

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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PLR-116719-13
Date:
September 27, 2013

Legend

Parent =

Sub 1 =

Sub 2 =

Sub 3 =

Utility 1 =

Utility 2 =

Utility 3 =

Utility 4 =

Utility 5 =

State A =

a =

b =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Month 1 =

Year 1 =

Year 2 =

Dear :

This letter responds to your representative's April 3, 2013 request for rulings on certain federal income tax consequences of the proposed transaction described below (the "Proposed Transaction"). The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a "penalties of perjury" statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

FACTS

Parent is a member-owned cooperative with approximately a members (the "Current Members"). Parent was incorporated in State A on Date 1. Parent originally was organized to provide Utility 1 to rural areas of State A. Over time, Parent's services have expanded to include Utility 2 and Utility 3, which are provided through subsidiaries of Parent.

In Month 1, Parent became exempt from federal income tax under section 501(c)(12) of the Internal Revenue Code (the "Code"), and Parent remained exempt from federal income tax under section 501(c)(12) in every year through Year 1. Parent has not been eligible for the exemption from federal income tax under section 501(c)(12) in any year since Year 1 because Parent has determined that, in every year starting in Year 2, Parent has not met the requirement in section 501(c)(12) that 85% or more of its income consist of amounts collected from members for the sole purpose of meeting losses and expenses (the "85% member income test").

Parent wholly owns Sub 1 and Sub 2, and Sub 2 wholly owns Sub 3 (each of Sub 1, Sub 2, and Sub 3, a “Sub,” and together, the “Subs”). Each Sub has only one class of stock outstanding. Sub 1 is a State A corporation that provides Utility 1 to approximately b customers. Sub 2 owns a minority interest in a certain partnership that provides Utility 4. Sub 2 and Sub 3 also own minority interests in certain partnerships that provide Utility 5. Sub 3 provides Utility 2 and Utility 3 as well. All of the Subs are taxable entities, and Parent has included them in its consolidated federal income tax return since their respective dates of incorporation.

PROPOSED TRANSACTION

Parent proposes to undertake the following transactions, in the following order (collectively, the “Proposed Transaction”), on Date 2:

- (i) Sub 3 will merge into Sub 2, with Sub 2 surviving (the “Sub 3 Merger”);
- (ii) Immediately after the Sub 3 Merger, Sub 2 will convert from a corporation to a limited liability company treated as disregarded as an entity separate from Parent for federal income tax purposes (the “Sub 2 Conversion”);
- (iii) Simultaneously with the Sub 2 Conversion in Step (ii) above, Sub 2 will distribute its Utility 2 and Utility 3 assets and certain real property to Parent (the “Sub 2 Distribution”); and
- (iv) Immediately after the Sub 2 Conversion, Sub 1 will liquidate into Parent through a state law dissolution (the “Sub 1 Liquidation”).

In connection with the Sub 1 Liquidation, the Sub 1 customers will become non-voting members of Parent (the “New Members”). After a transition period (the “Transition Period”) that will end no later than Date 3 (unless extended to Date 4 by Parent’s Board of Directors for good cause), the New Members will obtain full voting rights in Parent (and thus will possess the same rights as the Current Members).

According to Parent, consolidating services pursuant to the Proposed Transaction will allow Parent to market bundled services to its customers on a cooperative basis, reduce its state sales and franchise taxes, and streamline management and accounting functions.

Parent has submitted information indicating that, based on the continuation of present business conditions, it is unlikely to satisfy the 85% member income test on Date 2, during the Transition Period, and immediately after the Transition Period.

REPRESENTATIONS

The Sub 3 Merger

- (a) Sub 3 will adopt a plan of merger under State A law (the “Sub 3 Merger Plan”), and the Sub 3 Merger will occur pursuant to that plan.
- (b) On the date of adoption of the Sub 3 Merger Plan (the “Sub 3 Merger Plan Date”), and at all times thereafter until the Sub 3 Merger is complete, Sub 2 will own 100 percent of the single outstanding class of Sub 3 stock. Sub 3 does not have any outstanding warrants, options, convertible securities, or other obligations that may be classified as equity for federal income tax purposes.
- (c) No shares of Sub 3 stock were redeemed during the three years preceding the Sub 3 Merger Plan Date.
- (d) All deemed distributions from Sub 3 to Sub 2 pursuant to the Sub 3 Merger Plan will be made on Date 2.
- (e) Upon the Sub 3 Merger, Sub 3 will cease to exist for federal income tax purposes.
- (f) Sub 3 did not acquire assets in any nontaxable transaction at any time, except for acquisitions occurring more than three years prior to the Sub 3 Merger Plan Date.
- (g) No assets of Sub 3 have been, or will be, disposed of by Sub 3, Sub 2, or Parent except for (i) dispositions in the ordinary course of business, (ii) dispositions occurring more than three years prior to the Sub 3 Merger Plan Date, and (iii) dispositions pursuant to the Proposed Transaction.
- (h) Other than the Sub 2 Conversion and the Sub 2 Distribution, the deemed liquidation of Sub 3 in the Sub 3 Merger will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation of any of the businesses or assets of Sub 3, if persons holding, directly or indirectly, more than 20 percent in value of Sub 3’s stock also hold, directly or indirectly, more than 20 percent in value of the stock in the recipient corporation. For purposes of this representation, ownership will be determined by application of the constructive ownership rule of section 318(a) as modified by section 304(c)(3).
- (i) Prior to the Sub 3 Merger Plan Date, no assets of Sub 3 were distributed in kind, transferred, or sold to Sub 2, except for (i) transactions occurring in the normal course of business, and (ii) transactions occurring more than three years prior to the Sub 3 Merger Plan Date.

- (j) Sub 3 will report all earned income represented by assets that will be deemed distributed to Sub 2, such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.
- (k) The fair market value of the assets of Sub 3 will exceed its liabilities both (i) on the Sub 3 Merger Plan Date, and (ii) immediately prior to the Sub 3 Merger.
- (l) Other than certain intercompany payables that arose in the ordinary course of business, there is no intercorporate debt existing between Sub 2 and Sub 3, and none has been cancelled, forgiven, or discounted except in transactions that occurred more than three years prior to the Sub 3 Merger Plan Date.
- (m) Sub 2 is not an organization that is exempt from federal income tax under section 501 or any other provision of the Code (an "Exempt Organization"), and Sub 2 will not be an Exempt Organization at the time of the Sub 3 Merger.
- (n) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the Sub 3 Merger have been fully disclosed.
- (o) At the time of the Sub 3 Merger, there will be no deferred intercompany item (within the meaning of Treas. Reg. § 1.1502-13(b)) with respect to the Sub 3 stock.

The Sub 2 Conversion

- (p) Sub 2 will adopt a plan to convert from a corporation to a limited liability company under State A law (the "Sub 2 Conversion Plan"), and the Sub 2 Conversion will occur pursuant to that plan.
- (q) On the date of adoption of the Sub 2 Conversion plan (the "Sub 2 Conversion Plan Date"), and at all times thereafter until the Sub 2 Conversion is complete, Parent will own 100 percent of the single outstanding class of Sub 2 stock. Sub 2 does not have any outstanding warrants, options, convertible securities, or other obligations that may be classified as equity for federal income tax purposes.
- (r) No shares of Sub 2 stock were redeemed during the three years preceding the Sub 2 Conversion Plan Date.
- (s) All actual and deemed distributions from Sub 2 to Parent pursuant to the Sub 2 Conversion Plan will be made on Date 2.

