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LEGEND:

- State A =
- City =
- Company =
- Finco =
- B =
- C =
- D =

Dear

This is in response to a request for a ruling dated February 17, 2011, submitted by your authorized representative. The ruling concerns whether Finco, a corporation to be formed to provide treasury services and make loans to the member firms of B (“Member Firms”), will be a corporation operating on a cooperative basis within the meaning of section 1381(a)(2) of the Internal Revenue Code.

Finco has not been formed and thus does not yet have a taxpayer identification number. It is currently anticipated that Finco will be formed under the State A General

Corporation Law and that its headquarters will be located in City. Finco plans to file a federal income tax return on the basis of a 52-53 week fiscal year ending on the Friday closest to . Its overall method of accounting will be the accrual basis.

The ruling request is being made on Finco's behalf by C, one of the Member Firms and a company that will be a member of Finco. Company is a global organization of companies providing services under the Company name. Company is currently comprised of Member Firms operating in over countries around the world.

Each Company Member Firm is a separate legal entity which generally is owned and managed by in a single country. While there is just one Member Firm in some countries, in others there are several. The form of legal entity used by Member Firms differs from country to country, but generally Member Firms are organized as corporations, partnerships, limited liability companies or their equivalents under local law. In many countries, a Member Firm may, for reasons of local law, operate through several legal entities either under common or separate control. As separate legal entities with separate owners, one Member Firm is not liable for the acts of other Member Firms or for the debts of other Member Firms, unless otherwise agreed by contract.

Company has developed as it has because, among other things, of legal and regulatory restrictions placed by governments around the world upon the activities of firms. For instance, it is not uncommon for a country to require that only firms owned locally may provide an of a company organized in that country. Such limitations as well as other factors such as limitation of liability concerns have kept firms from merging into a single legal entity, operating worldwide.

Individual firms join Company by becoming members of B, a financially inactive company, which serves as the principal coordinating entity of Company. B does not own or control Member Firms or their practices. Each Member Firm is a separate legal entity and remains solely responsible for its own work for clients, but all Member Firms are part of a highly integrated organization to enable the delivery of seamless, consistent, high-quality service worldwide. B is not an operating entity providing services to clients. While Company releases certain information regarding the combined revenues, employee and headcounts, etc. of the organization, the figures reported are merely pro forma figures for the organization.

B coordinates the efforts of the Member Firms by way of agreements with Member Firms. Under the regulations of B, the Member Firms agree to operate their practices in accordance with agreed standards. Member Firms commit themselves to pursue the objectives of Company, such as the provision of seamless, consistent, high-quality services, worldwide. To that end, Member Firms undertake to

implement the global strategies and plans and to maintain the right scope of service capabilities. They are required to comply with common standards, methodologies and policies, including those relating to , independence, knowledge sharing, human resources and technology enablers.

Member Firms commit themselves to conduct their practices in accordance with applicable and ethical standards, as well as with all requirements of the law. The commitment is underpinned by a common and a shared set of values.

C, a limited liability partnership and its subsidiaries, currently provides a broad range of shared services to the Member Firms. C operates on a and files tax returns with the .

The services relate to:

- Advice about staffing, recruiting and related services
- Training
- Industry and strategy support
- Service lines support with marketing and client service tools
- Public relations
- Meeting coordination
- Computer support
- Database administration
- Network and computer system administration
- Financial reporting and limited treasury activities
- Budgeting
- Quality and risk management

While C provides limited treasury services and occasional loans to Member Firms, treasury services and lending is not its primary focus.

By centralizing various support functions that Member Firms require, C can realize economies of scale. The objective is to offer Member Firms a broader range of

high-quality services at lower cost than they could otherwise obtain. B has for some time believed that the Member Firms would benefit from a more efficient global treasury function.

Each Member Firm is responsible for handling its own treasury operations, i.e., managing working capital requirements and lender relationships in such a manner that it has the financial resources necessary to conduct its business and those resources are obtained in a cost-effective manner. In managing treasury operations, a Member Firm needs to have relationships with banks and other financial institutions so that it can borrow money as needed and so that it can invest any temporary surplus working capital it may have from time to time. Member Firms' needs fluctuate daily and seasonally throughout the year. At any time, some Member Firms are investing temporary surplus working capital, while others are borrowing to fund their operations.

Each Member Firm currently manages its treasury operations independently, dealing directly with local financial institutions on terms and conditions that have been negotiated based upon the size and financial strength of the individual Member Firm. This has often meant that the terms and conditions are less favorable than those given to larger companies. Collectively, Member Firms currently have relationships with nearly financial institutions and have over bank accounts.

In addition to the other support services it provides, C currently provides limited treasury services and has, from time to time, made loans to certain Member Firms. The limited treasury service that C currently provides include:

- Limited advances to some Member Firms where external funding is not available
- Advice to some Member Firms with respect to foreign exchange management
- Letters of comfort, letters of credit and guarantees to support some Member Firms' borrowing from banks and others
- Funding for market development activities for the benefit of Member Firms

These limited treasury and finance activities are all ancillary to C's core activities.

B believes that the formation of Finco, a global finance and treasury services company owned by Member Firms and operating on a cooperative basis, will allow Member Firms to enhance their treasury functions. The purpose of Finco will be to provide Member Firms with a variety of treasury services. Finco will also serve as a source of credit on a structured and strategic basis for Member Firms needing to borrow funds and as a place where Member Firms with temporarily unused working capital can loan funds and earn a market rate of return. Each Member Firm will ultimately continue

to remain responsible for its own treasury function, but Finco will coordinate and implement a global treasury strategy in order to achieve operational efficiencies which will allow each of the Member Firms to operate its local treasury function more efficiently.

It is intended that Finco will provide a variety of financial services to the Member Firms and their affiliates, including:

- Treasury advice on capital and debt structure, managing credit and interest rate risks, and identifying efficient sources of borrowing
- Covenant compliance
- Bank relationship management
- Credit assessment
- Technology and treasury systems administration
- Currency risk management advice and foreign exchange hedging
- Interest rate risk management and interest rate swaps
- Facilitating netting settlement of inter-firm payments and currencies

Finco also plans to lend funds to Member Firms and their affiliates and provide credit support. Finco anticipates providing:

- Loans to Member Firms and their affiliates in the form of annual credit facilities, revolving credit facilities or term loans
- Letters of comfort, letters of credit and guarantees to support third-party borrowing by Member Firms and their affiliates
- Loans to C and other central entities of Company to support their working capital and operating liquidity needs

The loans and credit support for third-party loans will be priced to allow Finco to cover its costs plus a slight margin.

Company has identified five principal categories of anticipated benefits from the establishment of Finco: (i) streamlined, strong banking relationships; (ii) better terms for external borrowing; (iii) improved risk management; (iv) more efficient internal lending and borrowing; and (v) more efficient settlement of inter-firm payments and other treasury services.

It is anticipated that Finco will reduce the cost to Member Firms when they need to borrow to fund their businesses by consolidating credit lines with fewer, larger lenders, negotiating more favorable terms and rates, and reducing other borrowing costs (including the costs of excess credit lines). The formation of Finco will permit the Member Firms collectively to transition from having individual credit lines with nearly

banks to having credit lines with Finco, which, in turn, will borrow from a select group of key relationship banks. Through Finco, the Member Firms will collectively become a significant, well-organized global client for lenders instead of a confusing, decentralized group of nationally-based ones. Finco should be able to negotiate better terms and rates than can be negotiated by most Member Firms, lowering the total cost of borrowing. Reducing the number of bank relationships should reduce the time, inconvenience and legal expense currently resulting from dealing with of banks. Equally important, Finco should be able to better manage the size of credit lines by consolidating the lines, significantly reducing the commitment fees and other costs paid currently being paid on a collective basis by Member Firms for credit lines that go unused.

Establishing Finco will also benefit Member Firms with a need to invest temporarily unused working capital. Member Firms will be offered the opportunity to loan those funds to Finco at a market rate of interest. Given the current financial environment, this may provide Member Firms with a higher return and lower risk than they otherwise would have received for their short-term investments.

To accomplish these objectives, the Member Firms plan to form a finance company to be known as Finco. Finco will be formed as a corporation under the State A General Corporation Law that is “operating on a cooperative basis.” The Member Firms have decided to organize Finco as a corporation “operating on a cooperative basis” because that form of business is most consistent with the Member Firms’ objectives with respect to ownership, control and operation at cost.

Finco’s principal business activities will be providing treasury services to Member Firms and their affiliates and providing loans and credit support to Member Firms and their affiliates. Both of these activities will be conducted on a patronage basis.

Finco will obtain funding for its loans from several sources – equity capital (common and preferred stock) provided by Member Firms, subordinated debt from Member Firms, revolving credit or term loans from banks, and private placement term debt from other interested lenders. Finco will pay a market rate of interest on any loans that it receives from Member Firms. Finco anticipates that Member Firms will initially be called upon to guarantee its borrowings from banks and other financial institutions for which appropriate guarantee fees will be paid. Over time, Finco intends to build up sufficient equity so Member Firm guarantees will no longer be necessary.

Upon formation, Finco's initial members will make capital contributions to Finco. The limited treasury and lending activities currently being conducted by C will be transferred to Finco where they will be expanded as described above.

Finco will not be formed and will not operate as a mutual savings bank, cooperative bank, domestic building and loan association or other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law. Its business will not consist of acquiring savings of the public (or accepting deposits from the public) and investing in loans. It will not be an insured institution within the meaning of section 401(a) of the National Housing Act. It will not be subject by law to supervision and examination by State or Federal authorities having supervision over banks, building and loan associations or other similar entities.

Finco's Certificate of Incorporation provides that Finco is to "operate on a cooperative basis for the benefit of its Members and Participating Patrons. A similar statement is contained in the Bylaws.

Finco's Certificate of Incorporation and Bylaws classify persons borrowing and receiving services from Finco into three groups: Members, Participating Patrons and Nonpatrons. Membership in Finco will be limited to persons that are members of B. Persons who apply for and are accepted as members of Finco are referred to in this ruling as "Members." Finco will not have more than one Member organized and doing business in any country unless the Members are not affiliated and the Board of Directors of Finco approves the multiple memberships. References in this ruling to "Member Firms" are to the members of B and references to "Members" are to the Members of Finco.

Members will be entitled to share in Finco's patronage dividends and will be eligible to vote. Each Member will own one share of Finco's voting common stock. The status as a Member of Finco is nontransferable and nonassignable without the prior written consent of Finco.

Finco also will do business on a patronage basis with certain persons who are not Members, but who qualify as "Participating Patrons" as that term is defined in Article 2.3 of the Bylaws. In order to be a Participating Patron, a person must be a member of B who is not a Member of Finco, and must do business with Finco.

In general, there are three categories of persons within Company that will be treated as Participating Patrons:

- For reasons of local law, in many countries Member Firms operate through several entities under common or separate control. When they

do, only one of the entities will be eligible to be a Member of Finco.<sup>1</sup> Finco may do business with some or all of the other entities and the other entities will be treated as Participating Patrons if they do business with Finco.

- Company also includes service entities established on a or other basis to serve the Member Firms. These entities are owned and controlled by one or more of the Member Firms. C is an example of such a service entity. Finco may provide treasury services or loans to some or all of these service entities, and they will be treated as Participating Patrons if they do business with Finco.
- If Finco some day establishes participation standards for membership (e.g., minimum levels of usage), Member Firms of B that do not meet the participation standards (and are thus not eligible to be Members of Finco) will continue to be eligible to do business with Finco as Participating Patrons.

Participating Patrons will be entitled to share in patronage dividends, the distribution of nonpatronage earnings, and the residual assets of Finco in the event of its dissolution, but will not be eligible to own a share of Finco voting common stock – thus, they will not be entitled to vote.

Finco will be authorized to provide treasury services and loans to persons who are neither Members nor Participating Patrons (referred to in this ruling as “Nonparticipating Patrons”), though it does not have any current plans to do so. If treasury services and loans are offered to Nonparticipating Patrons at some time in the future, such services and loans will be provided on a nonpatronage basis. Thus, Nonparticipating Patrons will not be entitled to share in patronage dividends, in distributions of nonpatronage earnings or in residual assets in the event of dissolution, and they will not have any voting rights.

Finco will do business with banks, third-party vendors and others as part of the activities Finco will routinely engage in so that it will be able to provide treasury and lending services to its Members and Participating Patrons.

Finco will be organized with two classes of capital stock – common stock and preferred stock. Finco will also be authorized to issue written notices of allocation (qualified or nonqualified) as part of its patronage dividends.

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1. The other entities are not permitted to be Members of Finco to insure that a Member Firm that operates through multiple entities is not entitled to cast multiple votes in Finco while a Member Firm that operates through a single entity can cast only one vote.



