Internal Revenue Service

Department of the Treasury

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Legend

Business A =

State B =

State C =

d =

e =

f =

g =

R =

S =

T =

V =

X =

Y =

Holding =

Dear:

This letter is in reply to a letter dated January 31, 2000, and supplemental correspondence, regarding certain federal income tax consequences of a proposed transaction. Specifically, you request significant subissue rulings in connection with the

taxpayer's representations that the transaction qualifies under § 368(a)(1)(F) and § 351 of the Internal Revenue Code (Code).

The information submitted indicates that X is a State B not-for-profit membership corporation which carries on Business A. As a membership organization, X has no authorized capital stock. Members ("Members") may hold one or more Memberships. X Members are entitled to an exclusive right to conduct business on the premises of X and receive special Member rates ("non-equity rights").

X Members may vote on changes to the X by-laws, and may vote for and serve on the Board of Directors. X gives each Member one vote regardless of the number of Memberships such Member holds. A Member is permitted to lease his right to conduct business on the premises of X to a lessee. In conducting business on the premises of X, a lessee receives special rates, but a lessee's rates are not the same as the Members' rates.

Subject to certain limitations, X Members are entitled to share ratably in the net proceeds from a complete liquidation of X. Lessees do not share in liquidation proceeds. Since X is a not-for-profit corporation, its Members do not have any right to dividends. X Members and lessees may earn continuous service credits in connection with Plan V.

Currently, X has d Memberships outstanding. In addition, X has g authorized but unissued Memberships. The d outstanding Memberships are not evidenced by certificates. X maintains a database register listing all of the X Members.

X is governed by its certificate of incorporation, by-laws, and rules created by the X Board of Directors. X Members' rights are established and governed by the State B Not-for-Profit Corporation Law ("N-PLC"), X's by-laws and rules. X is also regulated by R. R must approve all X by-laws and rules, including those which pertain to Membership. State B 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 B not-for-profit corporation into a State B for-profit corporation. However, State B law does not prevent a State B corporation from merging into a for-profit corporation in another jurisdiction.

Although X is a not-for-profit corporation under state law, it has never been recognized as tax-exempt under § 501 of the Code and X pays federal corporate income tax on Form 1120 as a for-profit corporation. X is taxed as a C corporation. X maintains its books and records, prepares its financial statements and files consolidated federal income tax returns based on the accrual method of accounting and uses a fiscal year ending December 31. X receives over e percent of its income from fees paid by Members and non-Members in association with the T business. Over f percent of X's income is generated by business S. The remainder of X's income is derived from investing in fixed income securities. As X is a not-for-profit

corporation there is no limit on the amount of money it may accumulate to use for expenses. In past years, X has been profitable and has earnings and profits.

The Plan of Reorganization: For what the taxpayer represents are valid business reasons, X will convert from a State B not-for-profit membership corporation to a State C for-profit membership corporation and operate in a holding company structure. Accordingly, X proposes the following transaction:

(i) An agent for X will form Y, a newly formed non-stock corporation organized under State C law. To the extent allowed by State C law, Y will adopt articles of incorporation and bylaws materially identical to those of X.

(ii) X will cancel the g authorized but unissued X Memberships without consideration.

(iii) X's Board of Directors will authorize the termination of Plan V prior to X's termination. The funds in the Plan V account will be liquidated as soon thereafter as practicable.

(iv) X will merge with and into Y under the laws of State B and State C, and as a result, Y will acquire all the property and rights and become responsible for all of the obligations of X. Y will not conduct business prior to the merger.

(v) As a result of the merger, each X Member will exchange all of the rights associated with his Membership in X for a Class A and a Class B Membership in Y. The Class A Membership represents non-equity rights in Y. The Class B Membership represents the right to vote for Y's board of directors, the right to receive any dividends declared by Y, and subject to certain limitations, the right to share ratably in the net proceeds from a complete liquidation of Y (collectively, the "equity rights"). Following the merger, the holders of the non-equity rights in X will hold, with no material change, the non-equity rights in Y and the rules of Y will apply to the Class A Members in the same way that the rules of X applied to the X Members. For example, under the rules of Y, Class A Members will maintain their jurisdiction on applications for Membership and will advise the Board of Directors on changes to the rules governing leasing of T privileges. Y will not issue Class A and B certificates of Membership, but Y will record the ownership of the d Class A and B Memberships as bookkeeping entries.

(vi) Holding was formed as a State C stock corporation. Holding has not yet issued any shares of its capital stock. Holding is authorized to issue d shares of one class of Holding common voting stock.

