

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Date:

April 24, 2023

**Legend**

Taxpayer =

Newco LLC =

Newco =

State A =

Year 1 =

Services =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to your authorized representatives' letter dated October 7, 2022, as supplemented by subsequent information and documentation requesting rulings on certain federal tax consequences of a series of transactions (the "Proposed

Transaction,” as defined below). The material information submitted in that letter and subsequent correspondence is summarized below.

This letter is issued pursuant to section 6.03(2) of Rev. Proc. 2022-1, 2022-1 I.R.B. 1, regarding one or more significant issues under section 368 of the Internal Revenue Code (the “Code”). The rulings contained in this letter only address one or more discrete legal issues involved in the Proposed Transaction. This office expresses no opinion as to any issue not specifically addressed by the rulings below.

The rulings contained in this letter are based upon facts 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**

Taxpayer is a nonprofit cooperative corporation organized under the laws of State A. Taxpayer was formed in Year 1 and does not currently qualify as a tax-exempt organization under section 501(c)(12). Taxpayer has no shareholders and no capital stock. Taxpayer has one class of membership interests outstanding.

Under Taxpayer’s bylaws, Taxpayer must allocate to its members, on a patronage basis, for all amounts received and receivable from the furnishing of Services in excess of Taxpayer’s properly chargeable operating costs and expenses (“Patronage Allocations”). Taxpayer also must treat the Patronage Allocations as capital furnished by its members (a “capital credit,” which is credited to a member’s “capital credit account”). Taxpayer may retire amounts from a member’s capital credit account at its discretion as to the method, priority, and order of retirement.

A membership interest carries certain rights, depending on whether a member is in active or inactive status. A member is considered active so long as the member receives and pays for Services furnished by Taxpayer. A member becomes inactive when it ceases receiving and paying for Services. Active members have the right to elect Taxpayer’s board of directors on a one member, one vote basis and the right to Taxpayer’s assets upon liquidation (following the satisfaction of debt and outstanding capital credit balances). Active members have the right to be allocated capital credits.

Inactive members forfeit the right to vote, receive liquidation proceeds, and receive allocations of capital credits. If a member has a zero balance in its capital credit account when it becomes inactive, its membership interest in Taxpayer terminates. If a member has a positive balance in its capital credit account when it becomes inactive, it retains its membership interest in Taxpayer with the only right being to be redeemed of its capital credit account.

### **Proposed Transaction**

For what are represented to be valid business reasons, Taxpayer proposes to engage in the following steps, some of which have been completed (collectively, the “Proposed Transaction”):

- (i) On Date 1, Taxpayer formed a new, wholly-owned limited liability company (“Newco LLC”) that elected to be treated as a corporation for federal income tax purposes as of Date 2.
- (ii) On Date 3, Taxpayer contributed all of its assets to Newco LLC in exchange for Newco LLC stock.
- (iii) Taxpayer will redeem the entire balance of all of its inactive members’ capital credit accounts with cash (the “Redemption”). As a result of the Redemption, inactive members will cease having a membership interest in Taxpayer.
- (iv) Taxpayer will merge with and into a newly formed for-profit corporation (“Newco”), with Newco surviving. In the merger, Taxpayer’s active members will exchange their interests in Taxpayer for stock in Newco in proportion to the balance of their capital credit accounts (the “Potential Reorganization”).

### **Representations**

- (a) Provided that the exchange of active members’ interests, consisting of a membership interest and a capital credit account in Taxpayer, for Newco stock qualifies as an exchange pursuant to section 354(a), the Potential Reorganization will qualify as a reorganization under section 368(a)(1)(F).
- (b) The capital credits qualify within the meaning of Treas. Reg. § 1.61-5(b) and are not with respect to capital assets as defined in section 1221 or property used in the trade or business within the meaning of section 1231.
- (c) Some, but not all, members are or were entitled to claim as deductions, under either section 162 or section 212, the costs of the furnished Services.

### **Rulings**

- (1) The exchange of active members’ interests in Taxpayer for Newco stock will qualify as an exchange under section 354(a) provided the Potential Reorganization otherwise qualifies as a reorganization under section 368(a)(1)(F).
- (2) The exchange of capital credits, described in Treas. Reg. § 1.61-5(b)(1) and Treas. Reg. § 1.61-5(b)(1)(iii), for cash or Newco stock will be treated as a redemption or other disposition within the meaning of Treas. Reg. § 1.61-5(b)(2). Each member,

whose capital credits are described in the prior sentence, will include in gross income, as ordinary income, such amount as determined under Treas. Reg. § 1.61-5(b)(2).

### **Caveats**

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the Proposed Transaction under any provision of the Code and regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the Proposed Transaction that is not specifically covered by the above rulings.

### **Procedural Statements**

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code 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, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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,

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Richard K. Passales  
Senior Counsel, Branch 4  
Office of Associate Chief Counsel (Corporate)

cc: