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Date:
September 28, 2015

LEGEND:

Taxpayer =

COOP =

COOP 2 =

CORP =

State A =

Dear :

This in response to a request for rulings dated March 30, 2015, submitted by your authorized representative. The ruling requests guidance under subchapter T and section 199 of the Internal Revenue Code with respect to tax effects of Taxpayer marketing grain through a limited liability company.

Taxpayer is organized as a cooperative association under the State A Agricultural Co-Operative Act. It is a nonexempt subchapter T cooperative. Taxpayer provides its members with a broad range of products and services used in farming, including fertilizers, herbicides and pesticides, turf products and fuel (gasoline, diesel fuel, LP gas, etc.). It also markets grain raised by members. Taxpayer serves a -county area in north central State A.

Taxpayer and a neighboring cooperative, Coop, are considering combining their grain marketing operations. COOP is a farm supply and grain marketing cooperative

similar in many respects to Taxpayer. The territories served by Taxpayer and COOP are contiguous. Taxpayer operates grain elevators and grain storage facilities. COOP operates a grain elevator and grain storage facility. Most of the grain that Taxpayer and COOP market is delivered by the producer to one of the elevators owned and operated by Taxpayer and COOP.

Some of the grain marketed by Taxpayer and COOP is referred to as "direct delivery" grain. Members contract to sell direct delivery grain to Taxpayer and COOP just as they do their other grain. However, instead of specifying one of Taxpayer's or Coop's elevators as the delivery location, the grain contracts require the grain to be delivered by the farmer directly to a designated elevator of one of Taxpayer's or Coop's customers. When Taxpayer or COOP enters into a direct delivery contract with one of its members, it also enters into a contract to sell the grain to the designated customer. The customer pays Taxpayer or COOP for the grain, and Taxpayer and COOP then pay their farmer members. Taxpayer sells direct delivery grain to various companies. Taxpayer's membership is limited to persons who are producers of agricultural products who are also members of the State A and a local . Taxpayer is required by the State A Act and its Articles of Incorporation and Bylaws to distribute earnings each year (after setting aside reasonable reserves) to members and to certain nonmember patrons ("participating patrons") as patronage dividends. Pursuant to section 1382(b)(1) of the Code, Taxpayer excludes or deducts the patronage dividends paid to members and participating patrons from taxable income.

Taxpayer also does business with some patrons who are not entitled to receive patronage dividends ("nonmembers"). Nonmember business is a relatively small portion of its overall business, particularly in grain marketing. During fiscal 2014, member (and participating patron) business accounted for % of Taxpayer's grain business, and nonmember business accounted for the remaining %. Net earnings from business with nonmembers are retained and thus subject to tax.

For its fiscal year 2014, Taxpayer paid patronage dividends totaling $, all of which were paid to supplies members and participating patrons. Its grain marketing activities generated a loss, so no patronage dividend was paid to grain members and participating patrons.

Taxpayer represents that is claims the domestic production activities deduction ("DPAD") provided by section 199 of the Code. It treats payments to members and participating patrons for grain as per-unit retain allocations paid in money ("PURPIMs") within the meaning of section 1382(b)(3). Taxpayer adds back PURPIMs and patronage dividends in its DPAD computations as provided in section 199(d)(3)(C) and section 1.199-6(c) of the Income Tax Regulations. Taxpayer has retained the DPAD it has earned rather than passing it through to members and participating patrons. For the fiscal year ended , Taxpayer earned $ of DPAD.

Taxpayer reports grain payments treated as PURPIMs in box 3 of the Form 1099-PATRs provided to the IRS and to members and participating patrons each year.

Taxpayer and COOP are considering forming a limited liability company (LLC) along with CORP, a wholly-owned, noncooperative subsidiary of COOP 2. COOP 2 is a regional farm supply and grain marketing cooperative. COOP 2 carries on a wholesale business as a federated cooperative.

LLC will not make a check-the-box election to be treated as an association taxed as a corporation. Thus, it will be taxed as a partnership for federal income tax purposes, and Taxpayer, Coop, and CORP will be treated as partners.

The objective of the joint venture will be to increase the profitability of Taxpayer's and COOP's grain marketing activities and thus to increase the amount that members and participating patrons of Taxpayer and COOP receive for grain. Because of its size, it is expected that the combined entity will be able to market grain more effectively, thereby increasing total grain sale proceeds. By combining the grain marketing activities of Taxpayer and COOP, it is expected that LLC will be able to achieve significant cost savings, improving the bottom line.

Taxpayer and COOP will each contribute its grain elevators, storage tanks, the real property on which they are located, and related grain operating assets to LLC. LLC will assume all responsibilities as warehouseman for grain in the elevators and storage tanks that is being stored for others. Any grain in the elevators which is owned by Taxpayer or COOP and related hedge positions and grain sale contracts will be sold to LLC at fair market value. Taxpayer and COOP will contract to sell to LLC any grain that they have contracted to purchase, but that has not yet been delivered, on the same terms as their purchase contracts, will transfer any related hedge positions (including open grain sale contracts) to LLC, and, to the extent that there are mark-to-market gains or losses, appropriate payments will be made.

CORP is not itself involved in the grain business except as the participant in several grain limited liability companies. Its role in LLC will be as a facilitator and investor. CORP's parent, COOP 2, looks for opportunities to help support the grain marketing activities of its members. COOP 2 files a consolidated federal income tax return with CORP. COOP 2 plans to treat CORP 's distributive share of the profits or losses of LLC as nonpatronage.

Each participant will receive a fixed percentage interest in LLC. The fixed interests will determine the participant's interest in LLC's net earnings, distributions and assets in the event of liquidation, and, for tax purposes, each participant's

distributive share of partnership net gain or loss and other partnership items.[1] The fixed percentage interests will be based upon an agreed value of each member's contribution. The respective interests of the parties have not yet been determined.

Employees currently involved in the grain activities of Taxpayer and COOP will either be transferred to LLC or leased to LLC on a full or part-time basis, as appropriate. Taxpayer may provide certain support services to LLC (e.g., accounting). Any such support services will be provided at cost.

Taxpayer and COOP will continue to exist as independent cooperatives. Each will continue to conduct farm supply and service activities. As described below, each will also continue to play a role in the grain operations, particularly in grain origination activities. As a member of LLC, each will be involved in overseeing the operations of LLC. Each will continue to operate on a cooperative basis and pay patronage dividends to its members and participating patrons.

After LLC is formed, Taxpayer and COOP will continue to play a role in the grain marketing process. Under the new arrangement, Taxpayer and COOP will continue to purchase grain from their respective members and participating patrons for marketing on a cooperative basis. They will then immediately sell the grain to LLC on terms that mirror the purchase terms. For grain delivered to one of its facilities, LLC will receive, handle, store, hedge and market the grain. For direct delivery grain, LLC will contract to sell the grain to its customer and be responsible for delivery of that grain to the customer and for handling the customer's payment for the grain.

Leaving Taxpayer and COOP in the middle of grain transactions will have various business and legal consequences. State A regulates the grain industry in State A. Because Taxpayer and COOP will continue to be purchasing grain from farmers in State A, each will continue to be a "grain dealer," regulated by the State A Department of Agriculture under the provisions of the State A Grain Code. Each will be required to have a State A Grain Dealer License.

Taxpayer and COOP will be at risk if farmers fail to deliver grain under their grain contracts. One significant grain marketing risk, particularly for grain that farmers contract to sell to elevators for future delivery, is the risk that farmers may fail to deliver the grain. When an elevator enters into a contract that calls for future delivery at a wholly or partially fixed price, it normally hedges the risk of price movement between the time the grain is priced and the time of delivery and ultimate sale of the grain. If a farmer does not deliver, the elevator is exposed to risk of loss on its hedge position.