Finco will have a single class of common stock (with a par value of \$ \_\_\_\_\_ per share and a liquidating value of \$ \_\_\_\_\_ per share) which will serve as its membership stock. The powers, privileges and rights of the common stock are described in detail in Article 4.2 of the Certificate of Incorporation.

Each Member will be required to purchase one share of common stock upon becoming a Member. The issue price will be \$ \_\_\_\_\_ per share. No Member will be permitted to own more than one share of common stock.<sup>2</sup>

A Member will not be entitled to receive dividends with respect to its share of common stock. Upon liquidation, a Member will be entitled to receive an amount equal to the issue price (\$ \_\_\_\_\_) for its share of common stock, and no more.

Common stock will be the only class of voting stock of Finco. Each share will be entitled to one vote. In the event that a holder of a share of common stock ceases to be a Member or Member Firm for any reason, the share will lose its voting rights, and Finco will have the right to repurchase the share for an amount equal to the issue price (\$ \_\_\_\_\_) of the share. Shares of common stock will not be transferable without the consent of Finco.

Finco will be authorized to issue shares of preferred stock (with a par value equal to \$ \_\_\_\_\_ per share) in series, with such rights as shall be established by the Board of Directors by resolution authorizing each series. Article 4.3 of the Certificate of Incorporation.

However, there will be certain limitations on all shares of preferred stock. Dividends may be paid on shares of preferred stock as set forth in the certificate of designations for each series (and they may be cumulative if so provided), but in no event will the dividends paid on the shares of preferred stock of any series exceed 8 percent of the issue price per annum. Shares of preferred stock will not be eligible to vote (except as provided by State A law). Upon dissolution and liquidation, a holder of shares of preferred stock will be entitled to receive an amount equal to the issue price of the shares and any cumulative, accrued unpaid or declared and unpaid dividends, and no more.

At the time of Finco's formation, the Board of Directors will provide for the issuance of shares of Series A Preferred Stock in a certificate of designations. Shares of Series A Preferred Stock will be issued and sold only to Members and Participating Patrons.

Series A Preferred Stock will have a par value of \$ \_\_\_\_\_ per share and an issue price of specified in the certificate of designations. Series A Preferred Stock may be

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2. Where a Member Firm does business through multiple entities under common control, only one entity will be eligible to be a Member of Finco. Certificate of Incorporation, Article 4.2(a).

entitled to dividends, but not in excess of 8 percent of the issue price per annum. Series A Preferred Stock will not have conversion rights. Series A Preferred Stock will be nonvoting, except to the extent required by State A law. Finco will have the right to redeem shares of Series A Preferred Stock at any time for an amount equal to its issue price. A holder may not transfer shares of Series A Preferred Stock without the consent of Finco. Upon dissolution and liquidation of Finco, a holder of shares of Series A preferred stock will be entitled to receive an amount equal to the issue price of the shares, and no more.

While ownership of Series A preferred stock will be limited to Members and Participating Patrons, shares of preferred stock of other series to be created in the future through certificates of designation may be sold to outside investors to provide additional equity capital for Finco.

It is currently anticipated that each Member Firm will be required to provide funds to Finco in an amount equal to      percent of its total net revenue for its      fiscal year. Such funding is planned to occur during the      fiscal year, beginning in

, and may occur in installments.

Of the initial funding provided by each Member Firm, \$      will be applied to the purchase of one share of common stock. The remainder will be applied to the purchase of shares of Series A Preferred Stock at a purchase price equal to the issue price per share contained in the certificate of designations or to purchase of subordinated promissory notes. If a Member Firm operates through more than one entity, the entity that is to be the Member of Finco and will purchase the share of Finco common stock. The shares of Series A Preferred Stock may be owned by the Member or by a Participating Patron.

Finco will have a lien upon shares of common stock, preferred stock, written notices of allocation (qualified or nonqualified) and subordinated promissory notes owned by Members and Participating Patrons and upon any patronage dividends payable to Members and Participating Patrons. Finco will also have the right to set off amounts due from Members and Participating Patrons to Finco against amounts due to Members and Participating Patrons with respect to such interests.

Finco will be obligated to allocate and distribute its earnings from business done with or for Members and Participating Patrons each year to Members and Participating Patrons as patronage dividends. The provisions related to the allocation and payment of patronage dividends are contained in Article 5 of the Certificate of Incorporation and in Article 8 of the Bylaws. In pertinent part, these Sections will provide:

- Each year Finco will determine its net earnings or loss from business done with or for Members and Participating Patrons (its “patronage earnings”) and its net earnings or loss from other business (its “nonpatronage

earnings”). The starting point for this determination will be net income as determined for financial reporting purposes.

