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Dear :

This is in reply to a letter dated January 28, 2000, requesting rulings as to the federal income tax consequences of a proposed transaction. The information submitted for consideration is substantially as set forth below.

A is a **State X** corporation engaged principally in manufacturing and distributing **a** in the United States. Shares of **A**'s common stock are traded on the **b**.

B ("Newco1") is a **State X** stock corporation and wholly-owned by **A**. **C** is a **State X** non-stock corporation with cooperative by-laws whose sole member is Newco1. **D** ("LLC1"),

E ("LLC2"), **F** ("LLC3") and **G** ("LLC4") are **State X** limited liability companies, each of whose sole member is Newco2. None of LLC1, LLC2, LLC3 or LLC4 will file an election to be treated as a corporation for federal income tax purposes under §301.7701-3(c) of the Income Tax Regulations.

H ("Association") is a **State Y** agricultural marketing association organized under **c**. Association is principally engaged in manufacturing and distributing **d** in its geographic market area. Association is a non-exempt farmer's cooperative operating on a cooperative basis and subject to the rules of Subchapter T of the Code. Association currently has **e** members.

A "qualified written notice of allocation" ("QWNA") is (A) a written notice of allocation which may be redeemed in cash at its stated dollar amount at any time within a period beginning on the date such written notice of allocation is paid and ending not earlier than 90 days from such date, but only if the distributee received written notice of the right of redemption at the time he receives such written notice of allocation, or (B) a written notice of allocation which the distributee has consented, in the manner provided in section 1388(c)(2) to take into account at its stated dollar amount as provided in section 1385(a). Association has issued all its outstanding QWNAs utilizing the method described in subparagraph (B).

The equity of Association consists of (i) **i**, which is represented or held in the form of QWNAs and (ii) a residual value in Association in excess of the face amount of outstanding QWNAs. The residual value is hereinafter referred to as Deemed Gain.

It has been Association's practice for many years to redeem QWNAs at face value approximately **g** years after they are issued. Depending upon the circumstances under which former Patrons (as defined below) ceased doing business with Association on a cooperative basis, such persons may or may not hold QWNAs. For example, it is Association's practice to redeem QWNAs held by the estates of deceased members at the request of the deceased member's personal representative. Most Patrons are individuals or pass-through entities who file Federal tax returns on a calendar year basis, although a few Patrons are C corporations.

A desires to acquire Association. To accomplish the acquisition, Newco2 will offer to purchase (the "Offer") all of the membership interests in Association (including all QWNAs and all other interests of Association held by such Members). If Newco2 is successful in purchasing all of the membership interests in Association, or if **A** otherwise elects to proceed with the acquisition, each outstanding membership interest in Association (other than membership interests in Association held by Newco2, LLC1, LLC2, LLC3 and LLC4), QWNAs and other interests of members in Association will be purchased for (i) cash in an amount equal to the face amount of QWNAs held by such member and (ii) cash and **A** Contractual Payments to members as Deemed Gain Payments (defined above). Immediately after the successful consummation of the Offer, Association will be merged into Newco2 (the "First Merger") with Newco2 surviving. Under the terms of merger agreement, as amended (the "Amended Merger Agreement") all remaining QWNAs and other interests in Association of Patrons of Association will be converted into the right to receive (i) cash in

an amount equal to the face amount of QWNAs held by such Patron and (ii) cash and **A** Contractual Payments to Patrons as Deemed Gain Payments. In order to accommodate provisions of the Merger Agreement providing for purchase price adjustments and distribution reserves, a portion of the cash payable to members and Patrons will be paid after the effective time of the First Merger; these deferred payments constitute the **A** Contractual Payment. The formula will be identical for determining the amount of Total Consideration (as defined below) that will be received by members of Association who sell their membership interests, QWNAs and other interests in Association to Newco2 pursuant to the Offer and for conversion of the QWNAs and equity interests of Patrons into cash in the Amended Merger Agreement.

Patrons of Association are defined in the Offer and the Amended Merger Acquisition to be persons (or such Patron's personal representatives, heirs, or assigns, as the case may be) who hold outstanding QWNAs at the effective time of the First Merger and who have transacted business with Association on a cooperative basis after **o**.

The Total Consideration as defined in the Amended Merger Agreement will equal **k** subject to positive and negative adjustments. After payment of the QWNAs at face value, Deemed Gain Payments will be allocated among the Patrons as follows in accordance with Association's by-laws.¹ Each Patron will receive a portion of the Deemed Gain Payments computed by multiplying the total Deemed Gain Payments by the Patron's Patronage Percentage, computed as described below. A Patron's Patronage Percentage will be computed by dividing the Patron's Patronage (as defined below) during the Patronage Period (as defined below) by the aggregate amount of all Patrons' Patronage during the Patronage Period. The Patronage Period is the period from **l** through the effective time of the First Merger. A Patron's Patronage is the sum of all patronage dividends paid to the Patron during the Patronage Period (determined without regard to whether such patronage dividend was paid in cash or distributed as a QWNA).

