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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: APR 07 2000

Employer Identification Number:

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T 2

Significant Issue Numbers:
- 501.06-00
513.00-00

Legend:

M =
N =
O =
m =
x =
y =

Dear Applicant:

This letter is in reply to the letter from your authorized representatives dated October 12, 1999, as amended by letter dated January 6, 2000, in which M and N requested rulings with respect to the tax consequences of a proposed transaction as described below.

M is an organization recognized by the Internal Revenue Service as exempt from federal income tax under section 501(c)(6) of the Internal Revenue Code.

Each member of M has one vote.

M split its principal operations into two separate subsidiaries, N and O. N, organized at that point in time and a wholly owned subsidiary of M, is responsible for M's function, and is an organization recognized by the Service as exempt from federal income tax under section 501(c)(6) of the Code. O, a wholly owned subsidiary of M through a holding company, is a for-profit corporation earlier formed by M to implement m.

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M states that, recently, technology and related developments have radically transformed the function referred to above.

The projected effects on the m industry from the operation of these alternatives, if not properly coordinated, raise concerns

M states that the current ownership structure of O makes it difficult for O to respond quickly and effectively to the recent developments

Therefore, M states that it and its board of directors may be constrained from taking actions and undertaking expenditures necessary to continue O's position. M states that its ability to fund O is further constrained by the competing needs of M and N for capital to support M's responsibilities

M is proposing to recapitalize the outstanding common stock of O from the current number of shares to x shares, all of which will be initially held by M. The proposed transaction will consist of a private placement including the sale by O of y newly issued shares. After a vote by the members of M to approve the transaction, it will proceed as follows:

(1) The phase of the private placement will be conditioned on an affirmative vote of M's members. O will initially offer to sell approximately percent of the newly issued shares in O to a broadly defined group of participants and to certain companies for a purchase price equal to their fair market value; the shares will be voting shares of O common stock; O will have only one class of common stock. Simultaneously, M will offer to issue and sell to certain participants, companies, and all of M's members in good standing warrants to purchase approximately percent of the O common stock held and owned by M. The purchase price for the warrants will be equal to their fair market value and will be exercisable in tranches with one share of common stock available for purchase in each tranche. The warrants will entitle the holder to purchase, during each of the year exercise periods, one share of common stock at an exercise price increasing approximately percent annually. In lieu of purchasing these warrants, M's members may choose to purchase common stock.

(2) The phase of the private placement will be conditioned on an affirmative vote of M's members, if necessary, and will be structured as follows:

(a) O will offer to sell approximately percent of the newly issued shares of common stock to the group above (resulting in a total aggregate of approximately percent of shares of common stock outstanding after both phases). The purchase price for the shares will be equal to their fair market value.

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(b) M will offer to issue and sell to the group described above warrants to purchase approximately percent of O common stock held and owned by M (after which, approximately percent of M's common stock shares of O will be subject to warrants). The purchase price for the warrants will be equal to their fair market value, and the warrants are expected to have the same structure and maturity dates as the warrants issued in the first phase.

(c) In the event that the warrants offered to M's members, described immediately above, go unpurchased, M will offer the underlying shares for sale at their fair market value to M members that participate in the transaction and who qualify based on specified criteria.

(d) M's share of the voting power in O stock will drop from approximately percent control to approximately percent , and majority control will transfer from M to the above described group upon O's registration.

M states that the number of shares and warrants to be offered to different groups of investors will vary in a manner that M believes will maximize O's business value. M states that in phases, above, the shares and warrants will be sold for a price equal to their fair market value as indicated by a valuation prepared by the investment banking division of a nationally recognized investment firm, working in conjunction with the finance and management personnel of M. M also states that the same broadly defined group and all members of M that have chosen to participate in the first phase of the offering will be given the opportunity to participate in the second phase of the offering (including those members who chose not to participate). The transaction will be subject to review by an independent committee of M's Board and O's Board of Directors. The transaction also will be subject to review by an independent review committee of M's Board which has been provided legal counsel. In addition, the review committee has engaged a nationally recognized investment banking firm to provide it with a fairness opinion on the valuation of the shares and warrants. The investment banking firm is also analyzing the relationship between O's business needs and the amount of equity being offered across and within investor segments.

M states that the transaction is structured in phases in order to secure approval of the transaction from its membership. However, state law prohibits the sale of all or substantially all of M's assets without an affirmative vote of a majority of all of its members, not just a majority of those participating in the vote. Each member of M has one vote. As is not uncommon in organizations of this type, the past participation of M's members have not been at the level that would be needed to meet the requirements of state law. Thus, M states that it will take time to contact each member, to explain the proposed transaction, and to organize a vote. Therefore, M has separated the transaction into phases with less than percent of M's interest in O being sold in the phase and with most of the offering to M's membership occurring in the phase.