- (t) Upon the Sub 2 Conversion, Sub 2 will cease to exist for federal income tax purposes.
- (u) Sub 2 did not acquire assets in any nontaxable transaction at any time, except for acquisitions occurring more than three years prior to the Sub 2 Conversion Plan Date.
- (v) No assets of Sub 2 have been, or will be, disposed of by either Sub 2 or Parent except for (i) dispositions in the ordinary course of business, (ii) dispositions occurring more than three years prior to the Sub 2 Conversion Plan Date, and (iii) dispositions pursuant to the Proposed Transaction.
- (w) Other than the Sub 2 Distribution, the deemed liquidation of Sub 2 in the Sub 2 Conversion will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation of any of the businesses or assets of Sub 2, if persons holding, directly or indirectly, more than 20 percent in value of Sub 2's stock also hold, directly or indirectly, more than 20 percent in value of the stock in the recipient corporation. For purposes of this representation, ownership will be determined by application of the constructive ownership rule of section 318(a) as modified by section 304(c)(3).
- (x) Prior to the Sub 2 Conversion Plan Date, no assets of Sub 2 were distributed in kind, transferred, or sold to Parent, except for (i) transactions occurring in the normal course of business, and (ii) transactions occurring more than three years prior to the Sub 2 Conversion Plan Date.
- (y) Sub 2 will report all earned income represented by assets that will be deemed distributed to Parent, such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.
- (z) The fair market value of the assets of Sub 2 will exceed its liabilities both (i) on the Sub 2 Conversion Plan Date, and (ii) immediately prior to the Sub 2 Conversion.
- (aa) Other than certain intercompany payables that arose in the ordinary course of business, there is no intercorporate debt existing between Parent and Sub 2, and none has been cancelled, forgiven, or discounted except in transactions that occurred more than three years prior to the Sub 2 Conversion Plan Date.
- (bb) Parent is not an Exempt Organization, and Parent will not be an Exempt Organization at the time of the Sub 2 Conversion. Parent does not expect to be an Exempt Organization at any time during the Transition Period or immediately after the Transition Period.

- (cc) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the Sub 2 Conversion have been fully disclosed.
- (dd) At the time of the Sub 2 Conversion, there will be no deferred intercompany item (within the meaning of Treas. Reg. § 1.1502-13(b)) with respect to the Sub 2 stock.

The Sub 1 Liquidation

- (ee) Sub 1 will adopt a plan to liquidate into Parent under State A law (the “Sub 1 Liquidation Plan”), and the Sub 1 Liquidation will occur pursuant to that plan.
- (ff) On the date of adoption of the Sub 1 Liquidation Plan (the “Sub 1 Liquidation Plan Date”), and at all times thereafter until the Sub 1 Liquidation is complete, Parent will own 100 percent of the single outstanding class of Sub 1 stock. Sub 1 does not have any outstanding warrants, options, convertible securities, or other obligations that may be classified as equity for federal income tax purposes.
- (gg) No shares of Sub 1 stock were redeemed during the three years preceding the Sub 1 Liquidation Plan Date.
- (hh) All distributions from Sub 1 to Parent pursuant to the Sub 1 Liquidation Plan will be made on Date 2.
- (ii) Upon the Sub 1 Liquidation, Sub 1 will cease to exist for federal income tax purposes.
- (jj) Sub 1 did not acquire assets in any nontaxable transaction at any time, except for acquisitions occurring more than three years prior to the Sub 1 Liquidation Plan Date.
- (kk) No assets of Sub 1 have been, or will be, disposed of by either Sub 1 or Parent except for (i) dispositions in the ordinary course of business, and (ii) dispositions occurring more than three years prior to the Sub 1 Liquidation Plan Date.
- (ll) The liquidation of Sub 1 in the Sub 1 Liquidation will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation of any of the businesses or assets of Sub 1, if persons holding, directly or indirectly, more than 20 percent in value of Sub 1’s stock also hold, directly or indirectly, more than 20 percent in value of the stock in the recipient corporation. For purposes of this representation, ownership will be determined by application of the constructive ownership rule of section 318(a) as modified by section 304(c)(3).

- (mm) Prior to the Sub 1 Liquidation Plan Date, no assets of Sub 1 were distributed in kind, transferred, or sold to Parent, except for (i) transactions occurring in the normal course of business, and (ii) transactions occurring more than three years prior to the Sub 1 Liquidation Plan Date.
- (nn) Sub 1 will report all earned income represented by assets that will be distributed to Parent, such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.
- (oo) The fair market value of the assets of Sub 1 will exceed its liabilities both (i) on the Sub 1 Liquidation Plan Date, and (ii) immediately prior to the Sub 1 Liquidation.
- (pp) Other than certain intercompany payables that arose in the ordinary course of business, there is no intercorporate debt existing between Parent and Sub 1, and none has been cancelled, forgiven, or discounted except in transactions that occurred more than three years prior to the Sub 1 Liquidation Plan Date.
- (qq) Parent is not an Exempt Organization, and Parent will not be an Exempt Organization at the time of the Sub 1 Liquidation. Parent does not expect to be an Exempt Organization at any time during the Transition Period or immediately after the Transition Period.
- (rr) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the Sub 1 Liquidation have been fully disclosed.
- (ss) At the time of the Sub 1 Liquidation, there will be no deferred intercompany item (within the meaning of Treas. Reg. § 1.1502-13(b)) with respect to the Sub 1 stock.

Additional Representations

- (tt) The Current Members (i) will periodically assemble in democratically conducted meetings, (ii) will each have one vote, and (iii) will deal with issues concerning the conduct of Parent's business.
- (uu) Parent's bylaws state that Parent is obligated to account on a patronage basis to all its patrons for all amounts received and receivable from the furnishing of Utility 1 in excess of operating costs and expenses properly charged against the furnishing of Utility 1.

- (vv) Parent's bylaws provide that Parent's members have ultimate rights to Parent's assets upon its dissolution.
- (ww) All patronage allocations will be made pursuant to Parent's bylaws.
- (xx) Parent has been a taxable corporation in each year since Year 1 solely because less than 85 percent of its income in each such year has consisted of amounts collected from members for the sole purpose of meeting losses and expenses.

RULINGS

The Sub 3 Merger

- (1) The Sub 3 Merger will be treated as a distribution in complete liquidation of Sub 3 under section 332 and Treas. Reg. § 1.332-2(d).
- (2) Sub 2 will recognize no gain or loss on the receipt of all assets and liabilities of Sub 3 in the Sub 3 Merger (section 332(a)).
- (3) Sub 3 will recognize no gain or loss on the deemed distribution of its assets and liabilities to Sub 2 in the Sub 3 Merger (section 337(a)).
- (4) Sub 2's basis in each asset received from Sub 3 in the Sub 3 Merger will equal the basis of that asset in the hands of Sub 3 immediately before the Sub 3 Merger (section 334(b)(1)).
- (5) Sub 2's holding period for each asset received from Sub 3 in the Sub 3 Merger will include the period during which Sub 3 held the asset (section 1223(2)).
- (6) Sub 2 will succeed to and take into account the items of Sub 3 described in section 381(c), subject to the conditions and limitations specified in sections 381, 382, 383 and 384 and the regulations thereunder (section 381(a) and Treas. Reg. § 1.381(a)-1).
- (7) Except to the extent Sub 3's earnings and profits are reflected in Sub 2's earnings and profits, Sub 2 will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of Sub 3 as of the date of the Sub 3 Merger (section 381(c)(2)(A); Treas. Reg. §§ 1.381(c)(2)-1 and 1.1502-33(a)(2)). Any deficit in the earnings and profits of Sub 3 can be used only to offset earnings and profits accumulated after the date of the Sub 3 Merger (section 381(c)(2)(B)).