The distribution formula described above for Deemed Gain Payments has been formally approved by the Board of Directors of Association. In support of its allocation formula, Association specifically represents the following:

(1) The membership over time has been very stable. Inclusion of patronage dividends for periods prior to **l**, would have a small effect on how proceeds would be distributed both because the dollar volume of patronage dividends has generally been larger in more recent years and because many current members have been Patrons of Association for many years prior to **m**.

¹ Association's by-laws will be amended based on a vote of or consent by its Members to read: "If all or substantially all the equity interests in the Association are acquired by a single acquiror in consideration for cash, the acquiror's stock or notes, or other consideration, such consideration shall be apportioned among patrons and holders of patrons' equities as equitably as the Board of Directors finds practicable having due regard for the Association's operation on a cooperative basis and the other provisions of these by-laws."

(2) Once a Patron no longer has a financial interest in Association in the form of an outstanding QWNA, there is little incentive for either Association or the Patron to maintain contact. Accordingly, Association's Board of Directors believes that inclusion of patronage dividends for periods prior to **I**, in the formula would significantly increase the amount of proceeds which would be unclaimed.

(3) Association's by-laws provides that:

a member, active terminated or deceased shall not be deemed to have any property rights or financial interest in Association other than as may be evidenced on the books of Association as a capital investment of such member or as a patronage allocation credited to the account of such member or to be credited to the account of such member, and except for the discretionary settlement as provided by Article V of these By-laws, such member shall be paid in the manner and at the time payment would have been paid had such membership continued.

Thus, members whose membership has terminated have no further financial interest or property rights in Association when they no longer have any amount allocated to them on Association's books. All QWNAs for periods prior to **I**, have been retired.

(4) The membership, as part of accepting the Offer, will approve the new by-law provision for Association and will be aware of the distribution formula proposed by the Board at such time.

Association has also represented that:

(5) All QWNAs of Association are held by Patrons.

(6) The QWNAs represent equity interest in Association.

Immediately prior to the consummation of the Offer and the First Merger, Association will sell its 50% partnership interest in **I**, a **State Y** general partnership which operates a **p** in **h** and all of its marketing agreements with current Patrons to **J**, which owns the other 50% interest in **I**. **J** is a nonexempt Subchapter T cooperative. In exchange for these assets, New Association will receive (i) a cash payment by **J** in the amount of **i** and (ii) **J** equities with an aggregate face amount of **j**. The **J** equities will be sold by Association to a trustee for the Association's Members and transferred by the trustee to Association Members. Immediately after the First Merger, Newco2 will be merged with and into Newco1 with Newco1 surviving the merger as a wholly-owned subsidiary of **A** (the "Second Merger").

In order to qualify under Subchapter T, a cooperative must make its apportionments on a patronage basis. Although neither the Code nor the regulations define what constitutes a patronage basis, the regulation do provide examples. In the context of gain on the sale of a capital asset, section 1.1382-3(c)(3) of the Treasury Regulations states:

For example... if capital gains are realized by the association from the sale or exchange of capital assets held for a period extending into more than one taxable year income realized from such gains must be paid, *insofar as is practicable*, to the persons who were patrons during the taxable years in which the asset was owned by the association in proportion to the amount of business done by such patrons during such taxable years. (Emphasis added.)

The period proposed in the instant case is intended to limit the administrative and legal burdens of determining how to distribute amounts on a patronage basis in the case of assets with long holding period while complying with the requirements in section 1.1382-3(c)(3) of the regulations. Association's proposed look-back period for distribution of the Deemed Gain on a patronage basis was chosen to limit the foregoing burdens and prevent portions of the Deemed Gain Payments from escheating to the state. We conclude that Association's look-back period, I to the effective time of the First Merger, a period of approximately q years, complies with the "insofar as is practicable" requirement of section 1.1382-3(c)(3) of the regulations.

Accordingly, based solely on the foregoing analysis and representations of Association, we conclude:

1. The Offer, the First Merger and Second Merger and the apportionment of the Proceeds of the Offer and First Merger to Holders of QWNAs in an amount equal to the face amount of such QWNAs and to Patrons as Deemed Gain Payments based on the Patrons Patronage Percentages will not adversely affect Association's status as a cooperative under Subchapter T through and including the effective time of the First Merger.

2. Newco1, as successor by merger to Association and Newco2, will be entitled to deduct, pursuant to Section 1382(b) of the Code, any Current Patronage Dividends paid to Current Patrons with respect to periods of operation of Association after n and through the effective time of the First Merger, provided such payment is made within the period prescribed by Section 1382(d) of the Code.

3. The sale of assets to J by Association and the sale of J equities by Association to the trustee will not affect Association's status as a cooperative under Subchapter T through and including the effective time of the First Merger.

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

Sincerely yours,

Walter Woo

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