Direct Participation Programs Limited Representative Qualification Examination (Test Series 22)

Study Outline

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Introduction

The FINRA Direct Participation Programs Limited Representative (Series 22) Qualification Examination (hereinafter called “DPP”) is designed to test a candidate's knowledge of the products, rules and statutory provisions applicable to this category of registration. By passing the DPP examination, a candidate becomes a Series 22 Limited Registered Representative. The DPP Registered Representative can participate in the purchase and sale of certain direct participation programs offered (see Section 1.1-Direct Participation Programs Investment Entities and Section 2.0 - Types of Direct Participation Programs). Section 1.2 lists securities that cannot be sold by the DPP Registered Representative--either because these securities are registered under the Investment Company Act of 1940 or the trades take place on the secondary market.

This study outline has been prepared to assist FINRA member firms in preparing candidates to sit for the Series 22 examination. It may be used to structure or prepare training materials, develop lecture notes and seminar programs, and as a training aid for candidates themselves. This outline and the examination are divided into six topical sections listed below, along with the percentage of each section’s representation in the overall examination.

Section	Description	Number of Questions
1	Investment Entities for Direct Participation Programs	12
2	Types of Direct Participation Programs	11
3	Offering Practices Applicable to Direct Participation Programs	14
4	Tax Issues Applicable to Direct Participation Programs	20
5	Regulation of Direct Participation Programs	32
6	Factors to Consider in Evaluating Direct Participation Programs	11
Total		**100**

The Series 22 examination is composed of 100 multiple-choice questions covering all of the material in the following outline in accordance with the subject matter distribution shown above. Candidates will be allowed 2 hours and 30 minutes to complete the examination. A candidate must correctly answer 70 percent of the questions to receive a passing grade.

To ensure that new questions meet acceptable testing standards prior to use, this examination includes 5 additional, unidentified "pre-test" questions that do not contribute towards the candidate's score. The 5 questions are randomly distributed throughout the

examination. Therefore, each candidate takes a total of 105 questions, of which 100 questions are scored.

At the completion of the examination, each candidate will receive an informational breakdown of their performance on each section and their overall score. The examination is a closed-book test and candidates will not be permitted to use any reference material during their testing session. Scratch paper and a basic electronic calculator will be provided by the test center administrator. Severe penalties are imposed on candidates who cheat on securities industry qualification examinations.

Examination questions are updated regularly to reflect the most current interpretations of the rules and regulations. Questions on new rules will be added to the pool of questions for this examination within a reasonable period of their effective dates.

At the end of this outline are four sample questions written in the various formats used in the actual Series 22 examination. The samples do not mirror the difficulty level of actual test questions or the subject matter distribution of the test itself. Their use is merely to familiarize the candidate with the style of multiple-choice questions used in the Series 22 examination.

Information about qualifications exams may be found at
http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/Qualifications/index.htm
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Please Note: Candidates are responsible for keeping abreast of changes made to the applicable rules and regulations, as the examination is updated when new rules are introduced and/or amended.

The following reference materials may be used in preparing for the examination.

REFERENCE MATERIALS

Blue Sky Practice for Public and Private Direct Participation Offerings
Peter M. Fass and Derek A. Wittner
610 Opperman Drive
St. Paul, MN 55123
www.westgroup.com

Federal Securities Law Reporter
Vol. 1 - Securities Act – Vol. 2 – Exchange Act
Commerce Clearing House, Inc.
4025 W. Peterson Avenue
Chicago, IL 60646

Federal Taxation of Partnerships and Partners,
W.S. McKee, W.F. Nelson and R.L. Whitmire
Warren, Gorham & Lamont, Inc.
Boston, MA 02111

FINRA Publications available through www.finra.org:
FINRA/NASD Rules
FINRA Notices

Guide to Limited Liability Companies,
CCH Incorporated
P.O. Box 5490
Chicago, IL 60680
www.cch.com

Investment Limited Partnerships Handbook
R. J. Haft and P. M. Fass
Clark Boardman Callaghan
155 Pfingsten Road
Deerfield, IL 60015
www.west.thomson.com

Limited Liability Company Handbook
M. A. Sargent and W.D. Schwidetzky
610 Opperman Drive
St. Paul, MN 55123
www.west.thomson.com

Oil and Gas: Federal Income Taxation (2005)
Patrick A. Hennessee, Ph.D., CPA
CCH Incorporated
P.O. Box 5490
Chicago, IL 60680
www.cch.com

2005 Federal Tax Course
Aspen Panel Publishers
1185 Avenue of the Americas
New York, NY 10036
http://tax.cchgroup.com/Aspen

Resales of Restricted Securities
J. William Hicks
West Group
620 Opperman Drive
St. Paul, MN 55164
www.westgroup.com

Securities Act Handbook
Aspen Publishers
111Eighth Avenue
New York, NY 10011
www.aspenpublishers.com

Securities Law Handbook, 2005 ed.
H.S. Bloomenthal
Clark Boardman Callaghan
610 Opperman Drive
St. Paul, MN 55164
www.west.thomson.com

Tax Advantaged Securities Handbook
R. J. Haft and Peter M. Fass
West Group
610 Opperman Drive
St. Paul, MN 55164
www.westgroup.com

1.0

INVESTMENT ENTITIES FOR DIRECT PARTICIPATION PROGRAMS

1.1 Investment Entities

1.1.1 Limited Partnerships (LP)

1.1.1.1 Limited liability

1.1.1.2 Consequences of the pass through tax provision

1.1.1.3 Filing of limited partnership organizational documents in the states - usually called the certificate of limited partnership

1.1.1.3.1 Contains name, address, purpose, date of formation and names of general partner(s) and in some states the names, addresses, and amount of capital contribution of the general and limited partners

1.1.1.3.2 Required to create a limited partnership

1.1.1.3.3 Required for amendments to information contained in Section 1.1.1.3.1 above

1.1.1.4 Agreement of limited partnership--the contract between the general partner(s) and limited partners to conduct the business of the limited partnership

1.1.1.4.1 Lists the date of formation, name, place of business, purpose and date of termination

1.1.1.4.2 Specifies the types of partners, each individual partner, the capital contribution of each partner and the provisions in the event a partner defaults on a capital contribution

Types of partners--general, limited, original limited, special limited

Name, address, capital contribution and percent interest in limited partnership are usually listed on separate exhibit

Capital contributions can be made at one time, staged over a defined period or are subject to being called under specified circumstances

Default of partner's obligation to contribute can lead to dilution of interest or dismissal from limited partnership

1.1.1.4.3 Allocates operating income and loss, capital gain and loss, operating cash distributions and capital cash distributions among the partners

- Disproportionate allocation of income, loss, gain and cash distribution among the partners
- Preferred cash distribution
- Cumulative cash distribution
- Subordinated distribution

1.1.1.4.4 General partner(s)--rights and obligations

1.1.1.4.4.1 Exclusive power and authority to manage the partnership

1.1.1.4.4.2 Usual duties

- Execute all agreements, contracts and certificates to operate partnership
- Borrow funds
- Purchase liability and casualty insurance
- Employ agents, attorneys, accountants and contractors
- Pay all expenses
- Act as tax matters partner
- Sell or dispose of partnership assets
- Act as attorney-in-fact for limited partners

1.1.1.4.4.3 Usual limitations on powers of general partner(s) without approval of limited partners

- Admission of new general partner(s)
- Substitution of existing general partner(s)
- Change the purpose of the partnership
- Sale of all or substantially all the assets of the partnership
- Refinancing in certain situations

1.1.1.4.4.4 Compensation of general partner(s)

- Only as specified in partnership agreement
- Affiliate can be compensated but only at competitive rates

1.1.1.4.4.5 General partner liability

1.1.1.4.4.6 General partner indemnification

1.1.1.4.4.7 Right to compete with partnership

1.1.1.4.4.8 Fiduciary responsibility to limited partners

1.1.1.4.5 Limited partners' rights

- Amend partnership agreement
- Vote to lift restrictions on power of general partner(s) (see Section 1.1.1.4.4.3)
- Receive periodic reports
- Inspect and copy books and records
- Vote to continue partnership upon death, bankruptcy or incompetency of sole remaining general partner
- Remove general partner(s) if provided in partnership agreement

1.1.1.4.6 Limited partners' obligations

- Pay capital contribution
- Potential liability for unpaid capital contributions and distributions received, in event of default

1.1.1.4.7 Transfer of interest in limited partnership

1.1.1.4.7.1 General partner(s)

- Need approval of limited partners
- Opinion of counsel that partnership will not be terminated or taxed as corporation
- Bankruptcy, death or incompetence

1.1.1.4.7.2 Limited Partners

- Opinion of counsel that partnership will not be terminated or taxed as a corporation
- General partner(s) approval
- Restrictions usually on transfer to non-family
- General partner(s) right of first refusal

1.1.1.4.8 Dissolution and liquidation of a limited partnership

1.1.1.4.8.1 Events causing dissolution

- Withdrawal of last general partner
- Vote of partners
- Sale of all the assets of the partnership
- Approval of general partner(s) and required number of limited partners
- Expiration of term of partnership

1.1.1.4.8.2 Liquidation

- Payment of expenses and liabilities of partnership
- Distribution to partners in accord with terms of partnership agreement
- Filing of termination certificates

1.1.2 Limited Liability Companies (LLC)

1.1.2.1 Advantages
Receive same pass through tax advantages as a limited partnership
Have limited liability attributes of corporations
Allows disproportionate allocation of income, loss, gain and cash distribution

1.1.2.2 Organization filings of LLC--usually called the Articles of Organization

1.1.2.2.1 Contains name, address, date of formation and termination and names of members (a minimum of two required) and may contain other provisions from operating agreement

1.1.2.2.2 Required to create LLC

1.1.2.2.3 Required for amendments to information contained in Section 1.1.2.2.1

1.1.2.3 Operating Agreement of LLC--the contract among the members to conduct the business of the LLC

1.1.2.3.1 Lists date of formation, name, place of business, purpose and date of termination

1.1.2.3.2 Specifies duties of members (may create Managing Member(s)) and their capital contributions

1.1.2.3.3 Specifies duties and responsibilities of members

1.1.2.3.4 Allocates operating income and loss, capital gain and loss, operating cash distributions and capital cash distributions among members

1.1.2.3.4.1 Disproportional allocations

1.1.2.3.4.2 Preferred cash distributions

1.1.2.3.4.3 Cumulative cash distributions

1.1.2.3.4.4 Subordinated distributions

1.1.2.3.5 Rights of members
Elect managing members
Amend operating agreement

Vote on LLC matters as provided in the operating agreement
Approve transfers of membership interests unanimously
Consent to dissolve the LLC

1.1.2.3.6 Rights and powers of managing member(s)
Exclusive power to manage the affairs of the LLC
Term of office specified in operating agreement
Duties similar to general partner(s) in limited partnership
Limitation of powers similar to general partner(s) in limited partnership

1.1.2.3.7 Liabilities of members including managing member(s) are only for promises of contributions and services to the LLC; not liable for debts and obligations of the LLC

1.1.2.3.8 Transfer of member's ownership in the LLC

1.1.2.3.9 Indemnification of managing members

1.1.2.3.10 Dissolution of the LLC

1.1.2.3.10.1 Events causing dissolution
Consent of all members
Expiration of term of the LLC

1.1.2.3.10.2 Liquidation
Payment of expenses and liabilities of the LLC
Distributions to members

1.1.2.3.10.3 Filing of certificate of dissolution

1.1.3 S Corporations

1.1.3.1 Requirements for eligibility
Limited number of shareholders
Must be a domestic, eligible corporation
Shareholders must be individuals, certain estates, trusts, or tax exempt organizations

1.1.3.2 Election of tax year

1.1.3.3 Generally a tax pass-through entity
No disproportionate allocation
No negative capital account

1.1.3.4 Termination of S Corporation election
Revoking the election
Ceasing to qualify as an S corporation
Violating the passive investment income restrictions
Restrictions against re-establishing S corporation

1.1.4 General Partnerships

1.1.4.1 Liabilities of general partners

1.1.4.2 Partnership subject to technical dissolution by reason of death or legal disability of a partner even though the partnership may continue

1.1.4.3 Passive interests are treated as securities

1.1.5 Joint ventures

1.1.5.1 Liabilities of venturers

1.1.5.2 Co-venturers join together for a specific project

1.1.5.3 Joint venture is terminated upon completion of project

1.1.5.4 In some jurisdictions, a corporation may not be a partner, but may take a position as a joint venturer

1.1.5.5 Passive interests are treated as securities

1.1.6 Grantor trusts

1.1.6.1 Generally used for equipment leasing programs

1.1.6.2 May provide pass-through tax benefits

1.2 Securities Products That Cannot be Sold by a Direct Participation Programs Representative

1.2.1 Real estate investment trusts (REITs)

1.2.2 Master limited partnerships
Roll-ups
Exchange listed real estate limited partnerships

1.2.3 Public limited partnership units in the secondary market

1.2.4 **Municipal securities**

1.2.5 **Corporate securities (domestic and foreign)**
- Stocks
- Bonds
- Rights and warrants

1.2.6 **Options**

1.2.7 **Mortgage-backed instruments**
- Collateralized mortgage obligations (CMOs)
- Real estate mortgage investment conduits (REMICs)

1.2.8 **Mutual funds (closed-end and open-end investment company shares)**

1.2.9 **Variable annuities**

1.2.10 **U.S. government and agency securities**

2.0

TYPES OF DIRECT PARTICIPATION PROGRAMS

2.1 Real Estate Programs

2.1.1 Affordable housing

2.1.1.1 Advantages

- Tax credits
- Passive losses
- Predictable tax benefits
- Long term, highly leveraged mortgage financing

2.1.1.2 Risks

- Changes in government policy and practice
- Subsidized rent greater than market rent
- Historic lack of appreciation potential
- Cash distributions limited by Government regulations
- Loss of rental and other subsidies
- Highly leveraged financing

2.1.2 Development properties (new construction)

2.1.2.1 Advantages

- Higher appreciation potential
- Maintenance and replacement costs lower in early years
- Leverage
- Tax deferred cash flow
- Passive losses
- Long term take-out mortgage financing

2.1.2.2 Risks

- Market acceptability of new development
- Pace of renting to tenants (rate of absorption)
- Development costs in excess of forecast
- Cost and availability of long-term mortgage financing
- Competition - overbuilding-effect on rents
- Governmental restrictions: zoning and building codes
- Changing Governmental regulations: rent control and environmental

2.1.3 Existing properties

2.1.3.1 Advantages

- Greater predictability of net operating income

Higher reliability of operating cost forecasts
Physical condition subject to inspection
Known tenant composition
Tax deferred cash flow
Passive losses
Financing often available from seller

2.1.3.2 Risks

Higher maintenance and replacement costs
Unpredictable major maintenance and rehabilitation costs
Restrictions in existing leases
Additional competitive properties
Changing governmental regulations: rent control and environmental issues

2.1.4 Land Development

2.1.4.1 Advantages

Potential for higher appreciation
Seller financing-purchase money mortgage note
Usually low leverage

2.1.4.2 Risks

No cash flow
Carrying costs (taxes and debt service) with no revenue
Government restrictions: zoning and environmental
Lack of appreciation in excess of acquisition and carrying costs of land
Institutional financing often difficult to obtain
Higher potential for loss

2.1.5 Sale-Leaseback

2.1.5.1 Advantages

Predictable taxable income, loss and cash flow
Risk decreases as net worth of lessee increases
Mortgage financing more readily available

2.1.5.2 Risks

Term of lease
Cash flow and appreciation restricted by lease
Appreciation often more dependent on financial market conditions than performance of property
Re-rental after termination of initial lease
Cost of acquisition greater than market value of property

2.1.6 Mortgage partnerships

2.1.6.1 Advantages
- First lien
- Predictable income
- Interest spread

2.1.6.2 Risks
- Junior liens
- Leverage
- Collection

2.1.7 Condominium securities

2.1.7.1 Rental Pools

2.2 Oil and Gas Programs

2.2.1 Types of programs

2.2.1.1 Exploratory
- High deductibility of investment
- Return potential determined after drilling stage
- Higher risk of "dry holes"

2.2.1.2 Development
- High deductibility of investment
- Return potential less than returns on successful exploratory program
- Lease costs tend to be higher
- Lower dry-hole risk versus exploratory

2.2.1.3 Income
- Few front-end tax benefits
  - Capitalized acquisition costs
- Cash flow program with reinvestment feature
- Factors to consider in evaluating an income program
  - Amount of oil and gas reserves still in the ground
  - Estimated future net revenues from reserves and calculated present value
  - Present value less various risk factors to obtain "fair market value" of property
  - Liquidity on present value
  - Inflation hedge
  - Possible future enhanced recovery techniques

2.2.1.4 Combination investment (drilling and income)
- Diversification may reduce amount of risk
- Potential to achieve tax deferral and cash flow

2.2.1.5 Completion
- Intangible expenses and deductions
- Depreciable tangible expenses
- Receive a smaller percentage of revenue from wells

2.2.2 Analyzing sharing arrangements of oil and gas programs (methods of allocating costs and revenues)

2.2.2.1 Overriding royalty interest
- Does not share program costs
- Shares in revenues through cost free interest in production revenues
  - Payable under an oil and gas lease out of total production of well or deposit

2.2.2.2 Working interest
  - Interest in production revenues
  - Lessor does share program costs

2.2.2.3 Reversionary working interest
- Does not share program costs
- Shares in revenues after investors recover their costs
  - If the lessee's share of the oil extracted; the balance belongs to the land owner as his royalty interest plus owner’s share of overriding interest

2.2.2.4 Net operating profits interest
- Limited to private deals

2.2.2.5 Disproportional sharing arrangement
- Sponsor pays a lower percentage of all costs in return for a higher percentage of program revenues
- Sponsor may share in costs of dry holes
- Normally investors pay deductible costs and sponsor pays non-deductible costs

2.3 Equipment Leasing Programs

2.3.1 Structure of programs

2.3.1.1 Financial (or full payout) lease--no residual value

2.3.1.2 Operating lease-- residual value

2.3.2 Advantages

2.3.2.1 Depreciation
2.3.2.2 Interest deductions on borrowed funds
2.3.2.3 Predictable income

2.3.3 Risks

2.3.3.1 Investor tax basis limited by at-risk rules
2.3.3.2 Investment interest limitations on use of tax losses
2.3.3.3 Alternative minimum tax may limit deductibility of losses
2.3.3.4 Uncertain residual value
2.3.3.5 Potential phantom income upon sale of equipment
2.3.3.6 Cost allocations
2.3.3.7 Competition impacts re-leasing and sale

2.4 Miscellaneous Programs

2.4.1 Agricultural

2.4.1.1 Available deductions
- Write-offs on start-up programs
- Row crops
- Depreciable property, i.e. perennial plants, property improvements, etc.

2.4.1.2 Profits achieved by
- Sales of agricultural products
- Appreciation of land value

2.4.1.3 Risks include
- Natural elements
- Disease
- Market conditions

2.4.2 Livestock

2.4.2.1 Holding period requirement

2.4.2.2 Capitalized costs

2.4.2.3 Capital gains

2.4.2.4 Deductible maintenance costs

2.4.3 Entertainment

2.4.3.1 Structure of entertainment programs
- Advertising service partnership
- Production service company

2.4.3.2 Movie syndications
- Income forecast method of depreciation
- Accounting standards

2.4.4 Research and development/venture capital

2.4.4.1 Deductibility of royalty income

2.4.5 Debt-based (non-equity) direct participation programs

2.4.5.1 Portfolio income

2.4.5.2 Characteristics of debt vs. equity

2.4.5.3 Tax treatment

2.4.5.4 Eligibility of retirement accounts

2.4.6 Commodity pools

2.4.6.1 Typically structured as limited partnerships, limited liability companies or business trusts

2.4.6.2 Commodity Pools are regulated both under the securities laws and the Commodity Futures Trading Commission Act

2.4.6.3 Commodity Pools typically invest in commodity futures contracts traded on regulated futures exchanges

2.4.7 Like-kind exchanges

2.4.7.1 Section 1031 of the Internal Revenue Code

2.4.7.2 Tenants-in-common structure

2.4.7.3 Applicability of private placement exemption rules and anti-fraud rules

3.0

OFFERING PRACTICES APPLICABLE TO DIRECT PARTICIPATION PROGRAMS

3.1 Types of Underwriting Commitments

3.1.1 Best efforts

Contingent
All or none
Mini-Max

3.1.2 Firm commitment

3.2 Syndication Practices

3.2.1 Managed offerings

3.2.1.1 Selling group manager

3.2.1.2 Soliciting dealer

3.2.1.3 Dealer manager functions

Performs due diligence
Solicits and allocates retail participation by other broker-dealers
Maintains books and records
May assist issuer in planning and preparation of offering
May coordinate investor relations after the offering
Enters into dealer/manager agreement with the program sponsor
May be an affiliate of the sponsor

3.2.1.4 Sponsor-managed offerings

Each dealer enters into agreement directly with program sponsor
Dealers are paid directly by the program sponsor

3.2.2 Role of wholesalers

Individuals or firms paid to retain selected dealers for the offering
Interface between issuer and broker-dealers and their sales force
Usually compensated on the basis of sales of program interests

3.2.3 Due diligence

3.2.3.1 The exercise of reasonable care to determine that the offering disclosures are accurate and complete

3.2.3.2 Public offerings--statutory defense available

3.2.3.3 Private offerings--helps avoid fraud charges

3.2.3.4 Should be performed by broker-dealers making the offering

3.2.3.5 Typical activities
- Verify all material statements in the offering documents
- Confirm compliance with registration/exemption rules
- Review financial data
- Investigate management background
- Check issuers track record
- Review any assumptions in offering forecasts or projections
- Evaluate all fees and other distributions of proceeds

3.2.4 Finders

3.2.4.1 Defined as an un-registered introducer

3.2.4.2 Prohibited practices
- Sales compensation to non-members of a national securities exchange association registered with the Securities and Exchange Commission
- Referrals by non-members of individual clients to broker-dealers in exchange for compensation from broker-dealer

3.3 Subscription Practices

3.3.1 Signature pages of partnership documents

3.3.1.1 Purchaser representations
- Liquidity
- Marketability
- Suitability

3.3.2 Responsibility of the DPP registered representatives
- Familiarity with the DPP offering
- Timely delivery of the prospectus
- Know Your Customer and Suitability Rules
  - Understanding of the risks involved
  - Net worth, income and suitability
- Accuracy of investor's representations

3.3.3 Sales are conditioned upon acceptance of subscribers

3.3.4 Supervision of order by broker-dealer--review of documents

3.4 Underwriting Compensation

3.4.1 Types of compensation

3.4.1.1 Cash

3.4.1.2 Non-cash

3.4.1.3 Indeterminate
- Carried interest /continuing compensation
- Other securities

3.4.2 FINRA guidelines on sales compensation in public offerings

3.4.2.1 Limited to amount stated in offering document

3.4.2.2 Limit applies to total sales

3.4.2.3 10% of gross dollar amount of securities sold in public offerings; plus up to 3% for reimbursement of bona fide due diligence expenses

3.4.2.4 15% of proceeds for organization and offering expenses

3.4.2.5 Sharing commissions

4.0

TAX ISSUES APPLICABLE TO DIRECT PARTICIPATION PROGRAMS

4.1 Federal Tax Treatment of Direct Participation Programs

4.1.1 General characteristics

4.1.1.1 Conduit nature of entity

4.1.1.2 Required to file informational tax returns (IRS Forms 1065 and 1120S)

4.1.1.3 Required to allocate profits, losses, deductions and credits to partners

4.1.1.4 Tax elections

4.1.1.5 Some choice of accounting method

4.1.1.6 Some selection of taxable year (generally calendar year)

4.1.1.7 State tax treatment - generally like federal

4.1.2 Depreciation and amortization for tax purposes

4.1.2.1 Allows non-cash deduction based on entity's cost of depreciated or amortized asset

4.1.2.2 Depreciation requires asset held for production of income or used in trade or business

4.1.2.2.1 Amortization allows straight line write-off of cost of intangible asset

4.1.2.3 Cannot depreciate unimproved land or inventory (e.g. lots for sale)

4.1.2.4 Types of depreciable properties
- Personal property, equipment and land improvements
- Residential rental property
- Nonresidential real property

4.1.2.5 Tax benefits of depreciation
- Deferral of tax liabilities on partnership income
- Deductions in excess of income from partnership (passive income)

4.1.2.6 Basis of depreciable property-cost
- Purchased property

Constructed property
Improvements to property

4.1.2.7 Determination of recovery period
Depends on property type
Possession relinquished
Demolition
Exhaustion of allowable depreciation

4.1.2.8 Methods of depreciation
Straight line
Accelerated

4.1.3 Depletion--definition of depletable assets

4.1.3.1 Cost method

4.1.3.2 Percentage method

4.1.3.3 Independent producers and royalty owners (less than 1,000 barrels per day)
Limited to 100% of taxable income prior to depletion allowance
Limited to 65% of partners' taxable income from all sources

4.1.4 Deductibility of expense items

4.1.4.1 Expenses deductible in year of occurrence
Interest (except construction interest)
Intangible drilling and development costs
Taxes--state and local
Direct payroll taxes incurred by the partnership
General operating costs
Service fees
Annual management fees

4.1.4.2 Expenses amortized over specified periods of time
Prepaid interest
Construction interest
Phase-in rules
Prepaid fees
Project financing fees
Loan standby or commitment fees
Rent-up fees (for leases over one year)
Organization fees

4.1.4.3 Non-deductible, capitalized expenses

Syndication related costs
Securities brokerage compensation

4.1.5 Tax credits

4.1.5.1 Can offset tax on income taxes within limits, but does not offset alternative minimum tax (AMT)

4.1.5.2 Rehabilitation credits
For certain buildings originally placed in service before 1936
For certified historic structures and buildings located in historic districts

4.1.5.3 Low income housing credits
Determined in the year project is placed in service
Allowed over a specified number of years

4.1.6 Potential recapture on sale or other disposition of property
Tax credit
Depreciation

4.2 Tax Information Provided by Investment Entity to Investors (Schedule K-1)

4.2.1 Required to be sent to investors annually within a time usually specified in agreement of investment entity

4.2.2 Required to be filed with Internal Revenue Service with investment entity's tax return

4.2.3 Lists name, address and federal identifying number of investment entity and investor

4.2.4 Information required for S Corporations is substantially less than for other investment entities

4.2.5 Provides analysis of investor's capital account (not provided on S Corporation's K-1)

4.2.5.1 Investor's capital account is not the same as the investor's tax basis

4.2.5.2 Investor's capital account balance can be negative in all investment entities other than S Corporations

4.2.5.3 Components of the capital account and their impact of its balance

Cash contributions increase balance
Cash distributions decrease balance
Non-cash property contributions increase balance
Non-cash property distributions decrease balance
Income and gain increase balance
Losses decrease balance
Other items such as tax exempt interest and non-deductible expenses such as entertainment increase or decrease balance

4.2.6 Furnishes investor's share of income, loss, deductions, investment interest, credits, adjustments and tax preference items, foreign taxes, other items and supplemental information required. For investment entities other than S corporations self employment information is furnished, if applicable

4.3 Opinions of Tax Counsel for Direct Participation Programs

4.3.1 Typically refer to tax consequences of each material tax issue in offering

4.3.1.1 Opinion may be required as exhibit in certain programs.

4.4 Federal Tax Qualifications for Limited Partnerships (LP) and Limited Liability Companies (LLC)

4.4.1 Tax consequences

4.4.1.1 Newly formed entities can elect partnership LP/LLC tax status under certain circumstances

4.4.2 Maintaining LP and LLC status of the entity

4.4.2.1 Loss of conduit tax status means tax consequences at entity level and at partner/member level

4.4.3 LPs and LLCs organized according to state statutes may automatically qualify for conduit tax status

4.5 Federal Tax Treatment of Limited Partnerships (LP) and Limited Liability Companies (LLC)

4.5.1 Sources of partner/member income, gain, loss and tax adjustments

Taxable income and loss
Capital gain and loss
Investment interest income and interest expense
Gains and losses from sales or exchanges of property used in trade or

business and involuntary conversions
Tax credits
Tax preference items

4.5.2 Disposition of property and interests

4.5.2.1 Sale of LP/LLC interest
Capital gain or loss
Ordinary income

4.5.2.2 Tax free exchanges of LP/LLC property (Section 1031)
Requirement for like-kind exchange
No gain or loss
Tax basis is transferred

4.5.2.3 Gifts
Possibility of gift tax liability
Possibility of gain or ordinary income

4.5.2.4 Factors in disposition
Section 754 election--Step up basis upon the death of partner
Phantom income particularly in foreclosure or bankruptcy

4.5.3 Limitation on deduction of LP/LLC losses

4.5.3.1 Tax basis

4.5.3.1.1 Provides upper limit on deductibility of LP /LLC losses
4.5.3.1.2 Unused losses may be held until there is basis

4.5.3.1.3 Used to determine gain or loss on liquidation of LP /LLC or on sale or transfer of an interest

4.5.3.1.4 LP/LLC's basis in its assets (inside basis)

4.5.3.1.5 Partner's or member's basis is partner's interest in the LP or member's interest in the LLC (outside basis)

4.5.3.1.6 Components of basis
Cash contribution
Non-cash property contribution
LP /LLC debt for which the investor is personally liable
Non-recourse LP /LLC debt (no limitation for qualified debt in real estate, at-risk limitation for other investments)

4.5.3.1.7 Factors resulting in an increase in basis
- Taxable income and capital gains
- Cash contributions
- Non-cash contributions
- Unused amortized deductions (i.e. organization costs)
- Increase in LP /LLC debt for which partner/member is liable
- Increase in non-recourse LP /LLC debt (no limitation for qualified debt in real estate, at-risk limitation for other investments)

4.5.3.1.8 Factors resulting in a decrease in basis
- Taxable loss
- Cash distribution
- Non-cash distribution
- Non-deductible, non-capitalized expenses (i.e. 50% of entertainment expenses)
- Depletion deduction for oil and gas wells
- Decrease in LP /LLC debt for which partner/member is liable
- Decrease in non-recourse LP /LLC debt (no limitation for qualified debt in real estate, at-risk limitation for other investments)

4.5.3.2 Investment Interest
- Limitation on annual deduction
- Net investment income

4.5.3.3 Passive loss limitations
- Losses from a passive activity
- For limited partners and non-managing members generally only deductible against income from other passive activities
- Passive losses carried forward but not backward

4.5.3.4 “At Risk" limitations on deduction of losses
- Limited to partner’s/member’s capital contribution plus a portion of LP/LLC liabilities for which the partner/member is liable
- Qualified non-recourse financing in real estate is exempt from “At Risk" limitations

4.5.3.5 Alternative minimum tax (AMT)
- Major limit on potential tax benefits to individuals
- Direct participation program preference items
- Certain income tax brackets

4.6 Retirement Plans

4.6.1 ERISA (Employee Retirement Income Security Act) requirements

4.6.2 Types of retirement plans

4.6.2.1 Individual retirement account (IRA)
- Traditional IRA
- Roth IRA

4.6.2.2 Keogh Plans/HR-10 Plans

4.6.2.3 Corporate pension plans

4.6.2.4 Corporate deferred payment profit sharing plans

4.6.2.5 401(k) plans--cash or deferred arrangements (CODAs)

4.6.2.6 403(b) plans--for employees of non-profit organizations

4.6.2.7 457 plans--for government employees

4.6.3 Suitability
- Prudent man rules
- Self-directed or fiduciary directed

4.6.4 Rollover issues - maintaining non-taxed status

4.6.5 Unrelated business taxable income --debt vs. equity

4.6.6 Distributions from qualified plans -- tax effects vary

4.6.7 Rules against self-dealing

5.0

REGULATION OF DIRECT PARTICIPATION PROGRAMS

5.1 Federal Regulation of Direct Participation Programs

5.1.1 Securities Act of 1933 and SEC Rules Thereunder - Registration of Securities

5.1.1.1 Definitions under the Act
- Section 2(1) - Security
- Section 2(2) - Person
- Section 2(3) - Sale or sell; offer
- Section 2(4) - Issuer
- Section 2(11) – Underwriter

5.1.2 Form of Offering

5.1.2.1 Public programs

5.1.2.1.1 Securities Act of 1933

5.1.2.1.1.1 Form S-1 registration (general securities)

5.1.2.1.1.2 Form S-11 registration (real estate programs)

5.1.2.1.1.3 Form SB-1 registration (small issue registration)

5.1.2.1.1.4 Regulation A – conditional small issues exemption

5.1.2.2 Transactions exempt from registration

5.1.2.2.1 Private offerings

5.1.2.2.1.1 Section 4(2) -- Transactions by an issuer not involving any public offering

5.1.2.2.1.2 Section 4(6) -- Transactions involving offers or sales by an issuer solely to one or more accredited investors up to the Section 3(b) maximum

5.1.2.2.1.3 Regulation D -- Rules governing the limited offer and sale of securities without registration under the Securities Act of 1933

5.1.2.2.1.3.1 Rule 501 -- Definitions and terms used in Regulation D

Accredited investor
Affiliate
Aggregate offering price
Number of purchasers
Executive officer
Issuer
Purchaser representative

5.1.2.2.1.3.2 Rule 502 -- General conditions to be met
Integration—6-month safe harbor rule
Information requirements
When information must be furnished
Type of information to be furnished
Limitation on manner of offering
Limitations on resale

5.1.2.2.1.3.3 Rule 503 -- Filing of notice of sale
Filing Form D

5.1.2.2.1.3.4 Rule 504 -- Exemption for limited offers and sales of securities not exceeding $1,000,000
Exemption
Conditions to be met
Limitation on aggregate offering price

5.1.2.2.1.3.5 Rule 505 -- Exemption for limited offers and sales of securities not exceeding $5,000,000
Exemption
Conditions to be met
Limitation on aggregate offering price
Limitation on number of purchasers
Disqualification

5.1.2.2.1.3.6 Rule 506 -- Exemption for limited offers and sales without regard to dollar amount of offering
Exemption
Conditions to be met
Limitation of number of purchasers
Qualifications of purchasers

5.1.2.2.1.3.7 Rule 507 -- Disqualifying provision relating to exemptions under Rules 504, 505, and 506

5.1.2.2.1.3.8 Rule 508 -- Insignificant deviations from a term, condition or requirement of Regulation D

5.1.2.2.2 Intrastate offerings

5.1.2.2.2.1 Securities exempt from registration requirements for intrastate offerings

5.1.2.2.2.1.1 Section 3(a)(11) -- Any security which is part of an issue offered and sold only to persons resident within a single state or territory

5.1.2.2.2.1.2 Rule 147 -- "Part of an issue", "person resident" and" doing business with"
Part of an issue
Integration of offerings
Nature of the issuer
Offerees and purchasers; persons resident
Limitation of resales
Precautions against interstate offers and sales

5.2 Communications with the Public

5.2.1 Securities Act of 1933 and SEC Rules Thereunder

5.2.1.1 Section 2 -- Definitions under the Act
Section 2(8) -- Registration statement
Section 2(10) -- Prospectus
Rule 134 -- Communications not deemed a prospectus

5.2.1.2 Section 5 -- Prohibitions relating to interstate commerce and the mails
Rule 135 -- Notice of certain proposed offerings
Rule 135A -- Generic advertising

5.2.1.3 Section 6 -- Registration of securities and signing of registration statement
Regulation C -- Registration
Rule 425 -- Statement required in all prospectuses
Rule 425A -- Statement required on all prospectus regarding delivery of prospectuses by dealers

5.2.1.4 Section 10 -- Information required in prospectus
SEC Guide 4 - Oil and gas
SEC Guide 5 - Real estate

5.2.1.5 Section 11 -- Civil liabilities on account of false registration statement

5.2.1.6 Section 12 -- Civil liabilities arising in connection with prospectus and communications

5.3 Federal Regulation of Broker-Dealers

5.3.1 Securities Exchange Act of 1934 and SEC Rules Thereunder

5.3.1.1 Section 3 -- Definitions and Application of Titles
- Section 3(a)(3) -- Member
- Section 3(a)(4) -- Broker
  - Rule 3a4-1 -- Associated persons of an issuer deemed not to be brokers
- Section 3(a)(5) -- Dealer
- Section 3(a)(8) -- Issuer
- Section 3(a)(9) -- Person
- Section 3(a)(10) -- Security
- Section 3(a)(11) -- Equity security
- Section 3(a)(12) -- Exempted security
- Section 3(a)(13) -- Buy and purchase
- Section 3(a)(14) -- Sale and sell
- Section 3(a)(18) -- Persons associated with a broker or dealer
- Section 3(a)(24) -- Participant
- Section 3(a)(26) -- Self regulatory organization
- Section 3(a)(35) -- Investment discretion
- Section 3(a)(37) -- Records
- Section 3(a)(39) -- Statutory disqualification

5.3.1.2 Section 10 -- Regulation of the use of manipulative and deceptive devices

5.3.1.2.1 Rule 10b-1 -- Prohibitions with respect to securities exempted from registration

5.3.1.2.2 Rule 10b-3 -- Employment of manipulative and deceptive devices by brokers or dealers

5.3.1.2.3 Rule 10b-5 -- Employment of manipulative and deceptive devices
- False, misleading, or omitted material information

5.3.1.2.4 Rule 10b-9 -- Prohibited representations in connection with certain offerings
- Conditions of the underwriting

5.3.1.2.5 Rule 10b-10 -- Confirmation of transactions
- Information disclosure requirements

5.3.1.3 Section 15(c) -- Registration and regulation of brokers and dealers-prohibitions and sanctions for fraud

5.3.1.3.1 Rule 15c1-2 -- Fraud and misrepresentation

5.3.1.3.2 Rule 15c1-3 -- Misrepresentation by brokers and dealers as to registration

5.3.1.3.3 Rule 15c1-5 -- Disclosure of control

5.3.1.3.4 Rule 15c2-4 -- Transmission or maintenance of payments received with underwritings
- Handling investor funds
- Bank escrow requirements

5.3.1.3.5 Rule 15c2-8 -- Delivery of prospectus (to customers); see also Rule 174 under the 33 Act
- Preliminary prospectus (red herring)
- Effective prospectus
- Delivery to associated persons
- Delivery to other broker-dealers by managing underwriter

5.3.1.4 Section 17 -- Accounts and records, reports, examinations of exchanges, members and others

5.3.1.4.1 Rule 17a-8 -- Financial recordkeeping and reporting of currency and foreign transactions

5.3.1.4.2 Rule 17f-2 -- Fingerprinting of securities industry personnel (general requirement)

5.3.1.5 Regulation FD – Disclosure requirements

5.3.1.6 Regulation S-P – Privacy of consumer financial information

5.4 Insider Trading

5.4.1 Insider Trading and Securities Fraud Enforcement Act of 1988

5.4.1.1 Section 3 -- Civil penalties of controlling persons for illegal insider trading by controlled persons

5.4.1.2 Section 4 -- Increases in criminal penalties

5.4.1.3 Section 5 -- Liability to contemporaneous traders of insider trading

5.5 Restrictions on Installment Sales for SEC Registered Public Offerings

5.5.1 Regulation T -- Federal Reserve Board Requirements

5.5.1.1 Treated as an extension of credit on a non-marginable security
Not applicable to private offerings

5.5.2 Rule 3a12-9 -- Exemption of certain direct participation program securities from the restrictions regarding the extending or arranging of credit

5.5.2.1 Business development plan

5.5.2.2 Specified property program

5.6 Investment Advisers Act of 1940

5.6.1 Practices which would require registration

5.7 FINRA/NASD Rules

5.7.1 By-Laws

5.7.1.1 Article I -- Definitions
Branch office
Broker
Dealer
Investment banking or securities business
Person associated with a member

5.7.1.2 Article III -- Qualifications of members and associated persons

5.7.1.3 Article IV – Membership

5.7.1.4 Article V -- Registered representatives and associated persons

5.7.1.5 Article VI -- Dues, assessments and other charges

5.7.1.6 Article VII -- Board of governors

5.7.1.7 Article IX -- Committees

5.7.1.8 Article XII -- Disciplinary proceedings

5.7.1.9 Article XIII -- Powers of the Board to impose sanctions

5.7.1.10 Article XV -- Limitations of powers
Section 2 -- Use of Name of the corporation by members

5.7.2 General Provisions

5.7.2.1 FINRA Rule 0110 -- Adoption of rules
FINRA Rule 0140 – Applicability

5.7.2.2 FINRA Rule 0160 – Definitions in FINRA By-Laws

5.7.3 Membership, Registration and Qualification Requirements

5.7.3.1 NASD Rule 1020 – Registration of principals
Registration requirements
Definition of principal
Categories of principal registration
General securities principal
Limited principals