The Sub 2 Conversion

- (8) The Sub 2 Conversion will be treated as a distribution in complete liquidation of Sub 2 under section 332 and Treas. Reg. § 1.332-2(d).
- (9) Parent will recognize no gain or loss on the deemed receipt of all assets and liabilities of Sub 2 in the Sub 2 Conversion (section 332(a)).
- (10) Sub 2 will recognize no gain or loss on the deemed distribution of its assets and liabilities to Parent in the Sub 2 Conversion (section 337(a)).
- (11) Parent's basis in each asset deemed received from Sub 2 in the Sub 2 Conversion will equal the basis of that asset in the hands of Sub 2 immediately before the Sub 2 Conversion (section 334(b)(1)).
- (12) Parent's holding period for each asset deemed transferred from Sub 2 in the Sub 2 Conversion will include the period during which Sub 2 held the asset (section 1223(2)).
- (13) Parent will succeed to and take into account the items of Sub 2 described in section 381(c), subject to the conditions and limitations specified in sections 381, 382, 383 and 384 and the regulations thereunder (section 381(a) and Treas. Reg. § 1.381(a)-1).
- (14) Except to the extent Sub 2's earnings and profits are reflected in Parent's earnings and profits, Parent will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of Sub 2 as of the date of the Sub 2 Conversion (section 381(c)(2)(A); Treas. Reg. §§ 1.381(c)(2)-1 and 1.1502-33(a)(2)). Any deficit in the earnings and profits of Sub 2 can be used only to offset earnings and profits accumulated after the date of the Sub 2 Conversion (section 381(c)(2)(B)).
- (15) If Parent's status changes to a tax-exempt cooperative under section 501(c)(12) because Parent satisfies the 85% member income test after the Sub 2 Conversion, the deemed liquidation of Sub 2 in the Sub 2 Conversion will not be considered to have had a principal purpose of avoiding the application of the "change in status rule" in Treas. Reg. § 1.337(d)-4(a)(2) (see Treas. Reg. § 1.337(d)-4(a)(3)(iii)), and Parent's return to tax-exempt status will qualify for the exception in Treas. Reg. § 1.337(d)-4(a)(3)(i)(E) to the change in status rule.

The Sub 1 Liquidation

- (16) Parent will recognize no gain or loss on the receipt of all assets and liabilities of Sub 1 in the Sub 1 Liquidation (section 332(a)).

- (17) Sub 1 will recognize no gain or loss on the distribution of its assets and liabilities to Parent in the Sub 1 Liquidation (section 337(a)).
- (18) Parent's basis in each asset received from Sub 1 in the Sub 1 Liquidation will equal the basis of that asset in the hands of Sub 1 immediately before the Sub 1 Liquidation (section 334(b)(1)).
- (19) Parent's holding period for each asset transferred from Sub 1 in the Sub 1 Liquidation will include the period during which Sub 1 held the asset (section 1223(2)).
- (20) Parent will succeed to and take into account the items of Sub 1 described in section 381(c), subject to the conditions and limitations specified in sections 381, 382, 383 and 384 and the regulations thereunder (section 381(a) and Treas. Reg. § 1.381(a)-1).
- (21) Except to the extent Sub 1's earnings and profits are reflected in Parent's earnings and profits, Parent will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of Sub 1 as of the date of the Sub 1 Liquidation (section 381(c)(2)(A); Treas. Reg. §§ 1.381(c)(2)-1 and 1.1502-33(a)(2)). Any deficit in the earnings and profits of Sub 1 can be used only to offset earnings and profits accumulated after the date of the Sub 1 Liquidation (section 381(c)(2)(B)).
- (22) If Parent's status changes to a tax-exempt cooperative under section 501(c)(12) because Parent satisfies the 85% member income test after the Sub 1 Liquidation, the liquidation of Sub 1 in the Sub 1 Liquidation will not be considered to have had a principal purpose of avoiding the application of the "change in status rule" in Treas. Reg. § 1.337(d)-4(a)(2) (see Treas. Reg. § 1.337(d)-4(a)(3)(iii)), and Parent's return to tax-exempt status will qualify for the exception in Treas. Reg. § 1.337(d)-4(a)(3)(i)(E) to the change in status rule.

Additional Rulings

- (23) Parent will be operating on a cooperative basis during the Transition Period.
- (24) Amounts collected from the New Members during the Transition Period will not be considered "amounts collected from members for the sole purpose of meeting losses and expenses" for purposes of section 501(c)(12)(A).
- (25) Parent's patronage allocations to the New Members will qualify for exclusion from income as patronage dividends.

CAVEATS

Except as expressly provided herein and specifically set forth in the rulings above, no opinion is expressed or implied concerning the federal tax consequences of any aspect of the Proposed Transaction or item discussed or referenced in this letter under any other provision of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction.

PROCEDURAL MATTERS

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, any taxpayer filing its return electronically may satisfy this requirement by attaching a statement to the return that provides the date and control number of this letter.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Russell G. Jones
Assistant to the Branch Chief, Branch 2
Office of Associate Chief Counsel (Corporate)

cc: