

# **Bond Case Briefs**

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## **Private Letter Ruling: IRS Rules on Liquidation of Subsidiary Into Country Club.**

The IRS ruled that a country club's tax-exempt status will not be affected when its subsidiary is liquidated into the club because there will be no recognition of gain or loss when the club receives the subsidiary's assets and liabilities.

Release Date: 4/12/2013

Date: January 16, 2013

This is in response to your ruling request, dated October 21, 2009, requesting certain rulings with respect to the income tax consequences to you of the complete liquidation and dissolution of your wholly owned subsidiary that is tax exempt under § 501(c)(2) of the Internal Revenue Code ("Code").

### FACTS

You are a State nonprofit membership corporation organized in 1982 and recognized in 1984 as tax-exempt under § 501(c)(7) to operate as a country club. State statutes prohibited stock ownership of not-for-profit entities. Therefore in order to provide a mechanism for members to recoup all or part of their investment in the country club assets upon withdrawal, death, or change in membership classification, in 1984 the members formed Subsidiary, a State for-profit corporation recognized in 1995 as tax-exempt under § 501(c)(2) retroactive to its 1984 inception. Subsidiary owned all tangible property for a country club (the "Property"), leased the Property to you for use in furtherance of your exempt purposes, and paid all income to you less operational expenses. The amount of Subsidiary income you received was typically less than 3% of your gross receipts. Only your members could own stock in Subsidiary.

Your members were the only shareholders of Subsidiary until 2006. You state that this affiliate structure was administratively expensive requiring, among other things, separate accounting, auditing, and tax returns, therefore you decided to simplify and streamline the structure. On Date 1, you bought one (1) share of the common stock of Subsidiary through an issuance of Subsidiary. Immediately thereafter, Subsidiary redeemed all other shares of its stock, which shares were held by your members. As a result, Subsidiary became your wholly owned subsidiary. You and Subsidiary were eligible to file consolidated returns but did not.

All profits derived by Subsidiary, after payment of all ordinary and necessary expenses, have been turned over to you for your use and benefit in its operation as a social club. You propose to completely liquidate Subsidiary (the "Liquidation"). A plan of liquidation was adopted in 2009. Under the liquidation plan, all of the stock of Subsidiary will be redeemed and cancelled and Subsidiary will be dissolved. You, as the sole shareholder of Subsidiary, will receive all assets and assume all liabilities of Subsidiary in the liquidation. You will continue to use the assets distributed from Subsidiary in the direct performance of your exempt function.

Upon the Service's issuance of this private letter ruling, Subsidiary will make its first liquidating

distribution. At the same time, Subsidiary will cease to be a going concern and its activities will be limited to winding up its affairs, paying its debts, and distributing its remaining assets to you.

Once all the assets of Subsidiary are liquidated into you, Articles of Dissolution will be filed with State X with respect to Subsidiary, and Subsidiary will be dissolved.

## REPRESENTATIONS

In connection with the proposed Liquidation, you represent as follows:

1. You, on the date of adoption of the liquidation plan and at all times until the final liquidating distribution is completed, will be the owner of at least \* \* \* percent of the single outstanding class of Subsidiary stock.
2. No shares of Subsidiary stock will have been redeemed during the three (3) years preceding the adoption of the plan of complete liquidation of Subsidiary.
3. Subsidiary has adopted a liquidation plan specifying that the final liquidating distribution is to be completed within 3 years from the close of the taxable year of Subsidiary in which the first liquidating distribution is made.
4. Subsidiary will retain no assets following the final liquidating distribution.
5. As soon as the first liquidating distribution has been made, Subsidiary will cease to be a going concern and its activities will be limited to winding up its affairs, paying its debts, and distributing its remaining assets to its shareholders
6. Subsidiary will not have acquired assets in any nontaxable transaction at any time, except for acquisitions occurring more than 3 years prior to the date of adoption of the liquidation plan.
7. No assets of Subsidiary have been, or will be, disposed of by either Subsidiary or you except for dispositions in the ordinary course of business and dispositions occurring more than three (3) years prior to adoption of the liquidation plan.
8. The liquidation of Subsidiary will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation ("Recipient") of any of the businesses or assets of Subsidiary, if persons holding, directly or indirectly, more than twenty percent (20%) in value of the Subsidiary stock also hold, directly or indirectly, more than twenty percent (20%) in value of the stock in Recipient. For purposes of this representation, ownership will be determined by application of the constructive ownership rules of § 318(a) as modified by § 304(c)(3).
9. Prior to adoption of the liquidation plan, no assets of Subsidiary will have been distributed in kind, transferred, or sold to you, except for (i) transactions occurring in the normal course of business and (ii) transactions occurring more than 3 years prior to adoption of the liquidation plan.
10. Subsidiary will report all earned income represented by assets that will be distributed to its shareholders such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.
11. The fair market value of the assets of Subsidiary will exceed its liabilities both at the date of the adoption of the liquidation plan and immediately prior to the time the first liquidating distribution is made.

12. There is no intercorporate debt existing between you and Subsidiary and none has been cancelled, forgiven, or discounted, except for transactions that occurred more than three (3) years prior to the date of adoption of the liquidation plan.

13. All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the proposed liquidation of Subsidiary have been fully disclosed.

14. You have satisfied all the requirements to be classified as tax exempt under § 501(c)(7).

15. Subsidiary receives tax-exempt status under § 501(c)(2) and holds all tangible Property of the country club which is leased to you for use in connection with your exempt purpose.

16. Subsidiary has not engaged in activities that would give rise to unrelated business taxable income within the meanings of §§ 511 and 514.

17. All assets (including proceeds of sales of assets) distributed to you by Subsidiary in the liquidation will be used by you in the performance of your exempt function.

18. You will not use any of the assets received in the liquidation, or the proceeds from the sale of such assets, in any activity that would give rise to unrelated business taxable income within the meanings of §§ 511 and 514.

19. You represent that you intend to continue to use the assets distributed from Subsidiary in the direct performance of your exempt function.

20. If Property is sold by Subsidiary or by you, you will, within the period beginning one year before the date of such sale and ending three years after the date of such sale, reinvest the entire amount of the proceeds from the sale in the purchase of new exempt function property.

#### RULINGS REQUESTED

1: You will recognize no gain or loss upon the receipt of the assets and liabilities of Subsidiary in the liquidation. Section 332.

2: No gain or loss will be recognized by Subsidiary on the distribution of its assets to, or the assumption of liabilities by, you. Sections 337(a) and 336(d)(3). In particular, § 337(b)(2)(A) will not apply to the liquidation.

3: Your basis in each asset received from Subsidiary as a result of the liquidation will be the same as the basis of that asset in the hands of Subsidiary immediately before the liquidation. Section 334(b)(1).

4: Your holding period in each asset received from Subsidiary as a result of the liquidation will include the period during which that asset was held by Subsidiary. Section 1223(2).

5: That the liquidation of Subsidiary into you will not adversely affect your tax exempt status.

#### LAW

Section 332(a) provides that no gain or loss shall be recognized on the receipt by a corporation of property distributed in a complete liquidation of another corporation. Section 332(b) sets forth various requirements that must be met in order for a distribution to be considered in complete liquidation for purposes of § 332.

Section 337(a) provides that no gain or loss shall be recognized to the liquidating corporation on the distribution to the 80-percent distributee of any property in a complete liquidation to which § 332 applies.

Section 337(b)(2)(A) generally provides that §§ 337(a) and (b)(1) shall not apply where the 80-percent distributee is an organization (with limited exception not relevant on these facts) which is exempt from the tax imposed by Chapter 1.

Section 337(d) authorizes the Secretary to prescribe regulations as may be necessary or appropriate to carry out the purposes of the amendments made by subtitle D of title VI of the Tax Reform Act of 1986, including regulations to ensure that such purposes may not be circumvented through the use of a tax-exempt entity. The legislative history concerning a 1988 amendment to § 337(d) explains that the grant of authority in § 337(d) “includes rules to require the recognition of gain if appreciated property of a C corporation is transferred to . . . a tax-exempt entity in a carryover basis transaction that would otherwise eliminate corporate level tax on the built-in appreciation.” S. Rep. No. 445, 100th Cong., 2d Sess. 66 (1988) (footnote omitted).

Section 501(c)(2) provides for the exemption of corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under § 501(a) of the Code.

Section 501(c)(7) provides for the exemption from federal income tax of clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Pub. L. 94-568 amended § 501(c)(7) in 1976 so such organizations could receive some outside income without losing their exempt status.

S. Rep. No. 1318, 94th Cong., 2d Sess. 4 (1976) explains how Congress intends the amended § 507(c)(7) work including limits on gross receipts from outside sources and non-members, and certain exclusions such as unusual income.

Section 1.337(d)-4(a)(1) of the regulations sets forth the general rule that if a taxable corporation transfers all or substantially all of its assets to one or more tax-exempt entities, the taxable corporation must recognize gain or loss immediately before the transfer as if the assets transferred were sold at their fair market values.

## RULINGS

Based solely on the information submitted and representations provided, we rule as follows:

- 1: You will recognize no gain or loss upon the receipt of the assets and liabilities of Subsidiary in the liquidation. Section 332.
- 2: No gain or loss will be recognized by Subsidiary on the distribution of its assets to, or the assumption of liabilities by, you. Sections 337(a) and 336(d)(3). In particular, § 337(b)(2)(A) will not apply to the liquidation.
- 3: Your basis in each asset received from Subsidiary as a result of the Liquidation will be the same as the basis of that asset in the hands of Subsidiary immediately before the liquidation. Section 334(b)(1).

4: Your holding period in each asset received from Subsidiary as a result of the liquidation will include the period during which that asset was held by Subsidiary. Section 1223(2).

5: As there is no recognition of gain or loss as described in rulings (1), (2), and (3), the liquidation of Subsidiary into you will not adversely affect your tax exempt status.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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 by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore R. Lieber

Manager, Exempt Organizations

Technical Group 3