

Internal Revenue Service

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Person To Contact:
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Telephone Number:

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November 04, 2013

LEGEND:

Taxpayer =

b =

V =

W =

X =

Y =

Defendant =

Dear :

This letter responds to a letter, dated May 7, 2013, and subsequent correspondence, submitted on behalf of Taxpayer, regarding the proper allocation of certain employee pension expenses between Taxpayer's patronage income and nonpatronage income for purposes of section 1382 of the Internal Revenue Code.

Taxpayer is a farmer-owned cooperative originally formed to market b. Taxpayer markets the b and other farm products nationally and internationally.

This ruling request relates to the Taxpayer's proposal to use a portion of certain litigation settlement proceeds to make a special contribution to Taxpayer's retirement plan for its employees. Taxpayer recently received a payment of \$X from Defendant and certain of its affiliates to settle litigation relating to Defendant's actions that caused harm to Taxpayer's business. Taxpayer proposes to use approximately \$Y of those

settlement proceeds to make a special contribution to the defined benefit pension plan that Taxpayer maintains for its employees. That plan is currently underfunded.

Taxpayer allocates its income and deductions between patronage business and its nonpatronage business as required by section 1382 of the Code. Taxpayer's patronage business typically operates at close to break-even since it annually distributes substantially all of its patronage-sourced book income as patronage dividends pursuant to the requirements of its Bylaws. With respect to Taxpayer's nonpatronage business, it has operated at a slight loss recently after showing significant profit in prior years largely as a result of high volumes in its nonpatronage business.

Taxpayer has considered how it will be required to allocate the \$X settlement payment between its patronage business and its nonpatronage business on Schedule G of Form 1120-C. Taxpayer believes that it should (a) treat the portion of the settlement payment that relates to lost income on the patronage side of its business as patronage income on Schedule G, and (b) treat the balance of the settlement payment, which reflects compensatory payments for lost income on the nonpatronage side of its business and punitive damages as income allocated to its nonpatronage business.

Based on the forgoing, Taxpayer request a ruling that it may allocate the deduction associated with the special pension plan contribution between its patronage business and nonpatronage business for purposes of section 1382 in the same manner as it allocates the litigation settlement payment. Taxpayer represents that this approach will result in Taxpayer allocating approximately \$V of the \$X litigation settlement payment to Taxpayer's patronage business and approximately \$W of the litigation settlement to Taxpayer's nonpatronage business.

Neither Taxpayer nor we are aware of any authority that directly addresses the use of litigation settlement proceeds to fund an underfunded pension plan. Nevertheless, it is indisputable that a cooperative like Taxpayer must allocate its income and deductions between its patronage and nonpatronage businesses dependent on which side created the income and deduction.

Rev. Rul. 74-161, 1974-1 C.B. 247, and Rev. Rul. 82-76, 1982-1 C.B. 118, relate to a taxable cooperative's allocation of certain tax expenses between patronage and nonpatronage income. Rev. Rul. 74-161 dealt with state income taxes. The facts of the ruling indicate that the state in which the cooperative operates imposes an income tax on the cooperative's net profit derived from its nonmember business. Because the state income tax related only to earnings associated with the nonmember (i.e., nonpatronage) business, the ruling concluded that the deduction associated with the state tax should be allocated entirely to the cooperative's nonpatronage business.

Rev. Rul. 82-76 dealt with a state business and corporate privilege tax imposed on a taxable cooperative. The facts of the ruling indicate that the business and corporation privilege tax was imposed on the cooperative with respect to the cooperative's income derived from

both its patronage and nonpatronage business. The ruling concluded that the cooperative “must allocate to both its patronage and nonpatronage sourced income the tax imposed by State X.”

As the foregoing rulings illustrate the concept that the allocation of an expense between a cooperative’s patronage and nonpatronage income will depend on the facts relating to the expense. Where an expense arises from the generation of income on the nonpatronage side of the cooperative’s business, the expense will be allocated entirely to the nonpatronage side as in Rev. Rul. 74-161. Conversely, if the expense arises from the generation of income on the patronage side of the business exclusively, then the deduction will be allocated entirely against the cooperative’s patronage income. Where the expense arises from the generation of income on both the patronage and nonpatronage sides of the cooperative’s business, the expense will be properly allocated to both sides of the business as in Rev. Rul. 82-76.

In this instance Taxpayer is funding a pension plan for its employees. The employees are involved in the generation of income from both the patronage and nonpatronage side of Taxpayer’s business. Accordingly, Taxpayer should allocate the deduction for the payment between its patronage and nonpatronage income in the same proportion that it has allocated the receipt of the settlement amount between its patronage and nonpatronage income.

Based solely on Taxpayer’s representations and the discussion of the facts and law above, we rule that:

Taxpayer must allocate the deduction associated with the special pension plan contribution between its patronage business and nonpatronage business for purposes of section 1382 of the Code in the same manner as it allocates the litigation settlement payment.

No opinion is expressed or implied regarding the application of any other provision in the Code or regulations.

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 Handleman,
Chief, Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

cc: