

where a net capital gain is taxed as excess net passive income under section 1375.

(e) *Reduction in pass-thru for tax imposed on capital gain.* See section 1366(f)(2) for a special rule reducing the S corporation's long-term capital gains and the corporation's gain from sales or exchanges of property described in section 1231 for purposes of section 1366(a) by an amount of tax imposed under section 1374 and this section.

(f) *Examples.* The following examples illustrate the principles of this section and assume that a tax will not be imposed under section 1375:

Example 1. Corporation M is an S corporation for its taxable year beginning January 1, 1983. For 1983, M has an excess of net long-term capital gain over net short-term capital loss in the amount of \$30,000. However, its taxable income for the year is only \$20,000 as a result of other deductions in excess of other income. Thus, although the excess of the net long-term capital gain over the net short-term capital loss exceeds \$25,000 and also exceeds 50 percent of taxable income, M is not subject to the tax imposed by section 1374 for 1983 because its taxable income does not exceed \$25,000.

Example 2. Corporation N is an S Corporation for its 1983 taxable year. For 1983, N has an excess of net long-term capital gain over net short-term capital loss in the amount of \$30,000, and taxable income of \$65,000. Thus, although N's net capital gain (\$30,000) exceeds \$25,000, it does not exceed 50 percent of the corporation's taxable income for the year (50 percent of \$65,000, or \$32,500), and therefore N is not subject to the tax imposed by section 1374 for such year.

Example 3. Assume that Corporation O, an S corporation, is subject to the tax imposed by section 1374 for its taxable year 1983. For 1983, O has an excess of net long-term capital gain over net short-term capital loss in the amount of \$73,000, and taxable income within the meaning of section 1374, which includes capital gains and losses, of \$100,000. The amount of tax computed under paragraph (b)(1) of this section is 28 percent of \$48,000 (\$73,000—\$25,000), or \$13,440. Since this is lower than the amount computed under paragraph (b)(2) of this section, which is \$25,750 (\$3,750+\$4,500+\$7,500+\$10,000), \$13,440 is the amount of tax imposed by section 1374.

Example 4. Assume that in example (3) the taxable income of O for 1983 is \$35,000. This results from an excess of deductions over income with respect to items which were not included in determining the excess of the net long-term capital gain over the net short-term capital loss. In such case, the amount of tax, computed under paragraph (b)(2) of

this section, is \$5,550. Since this is lower than the amount computed under paragraph (b)(1) of this section, \$5,550 is the amount of tax imposed by section 1374.

Example 5. Corporation P, an S corporation, for its taxable year 1983 has an excess of net long-term capital gain over net short-term capital loss in the amount of \$65,000 and has taxable income of \$80,000. P's election under section 1362 has been in effect for its three immediately preceding taxable years, but P, nevertheless, is subject to the tax imposed by section 1374 for 1983 since it has an excess of net long-term capital gain over net short-term capital loss (in the amount of \$20,000) attributable to property with a substituted basis. The tax computed under paragraph (b)(1) of this section, \$11,200 (28 percent of \$40,000 (\$65,000—\$25,000)), is less than the tax computed under paragraph (b)(2) of this section, \$17,750. However, under the limitation provided in paragraph (c) of this section which is applicable in this factual situation, the tax imposed by section 1374 for 1983 may not exceed \$5,600 (28 percent of \$20,000, the excess of net long-term capital gain over net short-term capital loss attributable to property with a substituted basis).

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COOPERATIVES AND THEIR PATRONS

Tax Treatment of Cooperatives

§ 1.1381-1 Organizations to which part applies.

(a) *In general.* Except as provided in paragraph (b) of this section, part I, subchapter T, chapter 1 of the Code, applies to any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons.

(b) *Exceptions.* Part I of such subchapter T does not apply to:

(1) Any organization which is exempt from income taxes under chapter 1 of the Code (other than an exempt farmers' cooperative described in section 521);

(2) Any organization which is subject to the provisions of part II (section 591 and following), subchapter H, chapter 1 of the Code (relating to mutual savings banks, etc.);

(3) Any organization which is subject to the provisions of subchapter L (section 801 and following), chapter 1 of the

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Code (relating to insurance companies); or

(4) Any organization which is engaged in generating, transmitting, or otherwise furnishing electric energy, or which provides telephone service, to persons in rural areas. The terms *rural areas* and *telephone service* shall have the meaning assigned to them in section 5 of the Rural Electrification Act of 1936, as amended (7 U.S.C. 924).

[T.D. 6643, 28 FR 3153, Apr. 2, 1963]

§ 1.1381-2 Tax on certain farmers' cooperatives.

(a) *In general.* (1) For taxable years beginning after December 31, 1962, farmers', fruit growers', or like associations, organized and operated in compliance with the requirements of section 521 and § 1.521-1, shall be subject to the taxes imposed by section 11 or section 1201. Although such associations are subject to both normal tax and surtax, as in the case of corporations generally, certain special deductions are provided for them in section 1382(c) and § 1.1382-3. For the purpose of any law which refers to organizations exempt from income taxes such an association shall, however, be considered as an organization exempt under section 501. Thus, the provisions of section 243, providing a credit for dividends received from a domestic corporation subject to taxation, are not applicable to dividends received from a cooperative association organized and operated in compliance with the requirements of section 521 and § 1.521-1. The provisions of section 1501, relating to consolidated returns, are likewise not applicable.

(2) Rules governing the manner in which amounts paid as patronage dividends are allowable as deductions in computing the taxable income of such an association are set forth in section 1382(b) and § 1.1382-2. For the tax treatment, as to patrons, of amounts received during the taxable year as patronage dividends, see section 1385 and the regulations thereunder.

(b) *Cross references.* For tax treatment of exempt cooperative associations for taxable years beginning before January 1, 1963, or for taxable years beginning after December 31, 1962, with respect to payments attributable to patronage occurring during taxable years beginning

before January 1, 1963, see section 522 and the regulations thereunder. For requirements of annual returns by such associations, see sections 6012 and 6072(d) and paragraph (f) of § 1.6012-2.

[T.D. 6643, 28 FR 3153, Apr. 2, 1963]

§ 1.1382-1 Taxable income of cooperatives; gross income.

(a) *Introduction.* Section 1382(b) provides that the amount of certain patronage dividends (and amounts paid in redemption of nonqualified written notices of allocation) shall not be taken into account by a cooperative organization in determining its taxable income. Such section also provides that, for purposes of the Internal Revenue Code, an amount not taken into account is to be treated in the same manner as an item of gross income and as a deduction therefrom. Therefore, such an amount is treated as a deduction for purposes of applying the Internal Revenue Code and the regulations thereunder and, for simplicity, is referred to as a deduction in the regulations under such Code. However, this should not be regarded as a determination of the character of the amount for other purposes.

(b) *Computation of gross income.* Any cooperative organization to which part I, subchapter T, chapter 1 of the Code, applies shall not, for any purpose under the Code, exclude from its gross income (as a reduction in gross receipts, an increase in cost of goods sold, or otherwise) the amount of any allocation or distribution to a patron out of the net earnings of such organization with respect to patronage occurring during a taxable year beginning after December 31, 1962. See, however, section 1382(b) and § 1.1382-2 for deductions for certain amounts paid to patrons out of net earnings.

[T.D. 6643, 28 FR 3154, Apr. 2, 1963]

§ 1.1382-2 Taxable income of cooperatives; treatment of patronage dividends.

(a) *In general.* (1) In determining the taxable income of any cooperative organization to which part I, subchapter T, chapter 1 of the Code, applies, there shall be allowed as deductions from gross income, in addition to the other

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deductions allowable under chapter 1 of the Code, the deductions with respect to patronage dividends provided in section 1382(b) and paragraphs (b) and (c) of this section.

(2) For the definition of terms used in this section see section 1388 and § 1.1388-1; to determine the payment period for a taxable year, see section 1382(d) and § 1.1382-4.

(b) *Deduction for patronage dividends—*

(1) *In general.* In the case of a taxable year beginning after December 31, 1962, there is allowed as a deduction from the gross income of any cooperative organization to which part I of subchapter T applies, amounts paid to patrons during the payment period for the taxable year as patronage dividends with respect to patronage occurring during such taxable year, but only to the extent that such amounts are paid in money, qualified written notices of allocation, or other property (other than non qualified written notices of allocation). See section 1382 (e) and (f) and §§ 1.1382-5 and 1.1382-6 for special rules relating to the time when patronage is deemed to occur where products are marketed under a pooling arrangement or where earnings are includible in the gross income of the cooperative organization for a taxable year after the year in which the patronage occurred. For purposes of this paragraph, a written notice of allocation is considered paid when it is issued to the patron. A patronage dividend shall be treated as paid in money during the payment period for the taxable year to the extent it is paid by a qualified check which is issued during the payment period for such taxable year and endorsed and cashed on or before the ninetieth day after the close of such payment period. In determining the amount paid which is allowable as a deduction under this paragraph, property (other than written notices of allocation) shall be taken into account at its fair market value when paid, and a qualified written notice of allocation shall be taken into account at its stated dollar amount.

(2) *Special rule for certain taxable years.* No deduction is allowed under this section for amounts paid during taxable years beginning before January 1, 1963, or for amounts paid during tax-

able years beginning after December 31, 1962, with respect to patronage occurring during taxable years beginning before January 1, 1963. With respect to such amounts, the Internal Revenue Code of 1954 (including section 522 and the regulations thereunder) shall be applicable without regard to subchapter T.

(c) *Deduction for amounts paid in redemption of certain nonqualified written notices of allocation.* In the case of a taxable year beginning after December 31, 1962, there is allowed as a deduction from the gross income of a cooperative organization to which part I of subchapter T applies, amounts paid by such organization during the payment period for such taxable year in redemption of a nonqualified written notice of allocation which was previously paid as a patronage dividend during the payment period for the taxable year during which the patronage occurred, but only to the extent such amounts (1) are paid in money or other property (other than written notices of allocation) and (2) do not exceed the stated dollar amount of such written notice of allocation. No deduction shall be allowed under this paragraph, however, for amounts paid in redemption of nonqualified written notices of allocation which were paid with respect to patronage occurring during a taxable year beginning before January 1, 1963. For purposes of this paragraph, if an amount is paid within the payment period for two or more taxable years, it will be allowable as a deduction only for the earliest of such taxable years. Thus, if a cooperative which reports its income on a calendar year basis pays an amount in redemption of a nonqualified written notice of allocation on January 15, 1966, it will be allowed a deduction for such amount only for its 1965 taxable year. In determining the amount paid which is allowable as a deduction under this paragraph, property (other than written notices of allocation) shall be taken into account at its fair market value when paid. Amounts paid in redemption of a nonqualified written notice of allocation in excess of its stated dollar amount shall be treated under the applicable provisions of the Code. For example, if such excess is in the nature of

interest, its deductibility will be governed by section 163 and the regulations thereunder.

[T.D. 6643, 28 FR 3154, Apr. 2, 1963]

§ 1.1382-3 Taxable income of cooperatives; special deductions for exempt farmers' cooperatives.

(a) *In general.* (1) Section 1382(c) provides that in determining the taxable income of a farmers', fruit growers', or like association, described in section 1381(a)(1) and organized and operated in compliance with the requirements of section 521 and § 1.521-1, there shall be allowed as deductions from the gross income of such organization, in addition to the other deductions allowable under chapter 1 of the Code (including the deductions allowed by section 1382(b)) the special deductions provided in section 1382(c) and paragraphs (b), (c), and (d) of this section.

(2) For the definition of terms used in this section, see section 1388 and § 1.1388-1; to determine the payment period for a taxable year, see section 1382(d) and § 1.1382-4.

