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LEGEND:

Taxpayer =

State A =

Dear \_\_\_\_\_:

This in response to a request for rulings dated August 17, 2015, submitted by your authorized representative. The ruling requests guidance under subchapter T of the Internal Revenue Code with respect to the process that Taxpayer uses to obtain written consent from its patrons.

Taxpayer is a farmers' cooperative association organized under State A Cooperative Law. Taxpayer files a consolidated federal income tax return on Form 1120-C, U.S. Income Tax Return for Cooperative Associations, on the basis of a fiscal year. Taxpayer's overall method of accounting for federal income tax purposes is the accrual basis.

Taxpayer is one of the nation's leading integrated agricultural companies. It operates as a grain marketing and agricultural supply cooperative. It also provides its members with a variety of services. The members of Taxpayer include approximately \_\_\_\_\_ local farm supply and grain marketing cooperatives and over \_\_\_\_\_ farmers and ranchers.

Taxpayer sells a broad range of farm supplies – including energy products (such as diesel fuel, propane, heating oil, and gasoline), crop nutrients, crop protection products and livestock feed – to its local farm supply cooperative members, and they in turn sell those products to their farmer and rancher members. Taxpayer also sells farm supplies directly to farmer and rancher members.

In addition, Taxpayer markets grain for its farmer and local grain marketing cooperative members. The principal grains marketed include wheat, corn and soybeans. Taxpayer also markets barley, milo, sunflowers, oats, canola, flax, rye and millet. Some of the grain Taxpayer markets is processed by Taxpayer and joint ventures in which Taxpayer participates and sold in the form of value-added food, food ingredients and other grain products.

Taxpayer pays patronage dividends to members. Taxpayer generally does not pay patronage dividends to nonmembers, but Taxpayer's Bylaws provide that a nonmember can be eligible to share in patronage dividends if Taxpayer agrees to conduct business with the nonmember on a patronage basis. Taxpayer has agreements to conduct business with a few nonmembers on a patronage basis, but most nonmembers do not share in patronage dividends. Taxpayer refers to member and nonmembers who are eligible to share in patronage dividends as "patrons."

Taxpayer currently obtains a written consent from each patron (whether a member or nonmember) as that person is entered into Taxpayer's system as an individual or entity eligible to receive patronage dividends. The process of entering a member or nonmember into Taxpayer's system as an individual or entity eligible to receive patronage dividends is referred to as the "patronage eligibility process."

Currently, as the first step of the patronage eligibility process, an applicant is provided with a paper copy of a Patronage Application and Eligibility Form. All new members are provided with this form. Applicants must complete, sign and date that form and return it to Taxpayer. Taxpayer reviews applications to confirm that they are complete and that the data entered on the form is consistent with the information that Taxpayer already has related to the applicant. If there are inconsistencies or the form is not complete, Taxpayer contacts the applicant to remedy the deficiencies. If the form is consistent and complete, Taxpayer places the applicant on its patronage eligibility rolls.

The paper forms are retained as part of Taxpayer's permanent records. In addition, copies of the forms are included in Taxpayer's electronic records. They are associated with other information that Taxpayer retains with respect to each patron.

The Patronage Application and Eligibility Form asks applicants either to check a box for a written consent or to check a box to waive any patronage dividends the applicant may earn. Almost all applicants check the box for the consent, though a few waive their patronage dividends. If one of these boxes is not checked, the application

form is not processed. The back of the form contains a copy of the consent provisions from Taxpayer's Bylaws as well as a statement of their significance.

Taxpayer is going through the process of designing and installing an enterprise resource planning system with the assistance of SAP. Taxpayer's project is a company-wide business transformation to standardize global processes within an integrated, enterprise-wide system. By reducing complexity and cost and simplifying business processes, Taxpayer will be able to deliver better information and business intelligence to drive efficiencies and ultimately add more value for Taxpayer, its owners and customers.

As part of this, Taxpayer plans to change its patronage eligibility process. The following changes are contemplated. The new patronage eligibility process is referred to as the "new process" by Taxpayer.

As an initial step in the process, the Patronage Application and Eligibility Form will be made available on-line at the Taxpayer website so persons interested in applying will be able to print the form, complete it, and mail a copy of the completed form to Taxpayer just as they currently do. It is anticipated that this change will be implemented in 2015. The form also will be available in paper just as it is today.

As a second step in the process, Taxpayer plans to roll-out a Patronage Application and Eligibility Form that can be filled in by an applicant on-line and then be submitted to Taxpayer by clicking on a box.

Taxpayer anticipates that the on-line form will look much like the Patronage Application and Eligibility Form currently used by Taxpayer. The applicant will be required to complete the application by typing in such information as the applicant's name, mailing address, e-mail address, telephone number and social security or employer identification number. The applicant will be asked to click on a box identifying what type of entity it is, or, if it is an individual, whether it is an agricultural producer.

The applicant will be given the choice of checking either a box that contains a written consent or a box that contains a waiver of any patronage dividends that it might earn. The box with the written consent will provide:

CONSENT – By checking this box, entering my typed name below, and submitting this form, I consent to include in my gross income for federal income tax purposes in the year of receipt in the manner provided in Section 1385(a) of the Internal Revenue Code the stated dollar amount of each written notice of allocation which I receive from [Taxpayer] and its successors with respect to my patronage occurring during the current and all subsequent taxable years. This consent does not apply to any written notices of allocation labeled "nonqualified." Under Section 1385(b),

written notices of allocation attributable to personal, living or family items and those properly taken into account as an adjustment to basis of property need not be included in gross income. This written consent shall be revocable by me in writing at any time. I also acknowledge receipt of the [Taxpayer] Consent Bylaw and Statement of Significance set forth below, which provide additional information about my consent.

According to Taxpayer, the applicant will be required to date the application and to type in his or her name on the signature line. The applicant will then be able to submit the completed form to Taxpayer over the internet by clicking a box. If the applicant desires to retain a paper copy of the application, the applicant will be able to print the screen prior to submitting the completed form.

When Taxpayer receives the completed form, Taxpayer's system will generate an automatic reply thanking the applicant for the application and telling the applicant that he or she will be contacted if Taxpayer has any problems with the application. The system will record the date that each application is received. That date will become a permanent part of the application retained in Taxpayer's records.

Taxpayer will review and process the applications it receives as it has in the past, though certain parts of the review may be automated. It is anticipated that the system will not permit the applicant to submit the form unless the form is complete. So, for instance, if the applicant does not check either the consent box or the waiver box or if the applicant does not include a social security number or an employer identification number, the applicant will not be able to submit the form. Because of this, Taxpayer will no longer need to review applications to determine whether the information is complete. However, Taxpayer will continue to review applications to determine whether the information provided by the applicant is consistent with information already residing in Taxpayer's system regarding the applicant. If there are inconsistencies, Taxpayer will contact the applicant to remedy them.

If the application is consistent and complete, the applicant will be added to the list of patrons eligible to receive patronage dividends. The Patronage Application and Eligibility Forms will be retained as part of Taxpayer's electronic records permanently so long as the applicant remains a patron of Taxpayer. The form will be associated with the patron's account.

Based on the forgoing, Taxpayer requests a ruling that a consent for a patron that Taxpayer obtains electronically under the new process will be a valid "consent in writing" of the patron within the meaning of section 1388(c)(2)(A) of the Code.

Subchapter T cooperatives are permitted to exclude or deduct payments to patrons that qualify as "patronage dividends" as that term is defined in section 1388(a)

of the Code, provided the payments are made in the form and manner and within the time period specified in subchapter T.

Patronage dividends may be paid in cash, property, and written notices of allocation. Section 1388(b) of the Code defines the term “written notice of allocation” as any capital stock, revolving fund certificate, retain certificate, certificate of indebtedness, letter of advice, or other written notice, which discloses to the recipient the stated dollar amount allocated to him by the organization and the portion thereof, if any, which constitutes a patronage dividend.

Section 1.1388-1(b) of the Income Tax Regulations further provides that a mere credit to the account of a patron on the books of the organization without disclosure to the patron, is not a written notice of allocation. A written notice of allocation may disclose to the patron the amount of the allocation which constitutes a patronage dividend either as a dollar amount or as a percentage of the stated dollar amount of the written notice of allocation.

