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From:

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To:

Cc:

Subject: Patronage NOLs

This e-mail is in response to your question on whether a §199 deduction can create a patronage net operating loss (NOL).

Under §199(d)(3), patrons that receive a qualified payment from a specified agricultural or horticultural cooperative are allowed a deduction for an amount allocable to their portion of qualified production activities income (QPAI) of the organization received as a qualified patronage dividend or per-unit retain allocation which is paid in qualified per-unit retain certificates. Section 199(d)(3)(A)(ii) requires the cooperative to designate the patron's portion of the income allocable to the QPAI of the organization in a written notice mailed by the cooperative to its patrons no later than the 15th day of the ninth month following the close of the tax year.

Section 1.199-6(e) defines a qualified payment as any amount of a patronage dividend or per-unit retain allocation, as described in §1385(a)(1) or (3) received by the patron from a cooperative, that is attributable to the portion of the cooperative's QPAI, for which the cooperative is allowed a §199 deduction. For this purpose, patronage dividends and per-unit retain allocations include any advances on patronage and per-unit retains paid in money during the taxable year.

Section 1.199-6(h) provides that a cooperative may, at its discretion, pass through all, some, or none of the §199 deduction to its patrons. Patrons may claim the §199 deduction for the taxable year in which they receive the written notice from the cooperative informing them of the §199 amount without regard to the taxable income limitation under §1.199-1(a) and (b). Under §1.199-6(c), for purposes of determining a cooperative's §199 deduction, the cooperative's QPAI and taxable income are computed without taking into account any deduction allowable under §1382(b) or (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions). Under §1.199-6(k), a qualified payment received by a patron of a cooperative is not taken into account by the patron for purposes of §199.

Section 1.199-1(b)(1) provides that, except as provided in §1.199-7(c)(2), the deduction under §199 is not taken into account in computing any net operating loss or the amount of any net operating loss carryback or carryover. Under §199-7(c)(2), if a member of an expanded affiliated group (EAG) has some or all of the EAG's §199 deduction allocated to it and the amount allocated exceeds the member's taxable income, then the §199 deduction will create an NOL for the member. Similarly, the §199 deduction can increase the member's NOL.

In Rev. Rul. 69- 576, 1969-2 C.B. 166, the Service provides general rules for patronage or non patronage sourced income. Under §1388(j)(1), to the extent losses from one function may be attributable to business done with patrons, losses from that function may be netted against patronage earnings from another function, at the option of the cooperative. Cooperatives can net patronage losses against patronage gains. However, cooperatives subject to subchapter T cannot use patronage losses to offset nonpatronage gains. See Farm Service Cooperative v. Commissioner, 619 F.2d 718 (8th Cir. 1980).

If a cooperative adds back the deduction allowable under §1.199-6(c) and (e) in determining its taxable income and QPAI relating to its patronage sourced income, then the cooperative may pass through all, some, or none of its §199 deduction to its patrons provided written notice is provided to patrons under §199(d)(3)(A)(ii) and §1.199-6(g). Section 1.199-6(h) permits a patron to claim the §199 deduction received from the cooperative without regard to the patron's taxable income (or adjusted gross income) under §1.199-1(a) and (b). If a cooperative retains all or some of the §199 deduction, §1.199-1(b)(1) prevents the §199 deduction from creating a patronage net operating loss unless the cooperative is a member of an expanded affiliated group under §1.199-7(a)(1). If the cooperative is a member of an EAG and cooperative is allocated a §199 deduction relating to its patronage sourced income, and cooperative does not pass through all of its §199 deduction to its patrons, then the §199 deduction could create a patronage NOL.

Furthermore, based on Farm Service, a §199 deduction relating to a cooperative's patronage sourced income cannot be used to offset nonpatronage income.