[1] LLC operating agreement will provide for appropriate adjustments to tax allocations to comply with the provisions of section 704(c) of the Code.

Potential losses can be significant. If a farmer contracts to sell 10,000 bushels of grain to an elevator for future delivery in six months at a fixed price of $4.00 per bushel, the elevator will take a hedge position that, to the extent possible, has the economic effect of contracting to sell the grain to a third party on that date at that same price. If, when it comes time for the grain to be delivered, the price of grain has gone up to $6.00 per bushel, the elevator will have a loss in its hedge position of $2.00 per bushel (assuming the hedge is perfect). However, if the farmer honors the contract and delivers the grain, the elevator can turn around and sell the grain for which it just paid $4.00 per bushel for $6.00 per bushel. If the farmer does not honor the contract, the elevator will lose $2.00 per bushel when it closes out the hedge position. To recover that loss, it is necessary to take actions to enforce the elevator's rights under the contract with the farmer.

While most farmers honor most grain contracts, there are instances when they do not. Sometimes a farmer does not honor a contract because he cannot (for instance he contracted to sell more grain than he was able to produce because of drought conditions). Occasionally, a farmer will simply choose not to honor a contract. For instance, when the price of grain has gone to $6.00 a bushel, the farmer might sell his grain at that price to someone else, and try to disavow his contract with the elevator. Contracts may not be honored for other reasons. For instance, bankruptcy of a farmer might make it impossible for the farmer to deliver.

In recognition of these risks, the form of grain contract now used by Taxpayer contains provisions to protect Taxpayer's position in the event that Taxpayer has reason to believe a farmer might default or in the event of an actual failure to deliver. For instance, if Taxpayer has concerns that a farmer may not be able to perform, its contracts provide that "Buyer retains the right to require: (a) payment of dollars up to the replacement cost of any undelivered balance; or (b) other adequate assurance of Seller's performance, if, in Buyer's sole discretion, Buyer has reason to feel insecure about Seller's performance under Contract." In the event that a farmer does not deliver its grain, Taxpayer's grain contracts currently provide that a farmer's "failure to perform on this Contract will result in contract cancellation charges to Seller, the total of which will be the difference between the Contract price and the replacement cost at the time of cancellation, plus a minimum cancellation charge of twenty-five cents (25¢) per bushel. Seller shall also be liable for Buyer's attorney fees, costs of collection, plus interest."

These provisions do not eliminate the risk of nonperformance. In the event a member defaults, Taxpayer may find it necessary to sue its member. While the grain contracts specify the amount of damages, they provide no guarantee that a defaulting farmer will have the resources to pay. While Taxpayer has the ability to set off amounts a farmer owes to it against amounts it owes to the farmer (as well as against the farmer's stock and allocated equities in Taxpayer), these might not be adequate.

Under the proposed arrangement, Taxpayer and COOP will retain the farmer performance risk with respect to grain they contract to purchase from their members and participating patrons and then sell to LLC. Their grain contracts will be hedged by their contracts with LLC, and LLC will in turn hedge its potential risk. If prices increase and farmers do not deliver, Taxpayer and COOP will have to cover to meet their obligations under their grain sale contracts to LLC, leaving the risk of loss from a farmer's failure to deliver on Taxpayer and COOP.

Thus, if a farmer contracts to sell 10,000 bushels to Taxpayer for future delivery in six months at a fixed price of $4.00 per bushel, Taxpayer will contract to sell 10,000 bushels to LLC for future delivery in six months at a fixed price of $4.00 per bushel. If, when it comes time for the grain to be delivered, the farmer does not deliver and the price of grain has gone up to $6.00 per bushel, Taxpayer will suffer a loss of $2.00 per bushel (or $20,000) as it purchases grain so that it can fulfill its contract with LLC. Taxpayer's recourse will be against the farmer.

Taxpayer and COOP will be at risk if farmers deliver grain that has quality issues. A different kind of farmer performance issue relates to the quality of the grain delivered. Taxpayer's grain contracts provide that grain "not approved for export by all potential purchasing countries cannot be delivered on this contract." Farmers also are required to warrant that their grain "will meet the Federal Food, Drug and Cosmetic Act requirements." In the proposed arrangement, Taxpayer's grain contracts will continue to have similar covenants and warranties, and it will make similar covenants and warranties with respect to the grain it sells to LLC. As a result, under the proposed arrangement, this risk will be retained by Taxpayer and COOP with respect to grain they purchase and contract to purchase from their members and participating patrons and then sell to LLC.

Similarly, a farmer will be able to continue to look to his or her cooperative for performance under a grain contract. While a grain purchaser has the risk of nonperformance by farmers, farmers have the risk of nonperformance by the purchaser. If a farmer contracts to sell grain for future delivery at $6.00 per bushel, and the price at the time of delivery is $4.00 per bushel, the farmer stands to lose a profitable sale if the purchaser, for whatever reason, does not honor the contract.

If a grain purchaser does not honor its contracts, it will not remain in business for long. However, sometimes circumstances arise (e.g., bankruptcy) where the purchaser is not able to do so. Occasionally, the owners of grain elevators are involved in fraudulent activities, which can lead to farmer losses. Historically there have been enough elevator bankruptcies and other incidents involving elevators that most states (including State A) regulate grain dealers. In spite of this regulation, grain dealer bankruptcies and other grain dealer performance issues occasionally occur.

When a grain dealer goes bankrupt, farmers are not only at risk for grain that is under contract, but also for grain that they have delivered and for which they have not yet been paid. While this latter risk is minimized by rules that generally require prompt payment for grain and require grain dealers to post bonds, risk of nonpayment remains. In addition, some grain dealers purchase grain from farmers on a deferred payment or a price-later basis. Farmers selling grain on that basis are at risk for an elevator failure from the time they deliver their grain until they are paid.

If there are purchaser performance issues, farmers will have more assets to look to for payment under the proposed arrangement with Taxpayer and COOP being the purchaser. They will also be dealing with a company that they are used to dealing with.

For financial accounting purposes, Taxpayer and COOP will continue to be required to report grain purchases and sales. Taxpayer's and Coop's continued role in originating grain will also have accounting implications. Under generally accepted accounting principles, they will be required to continue to report grain purchases and sales in their annual financial statements.

Taxpayer and COOP will continue to originate grain to sell to the LLC. Taxpayer, Coop, and CORP believe that the member and participating patron performance risk should remain with Taxpayer and COOP in the new LLC arrangement. The local cooperatives are closest to the farmers, and they are felt to be best positioned to monitor that risk.

If a Taxpayer member does not deliver grain and a loss is incurred, the parties agree any resulting loss should be a Taxpayer loss, not a COOP or CORP loss. Similarly, if a COOP member does not deliver grain and a loss is incurred, the parties agree that any resulting loss should be a COOP loss, not a Taxpayer loss or CORP loss.

In contrast, the potential participants in LLC believe that LLC should be responsible for the performance risk with respect to grain purchased from persons who are not members or participating patrons of Taxpayer or COOP. As a consequence, they anticipate that such purchases will be made directly by LLC. If a nonmember does not deliver grain and a loss is incurred, any resulting loss would then be an LLC loss, which would mean that Taxpayer, Coop, and CORP would ultimately bear the loss in accordance with their respective percentage interests in LLC.

Farmer members of Taxpayer and COOP are accustomed to dealing with their cooperative. By leaving the cooperative in the middle on grain sales, farmers have the continued comfort of dealing with someone they know. It is possible that the cooperative's payment obligations may be guaranteed by LLC to provide further

payment protection for farmer members and participating patrons of Taxpayer and COOP. The decision as to whether there will be a guarantee has not yet been made.

