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LEGEND

Coop =

State A =

Area =

Crop =

Corp A =

States =

Dear

This is response to a request for rulings dated April 5, 2010, submitted by your authorized representative. The ruling concerns the liquidation of a subchapter T cooperative as more fully discussed below.

Coop is a State A non-profit corporation formed \_\_\_\_\_, under the State A Cooperative Marketing Law. Coop has operated as an exempt farmers cooperative subject to the provisions of section 521 and subchapter T of the Internal Revenue Code since the date of its incorporation and has filed federal income tax

returns using the accrual basis of accounting in accordance with its status as a cooperative.

Coop is organized without capital stock with each member having one vote in the affairs of the corporation. Capital is obtained from revolving fund retains which have been withheld from patrons based upon the amount of patronage business done with the cooperative by such patrons.

Coop was formed to provide a farmer owned facility for Area Crop growers to use in the marketing of their Crop production. Crop company buyers would come to Coop during the harvest season to purchase Crop in periodic auctions. Through growers participating in the auctions were guaranteed a minimum price through federal Crop price subsidy and stabilization programs.

Coop's facilities, located on land owned by Coop, included an auction floor, office and a warehouse with storage space where growers could bring their Crop prior to the auction and from which buyers' trucks could be loaded with the purchased Crop to be transported to manufacturing plants. The facilities have been the same since the formation of Coop with no major changes or additions other than some reconstruction as a result of a fire in .

The specialized purpose and need for the facilities to serve patrons limited their use by Coop to the annual fall Crop harvest period. Prior to commissions charged to cover the costs of providing the auction services were Coop's only revenues. In , in addition to auction commissions, Coop began receiving rental income from leasing the facilities to local businesses for storage during the off season.

According to Coop, for the past 20 plus years Crop growers have faced uncertain market conditions from a confluence of negative factors growing Crop: restructuring, reduction, and elimination of federal Crop price support programs in favor of a more free market; and reductions in the federal quota programs due to international trade agreements and actions.

On , legislation completely terminated the federal Crop supply control (quota) and price support programs. This legislation included "[Crop] Transition Program Payments" as part of the "[Crop] Quota Buyout" wherein Crop growers who signed up for the program are being paid over a -year period to buy back their crops as compensation for the loss of federal price supports and not growing Crop.

While United States Crop companies continue to manufacture Crop products for the domestic and international markets these products are largely made from Crop grown by United States farmers in direct contracts with the companies or from imported Crop. These market conditions have caused steady erosion in the number of Crop growers in Coop's geographic market area. Direct contracting with growers by the Crop

companies and removal of the federal price support minimum auction prices eliminated the need of most growers for auction services for the major portion of their annual crops, making it uneconomic for Coop to continue to conduct Crop auctions.

Faced with these market conditions, Coop's board of directors decided to suspend further auctions unless and until market conditions changed. This resulted in the fiscal year ending \_\_\_\_\_ being the last period in which Coop conducted Crop auctions and paid patronage refunds from its net income.

Coop's board of directors did not immediately decide to sell Coop's facilities because at that time there was uncertainty as to whether the changes in government's role in regulating the Crop production and marketing business would work as intended and whether government policy might change again resulting in renewed need for Coop's auction services. It was difficult for Coop's board of directors to recommend to members to immediately let go of a facility that had provided an essential service to community Crop growers since \_\_\_\_\_ and could not be easily replaced if it became needed again.

Prior to the fall of \_\_\_\_\_, Coop was approached by the Corp A with a request that it be allowed to conduct Crop auctions using Coop's facilities during the harvest season. Corp A, which is a cooperative formed in \_\_\_\_\_ to represent the interests of Crop growers in States, was acting throughout its traditional service areas to ensure growers producing Crop not covered under a private marketing contract would have an alternative marketing opportunity for their crop.

As a way to continue to meet the needs of members and other area growers still needing auction services to market all or part of their Crop, while providing time for the uncertainties regarding the possibility of a future need for Coop to resume auction services to be resolved, Coop entered into agreements with Corp A to conduct its own Crop sales on Coop's auction floor for the \_\_\_\_\_ and \_\_\_\_\_ fiscal years. The board of directors felt this was a reasonable way in the circumstances to continue providing beneficial services to members on a cooperative basis consistent with Coop's purposes. During this period Coop continued its long practice of leasing warehouse space to a third party during the off season.

