

Internal Revenue Service

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:B05 PLR-100524-00

Date:

November 3, 2000

Re:

Taxpayer =

State X =

State Y =

Business A =

Division 1 =

Division 2 =

Division 3 =

Division 4 =

Class 1 membership =

Class 2 membership =

	2
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Class 3 membership	=
Class 4 membership	=
<u>c</u> percent	=
<u>d</u> percent	=
<u>e:f:g</u> ratio	=
<u>h</u>	=
Federal Act	=
Activity	=
Regulator	=

We respond to your letter dated December 30, 1999, requesting rulings on the federal income tax consequences of proposed transactions. Additional information was submitted in letters dated March 17, June 1, September 21, 2000, and October 30, 2000. The information submitted for consideration is summarized below.

Taxpayer is a State X not-for-profit membership corporation, established under the State X Not-for-Profit Corporation Act and subject to tax as a Subchapter C corporation for federal income tax purposes. Taxpayer uses the calendar year as its annual accounting period and the accrual method of accounting. Taxpayer derives its revenues primarily from Business A. Pursuant to Federal Act, Taxpayer is self-regulated, but, with respect to Activity, Taxpayer is regulated by Regulator.

As a membership organization, Taxpayer does not have authorized capital stock. Rather, participation in Taxpayer is obtained through a membership interest. Currently, Taxpayer has a total of approximately h memberships outstanding. The outstanding memberships are not evidenced by certificates -- Taxpayer maintains a registry of its members. A person may own more than one membership. Currently, there are four membership divisions: Division 1, Division 2, Division 3, and Division 4.

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Members' rights are established and governed by the Taxpayer's Articles of Incorporation and the Rules, which serve as bylaws and were created by the Board of Directors. Members' rights with respect to Taxpayer are granted according to class. A Class 1 membership entitles a member to conduct business in Division 1, Division 2, Division 3, and Division 4. A Class 2 membership entitles a member to conduct business in Division 2, Division 3, and Division 4. A Class 3 membership entitles a member to conduct business in Division 3 and Division 4. A Class 4 membership entitles a member to conduct business only in Division 4. A member is entitled to an exclusive right to conduct business on the premises of Taxpayer, receive special member rates, and is permitted to lease his right to conduct business on the premises of Taxpayer to a lessee (collectively, the Non-Equity Rights).

In addition to electing members to the Board of Directors, a member is entitled to vote at all regular and special meetings of the Taxpayer and at all referenda. Each member is entitled to cast votes for each membership he owns. The voting power of the different divisions of membership is weighted for referenda involving "core rights," which include matters relating to voting, representation on the Board and an executive committee, certain rights associated with Business A and Activity, the right to share in assets on dissolution and other issues where the Board determines that weighted voting is appropriate because the issue directly affects the governance rights of members or has a direct and disproportionate impact on the value of memberships of a particular division. The Rules vest the power to amend the Rules in the Board, subject to certain referenda rights retained by the members. Subject to certain limitations, members are entitled to share in the net proceeds from a complete liquidation of Taxpayer. Since Taxpayer is a not-for-profit corporation, its members do not have any right to dividends. A member retains all rights to vote, to serve as a Board member, and to receive liquidation proceeds when he leases his right to conduct business on the premises of Taxpayer to a lessee (collectively, the Equity Interests).

State X law does not allow a not-for-profit corporation to amend its articles of incorporation to convert to a for-profit corporation, nor does it allow the merger of a State X not-for-profit corporation into a State X for-profit corporation. However, State X law does not prevent a State X corporation from merging into a not-for-profit corporation in another jurisdiction.

Taxpayer intends to convert the members' Equity Interests into stock interests and convert from a not-for-profit corporation into a for-profit corporation. In order to accomplish this intent, Taxpayer proposes the following transactions:

- (i) Taxpayer will merge into Transitory, a State Y not-for-profit corporation (the First Merger). Members of Taxpayer will be deemed to exchange their Equity Interests in Taxpayer for Equity Interests in Transitory and deemed to exchange their Non-Equity Rights in Taxpayer for Non-Equity Rights in Transitory;

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- (ii) Transitory will merge into Newco, a State Y for-profit corporation (the Second Merger). The original members of Taxpayer will be deemed to exchange their Equity Interests in Transitory for Equity Interests in Newco and their Non-Equity Rights in Transitory for Non-Equity Rights in Newco; and
- (iii) Newco will conduct a recapitalization, exchanging each Equity Interest in Newco for a Class A and a Class B Equity Interest in Newco (the Recapitalization).

