

activity, leases, rents, licenses, sells, exchanges, or otherwise disposes of such property, then the partnership's gross receipts from this latter disposition are treated as non-DPGR.

[T.D. 9381, 73 FR 8806, Feb. 15, 2008]

§ 1.199-6 Agricultural and horticultural cooperatives.

(a) *In general.* A patron who receives a qualified payment (as defined in paragraph (e) of this section) from a specified agricultural or horticultural cooperative (cooperative) (as defined in paragraph (f) of this section) is allowed a deduction under § 1.199-1(a) (section 199 deduction) for the taxable year the qualified payment is received for the portion of the cooperative's section 199 deduction passed through to the patron and identified by the cooperative in a written notice mailed to the person during the payment period described in section 1382(d). The provisions of this section apply solely for purposes of section 199 of the Internal Revenue Code (Code).

(b) *Cooperative denied section 1382 deduction for portion of qualified payments.* A cooperative must reduce its section 1382 deduction by an amount equal to the portion of any qualified payment that is attributable to the cooperative's section 199 deduction passed through to the patron.

(c) *Determining cooperative's qualified production activities income and taxable income.* For purposes of determining its section 199 deduction, the cooperative's qualified production activities income (QPAI) (as defined in § 1.199-1(c)) and taxable income are computed without taking into account any deduction allowable under section 1382(b) or (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

(d) *Special rule for marketing cooperatives.* In the case of a cooperative engaged in the marketing of agricultural and/or horticultural products described in paragraph (f) of this section, the cooperative is treated as having manufactured, produced, grown, or extracted (MPGE) (as defined in § 1.199-3(e)) in whole or in significant part (as defined in § 1.199-3(g)) within the United States (as defined in § 1.199-3(h)) any agricultural or horticultural products mar-

keted by the cooperative that its patrons have MPGE.

(e) *Qualified payment.* The term *qualified payment* means any amount of a patronage dividend or per-unit retain allocation, as described in section 1385(a)(1) or (3) received by a 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.

(f) *Specified agricultural or horticultural cooperative.* A *specified agricultural or horticultural cooperative* means a cooperative to which Part I of subchapter T of the Code applies and the cooperative has MPGE in whole or significant part within the United States any agricultural or horticultural product, or has marketed agricultural or horticultural products. For this purpose, agricultural or horticultural products also include fertilizer, diesel fuel, and other supplies used in agricultural or horticultural production.

(g) *Written notice to patrons.* In order for a patron to qualify for the section 199 deduction, paragraph (a) of this section 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.

(h) *Additional rules relating to pass-through of section 199 deduction.* The cooperative may, at its discretion, pass

through all, some, or none of the section 199 deduction to its patrons. A cooperative member of a federated cooperative may pass through the section 199 deduction it receives from the federated cooperative to its member patrons. Patrons may claim the section 199 deduction for the taxable year in which they receive the written notice from the cooperative informing them of the section 199 amount without regard to the taxable income limitation under § 1.199-1(a) and (b).

(i) *W-2 wages.* The W-2 wage limitation described in § 1.199-2 shall be applied at the cooperative level whether or not the cooperative chooses to pass through some or all of the section 199 deduction. Any section 199 deduction that has been passed through by a cooperative to its patrons is not subject to the W-2 wage limitation a second time at the patron level.

(j) *Recapture of section 199 deduction.* If the amount of the section 199 deduction that was passed through to patrons exceeds the amount allowable as a section 199 deduction as determined on audit or reported on an amended return, then recapture of the excess will occur at the cooperative level in the taxable year the cooperative took the excess section 199 deduction amount into account.

(k) *Section is exclusive.* This section is the exclusive method for cooperatives and their patrons to compute the amount of the section 199 deduction. Thus, a patron may not deduct any amount with respect to a patronage dividend or a per-unit retain allocation unless the requirements of this section are satisfied.

(l) *No double counting.* A qualified payment received by a patron of a cooperative is not taken into account by the patron for purposes of section 199.

(m) *Examples.* The following examples illustrate the application of this section:

Example 1. (i) Cooperative X markets corn grown by its members within the United States for sale to retail grocers. For its calendar year ended December 31, 2007, Cooperative X has gross receipts of \$1,500,000, all derived from the sale of corn grown by its members within the United States. Cooperative X pays \$370,000 for its members' corn and its W-2 wages (as defined in § 1.199-2(e)) for 2007 total \$130,000. Cooperative X has no

other costs. Patron A is a member of Cooperative X. Patron A is a cash basis taxpayer and files Federal income tax returns on a calendar year basis. All corn grown by Patron A in 2007 is sold through Cooperative X and Patron A is eligible to share in patronage dividends paid by Cooperative X for that year.

(ii) Cooperative X is a cooperative described in paragraph (f) of this section. Accordingly, this section applies to Cooperative X and its patrons and all of Cooperative X's gross receipts from the sale of its patrons' corn qualify as domestic production gross receipts (as defined § 1.199-3(a)). Cooperative X's QPAI is \$1,000,000. Cooperative X's section 199 deduction for its taxable year 2007 is \$60,000 (.06 × \$1,000,000). Because this amount is less than 50% of Cooperative X's W-2 wages, the entire amount is allowed as a section 199 deduction subject to the rules of section 199(d)(3) and this section.

Example 2. (i) The facts are the same as in *Example 1* except that Cooperative X decides to pass its entire section 199 deduction through to its members. Cooperative X declares a patronage dividend for its 2007 taxable year of \$1,000,000, which it pays on March 15, 2008. Pursuant to paragraph (g) of this section, Cooperative X notifies members in written notices that accompany the patronage dividend notification that it is allocating to them the section 199 deduction it is entitled to claim in the taxable year 2007. On March 15, 2008, Patron A receives a \$10,000 patronage dividend that is a qualified payment under paragraph (e) of this section from Cooperative X. In the notice that accompanies the patronage dividend, Patron A is designated a \$600 section 199 deduction. Under paragraph (a) of this section, Patron A must claim a \$600 section 199 deduction for the taxable year ending December 31, 2008, without regard to the taxable income limitation under § 1.199-1(a) and (b). Cooperative X must report the amount of Patron A's section 199 deduction on Form 1099-PATR, "Taxable Distributions Received From Cooperatives," issued to Patron A for the calendar year 2008.

(ii) Under paragraph (b) of this section, Cooperative X is required to reduce its patronage dividend deduction of \$1,000,000 by the \$60,000 section 199 deduction passed through to members (whether or not Cooperative X pays patronage on book or Federal income tax net earnings). As a consequence, Cooperative X is entitled to a patronage dividend deduction for the taxable year ending December 31, 2007, in the amount of \$940,000 (\$1,000,000 - \$60,000) and to a section 199 deduction in the amount of \$60,000 (\$1,000,000 × .06). Its taxable income for 2007 is \$0.

Example 3. (i) The facts are the same as in *Example 1* except that Cooperative X paid out \$500,000 to its patrons as advances on expected patronage net earnings. In 2007, Cooperative X pays its patrons a \$500,000

(\$1,000,000-\$500,000 already paid) patronage dividend in cash or a combination of cash and qualified written notices of allocation. Under paragraph (b) of this section and section 1382, Cooperative X is allowed a patronage dividend deduction of \$440,000 (\$500,000-\$60,000 section 199 deduction), whether patronage net earnings are distributed on book or Federal income tax net earnings.

(i) The patrons will have received a gross amount of \$1,000,000 in qualified payments under paragraph (e) of this section from Cooperative X (\$500,000 paid during the taxable year as advances and the additional \$500,000 paid as patronage dividends). If Cooperative X passes through its entire section 199 deduction to its members by providing the notice required by paragraph (g) of this section, then the patrons will be allowed a \$60,000 section 199 deduction, resulting in a net \$940,000 taxable distribution from Cooperative X. Pursuant to paragraph (l) of this section, the \$1,000,000 received by the patrons from Cooperative X is not taken into account for purposes of section 199 in the hands of the patrons.

[T.D. 9263, 71 FR 31283, June 1, 2006; 72 FR 6, Jan. 3, 2007; T.D. 9317, 72 FR 12973, Mar. 20, 2007]

§ 1.199-7 Expanded affiliated groups.

(a) *In general.* The provisions of this section apply solely for purposes of section 199 of the Internal Revenue Code (Code). All members of an expanded affiliated group (EAG) are treated as a single corporation for purposes of section 199. Notwithstanding the preceding sentence, except as otherwise provided in the Code and regulations (see, for example, sections 199(c)(7) and 267, §1.199-3(b), paragraph (a)(3) of this section, and the consolidated return regulations), each member of an EAG is a separate taxpayer that computes its own taxable income or loss, qualified production activities income (QPAI) (as defined in §1.199-1(c)), and W-2 wages (as defined in §1.199-2(e)). If members of an EAG are also members of a consolidated group, see paragraph (d) of this section.

(1) *Definition of expanded affiliated group.* An EAG is an affiliated group as defined in section 1504(a), determined by substituting *more than 50 percent for at least 80 percent* each place it appears and without regard to section 1504(b)(2) and (4).

(2) *Identification of members of an expanded affiliated group—(i) In general.* A

corporation must determine if it is a member of an EAG on a daily basis.

(ii) *Becoming or ceasing to be a member of an expanded affiliated group.* If a corporation becomes or ceases to be a member of an EAG, the corporation is treated as becoming or ceasing to be a member of the EAG at the end of the day on which its status as a member changes.

(3) *Attribution of activities—(i) In general.* If a member of an EAG (the disposing member) derives gross receipts (as defined in §1.199-3(c)) from the lease, rental, license, sale, exchange, or other disposition (as defined in §1.199-3(i)) of qualifying production property (QPP) (as defined in §1.199-3(j)) that was manufactured, produced, grown or extracted (MPGE) (as defined in §1.199-3(e)), in whole or in significant part (as defined in §1.199-3(g)) in the United States (as defined in §1.199-3(h)), a qualified film (as defined in §1.199-3(k)), or electricity, natural gas, or potable water (as defined in §1.199-3(l)) (collectively, utilities) that was produced in the United States, such property was MPGE or produced by another corporation (or corporations), and the disposing member is a member of the same EAG as the other corporation (or corporations) at the time that the disposing member disposes of the QPP, qualified film, or utilities, then the disposing member is treated as conducting the previous activities conducted by such other corporation (or corporations) with respect to the QPP, qualified film, or utilities in determining whether its gross receipts are domestic production gross receipts (DPGR) (as defined in §1.199-3(a)). With respect to a lease, rental, or license, the disposing member is treated as having disposed of the QPP, qualified film, or utilities on the date or dates on which it takes into account the gross receipts derived from the lease, rental, or license under its methods of accounting. With respect to a sale, exchange, or other disposition, the disposing member is treated as having disposed of the QPP, qualified film, or utilities on the date on which it ceases to own the QPP, qualified film, or utilities for Federal income tax purposes, even if no gain or loss is taken into account.