Under the agreements, Corp A paid a \$ \_\_\_\_\_ annual fee to cover auction floor operating costs. The growers participating in Corp A's auctions – who included Coop members who still needed auction services - were patrons of Corp A and had no transactional relationship with Coop. Therefore, while Corp A would have kept patronage records for its own purposes, there was no patron relationship between the growers dealing with Corp A and Coop that would form a basis of allocating Coop's net income in these fiscal years to those growers.

growers participated in Corp A auctions during the 2-year period. Coop board decided that this level of use did not justify continuing ownership of the facilities so that Corp A or Coop could continue to hold auctions.

In \_\_\_\_\_, after the board had determined that there was no longer any sufficient current or projected future market need or economic basis upon which to justify continuation of the cooperative or retaining the ownership of its facilities within the purposes for which Coop had been formed, the membership voted to sell Coop's property and begin liquidation proceedings. At that time Coop's property was appraised for \$ \_\_\_\_\_.

Because of the anticipated sale and liquidation, the arrangements with Corp A and the lease for off-season warehouse space was not renewed for the fiscal year. Consequently, Coop generated no revenues for that period other than a minor amount of interest on funds in a bank account.

In \_\_\_\_\_, facing no revenues being generated, Coop obtained an operating loan to pay its fixed costs and incidental operating expenses until the property can be sold. In \_\_\_\_\_ Coop signed a 12-month contract for the sale of the property with a commercial real estate broker.

No offers were received on the property under this sales contract. Faced with the slow commercial real estate market, Coop decided during \_\_\_\_\_ to lease the property to a major Crop product manufacturer for use as a delivery point and storage space for Crop grown in the area under contracts with the manufacturer. The manufacturer was considered a strong prospective buyer of the facility and this lease was an inducement for the manufacturer to move towards a purchase while at the same time providing some use of Coop's facilities for members and other local Crop growers. This lease arrangement in the \_\_\_\_\_ fiscal year lasted only six months and no offer to purchase the property was received.

After further review of prospects for use of the facilities under any feasible arrangement to benefit Crop growers and the bleak commercial real estate market outlook, Coop's board authorized the broker to make a sale offer to the Corp A with the understanding that the property would bring substantially less than it was originally appraised for in \_\_\_\_\_. The offer was accepted and the facilities along with office furniture and file cabinets were sold as of \_\_\_\_\_, with the hope that they may still be used to benefit local Crop growers. Coop is now in a position to make a final liquidating distribution of the remaining funds from the sale and other sources, after payment of any remaining obligations and redemption of remaining retained allocated patronage income credits, to member/patrons.

As established at formation of Coop and practiced through \_\_\_\_\_, growers who sold Crop on Coop's auction floor could apply for membership and, upon acceptance by

the board of directors and payment of a \$1 refundable membership fee, become voting members. The membership continued until terminated retroactively to the first day of Coop's fiscal year in which the producer did not sell any Crop through an auction at Coop. Upon termination of membership the \$1 membership fee was refunded. This membership structure resulted in a significant proportion of patrons who didn't take the time to apply for membership and a constant turnover of membership who participated in auctions only occasionally year to year.

In November            Coop's charter was amended such that all growers who sold Crop on Coop's auction floor were deemed to have applied for membership in Coop. The \$1 fee was eliminated. Memberships continued until terminated under the same conditions as before. This membership practice had the effect of making all producer patrons members so from            onward there has been no non-member auction business conducted by Coop.

In            Coop's Charter was amended so that membership continues until terminated in Coop's fiscal year in which the member did not sell any Crop through an auction at Coop and they had not done so for the previous four fiscal years.            . The Charter amendment was adopted by the membership to provide more continuity in membership in anticipation of the effect of the uncertain market conditions on whether members would plant Crop every year in the future and whether Coop would continue to conduct auctions every year.

As a result of this membership structure that has resulted in no non-member auction business since            and the look-back period that will be used to compute the proportional allocation, distribution of remaining funds at liquidation will be made only to members. There are currently            members of Coop.

On            , a fire destroyed Coop's office building. Records on desks, shelves and in file cabinets on the second floor of the building were completely destroyed. The building had a record storage vault on the first floor built of cement blocks (rather than steel) that settled and cracked during the fire. This resulted in severe smoke and water damage to records in the vault. Many of the salvaged records from the vault subsequently became unusable because of mold that developed as a result of their exposure to moisture.

Coop's patronage record procedures were as follows:

1. Each grower's sale transaction was listed in a floor book on the date of each auction sale.
2. The sale information from the floor book was posted to a file card for each patron

3. An allocation listing was made from sales information on the file cards showing the date of the sale and the net amount due each patron member from that auction sale after adjustment for commissions and other charges or price adjustments.
4. The allocation listings were then used to post the warehouse ledger books where the accumulated amounts due each patron member were shown on a yellow page for each member.
5. The yellow sheet from the ledger books were eventually destroyed as grower's accounts were settled.
6. If the grower participated in another auction after his previous sales were all settled, a new ledger sheet was created for the next round of sales.

All of the individual member patron cards from years before the fire were destroyed in the fire. Part of the floor books were soaked during the fire and were hung out in hopes that circulating air would dry them. Mold developed and made all soaked books not legible, so all these books were destroyed.

The available allocation sheets from the \_\_\_\_\_ fiscal year were on a second floor desk being worked on at the time of the fire and, therefore, were completely destroyed. Allocation records from many other years prior to the fire were partially or completely destroyed. There are some years with complete allocation records intact, but the surviving records do not provide a complete and reliable base for current allocations based on patronage for a consistent number of fiscal years before \_\_\_\_\_. Any attempt to accurately recreate the destroyed records would be impossible because of the loss of basic sales and patron patronage records.

As part of its liquidation process Coop will be redeeming allocated patronage income accounts remaining on its books. Historically, Coop did not make a profit each year to allocate, so there are not unredeemed allocated patronage accounts for a significant number of fiscal years prior to \_\_\_\_\_. Coop was able to salvage sufficient records to be able to make reasonable redemption payments to holders of these accounts and is in the process of doing so using proceeds from the sale of the facilities.

Past experience has shown that a large portion of checks sent out will be returned as undeliverable because these former patrons have quit farming and left the area or passed away. On \_\_\_\_\_, allocated credits from the \_\_\_\_\_ fiscal year were sent out and \_\_\_\_\_ percent were returned as undeliverable. On \_\_\_\_\_,

allocated credits from the \_\_\_\_\_ fiscal year were redeemed and \_\_\_\_\_ percent of the checks were returned as undeliverable. Amounts represented by the undeliverable

checks are considered abandoned property under State A statutes and will be paid to the state at the end of the allowed holding period (to allow time for owners to come forward and claim their undeliverable checks). Because there are not allocation records for all prior fiscal years, Coop board of directors does not feel they provide a consistent usable base upon which to make allocations of the proceeds from the sale of the facilities to years prior to

Coop is planning to distribute the net proceeds from sale of the facilities after redemption of all remaining allocated patronage accounts and payment of any remaining liabilities on a patronage basis based on patron business for a period covering auctions in fiscal years ending in through . This decision is based on the following factors:

- Because of the office fire, patronage records sufficient and reliable to use as a basis for allocation for all prior fiscal years ending through are not consistently available and cannot realistically be reconstructed;
- Even if records could be reconstructed for years prior to , former patrons for the most part have discontinued farming and left the area and/or passed away, so that the administrative burden of tracking them down would be very significant and unlikely to be successful. Based on Coop's recent experience redeeming allocated credits from fiscal years prior to the result would be that a substantial portion of the asset sale proceeds would go unclaimed (realistically to percent) and be transferred to the State A as abandoned property, defeating the objective of proportionally sharing Coop's remaining funds with patrons who used the facilities;
- Crop auctions by Coop ended in its fiscal year ending in , so there is no patronage business upon which to base an allocation beyond that year;
- Coop's organizational documents provide no continuing interest in Coop for members who withdraw from Coop;
- Patrons auctioning Crop during the to period do generally represent a cross section of Coop's patrons over a longer period of time. The changes in industry marketing practices have still left traditional patron growers with production in excess of contracted amounts and Crop not meeting contract quality standards that needed to be sold at auction. Long time members consistently grew about the same proportional number of pounds of Crop and in the new environment overall had about the same production not covered by their direct contracts that they continued to sell through auctions at Coop;

- Article X of Coop's bylaws provides in part that upon dissolution "... any balance of assets then remaining [after payment of all debts and redemption of patron equity accounts] shall be distributed to the patrons on an equitable patronage basis as determined by the board of directors"; and
- Both the board of directors and membership formally voted \_\_\_\_\_, to approve a look-back period covering fall \_\_\_\_\_, the earliest period for which detailed patronage records are available, through the last year when auctions were conducted, as an equitable basis for allocating any remaining funds to patrons after all obligations of Coop are paid.

Based on the foregoing, Coop is requesting rulings that:

1. The passage of time during which Coop had discontinued conducting its auction business directly with patron members and was holding its facilities initially to determine if there was any ongoing future need for the facilities and subsequently for sale does not change the status of Coop as operating on a cooperative basis for purposes of allocating and distributing the net proceeds from the sale of its facilities to members on a patronage basis and deducting such allocation from its taxable income in the year of distribution.
2. The net gain from the sale of Coop's facilities represents patronage income from the sale of facilitative assets and that any funds leftover after the payment of any remaining priority obligations and member equity accounts, may be distributed to members in proportion to their use of the facilities during the established look-back period as a deductible patronage dividend in the year of distribution.
3. The \_\_\_\_\_-year look-back period that Coop plans to use as the basis of the patronage based distribution to members from the net proceeds from the sale of its facilities is an acceptable representation of proportional use of the facilities by its members in the circumstances such that it will not jeopardize Coop's ability to continue to be recognized as operating on a cooperative basis and the distribution will be deductible as a patronage dividend in computing Coop's taxable income for the year of the distribution.

Section 521(a) of the Code provides that a farmers' cooperative described in section 521(b)(1) shall be exempt from taxes except as otherwise provided in Part I of subchapter T.

Section 521(b)(1) of the Code defines a tax exempt farmers' cooperative to include a farmers', fruit growers', or like associations organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other growers, and turning back to them the proceeds of sales, less the necessary marketing



expenses, on the basis of either the quantity or value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.

Section 521(b)(4) of the Code provides that exemption shall not be denied any association that markets the products of nonmembers in the amount the value of which does not exceed the value of the products marketed for members, or which purchases supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor growers does not exceed 15 percent of the value of all its purchases.

Section 1381(a)(2) of the Code provides that subchapter T applies to any corporation operating on a cooperative basis. Neither the Code nor the regulations define the term "operating on a cooperative basis."

Section 1381(b) of the Code provides that a tax exempt farmers' cooperative "shall be subject to the taxes imposed by section 11 (corporate income taxes) or section 1201 (capital gains taxes)." Under section 1.1381-2(a)(1) of the Income Tax Regulations, this includes both normal tax and surtax, where applicable. The basic approach to section 521 cooperative taxation is similar to that of other cooperatives. Gross income is reduced on an item-by-item basis through the application of specific deductions described in the Code such as patronage dividends. Income remaining is taxable to the cooperative.

Cooperatives are permitted to exclude patronage dividends from their taxable income under section 1382(b) of the Code.

Section 1382(c)(2) of the Code provides a deduction from gross income for distributions made on a patronage basis by tax-exempt cooperatives out of earnings derived from sources other than patronage.

Section 1.1382-3(c)(2) of the regulations defines income from sources other than patronage (nonpatronage income) to mean incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association such as income derived from lease of premises, from investment in securities, or from the sale or exchange of capital assets.

Section 1.1382-3(c)(3) of the regulations provides that in order that the deduction for amounts with respect to income derived from business done with or for the United States or any of its agencies or from sources other than patronage may be applicable, it is necessary that the amount sought to be deducted be paid on a patronage basis in proportion, insofar as is practicable, to the amount of business done by or for patrons

during the period to which such income is attributable. For example, if capital gains are realized from the sale or exchange of capital assets acquired and disposed of during the taxable year, income realized from such gains must be paid to patrons of such year in proportion to the amount of business done by such patrons during the taxable year. Similarly, 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 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.

Section 1.1388-1(a)(1)(i) of the regulations provides that the term “patronage dividend” means an amount paid to a patron of a cooperative from the net earnings of the organization subject to the provisions of subchapter T which is paid on the basis of the quantity or value of business done with or for such patron.

In Farmland Industries, Inc. v. Commissioner, 78 T.C.M. 846, 864 (1999), acq., AOD 2001-03, the taxpayer, a cooperative organized for the purpose of providing petroleum products to its patrons, sought to have the proceeds from the disposition of its stock in three subsidiaries, along with the income from the sale of its gas and soybean facilities, and miscellaneous depreciable business assets classified as “patronage sourced” income. The income from the sale included section 1231 and section 1245 recapture gain realized on the sale of taxpayer's gas and soybean facilities and from the sale of miscellaneous assets used in the course of the taxpayer's business activities. The gain also included “capital gain” from the sale of the stock in the taxpayer's subsidiaries. The Service did not contest the classification of the section 1245 recapture as patronage source, but argued that all of other gains and losses at issue were capital in nature and should be automatically classified as nonpatronage under the per se rule prescribed by section 1.1382-3(c)(2) of the regulations.

The court held that the sale of these assets was closely related to and stemmed from the taxpayer's cooperative enterprise of providing products and services to its patrons and therefore the section 1231 gain and the capital gain were patronage sourced income to the extent of business done with members. In reaching its decision, the court stated that its task was to “determine whether each of the gains and losses at issue was realized in a transaction that was directly related to the cooperative enterprise, or in one which generated incidental income that contributed to the overall profitability of the cooperative's marketing, purchasing, or servicing activities on behalf of its patrons.”

Coop has operated as an exempt farmers cooperative in conformance with the requirements of section 521 and subchapter T of the Code (and equivalent prior tax statute requirements) as applicable throughout its history. Coop meets the “purpose” requirements of section 521(b)(1)(A) and (B).

Section 1.521-1(a)(1) of the regulations provides that, in order for an organization to have the required cooperative nature, “nonmember patrons must be treated the same as members insofar as the distribution of patronage dividends is concerned.” Coop conducted no nonmember business after \_\_\_\_\_; therefore, the question whether both member and nonmember patrons will be treated equally is not in issue and for purposes of this analysis the words “member” and “patron” are interchangeable.

Coop has generated nonpatronage income from off-season rental of its facilities since \_\_\_\_\_. This rental income has been allocated to patrons each year on a patronage basis in keeping with the requirements of section 1.521-1(b)(1) of the regulations. Under Rev. Rul. 69-431, 1969-2 C.B. 133, because an exempt farmers' cooperative is required to operate for the benefit of its patrons, earnings from nonpatronage sources (such as that derived from investments, the sale of assets, and business done with or for the United States) must also be distributed to the patrons on a patronage basis.

Application of the concept of operating on a cooperative basis and distinguishing patronage and nonpatronage income, because of incomplete definition of these concepts in the Code, must be done in the context of the factual situation of the cooperative being considered. For example, the Tax Court stated in Illinois Grain Corp. v. Commissioner, 87 T.C. 435 (1986), as part of a decision recognizing certain interest and rental income as patronage sourced:

“A review of the statutory provisions, the decided cases in the area and, indeed, respondent's announced position on the subject, as embodied in Rev. Rul. 69-576, leads us to the conclusion that in this case, the petitioner must prevail as to both types of income here in issue. As the cases make clear, such a determination is necessarily fact-intensive. Income derived by a cooperative from its various business activities may indeed be so closely intertwined and inseparable from the main cooperative effort that it may be properly characterized as directly related to, and inseparable from, the cooperative's principal business activity, and thus can be found to “actually facilitate” the accomplishment of the cooperative's business purpose. On the other hand, it is equally possible that a cooperative may undertake business activities which, while profitable, have no integral and necessary linkage to the cooperative enterprise, so that it may fairly be said that the income from such activities does nothing more than add to the taxpayer's overall profitability. It all depends on the facts of each case.”

Courts have recognized the appropriateness of cooperatives conducting reasonable income generating activities not directly related to patron services but that are incidental to the cooperative's purpose in the totality of the circumstances. The

Court of Appeals for the Federal Circuit in Cotter & Co. v. United States, 765 F.2d 1106, 1107 (Fed. Cir. 1985), stated:

"A cooperative cannot merely 'clothe its shareholders as patrons and its corporate dividends as patronage payments' and retain the benefits of Subchapter T. Mississippi Valley, 408 F.2d at 835. But Subchapter T was also not enacted to require that a cooperative acting for its patrons function in an economically unreasonable manner or penalize it for acting reasonably. Considering the income-generating transaction in its relation to all the activity undertaken to fulfill a cooperative function will allow courts to distinguish from cooperative activity transactions which merely enhance overall profitability in a manner incidental to cooperative function. Such activity is not to receive the benefits of Subchapter T, but other activity, which does directly relate to cooperative function when considered in its actual business environment, cannot properly be considered outside 'business done with or for patrons'."

In Coop's situation, the limited portion of the year in which the facilities are needed to fully carry out its services to its patrons creates a unique situation where off-season rental of the facilities is a prudent management decision resulting in a reasonable incidental income source that allows Coop to maintain the facilities in good condition for use by its patrons. The prominence of this part-year rental income as a component of Coop's total revenues grew after strictly because of the declining auction revenues because of changes in the industry.

According to Coop, there has never been any action or intent by Coop to emphasize rental activities over its intended cooperative auction functions. There is no portion of Coop's facilities used exclusively for year round third party rentals. The off-season rental activity has facilitated Coop's accomplishment of its cooperative business purpose as referenced by the Tax Court in Illinois Grain. Therefore, this income should be considered incidental nonpatronage income not affecting Coop's cooperative status during all periods including fiscal years ending through after Crop auctions were no longer conducted in the facilities by Coop.

Payment of liquidating distributions is discussed in Rev. Rul. 69-431, 1969-2 C.B. 133, Rev. Rul. 70-481, 1970-2 C.B. 170, and Fertile Co-operative Dairy Assn. v. Huston, 119 F. 2d 274 (8th Cir. 1941), 1941-2 C.B. 180. The rulings and case provide in general that upon liquidation a cooperative must make its liquidating distribution in the same manner that it distributes its net earnings from patronage to its patrons. Coop's bylaws include liquidation language that conforms to this requirement.

Section 1381(b) of the Code provides that a tax exempt farmers' cooperative shall be subject to the taxes imposed by section 11 (corporate income taxes) or section 1201 (capital gains taxes). Section 1.1381-2(a)(1) of the regulations states this includes

both normal tax and surtax, where applicable. The basic approach to section 521 cooperative taxation is similar to that of other cooperatives. Gross income is reduced on an item-by-item basis through the application of specific deductions described in the Code. Income remaining is taxable to the cooperative.

This position as to taxation of tax exempt farmers' cooperatives is confirmed in a note to the Tax Court decision in Associated Milk Producers, Inc. v. Commissioner, 68 T.C. 729, 730 (Note 2) (1978), which states:

“Despite the tax ‘exemption’ provided to certain farmers' cooperatives under sec. 521, such cooperatives are subject to the corporation income tax and the alternative tax on capital gains (sec. 1201), but with special deductions allowed for patronage dividends, which normally result in no taxable income. The tax treatment of cooperatives is set forth in secs. 1381-1388 (subch. T), which sections were adopted in 1962 to replace comparable provisions in sec. 522, which was then repealed.”

With no patronage business upon which to base patronage income allocations, Coop was unable to make patronage based allocations of its net income in the fiscal years ending \_\_\_\_\_ and \_\_\_\_\_. Therefore, Coop became subject to income taxes in those fiscal years as described in section 1381(b) of the Code as it could not take advantage of deductions (the patronage dividend deduction) available for section 521 cooperatives in the Code. Absent any change in structure or intent, these circumstances would not automatically terminate Coop's section 521 status.

In the fiscal year ended \_\_\_\_\_ Coop incurred a substantial loss. This loss was carried back resulting in Coop having no net income for the total period to \_\_\_\_\_. The fiscal year ended \_\_\_\_\_ also resulted in an operating loss for Coop. Therefore, Coop had no net income for the entire liquidation period.

Because of market conditions and uncertainties beyond its control, Coop ceased patron transactions in its fiscal year ending \_\_\_\_\_. Nothing changed in its governing documents or intentions towards business with patrons after that date. Had Crop auctions resumed Coop would have continued to operate under the exempt cooperative requirements as it had done for the full period of its existence.

Given the market uncertainties faced by Coop's board of directors and their concern regarding liquidating Coop before it was clear the facilities would no longer be needed by members, plus the demonstrated efforts to continue to use the facilities to carry out the purposes of Coop for the benefit of patrons, it is reasonable to view the period \_\_\_\_\_ through the sale of the facilities in late \_\_\_\_\_ as an extended liquidation period. In the weak commercial real estate market, a sale in \_\_\_\_\_ after listing in \_\_\_\_\_ is a reasonable waiting period after the adoption of the resolution to dissolve.

It is clear from the appraisal that the value of Coop's land and buildings substantially deteriorated in the liquidation period to the point where they were sold in . Based on market conditions this reduction in value would be reflected from the time of the auction when the facilities were last used to provide member auction services. Therefore, Coop had no capital gain attributable to the holding period after its last Crop auction.

Section 1381(a)(2) of the Code provides that subchapter T applies to any corporation operating on a cooperative basis. If for any reason Coop does not qualify as an exempt farmers cooperative under section 521, it continues to be a nonexempt cooperative under subchapter T provided it continues to operate on a cooperative basis.

The loss of section 521 status doesn't preclude an organization from continuing to operate on a cooperative basis under subchapter T of the Code. If otherwise eligible, it will still be allowed single tax treatment of its patronage refunds and per-unit retains.

The mandate to allocate the proceeds from the sale of a cooperative's facilitative assets to member/patrons on a patronage basis, in light of its long history of cooperative operations, supports recognition of Coop's cooperative status through the conclusion of this liquidation period.

The funds being distributed came from sale of facilities that were used in providing the fundamental services to member patrons for which Coop was formed. Applying the rationale of in Farmland Industries, Inc., the sale of these assets was closely related to and stemmed from the taxpayer's cooperative enterprise of providing services to its patrons and therefore the section 1231 gain and the capital gain were patronage sourced income.

The rental income generated from the facilities during the off season did not change the character of the assets sold. The rental income itself would constitute nonpatronage income under section 1.1382-3(c)(2) of the regulations; however, the facilities were always used to provide services to the member patrons directly and indirectly during the Crop harvest season and no part of the facilities were built or used solely for the purpose of generating income to enhance the overall profits of Coop. The seasonality of Coop's purpose created a situation where off season rental of the facilities was a logical and reasonable incidental financial benefit to members requiring no additional investment or annual expenses that did not change Coop's fundamental cooperative operations. Operation as a section 521 cooperative assured that patrons individually shared in the economic benefit of allowing the facilities to be used in the off season through better assurance that the facilities will continue to be available in good condition to meet their marketing needs and enhancement of their patronage dividends representing net farming proceeds from marketing their Crop through Coop

Section 1.1382-3(c)(3) of the regulations provides that it is necessary that the amount sought to be deducted be paid on a patronage basis in proportion, insofar as practicable, to the amount of business done by or for patrons during the period to which such income is attributable.

While Coop has accurate patronage records for its last year of auctions in back to \_\_\_\_\_, Coop has represented that the partial destruction of Coop's records prior to \_\_\_\_\_ by fire has made accurate allocations to patrons prior to that year impossible. Recomputation of proportional business by patron by year for periods prior to \_\_\_\_\_ is impractical because of insufficient records and detailed information.

Coop's articles and bylaws give no property interest to those member/patrons who withdraw from contact with Coop other than the redemption at the discretion of the board of directors of any retained allocated patronage dividend accounts they may hold. All patrons of Coop automatically become members. The members receiving allocations during the proposed look-back period do, within reason and the limitations of available records, constitute a fair representation of patrons who used the facilities over a period of time longer than the look-back period.

Coop's bylaws give the board of directors full discretion to determine an equitable look-back allocation period. They have made that decision in light of the available records. Their decision was confirmed by member vote at a duly called membership meeting.

The proposed look-back distribution period, while set by the extent of available records, also serves 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 periods while complying with the requirements in section 1.1382-3(c)(3) of the regulations.

Based on the represented facts and discussion of applicable law, we rule:

1. The passage of time during which Coop had discontinued conducting its auction business directly with patron members and was holding its facilities initially to determine if there was any ongoing future need for the facilities and subsequently for sale was a reasonable liquidation period under the circumstances and does not change the status of Coop as operating on a cooperative basis for purposes of allocating and distributing the net proceeds from the sale of its facilities to members on a patronage basis and deducting such allocation from its taxable income in the year of distribution.
2. The net gain from the sale of Coop's facilities represents patronage income from the sale of facilitative assets and that any funds leftover after the payment of any remaining priority obligations and member equity accounts, may be distributed to members in proportion to their use of the facilities during

the established look-back period as a deductible patronage dividend in the year of distribution.

3. The -year look-back period that Coop plans to use as the basis of the patronage based distribution to members from the net proceeds from the sale of its facilities is an acceptable representation of proportional use of the facilities by its members, in so far as practicable, such that it will not jeopardize Coop's ability to continue to be recognized as operating on a cooperative basis and the distribution will be deductible as a patronage dividend in computing Coop's taxable income for the year of the distribution.

This ruling is directed only to the taxpayer that requested it. Under section 6110(k)(3) of the Code it may not be used or cited as precedent. In accordance with a power of attorney filed with the request, a copy of the ruling is being sent to your authorized representative.

Sincerely yours,

Paul F. Handleman  
Chief, Branch 5  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)