth and should include the following:

a. Whether a limited partner's responsibility for obligations of the partnership is limited to, and in no case exceeds, the amount of his or her contribution to the capital of the RELP.\textsuperscript{149} If there are any indemnification provisions which can be construed as rendering the limited partners unlimitedly liable for the obligations of the partnership,\textsuperscript{150} such should clearly be set forth. Failure to do so would seem to be inherently fraudulent.

\textsuperscript{148} The SEC has recently been requiring, in the case of offerings registered under the 1933 Act, in the Risk Factor part of RELP prospectuses a discussion of the fiduciary responsibility of the general partners and the remedies available to the limited partners in the event of a breach of such responsibility. It is the view of the authors that a similar discussion should appear in all disclosure documents, perhaps under another caption.

\textsuperscript{149} A discussion of the effect of N.M. Stat. Ann. §66-2-17(4) (Repl. 1972) may be advisable.

\textsuperscript{150} The Midwest Guidelines prohibit any indemnification of the general partners by the limited partners which would have the effect of rendering the limited partners unlimitedly liable.
b. Whether the interests of the general partners in the RELP's capital or distributions are subordinated to the interests of the limited partners.

c. Whether the limited partners are entitled to receive interest on their capital invested in the RELP.

d. Whether the general partners may be entitled to receive certain payments from the RELP, such as refinancing fees, brokerage fees, or management fees even if no distributions have been made to the limited partners.

e. The procedures for amending the partnership agreement and certificate of the RELP.

f. The method of resolving disputes arising among the partners.

g. The method of transfer, and the restrictions on transferability, of the interests in the RELP.

h. The termination of the RELP and the procedures for either continuing the business or liquidating the assets of the RELP.

3. Management of the RELP

a. The prospectus or circular should set forth a full description of the general partner or partners. A brief description of the past occupation and experience of the general partner(s) should be included, as well as a similar description for principals of a corporate general partner. In the event that the general partners have been involved in other real estate syndications, any relevant information concerning the history of such syndications should be set forth.151

b. It should be noted that the RELP is to be managed by the general partners and that the limited partners have no right to participate in the management of the RELP. Further, it should be noted that if the limited partners do take an active role in the affairs of the RELP, they may subject themselves to unlimited liability for the obligations of the RELP.152

c. The power of the general partners should be set forth so as to indicate the broad scope of their discretion. For example, it should be stated whether they may lease the

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151. The SEC has of late been requiring considerably broadened disclosures concerning the track record of the general partners or syndicator. In addition, the Midwest Guidelines call for disclosures along the same lines. Such track record disclosures must be drafted with considerable care in order to avoid misleading implications.

152. See note 11 infra.
property of the RELP, sell it, refinance, etc., and whether any or all of this may be done without the consent of the limited partners. It should also be stated whether the general partners are liable to the limited partners for any negligent acts or omissions and whether they may be removed by the limited partners. Any indemnification provision running to or from the general partners should be described in detail.\textsuperscript{153}

d. If the general partner has the authority to delegate management functions to any of its affiliates, subsidiaries or third parties, such authority should be set forth. Further, if there is any exception to the general rule that a general partner may not substitute one or more general partners except with the consent in writing of all of the limited partners, such exception should be stated. It should be indicated whether the general partners intend to spend their full time managing the RELP, and a reference should be made to the discussion of possible conflicts of interests.

e. All management fees and other compensation to the general partner and affiliates of the general partners should be carefully described.

4. Tax Aspects

a. The circular or prospectus should describe the specific suitability requirements of the investment and include the minimum net worth and annual income required for investment in the RELP.\textsuperscript{154}

b. A ruling of the Internal Revenue Service, or an opinion by tax counsel for the RELP, should be obtained and referred to concerning the taxability of the RELP as a partnership rather than as an association.\textsuperscript{155} If there is a significant possibility of an adverse determination of this issue, it should be discussed.