5.7.3.2 NASD Rule 1030 -- Registration of representatives
Registration requirements
Definition of representative
Categories of representative registration
General securities representative
Limited representative

5.7.3.3 NASD Rule 1060 -- Persons exempt from registration

5.7.3.4 NASD Rule 1070 -- Qualification examinations and waiver of requirements

5.7.3.5 NASD Rule 1080 -- Confidentiality of examinations

5.7.3.6 FINRA Rule 1250 -- Continuing Education Requirements
Firm Element
Regulatory Element

5.7.4 Conduct Rules

5.7.4.1 FINRA Rule 2010 - Standards of commercial honor and principles of trade

5.7.4.2 FINRA Rule 2020 - Use of manipulative, deceptive, or other fraudulent devices

5.7.4.3 FINRA Rule 2210 – Communications with the Public

5.7.4.4 FINRA Rule 2214 – Requirements for the Use of Investment Analysis Tools

5.7.4.5 FINRA Rule 3230--Telemarketing

5.7.4.6 FINRA Rule 2232 – Customer Confirmations

5.7.4.7 FINRA Rule 2262 - Disclosure of control relationship with issuer

5.7.4.8 FINRA Rule 2269 - Disclosure of participation or interest in primary or secondary distribution

5.7.4.9 FINRA Rule 2111--Suitability
FINRA Rule 2090--Know Your Customer

5.7.4.10 FINRA Rule 2150 – Improper use of customers' securities or funds; prohibition against guarantees and sharing in accounts
- Improper use
- Prohibition against guarantees
- Sharing in accounts; extent permissible

5.7.4.11 FINRA Rule 3240 - Borrowing from or lending to customers

5.7.4.12 NASD Rule 2420 - Dealing with non-members
- Transactions with non-members
- Transactions with foreign non-members
- Non-member broker or dealer
  - IM-2420-1 – Transactions between members and non-members
    - Member
    - Expelled dealer
    - Suspended dealer
    - Broker or dealer whose registration is revoked by the SEC
    - Membership resigned or canceled

5.7.4.13 NASD Rule 2430 - Charges for services performed

5.7.4.14 NASD Rule 2440 - Fair prices and commissions

5.7.4.15 FINRA Rule 5110 – Corporate Financing Rule-Underwriting terms and arrangements
- Definitions
- Filing requirements-public programs
- Underwriting compensation and arrangements

5.7.4.16 FINRA Rule 5130- Restrictions on the purchase and sale of initial equity Public offerings

- General prohibitions
- Preconditions for sale
- General exemptions
- Issuer-directed securities
- Anti-dilution provisions
- Stand-by purchasers
- Undersubscribed offerings
- Definitions

5.7.4.17 FINRA Rule 2310 - Direct participation programs

- Definitions
- Requirements
  - Application
  - Suitability
  - Disclosure
  - Organization and offering expenses
  - Valuation for customer accounts
  - Participation in rollups

5.7.4.18 NASD Rule 3010 - Supervision

- Supervisory systems
- Written procedures
  - Supervisory manual
    - Readily accessible and continuously updated
- Internal inspections
- Review of transactions and correspondence
- Qualifications investigated
- Applicant's responsibility
- Definitions
  - Office of supervisory jurisdiction (OSJ)
  - Branch office

5.7.4.19 FINRA Rule 3310 - Anti-money laundering compliance program

- Bank Secrecy Act

5.7.4.20 FINRA Rule 3270 - Outside business activities of registered persons

5.7.4.21 NASD Rule 3040 - Private securities transactions (selling away)

- Applicability to all associated persons of the member
- Prompt written notice to the employer member
- Transactions for compensation
- Transactions not for compensation
- Definitions

Private securities transaction
Selling compensation

5.7.4.22 NASD Rule 3050 - Transactions for or by associated persons
Determine adverse interest
Obligations of executing member
Obligations of associated persons concerning an account with a member
Obligations of associated persons concerning an account with an investment adviser, bank, or other financial institution
Exemption for transactions in investment company shares and unit investment trusts

5.7.4.23 FINRA Rule - 3220 Influencing and rewarding employees of others

5.7.4.24 FINRA Rule 4530 - Reporting requirements

5.7.4.25 Books and Records
FINRA Rule 2268 - Requirements When Using Predispute Arbitration Agreements for Customer Accounts
FINRA Rule 4511 - General Requirements
FINRA Rule 4512 - Customer Account Information
FINRA Rule 4513 - Records of Written Customer Complaints

5.7.4.26 FINRA Rule 2060 - Use of information obtained in fiduciary capacity

5.7.5 FINRA Procedural Rules

5.7.5.1 Rule 8000 -- Investigations and sanctions

5.7.5.1.1 Rule 8100 -- General provisions
Rule 8110 - Availability of manual to customers

5.7.5.1.2 Rule 8200 -- Investigations
Rule 8210 - Provision of information and testimony and inspection and copying of books

5.7.5.1.3 Rule 8300 -- Sanctions
Rule 8310 - Sanctions for violation of the rules
Rule 8311 – Effect of a suspension, revocation, cancellation, or bar
Rule 8313 – Release of disciplinary complaints, decisions and other information
Rule 8320 - Payment of fines, other monetary sanctions, or costs; summary action for failure to pay
Rule 8330 - Costs of proceedings

5.7.5.2 Rule 9000 -- Code of Procedure

5.7.5.2.1 Rule 9100 -- Application and purpose
- Rule 9110 - Application
- Rule 9120 - Definitions
- Rule 9130 - Service; filing of papers
- Rule 9140 - Proceedings
- Rule 9160 - Recusal or disqualification

5.7.5.2.2 Rule 9200 -- Disciplinary proceedings
- Rule 9210 - Complaint and answer
- Rule 9220 - Request for hearing; extensions of time, postponements, adjournments
- Rule 9230 - Appointment of hearing panel, extended hearing panel
- Rule 9240 - Pre-hearing conference and submission
- Rule 9250 - Discovery
- Rule 9260 - Hearing and decision
- Rule 9270 - Settlement procedure
- Rule 9280 - Contemptuous conduct

5.7.5.2.3 Rule 9300 -- Review of disciplinary proceeding by National Adjudicatory Council and FINRA Board; application for SEC review
- Rule 9310 - Appeal to or review by National Adjudicatory Council
- Rule 9320 - Transmissions of record; extensions of time, postponements, adjournments
- Rule 9340 - Proceedings
- Rule 9350 - Discretionary review by FINRA Board
- Rule 9360 - Effectiveness of sanctions
- Rule 9370 - Application to SEC for review

5.7.5.2.4 Rule 9500 -- Other Proceedings
- Rule 9520 - Eligibility Proceedings

5.7.5.2.5 Rule 9600 Series -- Procedures for Exemptions

5.7.5.3 Rule 10000 -- Code of Arbitration Procedure

5.7.5.3.1 Rule 12000 – Code of Arbitration Procedure for Customer Disputes
- IM-12000 - Failure to Act Under Provisions of Code of Arbitration Procedure for Customer Disputes
- 12302 - Filing an Initial Statement of Claim
- 12303 - Answering the Statement of Claim

5.7.5.3.2 Rule 13000 – Code of Arbitration Procedure for Industry Disputes

IM-13000 - Failure to Act Under Provisions of Code of Arbitration Procedure for Industry Disputes
Rule 13600 Series - Required Hearings
Rule 13800 Series - Simplified Arbitration
Rule 13900 Series - Fees and Awards

5.7.5.3.3 Rule 14000 – Code of Mediation Procedure
Rule 14104 --Mediation under the Code
Rule 14108 - Limitation on liability
Rule 14109 - Mediation ground rules

5.8 State (Blue Sky) Registration and Filing Requirements

5.8.1 State Regulation of DPP Programs
North American Securities Administrators Association (NASAA) Statement of Policy

5.8.2 Exemptions from state registration

5.8.3 Broker-dealer state registration

5.8.4 Registered representative/principal state registration

6.0

FACTORS TO CONSIDER IN EVALUATING DIRECT PARTICIPATION PROGRAMS

6.1 Evaluation of the Direct Participation Program

6.1.1 Economic soundness of program

6.1.2 Basic objectives of program

6.1.3 Value of assets

Cost to general partner
Cost to program
Third party appraisal of property, if applicable

6.1.4 Nature of Assets

Location
Economics of area
Demographics
Climatic conditions
Physical conditions

6.1.5 Principal Risk factors

Investment risk
Business/credit risk
Interest rate risk
Risk of liquidating investment at inappropriate times
Marketability or redeemability of the investment
Tax impact
Management ability
Market risk
Economic, social and political risk
Exchange rate risk
Lack of investment liquidity
Possible loss of principal
Unpredictability of income and expenses
Capability of general partner
Leverage
Competition

6.1.6 Potential conflicts of interest

Competing property interests held by the sponsor and his affiliates
Commingling program funds

Sponsor receives compensation for services rendered at favorable rates
Purchase or sale of property to partnership by general partner

6.1.7 Sponsor and affiliate interest and compensation

6.1.7.1 Organization and offering period
- Acquisition and development fees
- Other offering and organization fees paid
- Selling compensation
- Asset mark-ups
- Cost reimbursement

6.1.7.2 Operational period
- Asset management fees
- Property management fees
- Interest in profits, losses and cash distributions (subordinated or non-subordinated)

6.1.7.3 Termination period
- Disposition fee
- Cost reimbursement
- Carried interest in gain, loss and cash distribution (subordinated or non-subordinated)

6.1.8 Sponsor's track record
- Review data from sponsor's previous programs to determine experience in the type of program begin offered
- Success ratio versus type of program

6.1.9 Sources of offering proceeds
- Capital contributions
- Installment or staged payments
- Letters of credit
- Loans
- Assessments (additional capital contributions)

6.1.10 Use of offering proceeds

6.1.10.1 Offering proceeds less offering and organization (front-end load) expenses equals amount available for investment

6.1.10.2 Types of offering and organization expenses
- Underwriting compensation (sales and wholesaling fees)
- Due diligence fees
- Advisory fees (legal, accounting, consulting, investor relations, etc.)

Direct costs (printing, mailing, administrative, etc.)

6.1.10.3 Amounts of offering and organization expenses paid to sponsor and affiliates

6.1.10.4 Limits on offering and organization expenses in public programs

6.1.10.5 Indeterminate compensation adjustments on underwriting compensation

6.1.10.6 Use of amount available for investment
- Acquisition of assets
  - Reimbursement of prepayments for loans, options, advisory fees, and administrative costs--amounts paid to sponsor and affiliates
  - Acquisition fees (real estate commissions) -- amounts paid to sponsor and affiliates
  - Net cash to acquire assets
- Working capital reserve

6.1.11 Anticipated cash flow
- Payments to investors
- Automatic re-investment plan
- Preferred returns
- Guaranteed returns
- Subordinated returns
- Cumulative returns
- Sharing ratio(s)

6.1.12 Anticipated returns on investments
- Analyze elements of return before and after taxes
- Examine tax factors by year over life of the investment
- Methods of calculating return and present value (time value of money)
  - Internal rate of return
  - Discounted cash flows

6.2 Investor Suitability

6.2.1 Suitability
- FINRA Rule 2090--Know Your Customer
- FINRA Rule 2111--Suitability

6.2.2 Investor's understanding of the direct participation program
- Ability to understand risks of the underlying investment
- Lack of liquidity and marketability

6.2.3 Alternative investment products -- appropriateness for investors, given

the investor's investment objectives and risk-taking profile

Treasury bills
Money market funds
Short-term government bond funds
Intermediate government bond funds
Long-term government bond funds
Municipal securities
Corporate securities
Real-estate investment trusts
Aggressive growth funds
Speculative stocks
Option trading

SAMPLE QUESTIONS

The questions that appear below are similar in format and content to questions on the examination. This sample of questions, however, is not intended to exactly parallel either the level of difficulty or the subject coverage of the examination. Their purpose here is to assist candidates and training personnel in preparing for the types of multiple-choice questions which will appear on the examination.

1. In a joint venture, a venturer has liability that is equivalent to the liability of a:

   (A) Limited partner
   (B) General partner
   (C) Shareholder in a C corporation
   (D) Shareholder in an S corporation

2. Which of the following is TRUE of a partner in a general partnership?

   (A) He cannot participate in management without jeopardizing his status.
   (B) He has limited liability.
   (C) He has personal liability for obligations of the partnership.
   (D) He is not responsible to creditors of the partnership beyond the subscription amount.

3. When calculating the cash flow from a residential property, which two of the following items must be considered?

   I. The amount of the rent received.
   II. The amount of cash expenses paid to operate the property.
   III. The amount of cash expenses less depreciation.
   IV. The amount of all amortized items.

   (A) I and II
   (B) I and IV
   (C) II and III
   (D) III and IV

4. Each of the following is true of a public limited partnership offering EXCEPT:

   (A) The offering must be filed with the SEC and FINRA.
   (B) The offering may be advertised in securities industry magazines.
   (C) The number of accredited investors is limited to 35.
   (D) The offering may be made in more than one state.

ANSWERS TO SAMPLE QUESTIONS

1. (B)
2. (C)
3. (A)
4. (C)