(vii) Holding will form a State C transitory corporation, "Transitory-Sub." Holding will contribute all d shares of its common stock to Transitory-Sub in exchange for a single membership in Transitory-Sub. Transitory-Sub will merge with and into Y.

The holders of Class B Memberships in Y will exchange each Class B Membership in Y for one share of Holding common stock. Holding will not conduct any business prior to the merger of Transitory-Sub with and into Y.

A recapitalization of the d shares of Holding common stock, issuance of additional Holding common stock or additional classes of Holding stock, or public offering of Holding stock will not soon follow the merger of Transitory-Sub with and into Y.

The Merger of X with and into Y

You propose that the merger of X with and into Y be treated as a reorganization qualifying under § 368(a)(1)(F) of the Code. Section 3.01(27) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 107-108, provides that the Internal Revenue Service will not rule on whether a transaction constitutes a reorganization within the meaning of § 368(a)(1)(F), and whether the taxpayer is subject to the consequences of qualification under that section that are adequately addressed by a statute, regulation, decision of the Supreme Court, tax treaty, revenue ruling, revenue procedure, notice or other authority published in the Internal Revenue Bulletin. However, the Service has the discretion to rule on significant subissues that must be resolved to determine whether a transaction that is in this no-rule area qualifies under § 368(a)(1)(F).

The following representations are made in connection with the proposed transaction:

(a) Subject only to the resolution of the issues addressed in rulings (1) - (4) below, the conversion of X to Y will qualify as a reorganization described in section 368(a)(1)(F) of the Internal Revenue Code of 1986.

(b) The amount of the distribution made in connection with the termination of Plan V described above will not exceed 50 percent of the fair market value of X immediately before the termination of Plan V.

(c) X, Y, Holding and X's Members will pay their own expenses that arise in connection with the transaction described above.

The Merger of Transitory-Sub with and into Y

You propose that the merger of Transitory-Sub with and into Y be treated as a constructive exchange of the d Class B Memberships in Y for the d shares of Holding common stock. Furthermore, you propose that the constructive exchange of the d Class B Memberships for d shares of Holding common stock be treated as the formation of Holding under § 351 of the Code. Section 3.01(22) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 104-105, states that the Service will not rule on whether § 351 applies to an exchange of stock for stock in the formation of a holding company, and

whether the taxpayer is subject to the consequences of qualification that are adequately addressed by a statute, regulation, decision of the Supreme Court, tax treaty, revenue ruling, revenue procedure, notice or other authority published in the Internal Revenue Bulletin.

The following representation is made in connection with the merger of Transitory-Sub with and into Holding:

(a) Subject only to the resolution of the issue addressed in ruling (5) below, the transfer of Class B Memberships to Holding by the holders of the Class B Memberships in exchange for d shares of common stock of Holding will constitute a transfer described in § 351 of the Code.

Based on the information and representations set forth above, we hold as follows:

(1) No gain or loss will be recognized on the exchange of the non-equity rights in X for the non-equity rights (that is, the Class A Membership) in Y.

(2) The Class B Membership interests in Y will be treated as equity interests.

(3) The continuity of interest requirement of § 1.368-1(b) and (e) of the Income Tax Regulations is satisfied upon the exchange of the X Members' equity rights in X for Class B Memberships in Y, as described above.

(4) The transaction described in step (vii), above, involving, in substance, the contribution of all of the Class B Memberships in Y to Holding in exchange for all of Holding's common voting stock, will not prevent the merger of X with and into Y from qualifying as a reorganization under section 368(a)(1)(F). See Rev. Rul. 96-29, 1996-1 C.B. 50

(5) The merger of Transitory-Sub with and into Y, followed by the exchange of the Class B Memberships for Holding common stock will be characterized as the contribution of all of the Class B Memberships to Holding by the Class B Members in exchange for the d shares of Holding's common stock. The Merger of Transitory-Sub with and into Y will be disregarded.

A determination as to whether the conversion of X to a State C for-profit membership corporation qualifies as a reorganization under section 368(a)(1)(F), and whether the contribution of the Class B Memberships to Holding in exchange for Holding common stock qualifies under section 351 will be made upon audit of the federal income tax returns of X, Y, and Holding.

No opinion is expressed as to the federal tax treatment of the transactions described in (i) - (vii) other than those specifically addressed in the above rulings. Furthermore, no opinion is expressed as to the allocation of the basis, if any, between

the Class A and Class B Memberships. No opinion is expressed on the federal tax treatment of the liquidation of the Plan V account and the distribution of the Plan V proceeds.

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.

It is important that a copy of this letter be attached to the federal income tax returns to 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 representative.

Sincerely yours,
Associate Chief Counsel (Corporate)
By Lewis K Brickates
Assistant to Chief, Branch 2