According to Taxpayer, one important objective of the formation of LLC is to achieve efficiencies in operations. Taxpayer contemplates entering into an Agency and Grain Sales Agreement with LLC, appointing LLC to act as its agent for the purposes of purchasing grain from Taxpayer members and participating patrons on behalf of Taxpayer and in Taxpayer's name. As agent, LLC would be responsible for generating the customary grain contract documentation for such purchases in Taxpayer's name. When the farmer delivered the grain, LLC would accept the grain, acting as agent for Taxpayer, generating a settlement statement in Taxpayer's name. LLC would be authorized to pay for the grain by a check in Taxpayer's name drawn on a Taxpayer bank account. COOP contemplates entering into a similar Agency and Grain Sales Agreement with LLC.

When Taxpayer or COOP purchases grain (or contracts to purchase grain), the grain simultaneously will be sold (or contracted to be sold) by Taxpayer or COOP to LLC. The Agency and Grain Sales Agreement will also be a master agreement for sales of grain from each of the cooperatives to LLC. It will provide that the terms of such sales will mirror the terms of the cooperative's purchase or contract with the member or participating patron. The Agency and Sale Agreement will provide that LLC will periodically provide the cooperative with such information that the cooperative may require for management and accounting purposes to report the grain purchases and sales accomplished on its behalf.

If a farmer fails to perform under his or her contract, the cooperative will be unable to perform under its mirror contract with LLC. LLC will notify the cooperative, and the Agency and Grain Sales Agreement will provide that the cooperative will be responsible to make LLC whole. LLC and each cooperative will agree that they will together take such actions, including, if necessary filing a lawsuit against the member or participating patron in the name of the cooperative, to obtain performance or to otherwise make the cooperative whole. However, the failure of any such actions to make the cooperative whole will not diminish the responsibility of the cooperative to make LLC whole.

RULINGS REQUESTED

1. Taxpayer's distributive share of the net income or loss of LLC for a year attributable to grain marketing will be patronage-sourced.

2. After the formation of LLC, grain payments to members and participating patrons of Taxpayer will constitute "per-unit retain allocations paid in money" within the meaning of section 1382(b)(3) of the Code.

3. By virtue of section 199(d)(3)(D) of the Code, Taxpayer will be treated as having manufactured, produced, grown or extracted in whole or significant part the grain purchased from its members and participating patrons, which the members and participating patrons have so manufactured, produced, grown or extracted.

4. For purposes of computing its section 199 domestic production activities deduction, Taxpayer's qualified production activities income and taxable income will, pursuant to section 199(d)(3)(C) of the Code, be computed without regard to any deduction for the grain payments to members and participating patrons.

Subchapter T cooperatives are permitted to exclude or deduct distributions to patrons that qualify as per-unit retain allocations or as patronage dividends, provided the distributions otherwise meet the requirements of subchapter T of the Code.

Section 1388(f) of the Code defines the term "per-unit retain allocation" to mean "any allocation, by an organization to which part I of [subchapter T] applies, to a patron with respect to products marketed for him, the amount of which is fixed without reference to net earnings of the organization pursuant to an agreement between the organization and the patron."

Per-unit retain allocations may be made in money, property or certificates. Per-unit retain allocations paid in money and in property are excludable or deductible under section 1382(b)(3) of the Code. Per-unit retain allocations paid in certificates are deductible under section 1382(b)(3) if the certificates are qualified. If the certificates are nonqualified, the cooperative is permitted a deduction under section 1382(b)(4) (or a tax benefit figured under section 1383) when the certificates are later redeemed.

Section 1388(a)(1) of the Code provides that the term "patronage dividend" means an amount paid to a patron by a cooperative on the basis of the quantity or value of business done with or for such patron. Section 1388(a)(2) provides that a "patronage dividend" is an amount paid "under an obligation" that must have existed before the cooperative received the amount so paid. Section 1388(a)(3) provides that "patronage dividend" means an amount paid to a patron that is determined by reference to the net earnings of the cooperative from business done with or for its patrons. That section further provides that a "patronage dividend" does not include any amount paid to a patron to the extent that such amount is out of earnings other than from business done with or for patrons. Section 1.1382-3(c)(2) of the regulations states that income derived from sources other than patronage means incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association.

Patronage dividends may be paid in money, property or written notices of allocation. Patronage dividends paid in money and in property are excludable or

deductible under section 1382(b)(1) of the Code. Patronage dividends paid in written notices of allocation are deductible under section 1382(b)(1) if the written notices of allocation are qualified. If the notices are nonqualified, the cooperative is permitted a deduction under section 1382(b)(2) (or a tax benefit figured under section 1383) when the notices are later redeemed.

Section 1388(b) of the Code provides that the term "written notice of allocation" means 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.

For cooperatives that use pooling, Rev. Rul. 67-333, 1967-2 C.B. 299, provides that pool advances are treated as per-unit retain allocations and the final pool payment, made after net earnings have been determined, is treated as a patronage dividend.

In order for Taxpayer's distributive share of the net income of LLC to be deductible to Taxpayer, the amount must be patronage-sourced income, i.e., income derived from business carried on with or for Taxpayer's patrons. While neither the Code nor the regulations provide a clear definition of patronage-sourced income, the courts have, in general, held that if the income at issue is produced by a transaction which is directly related to the cooperative enterprise, such that the transaction facilitates the cooperative's marketing, purchasing or service activities, then the income is deemed to be patronage income. Farmland Industries Industries v. Commissioner, 78 T.C.M. 846, 864 (1999), acq., AOD 2001-003 (citing Cotter & Co. v. United States, 765 F.2d 1102, 1106 (1985); Land O'Lakes, Inc. v. United States, 675 F.2d 988, 993 (8th Cir. 1982); Certified Grocers of Cal., Ltd. v. Commissioner, 88 T.C. 238, 243 (1987); Illinois Grain Corp. v. Commissioner, 87 T.C. 435, 459 (1986).

In Rev. Rul. 69-576, 1962-2 C.B. 166, the Service provided the following analysis of what it means for income to be patronage sourced:

> The classification of an item of income as from either patronage or nonpatronage sources is dependent on the relationship of the activity generating the income to the marketing, purchasing, or service activities of the cooperative. If the income is produced by a transaction which actually facilitates the accomplishment of the cooperative's marketing, purchasing, or service activities, the income is from patronage sources. However, if the transaction producing the income does not actually facilitate the accomplishment of these activities but merely enhances the overall profitability of the cooperative, being merely incidental to the association's cooperative operation, the income is from nonpatronage sources.

See also Rev. Rul. 74-160, 1974-1 C.B. 245 (ruling that interest income realized from loans made by the taxpayer was patronage source, because the loans "actually facilitated the accomplishment of taxpayer's cooperative activities, in that [the loans] enabled the taxpayer to obtain the necessary supplies for its operations.")

Courts have ruled in several instances that income from corporations organized by cooperatives to conduct activities related to the cooperative business is patronage sourced. In Farmland Industries, the taxpayer, a cooperative organized for the purpose of providing petroleum products to its patrons, sought to have the proceeds from the disposition of its stock in three subsidiaries classified as patronage-sourced income. In reaching its decision the court stated that its task was to determine whether each of the gains and losses at issue was realized in a transaction that was directly related to the cooperative enterprise, or in one which generated incidental income that contributed to the overall profitability of the cooperative but did not actually facilitate the accomplishment of the cooperative's marketing, purchasing, or servicing activities on behalf of its patrons, 78 T.C.M. at 870.

Emphasizing the need to focus on the totality of the circumstances and to view the business environment to which the income producing transaction is related, the Tax Court analyzed the reasons behind both the organization of the subsidiaries and their eventual disposition, Id. at 864, 865. First, it looked at whether the taxpayer's subsidiaries were organized to perform functions related to its cooperative enterprises. The subsidiaries had been organized to explore for, produce, and transport crude oil. The court determined that all of the subsidiaries were organized to perform functions related to the taxpayer's business and were not mere passive investments. Id. at 871.

In other cases, the direct relationship between the purpose of a cooperative business and its reasons for investing in a subsidiary were found to be dispositive on the question of whether income received from the subsidiary was patronage sourced. For example, in Astoria Plywood Corp. v. United States, 43 A.F.T.R. 2d 79-816, 79-1 USTC ¶ 9197 (D. Or. 1979), the court found that the income derived by a plywood and veneer workers cooperative from the cancellation of a lease on a veneer plant was patronage sourced, because the production of veneer was an integral part of the cooperative's business. In other words, the reason the cooperative leased the property to begin with had nothing to do with investing in real estate and everything to do with making veneer. Similarly, in Linnton Plywood Assoc. v. United States, 410 F.Supp. 1100 (D. Or. 1976), the court held that the dividends received by a plywood workers cooperative from West Coast Adhesives, a glue supplier which the cooperative helped to organize in order to supply its adhesive needs, were patronage-sourced income, since glue is essential for the manufacture of plywood, and the arrangement to produce the glue was reasonably related to the business done with or for the cooperative's patrons.

Under section 199(d)(3) of the Code, patrons that receive a qualified payment from a specified agricultural or horticultural cooperative are allowed a deduction for an amount allocable to their portion of qualified production activities income (QPAI) of the organization received as a qualified patronage dividend or per-unit retain allocation which is paid in qualified per-unit retain certificates. In particular, section 199(d)(3)(F) requires the cooperative to be engaged in the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, or in the marketing of agricultural or horticultural products. Under section 199(d)(3)(D), in the case of a cooperative engaged in the marketing of agricultural and horticultural products, the cooperative is treated as having manufactured, produced, grown, or extracted (MPGE) in whole or significant part any qualifying production property marketed by the cooperative that its patrons have MPGE (this is known in the industry as the "cooperative attribution rule"). In addition, section 199(d)(3)(A)(ii) requires the cooperative to designate the patron's portion of the income allocable to the QPAI of the organization in a written notice mailed by the cooperative to its patrons no later than the 15th day of the ninth month following the close of the tax year.

Under section 1.199-6(c) of the regulations, for purposes of determining a cooperative's section 199 deduction, the cooperative's QPAI and taxable income are computed without taking into account any deduction allowable under section 1382(b) or (c) of the Code (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

An agricultural or horticultural cooperative is permitted to "pass-through" to its patrons all or any portion of its section 199 deduction for the year provided it does so in the manner and within the time limits set by section 199(d)(3) of the Code. When a cooperative passes-through all or any portion of the section 199 deduction, the cooperative remains entitled to claim the entire section 199 deduction on its return, but is required under section 199(d)(3)(B) to reduce the deduction or exclusion it would otherwise claim under section 1382(b) for per-unit retain allocations and patronage dividends.

Section 199(d)(3)(A) of the Code provides that a cooperative passes through an amount of its section 199 deduction by "identifying" such amount in a written notice mailed to such person during the payment period described in section 1382(d). Section 1382(d) provides that the payment period for a year is the period beginning with the first day of such taxable year and ending with the fifteenth day of the ninth month following the close of such year.

Section 1.199-6(g) of the regulations provides that in order for a patron to qualify for the section 199 deduction, section 1.199-6(a) requires that the cooperative identify in a written notice the patron's portion of the section 199 deduction that is attributable to the portion of the cooperative's QPAI for which the cooperative is allowed a section 199 deduction. This written notice must be mailed by the

cooperative to its patrons no later than the 15th day of the ninth month following the close of the taxable year. The cooperative may use the same written notice, if any, that it uses to notify patrons of their respective allocations of patronage dividends, or may use a separate timely written notice(s) to comply with this section. The cooperative must report the amount of the patron's section 199 deduction on Form 1099-PATR, “Taxable Distributions Received From Cooperatives,” issued to the patron.

While a cooperative is permitted to disregard per-unit retain allocations and patronage dividends in its section 199 deduction, section 1.199-6(l) of the regulations provide that a qualified payment received by a patron of a cooperative is not taken into account by the patron for purposes of section 199.

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

Taxpayer will be entering into LLC to allow it to better market grain for its members and participating patrons. Thus, its participation in LLC will be directly related to and actually facilitate the accomplishment of what Taxpayer is organized to do on a patronage basis for its members.

LLC will help Taxpayer market its members’ grain. Taxpayer anticipates that the percentage of the grain it will be supplying LLC (compared to all grain LLC markets) will exceed its fixed percentage ownership interest in the LLC. However, if its grain percentage for a year was materially less than its ownership percentage in LLC, then Taxpayer anticipates that a portion of its distributive share would be patronage-sourced and a portion would be nonpatronage. The portion that would be patronage-sourced would equal its grain percentage for the year divided by its ownership percentage. The remainder would be nonpatronage. Thus, for example, if Taxpayer’s ownership percentage interest in LLC was 34 percent and grain percentage for a year was 27.2 percent, then 80 percent of Taxpayer’s distributive share would be patronage-sourced (i.e., 27.2 percent ÷ 34 percent) and the remaining 20 percent would be nonpatronage.

Taxpayer represents that it is appointing LLC to act as its agent for the purposes of purchasing grain from Taxpayer members and participating patrons on behalf of Taxpayer and in Taxpayer’s name. As Taxpayer’s agent, LLC will be responsible for generating the customary grain contract documentation for such purchases in Taxpayer’s name. When the farmer delivers the grain, LLC will accept

the grain, acting as Taxpayer's agent, generating a settlement statement in Taxpayer's name. LLC will be authorized to pay for the grain by a check in Taxpayer's name drawn on a Taxpayer bank account.

Taxpayer claims the benefit of the DPAD provided by section 199 of the Code. Before entering into LLC, Taxpayer seeks assurance that it grain payments will be treated as PURPIMs. Section 1388(f) defines the term "per-unit retain allocation" to mean "any allocation, by an organization to which part I of [subchapter T] applies, to a patron with respect to products marketed for him, the amount of which is fixed without reference to net earnings of the organization pursuant to an agreement between the organization and the patron."

A grain payment is a PURPIM if: (1) there is a payment in money; (2) by a subchapter T cooperative; (3) to a member or participating patron with respect to products marketed for him or her; (4) which is fixed without reference to the net earnings of the cooperative; (5) and is paid pursuant to an agreement between the cooperative and the member or participating patron.

The grain payments to the members and participating patrons of Taxpayer will meet all of these requirements after the formation of LLC. After the formation of the LLC: (1) the grain payments will be made in money; (2) Taxpayer is and will continue to be a nonexempt subchapter T cooperative, and the payments will be made by Taxpayer with LLC acting as its agent; (3) the payments will be made to members and participating patrons of Taxpayer for their grain; (4) the grain payments will be fixed without reference to the net earnings of Taxpayer; and (5) the grain payments will be paid pursuant to grain contracts between Taxpayer and its members or participating patrons. In addition, Taxpayer represents that it will continue its practice of reporting the payments in box 3 of the Form 1099-PATRs that it provides members and participating patrons.

Based on the forgoing we rule that:

1. Taxpayer's distributive share of the net income or loss of LLC for a year attributable to grain marketing will be patronage-sourced.

2. After the formation of LLC, grain payments to members and participating patrons of Taxpayer will constitute "per-unit retain allocations paid in money" within the meaning of section 1382(b)(3) of the Code.

3. By virtue of section 199(d)(3)(D) of the Code, Taxpayer will be treated as having manufactured, produced, grown or extracted in whole or significant part the grain purchased from its members and participating patrons, which the members and participating patrons have so manufactured, produced, grown or extracted.

4. For purposes of computing its section 199 domestic production activities deduction, Taxpayer's qualified production activities income and taxable income will, pursuant to section 199(d)(3)(C) of the Code, be computed without regard to any deduction for the grain payments to members and participating patrons.

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)