

**Internal Revenue Service**

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Person To Contact:

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Telephone Number:

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Date:

July 27, 2004

**Legend**

Taxpayer =

Date A =

Date B =

State =

a =

Dear :

This letter responds to your January 28, 2004 request for a ruling on certain federal income tax consequences of a proposed transaction. The information received in that request and in subsequent correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the

material submitted in support of the request for rulings, it is subject to verification on examination.

### **Summary of Facts**

Taxpayer is a nonprofit § 501(c)(7) federal income tax exempt membership organization formed on Date A. A determination letter was issued to Taxpayer on its § 501(c)(7) status on Date B. Taxpayer is a membership corporation currently comprised of a members. Members are required to pay a substantial initiation membership fee, monthly dues, and additional fees and assessments associated with their membership category.

Payment of monthly dues allows a member to use Taxpayer's facilities for entertainment. A separate fee is charged for guests, equipment, and refreshments. In general, the membership fees have been used for capital expenses, and the monthly dues, assessments, and separate fees have been used for non-capital operational and maintenance expenses. Taxpayer's bylaws describe the rights and privileges of each membership category.

There are four categories of membership interest in Taxpayer, Resident, Nonresident, Associate, and Sponsored (each a "Member"). A Member's proximity to Taxpayer determines whether they are classified as a Resident or Nonresident member. Associate membership is determined by age. Sponsored members are individuals sponsored by business entities who are admitted as a Resident, Nonresident, or Associate member.

Each Member is entitled to vote, by separate membership category. Members are entitled to vote for extraordinary Taxpayer matters. In particular, Members vote on amendments to Taxpayer's articles of incorporation and bylaws, and authorizations of new membership categories. In addition, Resident and Nonresident Members vote on mergers, the sale, lease, or exchange of all or substantially all of Taxpayer's assets, and dissolution of Taxpayer. The Board of Directors is self-appointed.

The Taxpayer may redeem a Member at any time. The redemption price is equal to the greater of the initiation fee paid by the Member or 80 percent of the current initiation fee, whichever is greater. Members do not receive dividends; however, upon redemption a Member is entitled to the greater of the amount paid for the initiation fee or 80 percent of the current initiation fee.

The Members are the owners of Taxpayer. Members hold jointly all the equity interests in Taxpayer's assets. Upon dissolution, after payment of all liabilities, the Taxpayer will distribute pro rata the net assets to Members up to the initiation fee paid by the Member and any remainder distributed to each member equally.

### **Proposed Transaction**

While the Taxpayer has been able to pay its current operating expenses to date, it has not been able to obtain and retain enough members to generate sufficient revenue to assure the Taxpayer's long-term financial viability or to service its existing bank debt used to fund part of the Taxpayer's business. In order to increase operating flexibility and the pool of potential members, and to make paying initial membership fees and monthly dues acceptable to more people, Taxpayer proposes the following transaction:

- (i) Taxpayer will form a State limited liability company ("LLC") and contribute all of its assets and liabilities to LLC.
- (ii) Taxpayer will liquidate and distribute all of its interest in LLC to its Members in exchange for the membership interest held by each Member. The LLC members will be exactly the same as the Members of Taxpayer at that time.

### **Ruling**

Section 1011 provides that the adjusted basis for determining gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis as determined under § 1012, or other applicable sections of the Code.

Section 1012 provides that the basis of property is equal to the cost of that property. Section 1.1012-1(a) of the Income Tax Regulations defines cost as the amount paid for the property in cash or other property.

Based on the information submitted, we rule that a Member will have a cost basis in their membership equal to the initiation fee paid for such membership pursuant to §§ 1011 and 1012.

### **Caveats**

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed or implied about the (i) tax treatment of the contribution of assets from Taxpayer to LLC, (ii) the distribution of the LLC interests from Taxpayer to Members, or (iii) the conversion of Taxpayer to a federal income taxable entity.

**Procedural Statements**

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

Each taxpayer involved in the transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the Proposed Transaction is completed.

Under a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

*Richard Passales*

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

(Corporate)

cc: