

Cooperatives; organization distributing electric power to members. The Service will not follow the Peninsula Light Co., Inc. decision that an organization formed for the purpose of distributing electric power to its members, not operated on a patronage basis, whose charter provides, instead, that each member has an equal share in the organization's assets, with its net assets upon dissolution to be divided equally among its then-current members, and whose former members' rights and interests are forfeited upon termination of membership, qualifies for exemption as a mutual or cooperative organization under section 501(c)(12) of the Code.

The Internal Revenue Service will not follow the Ninth Circuit's decision entered in *Peninsula Light Co., Inc. v. United States*, 552 F.2d 878 (9th Cir. 1977), affirming the decision of the District Court for the Western District of Washington, that the Peninsula Light Co., Inc. qualified for exemption from Federal income tax as a mutual or cooperative organization under section 501(c)(12) of the Internal Revenue Code of 1954.

The organization was formed for the purpose of distributing electric power to its members. Any individual or organization that qualified under the organization's by-laws could become a member upon payment of a \$100.00 fee. The organization had never operated on a patronage basis; instead, its charter provided that each of its members had an equal share in the organization's assets, and that its net assets upon dissolution would be divided equally among its then-current members. In 1967 a portion of the organization's system was taken through eminent domain. Members of the organization formerly served by that portion of the system terminated their memberships. Upon termination they received only refunds of their membership fees, plus the cost of certain equipment for which they had been billed individually. Any further rights and interests of these members in the organization's assets were forfeited.

Section 501(c)(12) of the Code provides for exemption from Federal income tax of mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations, if 85 percent or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Section 1.501(c)(12)-1(a) of the Income Tax Regulations provides that excess funds on hand at the end of the year may be retained to meet future losses and expenses, or returned to members.

The organization's method of operation was clearly in conflict with basic principles of mutual or cooperative operation. By failing to provide for computation of its members' interests on a patronage basis and by causing the forfeiture of former members' rights and interests upon termination of their

membership, the organization failed to operate on a mutual or cooperative basis. It is the position of the Service that organizations that do not operate on a mutual or cooperative basis do not qualify for exemption under section 501(c)(12) of the Code. See Rev. Rul. 72-36, 1972-1 C.B. 151.