Section 1388(c)(1) of the Code provides, in part, that a “qualified written notice of allocation” means (A) a written notice allocation which may be redeemed in cash at its stated dollar amount at any time within a period beginning on the date such written notice of allocation is paid and ending not earlier than 90 days from such date, but only if the distributee receives written notice of the right of redemption at the time he receives such written notice of allocation; and (B) a written notice of allocation which the distributee has consented, in the manner provided in section 1388(c)(2), to take into account at its stated dollar amount as provided in section 1385(a).

Section 1388(c)(2) of the Code provides that a distributee shall consent to take a written notice of allocation into account as provided in section 1388(c)(1)(B) only by (A) making such consent in writing, (B) obtaining or retaining membership in the organization after (i) such organization has adopted (after October 16, 1962) a bylaw providing that membership in the organization constitutes such consent, and (ii) he has received as written notification and copy of such bylaw, or (C) if neither section 1388(c)(2)(A) or section 1388(c)(2)(B) applies, endorsing and cashing a qualified check, paid as part of the patronage dividend or payment of which such written notice of allocation is also a part, on or before the 90th day after the close of the payment period for the taxable year of the organization for which such patronage dividend or payment is paid.

Section 1388(c)(3)(A)(i) of the Code provides that a consent described in section 1388(c)(2)(A) shall be a consent with respect to all patronage of the distributee with the organization occurring (determined with the application of section 1382(e)) during the taxable year of the organization during which such consent is made and all subsequent taxable years of the organization.

Section 1388(c)(3)(B)(i) of the Code provides that any consent described in section 1388(c)(2)(A) may be revoked (in writing) by the distributee at any time.

Section 1.1388-1(c)(3)(i) provides a distributee may consent to take the stated dollar amount of written notices of allocation into account under section 1385 by signing and furnishing a written consent to the cooperative organization. No special form is required for the written consent so long as the document on which it is made clearly discloses the terms of the consent. Thus, the written consent may be made on a signed invoice, sales slip, delivery ticket, marketing agreement, or other document, on which appears the appropriate consent.

The Code does not specify how cooperatives should go about obtaining consent in writing from patrons. The legislative history of subchapter T of the Code describes consent in writing as follows:

“In the case of nonmembers (and members if the cooperative prefers) this consent can be provided by the patron signing an agreement to do so.”<sup>1</sup>

“An alternative form of consent for members of the cooperative, and the only form of consent for nonmembers, is a written statement signed by the patron in which he gives the consent referred to above. ... By either of these forms of consent the patron has in effect constructively received the patronage dividend and reinvested it in the cooperative.”<sup>2</sup>

“For the allocation to be a qualified allocation, 20 percent of the patronage dividend involved must be paid in money (or in a ‘qualified check’ referred to below). In addition, for the allocation to be qualified one of two other conditions must be met. The patron must either have the opportunity to take down the allocation in cash for a limited period of time, or, in one of three specified forms, must have given his consent to having the allocation treated as constructively distributed to him and reinvested by him in the cooperative.”<sup>3</sup>

The rules under subchapter T of the Code were developed before the computer age. At the time subchapter T was enacted, obtaining “consent in writing” involved a patron physically signing a piece of paper that had on it an appropriate consent and then handing (or mailing) the piece of paper to the cooperative. The cooperative then retained the piece of paper in its permanent records to be produced and shown to the Service upon request.

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<sup>1</sup> H.R. Rep. No. 1447 (87<sup>th</sup> Cong., 2<sup>nd</sup> Sess.), 1962-3 C.B. 405, at 483.

<sup>2</sup> H.R. Rep. No. 1447 (87<sup>th</sup> Cong., 2<sup>nd</sup> Sess.), 1962-3 C.B. 405, at 485.

<sup>3</sup> S. Rep. 1881 (87<sup>th</sup> Cong., 2<sup>nd</sup> Sess.), 1962-3 C.B. 707, at 820.

Pursuant to § 1.1388-1(c)(3)(i), no special form is required for the written consent so long as the document on which it is made clearly discloses the terms of the consent. Consent can be made on a signed invoice, sales slip, delivery ticket, marketing agreement, or other document, on which appears the appropriate consent. Taxpayer's new process for obtaining consent will involve patrons completing and submitting an on-line form. This on-line form should be considered an "other document" within the meaning of § 1.1388-1(c)(3)(i).

A threshold question is whether consent obtained through completion of the electronic form and transmission of that form over the internet to Taxpayer can qualify as a consent "in writing" within the meaning of section 1388(c)(2)(A) of the Code. There is no guidance interpreting what it means to obtain a consent "in writing" as that phrase is used in this section of the Code.

Transmitting written notices of allocation electronically does not change their status as "written." Generally, the term "written" is used to distinguish communications that are made in writing from those that are made orally, by sign language, through pictures, etc. For example, Black's Law Dictionary (Ninth Edition) defines "writing" as:

"Any intentional recording of words that may be viewed or heard with or without mechanical aids. This includes hard-copy documents, electronic documents on computer media, audio and videotapes, e-mails, and any other media on which words can be recorded."

While there is no authority interpreting the term "written" as used in subchapter T, there is considerable authority interpreting that word elsewhere in the Code. That authority makes it clear that, when a written notice is transmitted by e-mail or some other form of electronic communication, the notice does not lose its character as a "written" notice. See e.g., the Circular 230 regulations provide specific rules related to the provision of written advice by practitioners. The rules apply to any written advice, including advice provided by means of electronic communication; and tax-exempt organizations are required to provide certain information to the public, and to provide copies of certain documents, such as an annual report, to any member of the public submitting a written request for the document. Section 301.6401(d)-1(d)(2) provides that requests in writing must be honored if "addressed to, and delivered by mail, electronic mail, facsimile, or a private delivery service" to any office of the tax-exempt organization.

While subchapter T of the Code describes what must be contained in a written notice of allocation, it does not specify any particular means for transmitting a written notice of allocation to a member. Cooperatives historically have employed a variety of delivery methods. Some bring members' patronage dividends (including any written notices of allocation) to the annual meeting and let members pick them up. Patronage dividends that are not picked up are then mailed (or otherwise delivered) to members.

Others have fieldmen make personal visits to hand deliver patronage dividends to members. The most common means employed to transmit patronage dividends is the U.S. mail. At one time, some cooperatives sent patronage dividends “special delivery.” Today, some cooperatives use messenger systems such as Federal Express or UPS.

Nothing in the Code or regulations precludes delivery of written notices of allocation electronically. We agree with Taxpayer that this approach should be followed in interpreting the language of subchapter T of the Code. Under the new process, the written consent will not be signed in the traditional sense of having the patron physically sign his or her name on a paper document. Rather, the consent will be an electronic document which will be signed by having the patron type in his name and then transmit the form to Taxpayer.

In recent years, the treatment of electronic documents and signatures in commerce has been addressed both on the national and on the state level by the adoption of legislation which equates electronic documents with paper documents and electronic signatures with physical signatures.

According to Taxpayer, on the federal level, the relevant law is the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 96 (Public Law 106-229, adopted June 30, 2000) (the “Electronic Signatures Act”). Section 7001(a) of that Act provides:

“(a) In general

Notwithstanding any statute, regulation, or other rule of law (other than this subchapter and subchapter II of this chapter), with respect to any transaction in or affecting interstate or foreign commerce –

(1) a signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form; and

(2) a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.”

For purposes of the Electronic Signature Act, the term “electronic signature” is defined to mean an “electronic sound, symbol, or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record.” Section 7006(5).

Taxpayer’s new process for obtaining “consent in writing” from patrons will result in patrons “signing” the electronic document as that term is understood today. A patron

will be required to complete a Patronage Application and Eligibility Form online and then to click to submit that form to Taxpayer. Completing the form will require the patron to provide information, including the patron's social security or employer identification number, to check a box next to the consent, and to type in his or her name. As part of the process, Taxpayer will compare the information on the Patronage Application and Eligibility Form with information already on file with respect to the patron. As noted earlier, if they do not match, Taxpayer will not accept the form. Such a process should result in "consent in writing" as that term is used in section 1388(c)(2)(A) of the Code.

Accordingly, based solely on the forgoing we rule that, a consent for a patron that Taxpayer obtains electronically under the new process will be a valid "consent in writing" of the patron within the meaning of section 1388(c)(2)(A) of the Code.

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 the Associate Chief Counsel  
(Passthroughs & Special Industries)