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

Date: SEP - 7 2001

Contact Person:

SIN: 513.03-00
501.12-03

Identification Number:

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Dear Sir or Madam:

This is in reply to a letter dated August 9, 2001, from your authorized representative, and previous correspondence, wherein you requested certain rulings concerning the federal tax consequences of the transactions described below.

You are an electric cooperative that is exempt from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(12). Your tax year is the calendar year. You represent that you owned the rights to sell satellite television service ("DBS") to your member-patrons, and you leased such rights to your subsidiary. You appoint all the members of the subsidiary's board of directors. You represent that the subsidiary is treated as a nonprofit organization, but it is not exempt from federal income tax. You have received installment payments in the amount of $x from your subsidiary.

You provide electricity to your member-patrons. You obtained a loan ("RUS loan") from the Rural Utilities Services, a governmental agency. You used the loan to finance the construction of an electric power generation plant and facilities, which deliver electricity to member-patrons. These facilities included poles, towers, fixtures, conductors, underground conduit, line transformers, services and meters. You state that you repaid the RUS loan before its maturity date and received a discount. The amount of the discount was $y.

You have requested the following rulings:

(1) To exclude from unrelated trade or business income as defined in section 512(a)(1) of the Code the debt discount received from a prepayment of a Rural Utilities Services loan; and

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(2) To exclude from unrelated trade or business income as defined in section 512(a)(1) of the Code installment sale payments received from the sale of a DBS franchise.

Section 501(c)(12) of the Code provides for the exemption from federal income tax of benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Rev. Rul. 83-170, 1983-2 C.B. 97, describes a cooperative organization formed to provide cable television service to its members. Membership is required in order to receive cable television service. The Rev. Rul. states that the term "like organization," as used in section 501(c)(12) of the Code, is applicable only to those mutual or cooperative organizations that are engaged in activities similar in nature to the public utility type of service or business customarily conducted by the specified organizations. The Rev. Rul. notes that cable television corporations are similar in nature to public utilities and concludes that the organization qualifies for exemption from federal income tax as a "like" organization within the meaning of section 501(c)(12).

Section 511(a)(1) 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 provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in section 512(b).

Section 513(a) of the Code provides, in pertinent part, that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, 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 its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 513(c) of the Code provides, in part, that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.513-1(a) of the Income Tax Regulations provides, in pertinent part, that unless one of the specific exceptions of section 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if: (1) It is income from trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt function.

Section 1.513-1(b) of the regulations provides, in pertinent part, that for purposes of section 513 the term "trade or business" has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or the performance of services.

Section 1.513-1(c)(1) of the regulations provides, in pertinent part, that in determining whether trade or business from which a particular amount of gross income derives is "regularly carried on" within the meaning of section 512, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the nonexempt business endeavors with which they compete. Hence, for example, specific business activities of an exempt organization will ordinarily be deemed to be "regularly carried on" if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

Section 1.513-1(d)(1) of the regulations provides that gross income derives from "unrelated trade or business," within the meaning of section 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question – the activities, that is, of producing or distributing the goods or performing the services involved – and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides, in pertinent part, that a trade or business is "related" to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related," for purposes of section 513, only if the causal relationship is a substantial one. For this relationship to exist, 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 exempt purposes. Whether such activities contribute importantly to such purposes depends, in each case, upon the facts and circumstances involved.

As noted in section 1.513-1(a) of the regulations, gross income of an organization subject to the unrelated business income tax is included in the computation of such tax if the activity that gives rise to the income has three attributes: first, the activity must constitute a trade or business; second, the trade or business must be regularly carried on by the organization, and third, the trade or business must not be substantially related to the organization's exempt purpose.

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Our review of the facts and circumstances in this case indicates that the payments of $x you received from your subsidiary for the lease of the satellite television rights does not have one of the three attributes required for an unrelated trade or business under section 513 of the Code. Specifically, the amounts in question are derived from an activity that furthers your exempt purposes under section 501(c)(12). Rev. Rul. 83-170, supra, states that providing cable television services is an activity permitted under section 501(c)(12). Like the organization described in the Rev. Rul., which provided cable television services, you provide satellite television services to your patron-members through your wholly controlled nonprofit subsidiary. The subsidiary charges your members for such services and makes payments to you in the amount of $x for the rights to satellite television service pursuant to a lease. Since the payment from your subsidiary is derived from an activity that is substantially related to your exempt purpose under section 501(c)(12), we conclude that payments in the amount of $x do not constitute unrelated business taxable income under section 512(a)(1).

The amount of $y, which you received for the early repayment of the RUS loan before its maturity date also does not have one of the required three attributes with regard to the unrelated business income tax. Specifically, the amount derived by prepaying the RUS loan is a one-time event and is not regularly carried on. Although this amount is income for purposes of the 85 percent member income test under section 501(c)(12)(A) of the Code, we conclude that it is not subject to the tax on unrelated business income.

Accordingly, based on the foregoing facts and representations, we rule as follows:

1. The debt discount received from a prepayment of a Rural Utilities Services loan is excluded from unrelated trade or business income under section 512(a)(1) of the Code; and

2. The installment sale payments received from the sale of a DBS franchise is excluded from unrelated trade or business income under section 512(a)(1) of the Code.

This ruling is subject to the following caveat: the amount received as a discount from the early repayment of a RUS loan is considered nonmember income for purposes of the 85 percent member income test under section 501(c)(12)(A) of the Code.

Except as otherwise ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under other provisions of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representatives. You should keep a copy of this letter in your permanent records.

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.

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.

Sincerely,

Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3