Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **20105101F**

Release Date: 12/23/10
CC:LB&I:RFPH:RAVillageliu
POSTF-143023-10

UILC: 199.06-00

date: November 19, 2010

to: Thomas W. Winegar, Supervisory Internal Revenue Agent
Tyler D. Mitchel, Internal Revenue Agent

from: Rogelio A. Villageliu
General Attorney (Retailers, Food, Pharmaceuticals & Healthcare)
(Large Business & International)

---

subject: [Subject]: Retroactive re-classification of purchases into PURPIMS
Taxpayer and EIN: Coop
Year: 20

This memorandum responds to your request for assistance.

LEGEND

Coop =

State =
A
b =
c =
d =
e =
f =
G =
H =
I =
J =
K =
L =

M =
N =
O =
P =
Q =

FACTS

Coop filed a claim for refund of overpaid taxes for their tax year ended December 20 .[1] The claimed overpayment is due to a recomputation of the Coop's I.R.C. §199 domestic production activities deduction. The recomputation consists of reclassifying b purchases from cooperative members into "per-unit retain allocations paid in money" [(within the meaning of I.R.C. §1382(b)(3)]. This is based on a PLR for the taxpayer's tax year 20 (the "PLR") that concluded, inter alia, that the Coop's purchases fit into the definition of per-unit retains in Subchapter T of the Internal Revenue Code.[2] The Coop's reclassification and resulting recomputation result in a significantly larger section 199 domestic production activities deduction.

Taxpayer received a Private Letter Ruling [PLR 200942022], (the "PLR), using facts from their tax year ended December 31, 20 . The same material facts that were found in the PLR for the 20 year are believed to exist for the year 20 . Consequently, those facts are set forth immediately below. In addition, the 20 year presents additional material facts that were not present for the year 20 . Facts that were not or may have not been considered in the PLR, which we consider to be material to the conclusion reached in this opinion for the tax year 20 , are set forth following those in the PLR.

PLR FACTS

Coop is a farmers' cooperative organized as a cooperative corporation under State A law. Coop markets b for its farmer members. Principal commodities marketed are c, d, and f. Coop also provides a broad range of the farm supplies to its farmer members, including petroleum products (such as diesel fuel, propane, heating oil, and gasoline), plant food (fertilizers), agricultural chemicals (herbicides and pesticides), feed, and seed.

---

[1] Specifically, Coop filed an amended Form 990-C, Farmer's Cooperative Association Income Tax Return, for the taxable year 20 . It reduced its taxable income from g to h and its tax from i to j, from what the Coop reported in its original Form 990-C for said year. The Coop's amended Form 990-C claimed an overpayment of k (to be credited for 20 estimated tax), which is the subject of this opinion.

[2] This is not surprising. Almost any payment made in money to a member or a participating patron for commodities that the Coop obtains from them and markets may be made to fit within the definition of a per-unit retain allocation for tax purposes, as allocations, made to patrons, being fixed with reference to the products being marketed for the patron, and without reference to the net earnings of the cooperative. This opinion attempts to clarify that, this does not mean that closed sale proceeds and per-unit retains are one and the same.

Coop's "members" are farmers who do business with it. Each member owns one share of Coop's capital stock (par value $100) and is entitled to share in the net earnings of the Coop in the form of patronage dividends. Coop currently has approximately P members.

Persons who are not farmers, but who wish to do business with Coop on a patronage basis, are eligible to become "participating patrons" of the Coop. Each participating patron is required to own a Certificate of Participation (stated dollar amount $100) and is entitled to share in the net earnings of the Coop in the form of patronage dividends. Participating patrons do not have voting rights. Coop currently has approximately Q participating patrons.

Coop is organized as a cooperative corporation pursuant to Sections L to O of the State A Statutes. These sections contain the basic requirements for cooperative operation. To the extent not inconsistent with what is provided in these sections, cooperative corporations are governed generally by the Business Corporation Act of State A.

Section L provides that cooperative corporations are formed "by the adoption of articles of incorporation in the same manner and with like powers and duties required of other corporations except as provided in sections L to O."

Section M required that, among other things, a cooperative corporation must include in its articles of incorporation:

> "... (2) That dividends on the capital stock shall be fixed but shall not exceed eight percent per annum of the amount actually paid thereon; (3) That the net earnings or savings of the company remaining after making the distribution provided in subdivision (2) of this section, if any, shall be distributed on the basis of or in proportion to the amount or value of the property bought from or sold to members, or members and other patrons, or of labor performed or other services rendered to the corporation ... (4) That the articles of incorporation or the Bylaws of the company shall give a detailed statement of the method followed in distributing earnings or savings ..."

Section N enumerates various powers that cooperative corporations may exercise, including the power "(6) to set aside each year to a surplus fund a portion of the savings of the company over and above all expenses and dividends or interest upon capital stock which surplus may be used for conducting the business of the corporation."

Coop's Revised Articles of Incorporation provide that it is organized on a stock basis. Stock may be owned only by:

> “... persons, including both landlords and tenants in share tenancies who are bona fide producers of agricultural products in the trade territory served by this corporation, who patronize the corporation annually.” (Article IV, Section 4).

As noted above, these persons are the members of Coop and are referred to in this ruling as “members.” Each stockholder is entitled to no more than one vote. (Article ***, Section 3). Persons not eligible to own capital stock, but wanting to do business with Coop on a patronage basis, are permitted to become “participating patrons” and to hold a “Certificate of Participation.” Such persons have “all the rights and privileges of a shareholder” (i.e., they are entitled to share in patronage dividends), except they may not vote. (Article IV, Section 5).

Article VIII of the Revised Articles of Incorporation provides general rules governing the allocation and distribution of earnings:

> “Section 1. After deducting all expenses which are lawfully deductible or excludable in determining the net margins of the corporation, the board of directors shall establish and deduct reasonable amounts for reserves, at such rates as shall be provided by the By-laws of the corporation.
>
> Section 2. From the balance remaining after complying with Section 1, as authorized in the By-laws, the board of directors may pay dividends on the paid up capital stock at a rate not to exceed eight percent (8 percent) per annum, provided, however, that dividends on such stock shall be non-cumulative from year to year.
>
> Section 3. The remaining net margins, after providing for the deductions under sections 1 and 2 of this article, shall belong to and be held for the stockholders and patrons and shall be apportioned among them on a patronage basis at the close of each fiscal year, as provided by the Bylaws of the corporation. The By-laws of the corporation shall give a detailed statement of the methods to be followed in distributing earnings or savings.”

Article VIII of Coop's By-laws provides a detailed statement of the methods to be followed in the distribution of savings.

Section 1 defines the term “net margins.” The gross receipts of this Cooperative shall include all proceeds from commodities marketed for patrons, plus all sums received for supplies and equipment and services procured for patrons, plus all income from all other sources. From the gross receipts shall be deducted all costs and expenses and other charges which are lawfully excludable or deductible from this Cooperative's gross income for the purpose of determining the amount of margins for the period.

As described in greater detail below, in determining “net margins” for this purpose, Coop deducts what it pays (other than patronage dividends) to members for the b that it markets for them on a patronage basis.

Though Article VIII of the Revised Articles of Incorporation provides that dividends may be paid on capital stock, Section 2 provides that no dividends shall be paid on capital stock, and, as a result, net margins are not reduced by dividends.

Section 3 provides that the net margins shall be reduced “by margins attributable to business done with persons who are not stockholders or participating patrons and from non-patronage sources” and by other reasonable reserves for necessary business purposes.

Section 4 then provides that the balance of said margins which remain shall be deemed to be the patrons' net margins. All of the patrons' net margins shall, as received by the Cooperative, belong to and be held for the patrons and shall be apportioned among them on a patronage basis at the close of each fiscal year.

Section 5 provides that allocation units may be used in determining how to apportion net savings on a patronage basis. Coop uses a single allocation unit for b marketing business, allocating patronage dividends on the basis of bushels of b marketed through Coop. Coop accounts for its b storage business in a separate allocation unit, allocating patronage dividends on the basis of storage fees paid to Coop. Coop currently uses three allocation units for its supplies business — (i) merchandise and feed, (ii) fertilizer, chemical and seed, and (iii) petroleum. Each of the supplies allocation units allocates patronage dividends based upon dollars of purchases from Coop of products sold by the unit.

Section 6 requires the allocated amount be paid to patrons, but permits the Board to pay a portion of the patronage dividend in written notices of allocation (referred to by Coop as “Members' Equity Credits”).

Article IX of Coop's By-laws provides that upon dissolution assets will first be used to pay all debts and liabilities. Remaining assets will then be distributed to the holders of Members' Equity Credits in an amount equal to the stated dollar amount of the Credits. The holders of capital stock and Certificates of Participation will then be entitled to receive what they paid for them. Any residual assets then remaining will be shared on a patronage basis “among the equity holders on the basis of their respective deferred patronage accounts as shown on the records of the cooperative insofar as possible.”

In the event that Coop incurs a loss, Section 7 of Article VIII authorizes Coop (among other things) to “charge such loss against the Members' Equity Credits and other equity held by those stockholders and participating patrons whose patronage gave rise to such loss.”

This letter relates to Coop's b marketing activities. Coop operates *** b elevators located throughout the territory it serves. Collectively, the elevators have the capacity to store approximately bushels of b. Coop's elevators located along rail lines tend to be larger and to have more storage capacity than Coop's truck facilities. Most are capable of loading 100-car trains used to ship b long distances to market. From the elevators, Coop is able to reach multiple domestic markets for b. From Coop's elevators served by truck, b can be sold to local users. b from the truck elevators can also be transferred to Coop's rail facilities for shipment by rail when the market dictates.

In very simple terms, Coop's b marketing business on behalf of its members consists of buying b from members and participating patrons, handling and storing the b at its elevators, and then selling the b to customers.

The issues in this opinion relate to the characterization for purposes of subchapter T of the Code and section 199 of payments that Coop makes to its members and participating patrons when it acquires their b for marketing on a patronage basis, which were originally characterized as “purchases” and not as per-unit retains. The payments that are the subject of this opinion (referred to as “b payments”) are amounts paid in cash to members and participating patrons for b delivered to Coop for marketing on a patronage basis. As the term is used in this opinion, “b payments” do not include any amounts that Coop may pay to persons who are not members or participating patrons. Also, as the term is used in this opinion, “b payments” do not include patronage dividends paid to members and participating patrons with respect to b marketed for them.

Coop does not operate on a pooling basis. Thus, in contrast to cooperatives that use pooling, the members of Coop do not commit to deliver all of the b they grow from specified acreage to Coop to be pooled with the b of other members. Coop's members retain the commodity price risk until they decide to sell their b to Coop for marketing — the price risk does not shift to a pool after harvest as it does for pooling cooperatives. All marketing proceeds are not shared equally on the basis of patronage, in the form of harvest advances and progress payments with a final settlement when the pool closes.

Rather, Coop pays each member a market price for his or her b determined individually as described below. Payments are made in cash and occur throughout the year as members sell b to Coop for marketing on a cooperative basis. Coop then markets each member's b along with the b of all of its members in the manner it thinks will produce the best return. Finally, after net earnings for the year are determined (subtracting b payments in this determination), Coop pays a patronage dividend to its members with respect to their b.

This system of operation and marketing means that two members that market the same quantity and quality of b through Coop during any year will likely receive different b payments, though they will receive the same patronage dividend.

Coop offers members several choices when they sell their b to Coop for marketing on a cooperative basis. Members can: (i) sell b to Coop in a spot sale at the current elevator bid price, (ii) sell b to Coop using a forward contract, (iii) sell b to Coop using a basis contract, and (iv) sell b to Coop using hedge-to-arrive contract. The first and second alternatives are the ones most commonly used by members. Basis and hedge-to-arrive contracts are less common.

Coop offers different alternatives to accommodate the desire of many members who want to retain as much flexibility as possible to determine when and how to sell their b. The alternatives that Coop offers are similar to the choices offered farmers by commercial b companies, though of course, commercial b companies do not market b on a patronage basis and pay patronage dividends.

One way to sell b to Coop for marketing on a patronage basis is to sell the b to Coop in a spot sale at the bid price. All country elevators have posted bid prices. The cash bid prices vary from day to day. The variations are in response to developments in the b markets (and future exchanges). Those markets are very active. Cash bid prices also vary during each day.

It is usually not advantageous for farmers to simply deliver b to sell it at the posted cash bid prices at the time of harvest since prices normally are lowest at the time. Some farmers have the capacity to store b on their farms and can deliver the b later when they believe the price is right. Many farmers deliver b to an elevator for storage (and pay the elevator storage fees), retaining ownership of the b until they believe the bid price is right.

The most popular way for members to sell their b to Coop is by forward contract (sometimes also referred to as a “to arrive” contract). Forward contract calls for a delivery of a specified quantity and quality of b, at a specified location, during a specified time period. Forward contracts also specify the price that is to be paid for the b. Forward contracts can be entered into before b is planted or while it is growing.

Farmers interested in entering into a forward contract with Coop can determine the price Coop is willing to pay at its various elevators during various periods of time in the future from Coop's cash b bid schedule. When a b company purchases b from a member pursuant to a forward contract, ownership of the b passes to the company at the time of delivery under the contract and ordinarily payment is then due.

A farmer can contract to sell his b to Coop at the time of harvest (or at some other time) under a basis contract. These contracts are sometimes used by Coop and its members, but are not as popular as forward contracts and selling b in spot sales.

Basis contracts allow a farmer, who believes that the future price of b will increase in the months after he or she enters into the contract, to defer setting the cash price until a later date. Contracts governing these arrangements specify the shipment period and time period during which the farmer has the option of asking that his or her b be priced. When the farmer elects to price the b, the price is the futures price on that day plus or minus an agreed amount specified in the contract and referred to as the “basis.”

Yet another option available to a farmer is to enter into a “hedge-to-arrive contract.” While not as popular as forward contracts, some of Coop's members prefer to sell their b to Coop under these contracts.

Operating in the manner described above, Coop makes b payments to members for b purchased in spot sales or pursuant to forward, basis and hedge-to-arrive contracts. Coop also typically makes b patronage dividends. It typically pays a certain percent in cash and a certain percent in qualified written notices of allocation (using Members' Equity Credits). Through the year 20 and thru the time of its request for a PLR for the year 20 , Coop has treated b payments made in cash to members as "purchases" for tax purposes and reported them on Schedule A, Line 2 of its Form 1120-C.

Through the year 20 and thru the time of its request for a PLR for the year 20 , Coop has not reported b payments made in cash as "per-unit retain allocations paid in money" and, therefore, has not reported them on Schedule A, Line 4b of its Form 1120-C. It has reported the patronage dividends paid to b members as a patronage dividend paid in money and qualified written notices of allocation on Schedule H, lines 3a and 3b of its Form 1120-C.

Because of this reporting, b payments paid in cash have entered into the determination of Coop's cost of goods sold for tax purposes. As is customary in the b business, Coop values its b inventories at year end at market for financial statement and for tax purposes.

Coop has done a section 199 computation in prior years. In that computation, it has added back patronage dividends

In all relevant years prior to the request for a PLR for the year 20 , Coop's section 199 computation has added back patronage dividends as permitted by section 199(d)(3)(C) of the Code, but it has not added-back b payments paid in cash. Coop has not passed through any portion of its section 199 deductions to its members in any of these years.

PLR HOLDING

In response to a request for rulings dated March 6, 20 , taxpayer received a Private Letter Ruling ("PLR", PLR 200942022) using facts from their tax year ended December 31, 20 . The PLR held 1) That the Coop's b payments to members and participating patrons constitute "per-unit retain allocations paid in money" within the meaning of section 1382(b)(3) of the Code; and 2) For the purpose of computing its section 199 domestic production activities deduction, Coop's qualified production activities income and taxable income should, pursuant to section 199 (d)(3)(C) of the Code, be computed without regard to any deduction for b payments to members and participating patrons. In other words, all of Coop's b payments in cash to members and participating patrons for 20 could be classified as "per-unit retain allocations paid in money" and that they should be added back in its section 199 computation.

ADDITIONAL FACTS MATERIAL TO THE 20 TAX YEAR

In addition to the facts considered in the 2008 PLR (those set above), there are other facts that need to be considered for the 20 year.

First, Examination has not been presented and is unaware of any facts that would contradict the conclusion that, at the end of 20 the Coop and its members (or participating patrons) considered the b purchases to be completed contractual purchases (closed transactions) and not open per-unit retain transactions.

Second, the documentary evidence that exists shows a closed transaction. Until on or about October 20 , the date of a memorandum from the Coop to its patrons informing them that they would be receiving amended Forms 1099PATR for the 20 year (Exhibit A), the taxpayer did not amend its Forms 1099-PATRs to treat “purchases” as per-unit retains paid in money. There is no evidence that members (or participating patrons) have agreed to reopen their closed b sales and turn them into open per-unit retain transactions. The Coop and its members (or participating patrons) have not agreed to amended by-laws that would change the treatment of sum certain, fixed proceeds from closed (oral or written) b purchase contracts into “per-unit retains.” To the extent that per-unit retains only represent an “advance” of the patrons’ equity in the b commodity, per-unit retains could conceivably be recovered by the Coop from the members or participating patrons, if they could not be resold by the Coop, at a profit; proceeds from fulfilled and completed b purchase contracts would not. The Coop and its members (or participating patrons) have neither amended nor entered into negotiations to amend the 20 b purchase contracts. There is no evidence that an amendment was effected either orally or in writing. Similarly, there is no evidence of mutual assent or mutual intention to effect an amendment. Finally, the Coop and its members (or participating patrons) have not enacted or agreed to enact amended cooperative by-laws that would obliterate distinctions between open per unit retains and closed b purchases; or, at least, shown an intention to treat them as one and the same.

Third, the Coop’s 8 ½ month payment period after the close of the Coop’s 20 tax year for payment of per-unit retains has ended (I.R.C. §1382(d)), and the period expired without the taxpayer and its members or participating patrons taking any steps to agree to reclassify or to treat purchases as per-unit retains; or to report to the members and participating patrons that the b purchases were being reclassified to per-unit retains.

Fourth, by the end of 20 , the members and participating patrons would have already received (or should have received) the Form 1099-PATR as well as statements about the pass-through of the domestic production activities deduction (“DPAD”). I.R.C. §199. The Coop, reportedly, did not pass-through any of its DPAD to its members and participating patrons.

Fifth, the Coop members and participating patrons would have reported their b sales, and per-unit retains paid in money, if any, in different lines of their Form 1040, U.S. Individual Income Tax, Schedule F, for their individual taxable years for their taxable year 20 .

Sixth, these members and participating patrons would have already computed their own Domestic Production Activities Deduction (DPAD), by preparing their own Form 8903, based on what everyone intended to be completed sales of b to the Coop.

Seventh, unlike the Coop which presumably kept its 20 tax year open, absent rare individual exceptions, if any exists, the tax year 20 is now closed for most, if not all of the members or participating patrons. They will be prejudiced by the Coop's retroactive one-sided reclassification of b purchases to per-unit retain; The Coop did not provide timely notice of the reclassification to its members and participating patrons before their taxable year 20 closed.

Eighth, unlike the Coop which presumably kept its 20 tax year open, absent rare individual exceptions, if any exists, it is now too late for the Service to make assessments against members and participating patrons for the taxable year 20 . The Service is prevented from effectively examining and preventing double deductions by the Coop, its members, and participating patrons that can result from the interplay of the rules in Subchapter T of the Internal Revenue Code (concerning the taxation of cooperatives and their patrons) and the calculation and recalculations of I.R.C. §199 deductions. The Service will be prejudiced by the retroactive, one-sided reclassification of b purchases to per-unit retains by the Coop.

Ninth, as best as Examination has been able to establish it, i.e., as orally reported by the Coop to Examination, the Coop did not enter into any type of agreement with its members and participating patrons with respect to per-unit retains. The first documented notice to the Coop's members and participating patrons that the Coop is making this reclassification appears to be the October 20 memorandum (Ex. A). This memorandum is not a mutual agreement; it is a one-sided notification by the Coop to its patrons, that they will be receiving amended Forms 1099PATR. The memorandum neither expresses nor implies a mutual agreement between the Coop and its members or participating patrons. Further, Examination understands that the Coop's bylaws, the Coop's typical member marketing agreement, and all other Coop documents that have been shown to Examination fail to mention per-unit retains, in connection with b purchases, and fail to set forth any agreements between the Coop and its members or participating patrons, with respect to the Coop's use or right to use per-unit retains, in connection with b purchases. Further, no documentation has been shown to Examination and Examination does not know of any documentation that purports to show any mutual agreement between the Coop and its members or participating patrons, to reclassify b purchases, as per-unit retains, for the taxable year 2005. A copy of the October 20 memorandum is attached hereto as Exhibit A.

ISSUES

1) Whether the Coop's b payments to members and participating patrons for the taxable year 20 constitute "per-unit retain allocations paid in money" within the meaning of section 1382(b)(3) of the Code. Answer: The answer is no. This is because the b transactions are mutually agreed completed sale transactions between the Coop and its members or participating patrons. Neither the form or the substance of the transaction nor any other collateral agreements provide evidence that the parties intended to treat the completed sales as PURPIMS, or as anything else other than completed sales.

2) Whether for the purpose of computing its section 199 domestic production activities deduction, for the taxable year 20 , Coop's qualified production activities income and taxable income should, pursuant to section 199 (d)(3)(C) of the Code, be computed without regard to any deduction for b payments to members and participating patrons. In other words, whether all of Coop's b payments in cash to members and participating patrons for 20 could be classified as "per-unit retain allocations paid in money" and that they should be added back in its section 199 computation. Answer: The answer is no. This is because based on the form and substance of the b transaction, the Coop originally treated the b transactions as purchases (a part of their cost of goods available for sale, and when sold to third party, deducted as cost of goods sold), and not as PURPIMS. Having failed to obtain a timely mutual agreement to reclassify the b purchases into PURPIMS, to allow an untimely reclassification would be prejudicial to the members, patrons, and to tax administration. The harm to the members, participating patrons, and to tax administration supports holding the Coop to its original reported position under the doctrines of election, consistency, and equitable principles, for the tax year 20 ..

DISCUSSION AND LEGAL ANALYSIS

Summary of what this opinion holds.

The Coop filed a claim for refund of overpaid taxes for their tax year ended December 31, 20 . The claimed overpayment is due to a recomputation of the Coop's I.R.C. §199 domestic production activities deduction. The recomputation consists of reclassifying b purchases from cooperative members and participating patrons into "per-unit retain allocations paid in money" [(within the meaning of I.R.C. §1382(b)(3)]. This is a unilateral and not a mutually agreed to reclassification. There is no evidence that the members and participating patrons in the b transactions agreed to this reclassification.[3]

[3] Exhibit A, the October 20 memorandum from the Coop to its patrons, is simply a post claim for refund, one-sided notification from the Coop to its patrons that they are receiving amended Forms 1099PATR. It neither expresses nor implies a mutual agreement by the Coop, its members, and participating patrons to reclassify b purchases into PURPIMS. The October 20 memorandum is an untimely, self-serving unilateral action by the Coop.

If the reclassification were to be allowed, this would result in a significantly larger section 199 domestic production activities deduction for the Coop and erroneous section 199 computations for an undetermined number of members/patrons. It would also be detrimental and cause irreparable harm to the member/patrons and tax administration.

If this reclassification is allowed, the members and participating patrons would have used incorrect amounts of b sales and Coop per-unit retain in reporting their federal income tax liability and determining their own I.R.C. §199 domestic production activities deductions, for the taxable year 20 . The members and participating patrons original reporting was based on completed contracts that the parties intended to be b purchases/sales and on the Coop's original reporting of these transactions to the members and participating patrons. No steps were taken by the Coop to obtain the b seller members and participating patrons timely agreement to this reclassification and, the Coop did not provide timely notice of the planned reclassification to the members and participating patrons, prior to the time for filing their income tax returns (and the expiration of the 3-year statute of limitations for the taxable year 200).

We conclude that the Coop's unilateral reclassification is not supported by the facts pertaining to the Cooperative's taxable year 20 . More specifically, we conclude that a reclassification can not be effected by a unilateral act by the Coop contrary to the original intention and settled expectations of the contracting parties to the b transaction. We further conclude that the Coop has not presented any evidence of the necessary mutual agreement to amend the original b transaction to show a timely agreement to treat the b sale/purchase proceeds as per unit retains. We can not assume that all or any number of members and participating patrons would be amenable to this reclassification. This is especially true because allowing this departure from the Coop's original treatment would result in erroneous 20 federal individual income tax returns for an undetermined number of the Coop's total members and participating patrons. To allow the Coop to amend its 20 return to treat the b purchases in a manner inconsistent with their original return will be detrimental to tax administration. This is because, given closed 3-year statutes of limitations for most, if not all of the total members and participating patrons. The Coop's untimely reclassification is prejudicial the Service's ability to determine and collect the correct amount of tax, from all the affected taxpayers.

<u>Limitations of this opinion</u>

In response to a request for rulings dated March 6, 20 , taxpayer received a Private Letter Ruling ("PLR", PLR 200942022) using facts from their tax year ended December 31, 20 . The PLR held 1) That the Coop's b payments to members and participating patrons constitute "per-unit retain allocations paid in money" within the meaning of section 1382(b)(3) of the Code; and 2) For the purpose of computing its section 199 domestic production activities deduction, Coop's qualified production activities income and taxable income should, pursuant to section 199 (d)(3)(C) of the

Code, be computed without regard to any deduction for b payments to members and participating patrons. In other words, all of Coop's b payments in cash to members and participating patrons for 20 could be classified as "per-unit retain allocations paid in money" and that they should be added back in its section 199 computation.

We are cognizant that, the conclusion that cash payments by a non-pooling-marketing cooperative to the patrons (which is intended by the cooperative and the members to be purchase proceeds) meets the definition of a per-unit-retain paid-in-money (PURPIM) under I.R.C. §§ 1388(f) and 1382(b)(3) is based on a number of recent Private Letter Rulings including the one issued to the instant taxpayer for 20 . This opinion attempts to clarify the teaching of those rulings by making clear that even if b purchases meet the language of what a PURPIM is under I.R.C. §§ 1388(f) and 1382(b)(3), this does not mean that you can have the same amounts considered to be PURPIMS and b sale/purchase consideration, at the same time, in any one specific transaction or series of transactions.

Although this opinion accepts as a given, the rulings of the PLR for taxpayer's 20 tax year, we do not extend these rulings to the 20 tax year. The 20 rulings are not precedent for rulings applicable to the year 20 . In our opinion, the additional factors that are considered for the year 20 sufficiently distinguish the situation in this earlier year, from that present in the ruling for 20 , that a ruling similar to that for 20 would not have been issued for 20 .

Further, if the facts for 20 are not sufficiently distinguishable from those for 20 , as we believe they are, then, we are of the opinion that, it is necessary to clarify, extent, or modify the teachings of the 20 PLR and similar rulings to make it clear that closed b sale proceeds are conceptually different from per unit retains paid in money. It needs to be made clear that, even if a transaction may qualify as either a per unit retain paid in money or as closed purchase transaction, under the definition of per-unit retains in the Code, this does not mean that they are identical nor that the parties to the transaction can have them be both, at once. The following discusses the difference between the two further.

This opinion does not interpret the PLR, for the taxable year 20 , to have changed, in any manner, the definition of "per-unit retain allocation" set forth in I.R.C. §1388(f). What this opinion does is recognize that a necessary element of this definition is a mutual agreement between the Coop and the member/patron that the b purchase price will be treated as a per-unit retain before it can be so classified. The Code definition reads, as follows:

(f) **Per-unit retains allocation**.

For purposes of this subchapter, the term "per-unit retain allocation" means any allocation, by an organization to which part I of this subchapter applies, to a patron with respect to products marketed for him, the amount of which is fixed without reference to the net earnings of the organization **pursuant to an agreement between the organization and the patron**. [**Emphasis added**].

Per-unit retains are unique; they are different from closed sale proceeds.

At the inception, one must recognize the difficulty presented by the fact that, almost any payment made in money to a member or a participating patron for commodities that the Coop markets may be made to fit within the definition of a per-unit retain allocation for tax purposes, namely, as allocations, made to patrons, being fixed with reference to the products being marketed for the patron, and without reference to the net earnings of the cooperative. See, Farm Service Coop. v. Commissioner, 619 F.2d 718 (8th Cir. 1980), rev'g 70 T.C. 145 (1978). However, as this opinion attempts to clarify, this does not mean that closed purchase price proceeds and per-unit retains are one and the same. The distinction between the two is not clean, but there is a distinction to be drawn.

Conceptually, in the case of per unit retains, the Coop is marketing the commodity on behalf of the patron and gives back some of the patron's equity (an "advance" in lieu of an eventual potential patronage dividend). In the case of a closed b sale/purchase transaction, the patron already received his/her equity in the commodity, as his/her b selling price. The blurring of the distinction between the two occurs because the patron in a closed sale/purchase transaction will also benefit from any patronage dividend that may be declared and this benefit is proportional to the amount of business that it does with the cooperative. Despite the blurring of the two concepts, we are of the opinion, that closed purchases and per unit retains paid in money remain distinct concepts.

Per-unit retains can be distributed in money, certificates, or other property. I.R.C. §§1382(b)(3)-(4). Per-unit-retains paid in money serve a very specific need: They are used to make cash payments to members or participating patrons before the profit from the coop's marketing of the member's or participating patron's commodity can be determined.

A typical situation would occur where the cooperative uses commodity pools. The profit (loss) from the pool is shared by the members (participating patrons) of the marketing cooperative. The profit (loss) from the pool can not be determined until the pool is closed; at that time, pool sale proceeds and associated expenses will be known. Per-unit retains represent part of the members or patrons' equity in b sale, which is being withheld by the cooperative; per unit retains paid in money (PURPIMS), on the other hand, represent part of the members or patrons' equity (from past pools or the present b pool) being distributed to the member or participating patron. As the time between the b sale to the cooperative and the closing of the b pool can straddle two or more years, at year-end, patronage dividend (or "patronage refund") from the b pool may not yet be determinable. Per-unit retains paid in money are payments of a portion of the per-unit retain, so that the member/participating patron receives operating cash.

Although, it must be recognized that there are separate provisions for per-unit retains and patronage dividends in the internal revenue code, per unit retains represent an "advance" of what, hopefully, would have otherwise become a patronage dividend (or patronage refund). The rest of his per-unit retain, his remaining equity in the b pool, he will receive, in the form of a patronage dividend (or patronage refund), if and when one is declared or distributed; or, it may remain undistributed, as part of his capital contribution to the cooperative.[4] The cooperative, in turn, obtains a current year deduction, when it pays the per-unit retains, without having to wait until it is able to declare a patronage dividend (or patronage refund). I.R.C. §§1388(f) and 1382(b)(3).

The fact that per-unit retains are basically a deductible substitute for, or a deductible "advance" for deductible patronage dividends (or patronage refunds) can be seen from the summary of the amendments to the Subchapter T, in the Senate Report to the Foreign Investors Act of 1966. In relevant, part, the Report explains, as follows:

> "The bill amends present law to provide tax treatment with respect to per-unit retain certificates which parallels, in general, the tax treatment applicable with respect to patronage dividends." See, S.Rep. No. 1707, 89th Cong. 2d Sess. 70 (1966), <u>reprinted in</u> 1966 U.S. Code Cong. & Admin. News 4446, 4515-4516; 1966-2 C.B. 1059, 1108.[5]

One more example of why a purchase and a per-unit retain are materially different concepts can be profitably considered. In an open per unit retain transaction, unlike a closed sale/purchase transaction, logically, one would expect that when the Coop distributes per-unit retains paid in money in excess of the Coop's proceeds from b sales to third parties, the Coop would be entitled to recoup the excess from the member/patron recipients. This recoupment, conceivably, could be done either by refunding part of the money paid as per unit retains paid in money or by agreeing to a debit (a reduction) to the members and participating patrons capital accounts, in the Coop, if any exist. In contrast to the previous situation, in a closed sales transaction, the b seller has ownership to the proceeds of the b sale to the Coop. There is no

---

[4] When a member or participating patron receives a per-unit retain, this amount compensates him for a portion or all of his b cost of production and delivery to the Coop and part of his profit margin on the delivery of b, if any, depending on the amount of per-unit retain "advanced" to him. Given the theoretical ideal of a Coop that returns all the gross b proceeds, except for those capitalized by agreement, to its members/patrons, whether a payment or distribution is characterized as a cost of goods sold, a per unit retain representing the member/patron's cost of goods sold or their profit margin, is irrelevant to the Coop's computation of taxable income. This is because the Coop obtains a deduction or an exclusion from income, for all cost of goods sold and per-unit retains. Further, to the extent that a patronage distribution is later effected, with respect to the marketing of b, the Coop also gets a patronage dividend deduction. This is true whether this patronage dividend distribution represents a further return of the member/farmer's cost of goods produced or profit. <u>See</u> I.R.C. §1382(a) and (b).

[5] Although recognizing that per-unit retains and patronage dividends are each provided for individually in the Internal Revenue Code, the equivalence between the two has been judicially recognized. <u>See</u> <u>Farm Service Cooperative v. Commissioner</u>, 619 F.2d 718, 725, n. 17 (8th Cir. 1980), 1980-1 U.S.T.C. Par. 9352, <u>rev'g</u>, 70 T.C. 145 (1978).

evidence in the instant case, that the members and participating patrons ever intended or that they would be amenable to returning any of the b sale proceeds to the Coop, in the event that the Coop's b sales to third parties failed to equal or exceed the amount of per-unit retains paid in money to the members and participating patrons. Therefore, a closed purchase and a per-unit retain are not identical concepts. They are significantly different in material ways.

If any question remains that a per-unit retain is a unique concept, not identical, and quite different from the concept of gross proceeds from completed b sales, <u>and</u> that per-unit retains are only those retained pursuant to mutual agreement, a reading of the relevant part of the Senate Report to the Foreign Investors Act of 1966, that provided parallel treatment to per-unit retains and patronage dividends, should dispel any confusion. The report, in relevant part, explains, as follows:

> "Although the practices of cooperatives are not uniform …, generally a per-unit retain certificate is issued by a cooperative to a patron to reflect the retention by the cooperative of a portion of the proceeds from the marketing of products for the patron. These amounts are retained pursuant to an authorization (usually in the bylaws of the cooperative) and are computed on the basis of units of products marketed.
>
> Prior to the amendments in 1962, the Internal Revenue Code permitted cooperatives to deduct amounts paid to patrons as patronage dividends. Patronage dividends are limited by definition to amounts which are 'determined with reference to the net earnings' of the cooperative. The treatment of per-unit retains, however, was not specifically dealt with in the code. The Revenue Act of 1962 substantially revised the income tax treatment of cooperatives and their patrons but the new provisions by their terms were applicable only to 'patronage dividends.' Because per-unit retain allocations are determined on the basis of units of products marketed for the patrons rather than with reference to net earnings, the new provisions are generally considered as not being applicable to them…
>
> ***
>
> The per-unit retains may be considered as contributions to capital…". See, S.Rep. No. 1707, 89th Cong. 2d Sess. 70 (1966), <u>reprinted in</u> 1966 U.S. Code Cong. & Admin. News 4446, 4515-4516; 1966-2 C.B. 1059, 1107-1108.

<u>There is no evidence that the Coop, the members and participating patrons ever intended the b purchase proceeds to be per-unit retains nor evidence that they ever timely changed this original intent.</u>

This cooperative does not use commodity pools, so one would expect the use of if they are ever used, to be a rare event, except to artificially increase Coop's section 199 domestic production deduction. It is to be noted that per-unit retains are allocations **pursuant to an agreement between the organization and the patron**. [**Emphasis added**]. It is our opinion, that absent documentation or other convincing evidence that, the b purchases were agreed to, or intended to be paid, in accordance with mutually agreed to per-unit retain provisions, what we have here are simply purchased price payments, for completed b delivery contracts. They are not, as a factual matter, per-unit retains paid in money.

There is no evidence whatsoever that any of the parties mutually intended at any time, to allow the cooperative to retain any of the members or participating patrons equity in the b commodity. The evidence is of a final transfer of the members or participating patrons equity in the b grain to the cooperative, for consideration. This is a very different concept from the concept of per unit retains, where the member or participating patron receives part of his equity in cash and lets and agrees to let the cooperative retain the rest, until the profit (or loss) from the sale of the commodity to third parties is established by closing of the pool, and the cooperative, at its discretion, declares a patronage dividend (patronage refund). Without per unit retains, you do not have per unit retains paid in money.

To reiterate and clarify, in this case, there is no evidence whatsoever that any of the parties timely agreed to or intended that any of the b purchase proceeds still belonged to Coop. The evidence is that these b purchase proceeds unconditionally belonged to the members and participating patron. None of the relevant parties viewed the transaction as open, which is inherent in the concept of a per-unit retain. The fact that the b purchases are closed transactions is evidenced by the fact that the taxpayer has not shown that the b purchase payments were anything but final sales; that any material terms of the b purchase contract remained open; the fact that no one intended anything other than a completed b purchase; the lack of evidence to indicate an incomplete or non- permanent transfer of rights and obligations from the seller to the purchaser; the lack of evidence that the parties agreed to allow the Coop to retain any of the b purchase proceeds as retains; and, the lack of any indication that the members and participating patrons agreed to, or were amenable to return any of the b sale proceeds to the Coop, if the Coop did not make a profit on their sale to third parties.

The documentary evidence that exists shows a closed transaction: Prior to the untimely October 20 memo (Exhibit A), the taxpayer had not amended its Forms 1099-PATRs to treat “purchases” as per-unit retains paid in money; Even after the October 20 memorandum (Exhibit A), there is no evidence that members (or participating patrons) have agreed to reopen their closed b sales and turn them into open per-unit retain transactions; The Coop and its members (or participating patrons) have not agreed to amended by-laws that would change the treatment of sum certain, fixed proceeds from closed (oral or written) contracts into “per-unit retains”; presumably, per unit retains paid in money could conceivably be recovered by the Coop from the members or participating patrons; The Coop and its members (or participating patrons) have neither amended nor entered into negotiations to amend the 20 b purchase contracts, either orally or in writing nor shown any mutual assent of an intention to do this; The Coop and its members (or participating patrons) have not enacted, let alone agreed to amended cooperative's by-laws that would obliterate distinctions between open per unit retains and closed b purchases; The October 20 memorandum (Exhibit A) strongly indicates that prior to this memorandum the Coop had not amended the Forms 1099-PATR for 20 to reclassify the b purchases into ; and, the October 20 memorandum neither expresses or implies mutual agreement between the Coop and its members and participating patrons to the reclassification. The October 20 memorandum is simply evidence of an untimely unilateral act by the Coop, without any indication of express or implied consent by the members and participating patrons to modify the completed b sale contracts.

<u>There are intractable problems that would be caused by a reclassification from completed b purchases to per-unit retains, for the taxable year 20</u> .

Consideration of the year 20 shows why the Service, in Private Letter Rulings, generally, rules prospectively and not retroactively. At the outset, it needs to be emphasized that, the 20 PLR nowhere expresses an intention that it be applied to earlier years. This is for good reason, as there are materially different facts to consider for the 20 year, which are not present in the 20 year. In our opinion, at least for the taxable year 20 , it is now too late for the taxpayer to reclassify the b purchase payments into per-unit retains. We are also of the opinion that the Coop can only reclassify by agreement with the other party to the b purchase, not unilaterally, and that this mutual agreement must be entered into prior to or at the time of the consummation of the b purchase transaction. It is now too late to modify these b sale/purchase contracts. Consequently, the Coop's claim for refund for the taxable year 2005 based on the reclassification should be denied.

The timing of the request for the private letter ruling for the year 20 and the time of the claim for refund for the year 20 are different. The Coop filed its request for a ruling for the year 20 on March , 20 . At that time, the time for the Coop to file a return for the taxable year 20 and, more important, the time to pay patronage dividends, per-unit retain allocations, or issue qualified written of allocations (I.R.C. §1382(d) and report to its patrons remained open. None of this is true for the Coop's 20 year, as of the time of Coop's claim for refund.

There is no precedent to require the application of a later year PLR (for 20) to determine completed b purchase transactions for a prior year (20). To do so would cause a multitude of returns that have already been filed to become gratuitously erroneous. In addition, this will cause confusion and inequitable treatment across the Cooperative industry, as other Coops will be forced to consider filing claims for refund or face accusations of being derelict in their duty to minimize taxation (no matter how unfounded), The confusion and prejudice that would be caused to other similarly situated Coops, which have relied on the form and substance of their purchases and in remaining consistent with their original reporting positions, and the confusion and prejudice that would be caused to multitude of Coop members and participating patrons, of the Coop and similarly situated Coops can not be exaggerated. For the Coop's and similarly situated Coops' members and participating patrons, applying the PLR to earlier years would render their original individual returns in error. This is especially true where the earlier year's time to file an amended return or a claim for refund has expired.

To summarize, applying the holding of the 20 PLR to the instant 20 year will cause clear and serious detriments to the Coops' members, participating patrons, and to the Service. In addition, as a matter of law, the PLR for 20 is of no legal effect for the year 20 . I.R.C. §6110(i)(3) specifically provides that "a written determination may not be used or cited as precedent."

Further, to the extent that some of the b purchases remained in ending inventory, at the end of 20 , the PLR (for 20) expressly lends no support to the Coop. The PLR provides that no express or implied ruling is being made as to whether b payments made during a taxable year attributable to b purchases, which is in inventory at year-end, qualify as per-unit retain allocations paid in money.[6] To reiterate, to the extent that any of taxpayer's b purchases remained in inventory at the end of 20 , the PLR expressly offers the taxpayer no support, even if the PLR were to be applicable to 20 , which it is not.

However, the Service does not ignore the insight obtained from the PLR for the Coop's 20 tax year. This opinion does not challenge the rulings of said PLR. It does not need to. This opinion reaches conclusions that are required by the additional facts that are present in the Coop's 20 tax year. More specifically, this opinion interprets the PLR to have ruled that the taxpayer's b purchase transactions, under the facts set forth in said ruling, can qualify as **either** "completed purchases" or "per unit retains" (**emphasis added**) under the internal revenue code, for the taxable year 20 . This opinion views this treatment as, arguably, affording the taxpayer and its members or patrons, at most, an opportunity (a sort of "mutual election") to agree to characterize certain transactions as "purchases" or as "per unit retains," when done in a timely manner.

Without having to challenge or revisit the holdings of the PLR, we are of the opinion that this ruling and its reasoning, at most, allows a Coop to **prospectively (emphasis added)** make a de facto election, between treating the b purchase as a purchase or as a per-unit retain and to document this election. We do not believe that

[6] To reclassify the b purchases would change the timing of their deduction from the year in which the cost of the b commodities in ending inventory were sold (a year, necessarily, subsequent to the year in which they still remain in ending inventory at year end) to immediate b purchase expensing as current year expenses, under I.R.C. §1382(b). This change in the timing of a taking a deduction, historically capitalized in prior years, is a change in a material item and a change in method of accounting. See Treas. Reg. §§ 1.446-1(e)(2)(ii)(a). I.R.C. §446(e) provides the Service broad discretion to deny the change and the Service would be amply justified to deny a retroactive change for the year 20 , given the fact that patrons, participating members and the Service would be detrimentally affected, by the patrons and participating members closed 3-year statutes for making assessments .

the PLR holds that a Coop is unilaterally free to elect to treat the transaction, as both, at the same time.

Further, the Coop's power to deal with its members and participating patrons' commodities flows from the powers that these confer in the Coop thru agreement, whether in the by-laws or by other contracts. Absent mutual agreement, the Coop does not possess the power to unilaterally change, especially ex post facto, the nature of the original agreement that it entered into with these parties. The October 20 memorandum (Exhibit A) neither expresses nor implies a mutual agreement; and, even if it did, which it does not, it would be untimely.

In other words, it is our opinion that, the prospective de facto decision or "election" to treat what under the parties' course of conduct has always been viewed as closed sale/purchase transactions as per unit retains can not be made ex parte by the Coop. It must reflect an underlying, express, and existing agreement between the Coop and its members or participating patrons. It must be evidenced by clear and unambiguous evidence of the intent of the parties to the transaction, to now treat what the parties have always expected to be a closed purchase transactions as open per-unit retains. For the Service to be convinced that this mutual agreement exists, the evidence of this per unit retain agreement needs to exist in documentary form and be a clear, unambiguous expression of the parties' agreement. It can not be presumed to exist, without documentation. It should not be presumed from general by-law Coop language, nor from by-laws boiler plate language, that was enacted without any indication that the members and participating patrons ever understood, discussed or agreed to per unit retain treatment, for transactions that they have always considered to be completed sale/purchases.

Clearly, such mutual agreement is neither expressed nor implied in the October 20 memorandum (Exhibit A). The memorandum only informs the patrons of the Coop's unilateral decision to amend the 1099PATR forms for a number of years, including 20 . Evidence of a mutual agreement to treat the b purchases as per-unit retains or to change the b purchases to per-unit retains is absent in this case.

Any manifestation of members or participating patrons intent to treat the b purchases as per-unit retains or to change the original b purchase transaction to per-unit retains is also absent. In fact, the evidence clearly shows the opposite. The evidence, both as to form, substance, and intent of the parties, is of completed contracts for b purchases. The fact that these transactions are completed purchases never intended to be per unit retains for the taxable year 20 is, conclusively, evidenced by the fact that the Coop admits that none of the contracting parties ever considered or treated the transaction as anything but a completed sale. The taxpayer admits that these b purchases have historically been treated as purchases, were treated as purchases during the year 20 , and have been treated as purchases up to the time of the claim for refund. The after the fact October 20 memorandum, a unilateral, untimely act by the Coop, does not remediate the missing mutual agreement.

We do not interpret the 20 PLR to hold that b purchases can be treated as purchases and then modified to per unit retains, to the detriment of the members and participating patrons. We further do not interpret the 20 PLR to hold that the b purchases can be treated as purchases and then modified to per unit retains at the sole discretion of the Coop, without a timely agreement from the Coop's members and participating patrons. We further do not interpret the 20 PLR to hold that the b purchases can be treated as purchases and then modified to per-unit retains for the year 20 , for which tax returns have already been filed and when the year is closed for most, if not all of the parties to the b purchase (except, for the Coop). To change the original reported treatment would disregard the undisputed form of the transaction, the substance of the transaction, and the admitted clear intent and expectations of the contracting parties to the b transaction.

We believe that there is no evidence that would contradict that the member or participating patron had an enforceable, contractual right and expectation that he would retain the full proceeds from the b sale. The member or participating patron did not receive a per-unit retain payment for its commodity, that may be or may not be altered, depending on the final Coop's unilateral decision, or at a later time. They exchanged b for consideration (the b sale proceeds). This consideration was the Coop's members and participating patrons to keep, regardless of the ultimate disposition of the b, i.e., at a profit or at a loss, by the Coop.

We further believe that there is no authority in the Code, or regulations issued there under, that requires the Service to allow a reclassification of a b purchase to a per unit retain, when it ignores the contractual understanding of a legal contract between the parties, acts to the detriment of the members or participating patrons who have already reported the transactions as purchases, and whose taxable year are now closed. Further, the fact that the terms of the purchase can be interpreted to fit the definition of per-unit retains in the Code does not mean that a purchase and a per-unit retain are one and the same. There is no reason to allow this artificial treatment when to allow the reclassification acts to the detriment of the Service's third-party beneficiary right to rely on the form and substance of the closed b purchase transaction. Given closed members' and participating patrons' years and no timely notice of the treatment of b purchases as per-unit retain, before the statute of limitations to make assessments against most of the parties to the b transaction is closed, the Service is clearly prejudiced by reclassification. This is because the Service is unable to plan and carry out examinations of closed patron and participating members' years, to prevent being whip-sawed by incompatible section 199 treatment between the Coop and its members and patrons. It follows, that once either the Cooperative's or the member's (or participating patron's) taxable year is closed, it is too late to reclassify a sale/purchase transaction, between the Cooperative and that member or participating patron, into a , for that year. This is true even if the parties are willing to agree to the reclassification.

The doctrines of election and consistency and equitable principles support the Service in denying the reclassification.

It is a given in this case that, the Coop and its members and participating patrons have an uninterrupted course of treating these b purchases as cost of goods sold, capitalizing them into the Coop's inventory. The Coop treated them as cost of goods sold and all the parties (Coop, members and participating patrons) intended to, and considered them to be completed sale proceeds, not per-unit retains paid in money. Assuming that the Coop could have chosen to treat the transactions as , it did not timely do so for the tax year 20 , as the time to timely file 20 income tax returns or amended returns have now expired. The Coop should be held to its election to treat the b purchases as capitalized inventory and, then, cost of goods sold; and the members and participating patrons should be protected in their reliance in this tax treatment, when filing their own tax returns. Similarly, the Service should be protected in having relied on petitioner's Forms 1099-PATR, as originally filed for the year 20 . The doctrines of election and consistency and equitable principles support holding the taxpayer to its original tax treatment of the b purchases.

In the Southern Pac. Transp. Co. v. Commissioner, 75 T.C. 497, 838-840 (1980) case, the U.S. Tax Court discussed a number of related theories that support preventing a taxpayer from changing its prior tax position when it unfairly operates against the Service. Among these are estoppel, quasi-estoppel, "duty of consistency", equitable estoppel, laches, election, and staleness of claim. The Court explained that the doctrine of "election" is sometimes invoked as an alternative to estoppel or quasi-estoppel. Finally, the Court explained that the doctrine of "election" binds a taxpayer to a choice made by him between two proper alternative treatments and to act consistent with his choice.

In Woods et ux. v. Commissioner, 92 T.C. 776, 784-786 (1981), the U.S. Tax Court (a Court of law, not of equity) upheld its authority to apply equitable doctrines and principles to prevent the taxpayer from actively exploiting the statute of limitations by taking a diametrically opposite position to that which it took prior to the running of the stature of limitations. Claims for refund are generally heard in federal district court. These have clear jurisdiction to apply both law and equity. If the Coop were to be allowed to unilaterally act for its patrons, by changing the b purchases into PURPIMS, after the statute of limitations for the Service to make assessments has expired with respect to those patrons, this would be an unfair active exploitation of the statute of limitations. The Service would be justified in asking the Court to apply equitable doctrines and principles to prevent this inequity.

In LeFever v. Commissioner, 103 T.C. 525, 541-542 (1994), the U.S. Tax Court cited a number of relevant case in explaining that the "duty of consistency" is based on the theory that the taxpayer owes the Service a duty to be consistent with his tax treatment of items, see Southern Pac. Transp. Co. v. Commissioner, 75 T.C. 497, 838-839 (1980) and Kurz v. United States, 156 F. Supp. 99, 106 (S.D.N.Y. 1957), affd. 254

F.2d 811 (2d Cir. 1958); that the taxpayer is prevented from taking one position in one year and a contrary position in a later year after the limitation period has run on the earlier year, see Herrington v. Commissioner, 854 F.2d 755, 757 (5th Cir. 1988), cert. denied 490 U.S. 1065, 109 S.Ct. 2062, 104 L.Ed.2d 628 (1989), affg. Glass v. Commissioner, 87 T.C. 1087 (1986); Unvert v. Commissioner, 72 T.C. 807, 814-817 (1979), affd, 656 F.2d 483 (9th Cir. 1981) cert. denied 456 U.S. 961, 102 S.Ct. 2036, 72 L.Ed.2d 484 (1982); and, Mayfair Minerals, Inc. v. Commissioner, 56 T.C. 82 (1971), affd. 456 F.2d 622 (5th Cir. 1972); and, that this change of position will not be allowed when it unjustly operates to the detriment of the Service, see Kurz v. United States, 156 F. Supp. 99, 106 (S.D.N.Y. 1957), affd. 254 F.2d 811 (2d Cir. 1958).

In Radiant Glass Co. v. Burnett, 60 App.D.C. 351, 54 F.2d 718 (Fed. Cir. 1931), the Court cited a number of authorities for the proposition that the election to file one or another sort of return is exercised by filing the return and that it is settled that the taxpayer can not change that choice later. This is true even where the taxpayer, under a mistake of law, was unaware that he had the right to choose. See Buttolph v. Commissioner, 29 F.2d 695 (7th Cir. 1928); see also Moran v. Commissioner, 67 F.2d 601 (1st Cir. 1933). Therefore, even if we were to assume, arguendo[7], that the Coop could have originally classified the b purchases a , when filing its 20 original returns, and that the Coop failed to do so because it was unaware that it could make this choice (and not because it failed to obtain a mutual agreement with its members/participating patrons to do so), the fact that the Coop originally did report the b transactions as purchases and not has tax consequences.

In Estate of Richard R. Wilbur, et al. v. Commissioner, 43 T.C. 322 (1964) the U.S. Tax Court held that a taxpayer may not, by amended return or otherwise, disavow an election made in the original return, when recomputation and readjustment of the tax liability would impose burdensome uncertainties upon tax administration. In that case, the taxpayer had capitalized certain farming cultural expenditures for 1956, 1958, 1959, and 1960. The taxpayer was prevented from later modifying this election by expensing expenditures that it had capitalized, even though the taxpayer could have originally expensed them.

In reaching this result, the Court in Estate of Richard R. Wilbur, et al. v. Commissioner, supra, cited Pacific National Co. v. Welch, 304 U.S.191, 58 S.Ct. 857, 82 L.Ed. 1282 (1938), affg 91 F.2d 590 (9th Cir. 1937), where a taxpayer had the option, under applicable statutes and regulations, to compute the gain from sales of its property either by the "deferred payment method" or by the "installment method." After reporting its income using one method, the taxpayer sought a refund based on a computation under the other method. The Supreme recognized that that the taxpayer could have used either method in its original return. Nevertheless, the Supreme Court held that once the election was made, it was binding. The ratio decidendi of the Supreme Court

[7] In other words, we are only assuming this for the sake of argument. We are not agreeing that the Coop could have correctly reported the b purchases as , in the absence of a mutual agreement to treat them as with its members/participating patrons.

included not only the recomputation and readjustments that would be needed, but also that burdensome uncertainties would result to tax administration.[8]

It is also an undeniable fact that, allowing the Coop to reclassify the b purchase proceeds as will result in erroneous returns for all the members and participating patrons, who relied in the original treatment, in filing their own returns. Even if they could, retroactive amendment will burden, confuse, and may increase the reported tax liability of the Coop's members and participating patrons, for the tax year In addition, given the closed 3 three year statute for assessments, the Service could not examine and make timely determinations to prevent erroneous double deductions between the cooperative, its members, and patrons. Finally, and very importantly, the tax situation of all similarly situated Coops, members, and participating patrons through the whole industry will be thrown into disarray. Coops will be faced with having to reclassify and file for refund (to prevent accusations of dereliction of duty, in seeking every possible refund) and, at the same time, will have to file returns that take positions that the Coops and its members never intended or envisioned. They will have to send corrected Forms 1099-PATR and have to deal with the confusion this will engender; and, they will need to face the concerns of members and patrons, who never intended or envisioned that their sale proceeds were going to be treated as anything but what they intended and contracted them to be, to wit, completed sale proceeds.

CONCLUSIONS

In summary, the claim for refund for the Coop's taxable year 20 should be denied for the reasons set forth above, including the following.

First, no facts have been put forward to contradict the conclusion that, at the end of 20 the Coop and its members (or participating patrons) considered the b purchases to be completed contractual purchases (closed transactions) and not open per-unit retain transactions;

Second, the Coop's 8 ½ month payment period after the close of the Coop's 20 tax year for payment of per-unit retains has ended (I.R.C. §1382(d)), and the period expired without the taxpayer and its members or participating patrons taking any steps to reclassify purchases to per-unit retains;

Third, under the doctrine of elections the Coop, its members and participating patrons made the choice to treat the b purchases, as such, and not as per unit retains. They should not be allowed to change this, simply to obtain a refund;

---

[8] After citing Pacific National Co. v. Welch, supra, the U.S. Tax Court in Estate of Richard R. Wilbur, et al v. Commissioner, supra, cited a number of cases for and against the proposition, in a variety of situations, none of which are identical to the instant case. The Court then held that the correct guidance from all of the cases, taken as a whole, was that taxpayers could not disavow the elections made in their original returns.

Fourth, the members and participating patrons have already received (or should have received) the Form 1099-PATR as well as statements about the pass-through of the domestic production activities deduction (“DPAD”). I.R.C. §199. These members and participating patrons would have reported their b sales, per-unit retains paid in money, in different lines of Schedule F (Form 1040) and computed their own Domestic Production Activities Deduction (DPAD) in their own Form 8903, based on what to them were completed sales of b. To re-characterize the b purchases into per-unit retains would place them in the position of having erroneously reported their income tax for the 20 tax year and destroy their contractual agreements and expectations, without their assent to this modification; and, all of this would be simply be done to allow the Coop to obtain a higher domestic production deduction;

Fifth, (unlike the situation of the Coop, assuming that its 20 year has been kept open by a timely claim for refund), for almost all the members (or participating patrons), the taxable year 20 is now be a closed year (assuming no extensions of the statute); Consequently, a reclassification of the members and participating patrons' b sales to per-unit retains would require them to recalculate their individual section 199 domestic production deduction;

Sixth, the recalculation of the members and participating patrons own section 199 domestic production deduction, [by forcing them to exclude b sales from their individual QPAI computations, which they had every right to believe belonged to them], would reduce their individual section 199 domestic production deductions;

Seventh, whether this section 199 reduction would be counterbalanced by a pass-through of the Coop's own section 199 is doubtful and speculative for two reasons: One, a cooperative must designate the patron's portion of the income allocable to QPAI in a written notice mailed by the cooperative to the patron no later than the fifteenth day of the ninth month following the close of the tax year. I.R.C. §199(d)(3)(A)(ii); and, Two, The Coop can elect or not elect to pass through to its members or participating patrons (as the Coop is not required to pass thru) the section 199 domestic production deduction;

Eighth, to allow the b payment re-characterization is prejudicial, detrimental, and confusing, and inequitable, without prior member or participating patron agreement. It denies the members and patrons the benefit of their contractual right and expectation to consider the b payments as their own sale proceeds;

Ninth, tax administration is also negatively impacted as the Service has relied on the form, substance, continuing course of conduct, and intention of the Coop, its members and participating patrons, with respect the b sale/purchase agreements. The statute of limitations for making assessments against these member and participating patrons, for the taxable year 20 has, in most cases, expired;

Tenth, even at the present time, there is no evidence that the Coop, its members and participating patrons have mutually rescinded the closed b purchased contracts (oral or written) and substituted a per-unit retain understanding between the parties, with respect to the b transactions; The only evidence of the intention to reclassify is ex post facto and one-sided, namely, the Coop's claim for refund and the Coop's unilateral October 20 memorandum announcing to its patrons that it is amending its 20 Forms 1099-PATR (among others);

Eleventh, the doctrine of election precludes the retroactive re-characterization of the b payments. To allow the b purchases to be treated as PURPIMS will be detrimental to the Coop members, patrons, other similarly situated Coops, their member and participating patrons, and tax administration.

Prior to being issued, this opinion was coordinated with (Branch Chief (P&SI) and , Attorney-Advisor (P&SI), who reviewed and concurred with the opinion. This concludes our legal opinion. If you have any questions, please contact Lead Industry Counsel (Cooperatives and Agriculture) , at , or Associate Industry Counsel (Cooperatives and Agriculture) , at .

Harmon B. Dow
Deputy Area Counsel (IP)

/Rogelio A. Villageliu/

By: ______________________________

Rogelio A. Villageliu
Industry Counsel
(Cooperatives and Agriculture)
(LB & I) (RFPH)