- Finco will then set aside from patronage earnings an amount of patronage earnings required (i) to pay or provide for dividends chargeable to patronage earnings, (ii) for net operating losses and (iii) for reasonable reserves required by the needs of its business. All remaining patronage earnings will be allocated among Members and Participating Patrons on a patronage basis.
- No later than eight and one-half months after the end of the fiscal year, Finco will pay the amounts so allocated to Members and Participating Patrons as patronage dividends. The payment will be in the form of cash, property and written notices of allocations (qualified or nonqualified), or any combination thereof, as the Board of Directors determines.
- No dividends will be paid on the common stock or written notices of allocation of Finco. Limited dividends (not to exceed 8 percent per annum) may be paid on shares of Series A Preferred Stock and on shares of preferred stock of other series (if such preferred stock is some day issued). Finco will use net earnings from nonpatronage business to pay or provide for any dividends upon preferred stock, and, only if such earnings are insufficient, will patronage earnings be used for dividends paid on shares of Series A Preferred Stock.
- Finco will use any nonpatronage earnings to pay or provide for taxes and to pay or provide for dividends (as described above). All or any portion of remaining nonpatronage earnings may, if the Board of Directors so determines, be allocated and distributed to Members and Participating Patrons on a patronage basis. Amounts not so allocated and distributed will be added to unallocated retained earnings (surplus) of the corporation.

Finco will allocate patronage dividends based upon a single allocation unit. Finco’s patronage-sourced net earnings will be allocated among Members and Participating Patrons on a patronage basis based upon the ratio of the total amount paid by each Member and Participating Patron to Finco for treasury services, loans and credit support during the year to the total gross amount paid by all Members and Participating Patrons for treasury services, lending and credit support during the year. The total amount paid will include, without limitation, interest paid, loan origination fees, loan participation or commitment fees, guarantee fees, letter of credit fees and comfort letter fees, but will exclude repayment of loan principal.

Finco will be authorized to pay patronage dividends in cash, property or written notices of allocation (qualified or nonqualified), or any combination thereof as determined by its Board of Directors. During its initial years, Finco anticipates that its

patronage dividends will be paid entirely in nonqualified written notices of allocation as it builds up the necessary equity base to support its business.

Finco's written notices of allocation will take the form of letters of advice from Finco to Members and Participating Patrons. The letters of advice will disclose to each recipient the stated dollar amount allocated to it on the books of Finco and the portion thereof which constitutes a patronage dividend. No interest or dividends will be paid upon the written notices of allocation, and they will not have any voting rights. Written notices of allocation will not have a due date or stated maturity and will not constitute evidences of indebtedness due to the holders thereof. Upon liquidation, a holder of written notices of allocation will be entitled to receive the stated dollar amount of the notices and no more.

In the event that Finco incurs a patronage loss, a nonpatronage loss or both patronage and nonpatronage losses, the Bylaws will authorize the Board of Directors to determine a fair and equitable method of handling the loss and list a variety of alternative approaches that may be adopted.

Finco will be organized and operated on a one-member, one-vote basis. The common stock will be the only class of voting stock, and each Member will own one (and only one) share of common stock. Thus, on all matters requiring a member vote, including election of directors, Members will vote on a one-member, one-vote basis. Voting may be in person, by majority consent or by proxy. Proxies may be granted only to an individual of \_\_\_\_\_ with a Member or Participating patron or to a director or officer of Finco.

Most matters submitted to a vote of the Members will require the affirmative vote of a majority of all Members. In the case of certain fundamental matters – i.e., an amendment of Finco's Certificate of Incorporation, the dissolution of Finco, the sale of all or substantially all of the assets of Finco, or a merger of Finco – the affirmative vote of two-thirds of the directors and of two-thirds of the Members will be required.

In the event of dissolution, after the claims of all creditors have been paid or provided for, the assets of Finco will be distributed as follows:

- First, to the holders of shares of preferred stock, in the order of any preferences that may be established in the certificates of designations for each series, an amount equal to the issue price of the preferred shares and cumulative, accrued unpaid or declared and unpaid dividends, if any.
- Second, to the holders of common stock, an amount equal to \$ \_\_\_\_\_ per share.
- Third, to the holders of qualified and nonqualified written notices of allocation an amount equal to the stated dollar amount thereof.

- Finally, any remaining assets will be shared by Members and Participating Patrons upon the basis of the quantity or value of business done with Finco during the seven fiscal years immediately preceding dissolution (or the period of existence of Finco, if shorter).

It is anticipated that Finco will have numerous Members. Any member of B will be eligible to be a Member of Finco, with the proviso that generally Finco will not have more than one Member organized and operating in any country. The only exception to the general rule will be for instances where two or more Member Firms are organized and operating in a country and they are not Affiliates (entities under common control). In such cases, with the approval of the Board of Directors of Finco, there may be more than one Member in a country.

Finco will be organized and operated on a one-member, one-vote basis. Thus, ownership and control of Finco will be widely dispersed among its Members. Finco's earnings will be shared by Members and Participating Patrons on a patronage basis. None of Finco's anticipated Members is currently included in a United States consolidated federal income tax return with any of Finco's other anticipated Members, nor are they qualified for such treatment. There is no intention for this to change.

Finco anticipates that it will have only one Member, D. D is an operating entity, organized as a limited liability partnership.

Based on the foregoing, a ruling is requested that, provided Finco is formed and operated as described above, Finco will be a corporation operating on a cooperative basis within the meaning of section 1381(a)(2) of the Code.

Section 1381(a)(2) of the Code provides that subchapter T shall apply to any corporation operating on a cooperative basis with certain exceptions. Section 1.1381-1(a) of the Income Tax Regulations states that subchapter T of the Code applies to any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of business done with or for such patrons. However, section 1381(a)(2)(B)(i) excepts an organization which is subject to the provisions of part II of subchapter H (relating to mutual savings banks, etc.) from subchapter T. Under section 591(a), the entities covered by part II of subchapter H are mutual savings banks, cooperative banks, domestic building and loan associations, and other savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law.

What it means to be operating on a cooperative basis within the mean of subchapter T of the Code is not defined in the Code or the regulations. Rev. Rul. 93-21, 1993-1 C.B. 188, provides that the cooperative principles in Puget Sound Plywood, Inc. v. Commissioner, 44 T.C. 305 (1965), acq. 1966-1 C.B. 3, provide the basis for determining whether a corporation is operating on a cooperative basis for purposes of subchapter T.

In Puget Sound Plywood, the Tax Court described three principles as fundamental to cooperative operation:

“(1) Subordination of capital, both as regards control over the cooperative undertaking, and as regards the ownership of the pecuniary benefits arising therefrom; (2) democratic control by the worker-members themselves; and (3) the vesting in and the allocation among the worker-members of all fruits and increases arising from their cooperative endeavor (i.e., the excess of the operating revenues over the costs incurred in generating those revenues), in proportion to the worker-members' active participation in the cooperative endeavor.

Implementation of the first of these three principles, relating to the subordination of capital contributions in determining the right to the pecuniary benefits, is effected through the statutes under which the cooperatives are organized, and also by the charters and bylaws of the cooperatives themselves—all of which contain limitations upon the amounts that may be distributed to members in respect of the stock which represents the necessary capital that the members themselves supply. Indeed in the case of many cooperatives, distributions in respect of the worker-members' stock are forbidden entirely. Also, implementation of the subordination of capital as regards control over the management and direction of the cooperative, is achieved through bylaw provisions which vest in the members themselves the right and power to elect the trustees and the officers of the cooperative.

Implementation of the second of the above principles, relating to democratic control, is effected by having the worker-members themselves periodically assemble in democratically conducted meetings at which each member has one vote and one vote only, and at which no proxy voting is permitted; and these workers there deal personally with all problems affecting the conduct of the cooperative.

And finally, the third of the above-mentioned principles of cooperatives, relating to the proportionate vesting in and allocation among the worker-members of all fruits and increases from their cooperative endeavor, is achieved through statutes, bylaws, and contractual arrangements between the association and its members, whereby the elected officers of the association are required to make periodic allocations of the same among the members in proportion to their active participation as workers.”

Rev. Rul. 66-98, 1966-1 C.B. 200, holds that a finance company established to provide accounts receivable financing for member department stores qualifies as a nonexempt subchapter T cooperative.

There is nothing in subchapter T of the Code limiting the membership of a nonexempt subchapter T cooperative to United States citizens, residents or businesses. It is not unusual for United States cooperatives to have foreign members. Some United States cooperatives are wholly-owned and controlled by members located outside of the United States.

The Service has recognized the cooperative status of corporations whose membership includes or consists solely of foreign members. See, for example, Rev. Rul. 66-53, 1966-1 C.B. 206, which recognized that a domestic corporation with foreign members qualified as a nonexempt subchapter T corporation and then concluded that patronage dividends paid by the cooperative to foreign members would be subject to withholding.

Rev. Rul. 70-481, 1970-2 C.B. 170, considered the status of a non-stock, non-profit corporation providing services to members “throughout the United States and Canada.” Among other things, the corporation served as “a clearing house to effect settlement of orders between its members” and provided “extensive advertising, public relations, and educational and research services for the benefit of its members.” Observing that “[t]he corporation in the instant case is supplying its members with services at cost,” the Service concluded that the corporation qualified as a nonexempt subchapter T cooperative.

Each of the Puget Sound Plywood principles and its application to Finco is considered in turn below. The first characteristic of a cooperative identified in Puget Sound Plywood is “subordination of capital.” Subordination of capital requires that control of the cooperative and ownership of the pecuniary benefits arising from the cooperative’s business remains in the hands of the member/patrons of the cooperative rather than with nonpatron equity investors in the cooperative. The purpose of this limitation is to insure that the gains that accrue to the cooperative from the business that it transacts with its patrons will largely or completely inure to the benefit of those patrons rather than to its stockholders. To be operating on a cooperative basis, a cooperative must limit the financial return with respect to its equity capital. Puget Sound Plywood, 44 T.C. at 308. Stated differently, a cooperative may not be operated for the purpose of paying a return on equity investments.

Finco will have a single class of common stock. As described above, that class of stock is membership stock. Because it will be owned only by Members, will not be entitled to dividends and will be limited on dissolution, the subordination of capital test will be met.

Finco’s initial series of preferred stock (the Series A Preferred Stock) will all be owned by Members and Participating Patrons, but preferred stock of other series may be sold to investors in the future. As described above, Finco will be authorized to issue preferred shares in series with rights to be determined by the Board of Directors in the certificate of designations authorizing each series. However, no series may provide for

a dividend in excess of 8 percent of the issue price per annum. Upon dissolution, holders of preferred shares will be entitled to receive an amount equal to the issue price of the preferred stock and cumulative, accrued unpaid or declared and unpaid dividends, if any, and no more. Thus, any preferred stock that may be issued will provide fixed and limited rights to share in earnings. For this reason, and given the fact that the shares of preferred stock will not be entitled to vote, the tests for determining that “capital is subordinated” will be met with respect to the preferred stock. Thus, both the common stock and preferred stock will be subordinated to the interests of the Members and Participating Patrons.

The second characteristic of a cooperative identified in Puget Sound Plywood is “democratic control by the worker-members.” Democratic control of the cooperative, as envisioned in Puget Sound Plywood, is typically achieved by voting on a one-member, one-vote basis. The only class of voting stock will be common stock, and each Member will own one (and only one) share of common stock. Thus, voting will be on a one-member one-vote basis.

Finco will permit Members to vote by proxy. Proxies may be granted only to an officer or director of Finco or to an individual who has with a  
Member or Participating Patron. The Service has recognized that cooperatives may have proxy voting without jeopardizing cooperative status. Rev. Rul. 75-97, 1975-1 C.B. 167, holds that an exempt section 521 cooperative “will not be denied exemption solely by reason of ... proxy voting.” In Thwaites Terrace House Owners Corp. v. Commissioner, 72 T.C.M. 578 (1996), a housing cooperative was found to be “operating on a cooperative basis” notwithstanding that it permitted proxy voting. In so holding, the Tax Court cited Rev. Rul. 75-97.

Most matters submitted to a vote of the Members will require the affirmative vote of a majority of all Members. In the case of certain fundamental matters – i.e., an amendment of Finco’s Certificate of Incorporation, the dissolution of Finco, the sale of all or substantially all of the assets of Finco, or a merger of Finco – the affirmative vote of two-thirds of the directors and of two-thirds of the Members will be required.

Rev. Rul. 93-21, 1993-1 CB 188, provides that a cooperative that operates on a for-profit, nonpatronage basis with nonmembers will not be precluded from being considered operating on a cooperative basis simply because it does less than 50 percent in value of its business with members on a patronage basis. Whether a corporation is operating on a cooperative basis under section 1381(a)(2) of the Code will be determined from all the facts and circumstances and the cooperative principles enunciated in Puget Sound Plywood.

Finco is authorized to provide the types of services to Members and Participating Patrons other persons (referred to as Nonparticipating Patrons) on a nonpatronage basis. However, there are no current plans to provide such services to Nonparticipating



Patrons. For purposes of this ruling, Finco represents that over 50 percent of its treasury service and finance business will be with Members and Participating Patrons and will be conducted on a patronage basis.

The third characteristic of a cooperative identified in Puget Sound Plywood is “the vesting in and allocation among the members of all fruits and increases arising from their cooperative endeavor.” Consistent with that objective, the Certificate of Incorporation and Bylaws provide that Members and Participating Patrons of Finco will share what Puget Sound Plywood referred to as the “fruits and increases from their cooperative endeavor” in the following manner:

- Each year Finco will determine its net earnings or loss from business done with or for Members and Participating Patrons (its “patronage earnings”) and its net earnings or loss from other business (its “nonpatronage earnings”). The starting point for this determination will be net income as determined for financial reporting purposes.
- Finco will then set aside from patronage earnings an amount of patronage earnings required (i) to pay or provide for dividends chargeable to patronage earnings, (ii) for net operating losses and (iii) for reasonable reserves required by the needs of its business. All remaining patronage earnings will be allocated among Members and Participating Patrons on a patronage basis.
- No later than eight and one-half months after the end of the fiscal year, Finco will pay the amounts so allocated to Members and Participating Patrons as patronage dividends. The payment will be in the form of cash, property and written notices of allocations (qualified or nonqualified), or any combination thereof, as the Board of Directors determines.
- No dividends will be paid on the common stock or written notices of allocation of Finco. Limited dividends (not to exceed 8 percent per annum) may be paid on shares of Series A Preferred Stock or on shares of preferred stock of other series (if such preferred stock is some day issued). Finco will use net earnings from nonpatronage business to pay or provide for any dividends upon preferred stock, and, only if such earnings are insufficient, will patronage earnings be used for dividends on shares of Series A Preferred Stock.
- Finco will use any nonpatronage earnings to pay or provide for taxes and to pay or provide for dividends (as described above). All or any portion of remaining nonpatronage earnings may, if the Board of Directors so determines, be allocated and distributed to Members and Participating Patrons on a patronage basis. Amounts not so allocated and distributed will be added to unallocated retained earnings (surplus) of the corporation.

These provisions are contained in Article 5 of Finco's Certificate of Incorporation and in Article 8 of Finco's Bylaws. They provide for a strict sharing of all earnings (not just patronage earnings) of Finco on a cooperative basis, both currently and on dissolution.

Article 8.9(d) of the Bylaws provides that upon dissolution any residual assets will be shared by Members and Participating Patrons based upon patronage for the seven years immediately preceding dissolution (or the period of existence of Finco, if shorter). This seven-year period was chosen to assure a cooperative sharing of earnings consistent with practicalities and the nature of the business. Seven years was felt to be long enough to assure sharing on a patronage basis, but without placing an undue record-keeping burden on Finco.

Finco has all of the characteristics necessary for an organization to be operating on a cooperative basis within the meaning of section 1381(a)(2) of the Code. Finco's capital stock will be subordinated to the membership interests of its Members and to the interests of Participating Patrons, it will be democratically controlled on a one-member, one-vote basis by its Members, operate at cost. In addition, it will conduct over half of its treasury and finance business with Members and Participating Patrons on a patronage basis.

Based solely on the foregoing facts, representations, law and analysis, we rule that Finco will be a corporation "operating on a cooperative basis" within the meaning of section 1381(a)(2) of the Code.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Specifically, we express no opinion on whether Finco will be an organization subject to the provisions of part II of subchapter H of the Code and excluded from subchapter T under section 1381(a)(2)(B)(i).

This ruling is directed only to the taxpayer that requested it. Under section 6110(k)(3) of the Code it may not be used or cited as precedent. In accordance with a power of attorney filed with the request, a copy of the ruling is being sent to your authorized representative.

Sincerely yours,

Paul F. Handleman  
Chief, Branch 5  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)