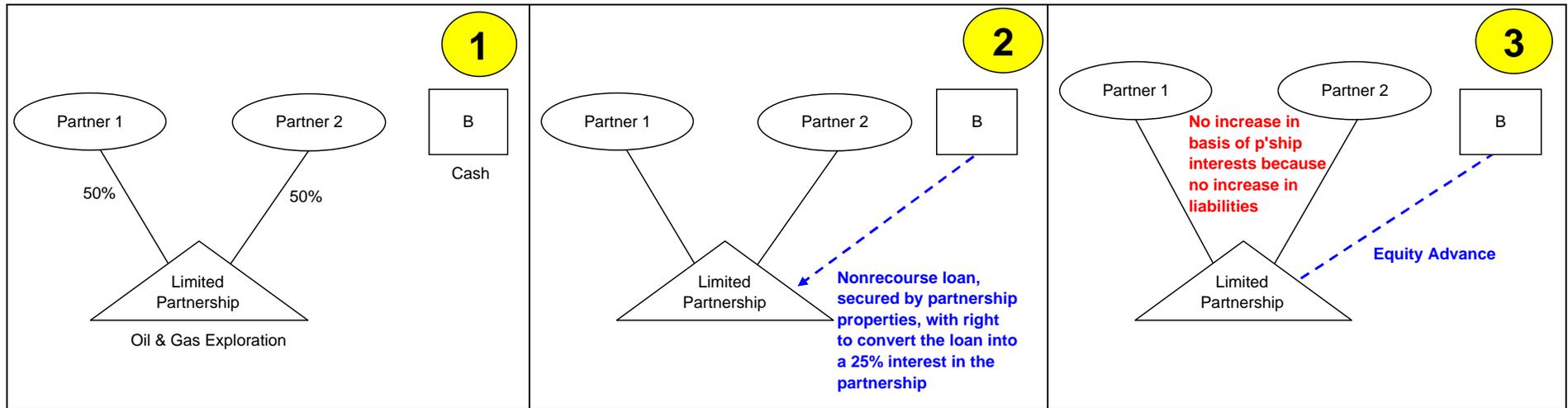


**Equity Advance Creates No Partner Debt Basis**

Initial Structure

Loan with Conversion Option

Recharacterization



B, a taxpayer, entered into an agreement ostensibly to make an advance of funds called a "loan" to an otherwise unrelated limited partnership. The organization was classified as a partnership for Federal tax purposes and was engaged in the business of exploring for oil and gas. The "loan" is secured by the partnership's properties consisting of some unproven leases and some expensive but virtually unsalvageable oil and gas well installations. None of the partners has any personal liability for repayment of the "loan." B, in addition to his rights in the partnership's properties, has the right, at any time, to convert the "loan" and receive in exchange a 25 percent interest in the partnership's profits. B had not executed, as a partner, either the articles of limited partnership or the certificate of limited partnership.

The ruling holds that the so-called "loan" is not a bona-fide debt but is, in reality, capital placed at the risk of the venture by B. Therefore, the funds advanced represent B's equity interest in the venture and the amount of the advance constitutes the basis to B for such interest. Thus, the bases of the partnership interests of the other parties under section 705 are not affected. See also Rev. Rul 72-135, which treats a "nonrecourse" loan to a limited partner or to the partnership by the general partner as a contribution of capital by the general partner.