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any of its agencies shall be disregarded in determining the right to exemption under section 521 and this section. An association to be entitled to exemption must not only be organized but actually operated in the manner and for the purposes specified in section 521.

(d) Cooperative organizations engaged in occupations dissimilar from those of farmers, fruit growers, and the like, are not exempt.

(e) An organization is not exempt from taxation under this section merely because it claims that it complies with the requirements prescribed therein. In order to establish its exemption every organization claiming exemption under section 521 is required to file a Form 1028. The Form 1028, executed in accordance with the instructions on the form or issued therewith, should be filed with the district director for the internal revenue district in which is located the principal place of business or principal office of the organization. However, an organization which has been granted exemption under the provisions of the Internal Revenue Code of 1939 or prior law may rely on that ruling, unless affected by substantive changes in the Internal Revenue Code of 1954 or any changes in the character, purposes, or methods of operation of the organization, and it is not necessary in such case for the organization to request a new determination as to its exempt status.

(f) A cooperative association will not be denied exemption merely because it makes payments solely in nonqualified written notices of allocation to those patrons who do not consent as provided in section 1388 and § 1.1388-1, but makes payments of 20 percent in cash and the remainder in qualified written notices of allocation to those patrons who do so consent. Nor will such an association be denied exemption merely because, in the case of patrons who have so consented, payments of less than \$5 are made solely in nonqualified written notices of allocation while payments of \$5 or more are made in the form of 20 percent in cash and the remainder in qualified written notices of allocation. In addition, a cooperative association will not be denied exemption if it pays a smaller amount of interest or dividends on nonqualified written notices

of allocation held by persons who have not consented as provided in section 1388 and § 1.1388-1 (or on per-unit retain certificates issued to patrons who are not qualifying patrons with respect thereto within the meaning of § 1.61-5(d)(2)) than it pays on qualified written notices of allocation held by persons who have so consented (or on per-unit retain certificates issued to patrons who are qualifying patrons with respect thereto) provided that the amount of the interest or dividend reduction is reasonable in relation to the fact that the association receives no tax benefit with respect to such nonqualified written notices of allocation (or such certificates issued to nonqualifying patrons) until redeemed. However, such an association will be denied exemption if it otherwise treats patrons who have not consented (or are not qualifying patrons) differently from patrons who have consented (or are qualifying patrons), either with regard to the original payment or allocation or with regard to the redemption of written notices of allocation or per-unit retain certificates. For example, if such an association pays patronage dividends in the form of written notices of allocation accompanied by qualified checks, and provides that any patron who does not cash his check within a specified time will forfeit the portion of the patronage dividend represented by such check, then the cooperative association will be denied exemption under this section as it does not treat all patrons alike.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6643, 28 FR 3162, Apr. 2, 1963; T.D. 6855, 30 FR 13135, Oct. 15, 1965]

§ 1.522-1 Tax treatment of farmers' cooperative marketing and purchasing associations exempt under section 521.

(a) *In general.* (1) Section 522 is applicable to farmers', fruit growers', or like associations organized and operated on a cooperative basis in the manner prescribed in section 521. Although such an association is subject to both normal tax and surtax, as in the case of corporations generally, certain special rules for the computation of taxable income are provided in section 522(b) and § 1.522-2. 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 subject to section 522. The provisions of section 1501, relating to consolidated returns, are likewise not applicable.

(2) Rules governing the manner in which amounts allocated as patronage dividends, refunds, or rebates are to be taken into account in computing the taxable income of such an association are set forth in § 1.522-3. For the tax treatment, as to patrons, of amounts received during the taxable year as patronage dividends, rebates, or refunds, see section 61 and § 1.61-5.

(b) *Meaning of terms.* For purposes of §§ 1.522-1 to 1.522-3, inclusive, §§ 1.6044-1 and 1.61-5, the following terms shall have the meaning ascribed below:

(1) *Cooperative association.* The term *cooperative association* includes any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons, except that the term does not include any cooperative or nonprofit corporation (including any cooperative or nonprofit corporation engaged in rural electrification) exempt from taxation under section 501(a) and described in section 501(c) (12) or (15) or any corporation subject to a tax imposed by subchapter L, chapter 1 of the Code (relating to insurance companies).

(2) *Patron.* The term *patron* includes any person with whom or for whom the cooperative association does business on a cooperative basis, whether a member or a nonmember of the cooperative association, and whether an individual, a trust, estate, partnership, company, corporation, or cooperative association.

(3) *Allocation.* The term *allocation* includes distributions made by a cooperative association to a patron in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, similar documents, or in any

other manner whereby there is disclosed to a patron the dollar amount apportioned on the books of the association for the account of such patron. Thus, a mere credit to the account of a patron on the books of the cooperative association, without disclosure to the patron, is not an allocation.