M states that it believes that the proposed transaction will enable O to respond to competition

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions and modifications.

Section 512(b)(5) of the Code includes in the modifications mentioned in section 512(a)(1) that there shall be excluded from the term "unrelated business taxable income" all gains or losses from the sale, exchange, or other disposition of property other than--

(A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or

(B) property held primarily for sale to customers in the ordinary course of the trade or business.

Section 512(b)(5) of the Code continues, in part, that there shall be excluded all gains or losses recognized, in connection with the organization's investment activities, from the lapse or termination of options to buy or sell securities (as defined in section 1236(c)) or real property and all gains or losses from the forfeiture of good-faith deposits (that are consistent with established business practice) for the purchase, sale, or lease of real property in connection with the organization's investment activities.

Section 1.512(b)-1(d)(2) of the regulations provides that there shall be excluded from the computation of unrelated business taxable income any gain from the lapse or termination after December 31, 1975, of options to buy or sell securities (as that term is defined in section 1236(c)). An option is considered terminated when the organization's obligation under the option ceases by any means other than by reason of the exercise or lapse of such option. If the exclusion is otherwise available it will apply whether or not the organization owns the securities upon which the option is written, that is, whether or not the option is "covered." However, income from the lapse or termination of an option is excludable only if the option is written in connection with the organization's investment activities. Thus, for example, if the securities upon which the options are written are held by the organization as inventory or for sale to customers in the ordinary course of a trade or business, the income from the lapse or termination will not be excludable under the provisions of this section.

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Similarly, if an organization is engaged in the trade or business of writing options (whether or not such options are covered) the exclusion will not be available.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the function constituting the basis for its exemption.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes; and it is "substantially related" only if the causal relationship is a substantial one. The regulation continues that for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Section 514(a)(1) of the Code provides that a portion of the income derived from, or on account of, each debt-financed property shall be included as an item of gross income derived from unrelated trade or business.

Section 514(b) of the Code defines "debt-financed property" to mean, with certain exceptions, any property which is held to produce income and with respect to which there is an "acquisition indebtedness" at any time during the taxable year.

Section 514(c) of the Code defines "acquisition indebtedness" as the unpaid amount of indebtedness incurred in acquiring or improving the property.

Subsequent to the proposed transaction, M and N will continue to operate for purposes within the meaning of section 501(c)(6) of the Code. The actions described above, in and of themselves, will have no adverse effect on a determination of exempt status. Further, the proposed transaction does not involve the regular carrying on of unrelated trade or business within the meaning of section 513 of the Code. Also, any gain or losses recognized by M from the sale of either the stock or the warrants would be excluded from the definition of unrelated business taxable income by section 512(b)(5) of the Code. Nor does the transaction, in this case, represent "acquisition indebtedness" incurred by M or N.

An organization that is exempt under section 501(c)(6) of the Code may not be operated for the profit of its individual members. Members may nevertheless receive some kinds of benefits from the organization, such as newsletters and similar informative material, and the profitability of the members' individual enterprises may be enhanced by the successful promotion of the common business interest. The inurement proscription of the statute, however, precludes furnishing benefits for some members at special rates, at the expense of the other members. Since M will be offering the shares of stock in O to all of its members, and others, at a fair market value, with no attempt to provide the shares to certain particular persons or groups at special prices that benefit certain members at the expense of other members, inurement does not exist. Furthermore, the placement is conditioned on an affirmative vote of M's members.

A parent organization which holds all of the stock of a taxable subsidiary corporation is not thereby precluded from recognition of exemption under section 501(c) of the Code where the subsidiary is formed for a *bona fide* business purpose and is not a mere instrumentality of the parent organization and where the parent organization does not actively participate in the day-to-day management of the subsidiary.

Accordingly, based on the facts and circumstances concerning the proposed transaction as stated above, we rule as follows:

(1) The proposed transaction, as described above, will not result in the net earnings of M or N inuring to the benefit of any private shareholder or individual and will not affect either M or N's tax-exempt status under section 501(c)(6) of the Code.

(2) The proposed transaction will not result in unrelated business taxable income under sections 511 through 514 of the Code to either M or N from the sales of shares of O common stock or warrants to purchase O common stock.

These rulings are based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any such change should be reported to the Tax Exempt and Government Entities (TE/GE) Customer Service Office. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. A copy of this ruling is being forwarded to the TE/GE Customer Service Office.

Except as we have specifically ruled herein, we express no opinion as to the consequences of these transactions under the cited provisions or under any other provisions of the Code.

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

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

(signed) Garland A. Carter

Garland A. Carter
Manager, Exempt Organizations
Technical Group 2