(b) *Deduction for dividends paid on capital stock.* In the case of a taxable year beginning after December 31, 1962, there is allowed as a deduction from the gross income of a cooperative association operated in compliance with the requirements of section 521 and § 1.521-1, amounts paid as dividends during the taxable year on the capital stock of such cooperative association. For the purpose of the preceding sentence, the term *capital stock* includes common stock (whether voting or non-voting), preferred stock, or any other form of capital represented by capital retain certificates, revolving fund certificates, letters of advice, or other evidence of a proprietary interest in a cooperative association. Such deduction is applicable only to the taxable year in which the dividends are actually or constructively paid to the holder of capital stock or other proprietary interest in the cooperative association. If a dividend is paid by check and the check bearing a date within the taxable year is deposited in the mail, in a cover properly stamped and addressed to the shareholder at his last known address, at such time that in the ordinary handling of the mails the check

would be received by such holder within the taxable year, a presumption arises that the dividend was paid to such holder in such year. The determination of whether a dividend has been paid to such holder by the corporation during its taxable year is in no way dependent upon the method of accounting regularly employed by the corporation in keeping its books. For further rules as to the determination of the right to a deduction for dividends paid, under certain specific circumstances, see section 561 and the regulations thereunder.

(c) *Deduction for amounts allocated from income not derived from patronage—*

(1) *In general.* In the case of a taxable year beginning after December 31, 1962, there is allowed as a deduction from the gross income of a cooperative association operated in compliance with the requirements of section 521 and § 1.521-1, amounts paid to patrons, during the payment period for the taxable year, on a patronage basis with respect to its income derived during such taxable year either from business done with or for the United States or any of its agencies or from sources other than patronage, but only to the extent such amounts are paid in money, qualified written notices of allocation, or other property (other than nonqualified written notices of allocation). For purposes of this subparagraph a written notice of allocation is considered paid when it is issued to the patron. An amount shall be treated as paid in money during the payment period for the taxable year to the extent it is paid by a qualified check which is issued during the payment period for such taxable year and endorsed and cashed on or before the ninetieth day after the close of such payment period. In determining the amount paid which is allowable as a deduction under this paragraph, property (other than written notices of allocation) shall be taken into account at its fair market value when paid, and a qualified written notice of allocation shall be taken into account at its stated dollar amount.

(2) *Definition.* As used in this paragraph, the term *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. For example, income derived from the lease of premises, from investment in securities, or from the sale or exchange of capital assets, constitutes income derived from sources other than patronage.

(3) *Basis of distribution.* In order that the deduction for amounts paid with respect to income derived from business done with or for the United States or any of its agencies or from sources other than patronage may be applicable, it is necessary that the amount sought to be deducted be paid on a patronage basis in proportion, insofar as is practicable, to the amount of business done by or for patrons during the period to which such income is attributable. For example, if capital gains are realized from the sale or exchange of capital assets acquired and disposed of during the taxable year, income realized from such gains must be paid to patrons of such year in proportion to the amount of business done by such patrons during the taxable year. Similarly, if capital gains are realized by the association from the sale or exchange of capital assets held for a period extending into more than one taxable year income realized from such gains must be paid, insofar as is practicable, to the persons who were patrons during the taxable years in which the asset was owned by the association in proportion to the amount of business done by such patrons during such taxable years.

(4) *Special rules for certain taxable years.* No deduction is allowable under this paragraph for amounts paid during taxable years beginning before January 1, 1963, or for amounts paid during taxable years beginning after December 31, 1962, with respect to income derived during taxable years beginning before January 1, 1963. With respect to such amounts, the Internal Revenue Code of 1954 (including section 522 and the regulations thereunder) shall be applicable without regard to subchapter T.

(d) *Deduction for amounts paid in redemption of certain nonqualified written notices of allocation.* In the case of a taxable year beginning after December 31, 1962, there is allowed as a deduction from the gross income of a cooperative

association operated in compliance with the requirements of section 521 and §1.521-1, amounts paid by such association during the payment period for such taxable year in redemption of certain nonqualified written notices of allocation, but only to the extent such amounts (1) are paid in money or other property (other than written notices of allocation) and (2) do not exceed the stated dollar amount of such nonqualified written notices of allocation. The nonqualified written notices of allocation referred to in the preceding sentence are those which were previously paid to patrons on a patronage basis with respect to earnings derived either from business done with or for the United States or any of its agencies or from sources other than patronage, provided that such nonqualified written notices of allocation were paid during the payment period for the taxable year during which such earnings were derived. No deduction shall be allowed under this paragraph, however, for amounts paid in redemption of nonqualified written notices of allocation which were paid with respect to earnings derived during a taxable year beginning before January 1, 1963. For purposes of this paragraph, if an amount is paid within the payment period for two or more taxable years, it will be allowable as a deduction only for the earliest of such taxable years. In determining the amount paid which is allowable as a deduction under this paragraph, property (other than written notices of allocation) shall be taken into account at its fair market value when paid. Amounts paid in redemption of a nonqualified written notice of allocation in excess of its stated dollar amount shall be treated under the applicable provisions of the Code.

[T.D. 6643, 28 FR 3155, Apr. 2, 1963]

§ 1.1382-4 Taxable income of cooperatives; payment period for each taxable year.

The payment period for a taxable 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.

[T.D. 6643, 28 FR 3156, Nov. 26, 1963]

§ 1.1382-5 Taxable income of cooperatives; products marketed under pooling arrangements.

For purposes of section 1382(b) and § 1.1382-2, in the case of a pooling arrangement for the marketing of products the patronage under such pool shall be treated as occurring during the taxable year in which the pool closes. The determination of when a pool is closed will be made on the basis of the facts and circumstances in each case, but generally the practices and operations of the cooperative organization shall control. This section may be illustrated by the following example:

Example: Farmer A delivers to the X Cooperative 100 bushels of wheat on August 15, 1963, at which time he receives a *per bushel* advance. (Both farmer A and the X Cooperative file returns on a calendar year basis.) On October 15, 1963 farmer A receives an additional *per bushel* payment. The pool sells some of its wheat in 1963 and the remainder in January of 1964. The pool is closed on February 15, 1964. For purposes of section 1382(b), A's patronage is considered as occurring in 1964.

[T.D. 6643, 28 FR 3156, Apr. 2, 1963]

§ 1.1382-6 Taxable income of cooperatives; treatment of earnings received after patronage occurred.

If earnings derived from business done with or for patrons are includible in the gross income of the cooperative organization for a taxable year after the taxable year during which the patronage occurred, then, for purposes of determining whether the cooperative is allowed a deduction under section 1382(b) and § 1.1382-2, the patronage to which these earnings relate shall be considered to have occurred during the taxable year for which such earnings are includible in the cooperative's gross income. Thus, if the cooperative organization pays these earnings out as patronage dividends during the payment period for the taxable year for which the earnings are includible in its gross income, it will be allowed a deduction for such payments under section 1382(b)(1) and paragraph (b) of § 1.1382-2, to the extent they are paid in money, qualified written notices of allocation, or other property (other than written notices of allocation).

[T.D. 6643, 28 FR 3156, Apr. 2, 1963]

§ 1.1382-7 Special rules applicable to cooperative associations exempt from tax before January 1, 1952.

(a) *Basis of property.* The adjustments to the cost or other basis provided in sections 1011 and 1016 and the regulations thereunder, are applicable for the entire period since the acquisition of the property. Thus, proper adjustment to basis must be made under section 1016 for depreciation, obsolescence, amortization, and depletion for all taxable years beginning prior to January 1, 1952, although the cooperative association was exempt from tax under section 521 or corresponding provisions of prior law for such years. However, no adjustment for percentage or discovery depletion is to be made for any year during which the association was exempt from tax. If a cooperative association has made a proper election in accordance with section 1020 and the regulations prescribed thereunder with respect to a taxable year beginning before 1952 in which the association was not exempt from tax, the adjustment to basis for depreciation for such years shall be limited in accordance with the provisions of section 1016(a)(2).

(b) *Amortization of bond premium.* In the case of tax exempt and partially taxable bonds purchased at a premium and subject to amortization under section 171, proper adjustment to basis must be made to reflect amortization with respect to such premium from the date of acquisition of the bond. (For principles governing the method of computation, see the example in paragraph (b) of § 1.1016-9, relating to mutual savings banks, building and loan associations, and cooperative banks.) The basis of a fully taxable bond purchased at a premium shall be adjusted from the date of the election to amortize such premium in accordance with the provisions of section 171 except that no adjustment shall be allowable for such portion of the premium attributable to the period prior to the election.

(c) *Amortization of mortgage premium.* In the case of a mortgage acquired at a premium where the principal of such mortgage is payable in installments, adjustments to the basis for the premium must be made for all taxable years (whether or not the association

was exempt from tax under section 521 during such years) in which installment payments are received. Such adjustments may be made on an individual mortgage basis or on a composite basis by reference to the average period of payments of the mortgage loans of such association. For the purpose of this adjustment, the term *premium* includes the excess of the acquisition value of the mortgage over its maturity value. The acquisition value of the mortgage is the cost including buying commissions, attorneys' fees, or brokerage fees, but such value does not include amounts paid for accrued interest.

[T.D. 6643, 28 FR 3156, Apr. 2, 1963]

§ 1.1383-1 Computation of tax where cooperative redeems nonqualified written notices of allocation.

(a) *General rule.* (1) If, during the taxable year, a cooperative organization is entitled to a deduction under section 1382 (b)(2) or (c)(2)(B) for amounts paid in redemption of nonqualified written notices of allocation, the tax imposed for the taxable year by chapter 1 of the Code shall be the lesser of:

(i) The tax for the taxable year computed under section 1383(a)(1), that is, with such deduction taken into account, or

(ii) The tax for the taxable year computed under section 1383(a)(2), that is, without taking such deduction into account, minus the decrease in tax (under chapter 1 of the Code) for any prior taxable year (or years) which would result solely from treating all such nonqualified written notices of allocation redeemed during the taxable year as qualified written notices of allocation when paid. For the purpose of this subdivision, the amount of the decrease in tax is not limited to the amount of the tax for the taxable year. See paragraph (c) of this section for rules relating to a refund of tax where the decrease in tax for the prior taxable year (or years) exceeds the tax for the taxable year.

(2) If the cooperative organization computes its tax for the taxable year under the provisions of section 1383(a)(2) and subparagraph (1)(ii) of this paragraph, then no deduction under section 1382 (b)(2) or (c)(2)(B) shall be taken into account in com-

puting taxable income or loss for the taxable year, including the computation of any net operating loss carryback or carryover. However, the amount of the deduction shall be taken into account in adjusting earnings and profits for the taxable year.

(3) If the tax determined under subparagraph (1)(i) of this paragraph is the same as the tax determined under subparagraph (1)(ii) of this paragraph, the tax imposed for the taxable year under chapter 1 of the Code shall be the tax determined under subparagraph (1)(1) of this paragraph, and section 1383 and this section shall not otherwise apply. The tax imposed for the taxable year shall be the tax determined under subparagraph (1)(ii) of this paragraph in any case when a credit or refund would be allowable for the taxable year under section 1383(b)(1).

(b) *Determination of decrease in tax for prior taxable years—*(1) *Prior taxable years.* The prior taxable year (or years) referred to in paragraph (a) of this section is the year (or years) within the payment period for which the nonqualified written notices of allocation were paid and, in addition, any other prior taxable year (or years) which is affected by the adjustment to income by reason of treating such nonqualified written notices of allocation as qualified written notices of allocation when paid.

(2) *Adjustment to income in prior taxable years.* The deduction for the prior taxable year (or years) in determining the decrease in tax under section 1383(a)(2)(B) and paragraph (a)(1)(ii) of this section shall be the amount paid in redemption of the nonqualified written notices of allocation which, without regard to section 1383, is allowable as a deduction under section 1382 (b)(2) or (c)(2)(B) for the current taxable year.

(3) *Computation of decrease in tax for prior taxable years.* In computing the amount of decrease in tax for a prior taxable year (or years) resulting under this section, there must first be ascertained the amount of tax previously determined for the taxpayer for such prior taxable year (or years). The tax previously determined shall be the sum of the amounts shown as such tax

by the taxpayer on his return or returns, plus any amounts which have been previously assessed (or collected without assessment) as deficiencies, reduced by the amount of any rebates which have previously been made. The amount shown as the tax by the taxpayer on his return and the amount of any rebates or deficiencies shall be determined in accordance with the provisions of section 6211 and the regulations thereunder. After the tax previously determined has been ascertained, a recomputation must then be made to determine the decrease in tax, if any, resulting under this section. In determining the decrease in tax for the prior taxable year (or years), appropriate adjustment shall be made to any item which is dependent upon the amount of gross income or taxable income (such as charitable contributions, net operating losses, the foreign tax credit, and the dividends received credit).

(c) *Refunds.* If the decrease in tax for the prior taxable year (or years) determined under section 1383(a)(2)(B) and paragraph (a)(1)(ii) of this section exceeds the tax imposed by chapter 1 of the Code for the taxable year computed without the deduction under section 1382 (b) or (c)(2)(B), the excess shall be considered to be a payment of tax for the taxable year of the deduction. Such payment is deemed to have been made on the last day prescribed by law for the payment of tax for the taxable year and shall be refunded or credited in the same manner as if it were an overpayment of tax for such taxable year. See section 6151 and the regulations thereunder, for rules relating to time and place for paying tax shown on returns.

(d) *Example.* The application of section 1383 may be illustrated by the following example:

Example: The X Cooperative (which reports its income on a calendar year basis) pays patronage dividends of \$100,000 in nonqualified written notices of allocation on February 1, 1964, with respect to patronage occurring in 1963. Since the patronage dividends of \$100,000 were paid in nonqualified written notices of allocation the X Cooperative is not allowed a deduction for that amount for 1963. On December 1, 1966, the X Cooperative redeems these nonqualified written notices of allocation for \$50,000. Under section 1382(b)(2), a deduction of \$50,000 is allowable

in computing its taxable income for 1966. However, the X Cooperative has a loss for 1966 determined without regard to this deduction. The X Cooperative, therefore, makes the computation under the alternative method provided in section 1383(a)(2). Under this alternative method, it will claim a credit or refund (as an overpayment of tax for 1966) of the decrease in tax for 1963 and for such other years prior to 1966 as are affected which results from recomputing its tax for 1963 and such other years affected) as if patronage dividends of \$50,000 had been paid on February 1, 1964, in qualified written notices of allocation. In addition, under this alternative method the X Cooperative cannot use the \$50,000 as a deduction for 1966 so as to increase its net operating loss for such year for purposes of computing a net operating loss carryback or carryover. If the X Cooperative also redeems on December 1, 1966, nonqualified written notices of allocation which were paid as patronage dividends on February 1, 1965, with respect to patronage occurring in 1964, it will claim a credit or refund (as an overpayment of tax for 1966) of the decrease in tax for 1964 and for such other years prior to 1966 as are affected. It shall not, however, apply one method for computing the tax with respect to the redemptions in 1966 of the nonqualified written notices of allocation paid in 1964 and the other method with respect to the redemption in 1966 of the nonqualified written notices of allocation paid in 1965.

[T.D. 6643, 28 FR 3156, Apr. 2, 1963]

TAX TREATMENT BY PATRONS OF PATRONAGE DIVIDENDS

§ 1.1385-1 Amounts includible in patron's gross income.

(a) *General rules.* Section 1385(a) requires every person to include in gross income the following amounts received by him during the taxable year, to the extent paid by the organization in money, a qualified written notice of allocation, or other property (other than a nonqualified written notice of allocation):

(1) The amount of any patronage dividend received from an organization subject to the provisions of part I, subchapter T, chapter 1 of the Code, unless such amount is excludable from gross income under the provisions of section 1385(b) and paragraph (c) of this section, and

(2) The amount of any distribution received from a farmers', fruit growers', or like association, organized and