(4) *Patronage dividends, rebates, and refunds.* The term *patronage dividend, rebate, or refund* includes any amount allocated by a cooperative association, to the account of a patron on the basis of the business done with or for such patron. The following are not patronage dividends, rebates, or refunds:

(i) Amounts distributed in redemption of capital stock, or in redemption or satisfaction of certificates of indebtedness, revolving fund certificates, retain certificates, letters of advice, or other similar documents;

(ii) Amounts allocated (whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, refund, or rebate) by the association for products of members or other patrons to the extent such amounts are fixed without reference to the earnings of the cooperative association. For this purpose, the term *earnings* includes the excess of amounts retained (or assessed) by the association to cover expenses or other items over the amount of such expenses or other items.

(c) *Examples.* The application of paragraph (b) of this section may be illustrated by the following examples:

Example 1. Cooperative A, a marketing association operating on a pooling basis, receives the products of patron W on January 5, 1954. On the same day Cooperative A advances to W 45 cents per unit for the products so delivered and allocates to him a *retain certificate* having a face value calculated at the rate of 5 cents per unit. During the operation of the pool, and before substantially all the products in the pool are disposed of, Cooperative A advances to W an additional 40 cents per unit, the amount being determined by reference to the market price of the products sold and the anticipated price of the unsold products. At the close of the pool on November 10, 1954, Cooperative A determines the excess of its receipts over the sum of its expenses and its previous advances to patrons, and allocates to W an additional

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3 cents per unit and shares of the capital stock of A having an aggregate of face value calculated at the rate of 2 cents per unit.

The amount of patronage dividends, rebates, or refunds allocated to W during 1954 amount to 5 cents per unit, consisting of the aggregate of the following per-unit allocations: The amount of cash distribution (3 cents), and the face value of the capital stock of A (2 cents), which are fixed with reference to the earnings of A. The amount of the two distributions in cash (85 cents) and the face amount of the *retain certificate* (5 cents), which are fixed without reference to the earnings of A, do not constitute patronage dividends, rebates, or refunds.

Example 2. Cooperative B, a marketing association operating on a pooling basis, receives the products of patron X on March 5, 1954. On the same day Cooperative B pays to X \$1.00 per unit for such products, this amount being determined by reference to the market price of the product when received, and issues to him a participation certificate having no face value but which entitles X on the close of the pool to the proceeds derived from the sale of his products less the previous payment of \$1.00 and the expenses and other charges attributable to such products. On March 5, 1957, Cooperative B, having sold the products in the pool, having deducted the previous payments for such products, and having determined the expenses and other charges of the pool, redeems the participation certificate of X in cash for 10 cents per unit. The allocation made to X during 1957, amounting to 10 cents per unit, is a patronage dividend, rebate, or refund. Neither the payment to X in 1954 of \$1.00 nor the issuance to him of the participation certificate in that year constitutes a patronage dividend, rebate, or refund within the meaning of this section.

Example 3. Cooperative C, a purchasing association, obtains supplies for patron Y on May 1, 1954, and receives in return therefor \$100. On February 1, 1955, Cooperative C, having determined the excess of its receipts over its costs and expenses, allocates to Y a cash distribution of \$1.00 and a revolving fund certificate of a face amount of \$1.00. The amount of patronage dividends, rebates, or refunds allocated to Y for 1955 is \$2.00, the aggregate of the cash distribution of \$1.00, and the face amount, \$1.00, of the revolving fund certificate.

Example 4. Cooperative D, a service association, sells the products of members on a fee basis. It receives the products of patron Z under an agreement not to pool his products with those of other members, to sell his products, and to deliver to him the proceeds of the sale. Patron Z makes payments to Cooperative D during 1954 aggregating \$75 for service rendered him by Cooperative D during that year. On May 15, 1955, Cooperative D, having determined the excess of its re-

ceipts over its costs and expenses, allocates to Z a cash distribution of \$2.00. Such amount is a patronage dividend, rebate, or refund allocated by Cooperative D during 1955.

(d) *Returns of exempt cooperative associations.* For requirements of annual returns by exempt cooperative associations, see sections 6012 and 6072(d) and paragraph (f) of § 1.6012-2.

§ 1.522-2 Manner of taxation of cooperative associations subject to section 522.

(a) *In general.* 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, except that there shall be allowed as deductions from gross income, in addition to the other deductions allowable under chapter 1 of the Code, certain special deductions provided in section 522(b)(1)(A) and paragraph (c) of this section, and section 522(b)(1)(B) and paragraph (d) of this section. Amounts allocated as patronage dividends, refunds, or rebates, whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated, with respect to patronage for the taxable year or for preceding taxable years, shall be taken into account in the manner provided in section 522 and in § 1.522-3.

(b) *Cooperative association exempt from tax before January 1, 1952.* (1) For the purpose of determining the method of accounting under section 446 in the case of a cooperative association which was exempt from tax for taxable years beginning prior to January 1, 1952, the method of accounting, recognized under sections 41, 42, and 43 of the Internal Revenue Code of 1939 and the regulations prescribed thereunder and utilized in the return of such association for its last taxable year to which the Internal Revenue Code of 1939 was applicable, shall be deemed to constitute the method of accounting regularly employed by the cooperative association. Any change from this method may be made only if permission is