c. There should be some discussion of the effect of the 10 percent tax\textsuperscript{156} on certain tax preference items\textsuperscript{157} since,

\begin{itemize}
  \item 153. It should be stated, if applicable, that it is the position of the SEC that any provisions which purport to indemnify officers or directors for liabilities arising under the securities laws are unenforceable.
  \item 154. Since one of the prime purposes of the investment is the flow-through of depreciation and losses, the higher the tax bracket an investor is in the higher his taxable rate (subject to the maximum tax on earned income, Int. Rev. Code of 1954, §1348) and the greater the tax value of the losses.
  \item 155. See text at 257 infra. This is required by the SEC and by the Midwest Guidelines.
  \item 156. Int. Rev. Code of 1954, §56.
\end{itemize}
in the case of interests in RELPs, such items may be involved, particularly accelerated depreciation and capital gains. Moreover, it should be noted that there is a limitation on the excess investment interest deductions.\textsuperscript{158}

d. There should be a complete description of the tax consequences to an investor in the event of a sale of a limited partnership interest by a limited partner or a sale of or foreclosure on the property.\textsuperscript{159}

e. Investors should be told that the tax losses of the RELP will decline over a period of time\textsuperscript{160} and that income from its operations will then become taxable in increasing proportions. Indeed, at some point, the limited partner’s taxable income could exceed the cash distributed to him.

f. All proposed major deductions (such as depreciation, prepaid interest, guaranteed payments and management fees) should be described, and, where appropriate, reference should be made to possible adverse positions\textsuperscript{161} of the Internal Revenue Service. If there is a tax issue present with respect to the inclusion of a partner’s share of non-recourse liability in his basis,\textsuperscript{162} it should be discussed. The extent that these items, or other tax issues present, increase the likelihood of an audit of an investor’s individual tax return should be prominently highlighted, perhaps as a risk factor.

g. It should be stated that possible future legislation may reduce or eliminate some of the tax benefits described.


\textsuperscript{159} Depending on the nature of the property and the length of holding period, there may be a recapture of accelerated depreciation deductions at ordinary income rates (see Int. Rev. Code of 1954, §1250) on the sale (or taxable exchange or foreclosure) of the property or on the sale or taxable exchange by the limited partner of his interest in the RELP. In addition, upon certain sales of the property, there may not be sufficient cash proceeds raised to cover the tax liabilities created for the partners by such sale, such as where the gross proceeds exceed the depreciated tax basis of the property by an amount significantly greater than the net proceeds after payment of the remaining principal amount of the mortgage loan. Moreover, whether capital gains treatment will be afforded to the RELP or the limited partner in the event of such sale will depend on whether such RELP or person was deemed for tax purposes to be holding property primarily for sale to customers in the ordinary course of business, Int. Rev. Code of 1954, §1221.

\textsuperscript{160} This is so because the amount of accelerated depreciation which may be deducted will decline and where the permanent mortgage is payable in constant level payments the amount allocable to deductible interest, rather than nondeductible principal repayments, will also decline.

\textsuperscript{161} See, e.g., Technical Advice Memorandum dated November 17, 1972 in Practicing Law Institute, \textit{Real Estate Syndications 1973} at 513-21.

Any significant proposed or pending tax legislation in this area should be indicated.  

h. Any relevant state tax laws affecting the RELP should be discussed.  

5. Terms of the Offering  

a. The total number of units being offered, the price per unit and the minimum number of units which may be purchased by any investor should be indicated. In addition, the net proceeds of the offering to the RELP, after payment of all expenses of the offering, should be disclosed. The expenses of the offering should be separately stated, in such a way as to break down commissions paid, total compensation paid to persons directly or indirectly in connection with the organization of the RELP, expenses incurred for advertising, escrow charges, printing costs, appraisals, legal and accounting fees, etc.  

b. The principal purposes for which the net proceeds are intended to be used should be described in detail. Further, the prospectus or circular should contain an explanation of the consequences if all of the limited partnership interests of the RELP offered are not sold. For example, there should be a statement as to whether the interests remaining unsold will be purchased by any particular persons, or whether the offering will be cancelled and the funds returned unless some designated percentage of the offering has been sold. If the proceeds of the offering are to be held in escrow until some designated percentage of the offering has been sold, it should be stated. More importantly, if all necessary funds are not obtained from the sale of units of the RELP, a description of when and how the additional financing will be obtained should be made.  

6. Development Plan and Description of Property  

As most RELPs are in the developmental stages, this section, with the necessary financial information, should be the principal portion of the circular or prospectus. It is in this section that the nature of the  

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164. For example, it should be stated whether a Texas investor in a New Mexico RELP holding New Mexico property would be subject to New Mexico Income Tax on his investment.
business of the RELP should be described in detail. Among the items that should be set forth hereunder are the following:

a. Description of the Property. Information should be given with respect to the location and general character of all real property held or to be held by the RELP. In addition to the nature of the RELP’s interest in the property, all zoning regulations, material mortgages, liens or encumbrances on such property should be set forth including the relevant provisions of such liens. The book value of the various properties should be set forth, and a statement as to whether the properties are adequately covered by title and liability insurance. Further, information should be given with respect to (1) the relevant local tax rates as of a recent date, (2) the history of such tax rates and any contemplated changes in such tax rates, and (3) the tax assessed value of the property.

b. If the properties are yet to be constructed, a description of the builder and the related contracts and guarantees, and a description of the type of construction and the architectural and landscaping features.

c. A brief reference to the types of swimming pools, recreation buildings and facilities to be offered therein, if relevant.

d. The principal terms of standard leases, including length of lease and security and the method of renting units (rental agents, direct mailing, etc.).

7. Competition

a. This section of the prospectus or circular should enable the investor to compare one project with other comparable projects in the area and an attempt should be made to describe each of the projects in comparable detail, if possible.

b. The sources of all competitive information should be given.

c. If there are any other developments in the general area for which information is not available, a general statement to this effect should be made.

d. The occupancy rates of the projects described, if known, should be indicated.

8. Financial Information

As is the case with other ventures, the financial disclosures contain
some of the more significant information concerning the RELP. However, because of the peculiar nature of the RELP, a balance sheet, a statement of income and expense and a statement of realized capital gain or loss on investments will not be sufficient to inform the investor, who may be more interested in tax free distribution of cash than in profits. For not only must the RELP perform well, it must perform in such a way as to fit the investor's tax needs. If a RELP does well by selling its major income producing property, the resulting gain that the limited partner may be forced to recognize may be far less desirable than the paper loss received by the continued operation of the property. Thus, the following projections of financial data (some of which are not at present allowed by the SEC in registered public offerings, but which are commonly contained in private placement brochures), if accompanied by a complete statement of the assumptions upon which they are based and appropriate cautionary language would appear to give the investor a more adequate understanding of his investment than would conventional financial statements:

a. A schedule of projected annual revenues (by source) and expenses (itemized).

b. A schedule of interest and principal repayment obligations on the mortgage loan and payments with respect to other permanent financing, such as sale and leaseback.

c. A schedule of projected annual cash flow.

d. A schedule of projected annual allocations of taxable profits and losses.

165. The SEC has indicated a willingness to consider permitting certain projections in registered offerings. See note 145 supra.

166. See, e.g., the legend required by the Midwest Guidelines at Section 23, C 1.(c). These Guidelines propose other requirements with respect to the use of projections.

167. See generally, Kaster, Subsidized Housing: Facts Versus Tax Projections, 26 Tax Lawyer 125 (1972). Nevertheless, the sensitivity of even the most carefully determined projections, as a source of potential litigation, should not be underestimated.

168. Relevant assumptions which should be set forth relate to schedule of occupancy, rental increases, growth in operating expenses, capital expenditures, and depreciation method indicating useful life and allocations of basis to the component parts, if appropriate. The required occupancy rate (the break-even rate) to meet debt service and expenses should be indicated.

169. Cash flow consists basically of net income plus depreciation and certain amortizable expenses but less non-deductible payments such as repayment of the principal of the mortgage loan.

170. It would appear to be appropriate to make such projections to at least beyond the time that the RELP's taxable income would exceed its cash flow. The Midwest Guidelines limit carrying projections beyond ten years. Moreover, they would not permit separate tax projections for various tax brackets.
CONCLUSION

The offer and sale of limited partnership interests in RELPs are within the broad scope of the law of federal and state securities regulation. The prospect of increased regulation, both from the standpoint of the information that must be disclosed to the investor, as well as from that of outright prohibition of the offering of interests in those RELPs that fail to meet strict substantive standards, is imminent. During the past few months the attention that the RELP has received from the SEC, the Federal Reserve Board, the NASD, the Midwest Securities Commissioners Association, as well as the New Mexico Legislature, has come close to equaling that which it has been receiving from tax-conscious real estate professionals and investors for several years. In addition to the foregoing attention from the securities regulators, the Internal Revenue Service also made significant pronouncements and rulings in this area with the implication that additional limitations may be on the way. Along with the increased use of the RELP and the increased actual and proposed regulation of such use, one may also expect the next few years to see increased litigation in those cases which will surely arise when the disappointed limited partner finds to his chagrin that his RELP investment is producing neither the promised tax losses nor the expected long-term appreciation.