As a result of these steps, Taxpayer proposes to convert the members' Equity Interests in Taxpayer into instruments denominated as shares of capital stock of Newco. Each former member of Taxpayer will exchange his new Equity Interest in Newco for a Class B Equity Interest and, except for holders of Class 4 memberships, a Class A Equity Interest in Newco. Both Class A and Class B will encompass a right to dividends and proceeds upon liquidation. The dividend and liquidation rights will be distributed in such a manner that c percent of such rights will be attributable to Class A and d percent will be attributable to Class B. Class A and Class B will also contain rights to vote for members of Newco's board of directors and other general voting rights. In addition, Class B includes special voting rights with respect to matters affecting certain core rights. Class A shares will be divided among the Class 1, Class 2, and Class 3 members in an e:f:g ratio in order to reflect the current membership structure. The holders of Class B will be entitled to the Non-Equity Rights currently encompassed in the membership interests in Taxpayer.

There will be four series of the Class B Equity Interests (Class B-1, Class B-2, Class B-3 and Class B-4) that will correspond to the four current membership Classes. Each Class 1 member's Equity Interest will be exchanged for one Class B-1 interest, each Class 2 member's Equity Interest will be exchanged for one Class B-2 interest, each Class 3 member's Equity Interest will be exchanged for one Class B-3 interest, and each Class 4 member's Equity Interest will be exchanged for one Class B-4 interest.

Taxpayer has made the following representations:

- (a) Subject only to the resolution of the issues addressed in Rulings (1) - (5) below, and disregarding Non-Equity Rights, the First Merger will qualify as a reorganization described in § 368(a)(1)(F) of the Internal Revenue Code.
- (b) Subject only to the resolution of the issues addressed in Rulings (1) - (5) below, and disregarding Non-Equity Rights, the Second Merger will qualify as a reorganization described in § 368(a)(1)(F).

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- (c) The Rules of Newco will apply to the Class B holders who have qualified to be holders of the Non-Equity Rights in the same way that the Rules of Taxpayer apply to the members. Further, the holders of the Non-Equity Rights in Taxpayer immediately prior to the proposed transaction will hold, with no material change, the Non-Equity Rights in Newco immediately after the proposed transaction.

Although the Non-Equity Rights are associated with the Class B Equity Interests, the Non-Equity Rights are not attributes of equity, and we have deemed a separation of the Equity Interests and the Non-Equity Rights for analytical purposes. Thus, based solely on the information submitted, the representations set forth above, and the deemed separation of Equity Interests and Non-Equity Rights, we hold as follows:

- (1) Assuming the First Merger otherwise qualifies as a reorganization under § 368(a)(1)(F), a member will not recognize any gain or loss on the deemed exchange of his Equity Interest in Taxpayer for an Equity Interest in Transitory.
- (2) Assuming the Second Merger otherwise qualifies as a reorganization under § 368(a)(1)(F), a member will not recognize any gain or loss on the deemed exchange of his Equity Interest in Transitory for an Equity Interest in Newco.
- (3) The continuity of interest requirement of § 1.368-1(b) and (e) of the Income Tax Regulations is satisfied upon the deemed exchanges of the members' Equity Interests in Taxpayer for Equity Interests in Transitory and ultimately for Equity Interests in Newco, as described above.
- (4) The Recapitalization will constitute a reorganization within the meaning of § 368(a)(1)(E). Each member will be deemed to exchange his Equity Interest in Newco for a Class B Equity Interest and, except for a holder of a Class 4 membership, a Class A Equity Interest in Newco, while retaining his Non-Equity Rights. The aggregate basis and holding period of each member in his Equity Interest in Newco will be maintained. Newco will not recognize any gain or loss on its issuance of stock in the Recapitalization (§ 1032).
- (5) A member will not realize any gain or loss on the deemed exchange of his Non-Equity Rights in Taxpayer for Non-Equity Rights in Transitory and on the deemed exchange of his Non-Equity Rights in Transitory for Non-Equity Rights in Newco (§ 1001).

We express no opinion as to the federal tax treatment of the transactions described in steps (i) through (iii) other than those specifically addressed in the above

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rulings. Further, we express no opinion as to the allocation of the basis, if any, among the Class A Equity Interests, the Class B Equity Interests, and the Non-Equity Rights.

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

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this letter are consummated.

Pursuant to a power of attorney on file in this office, a copy of this letter has been sent to your authorized representative.

Sincerely yours,

Associate Chief Counsel (Corporate)

By *Filiz A. Serbes*

Filiz A. Serbes

Assistant to Chief, Branch 5