

PATRONAGE DETERMINATIONS

DAVID R. COOK

Autry, Hall & Cook, LLP



Patronage Determinations: Statutory Requirements

- Patronage-Dividend Deduction Requirements
 - Patronage Basis
 - Pre-Existing Legal Obligation
 - Patronage-Sourced Earnings
- Patronage Dividend – “[A]mount paid to a patron . . . which is determined by reference to the net earnings . . . from business done with or for its patrons.”

Patronage Determinations: Statutory Requirements

- Patronage Earnings - “[E]arnings . . . which are derived from business done with or for patrons. . . .”
- Patron – “[A]ny person with whom or for whom the cooperative association does business on a cooperative basis, whether a member or nonmember. . . .”
- Net Earnings – “[E]xcess of amounts retained (or assessed) by the organization to cover expenses or other items over the amount of such expenses or other items.”

Patronage Determinations: Exclusions

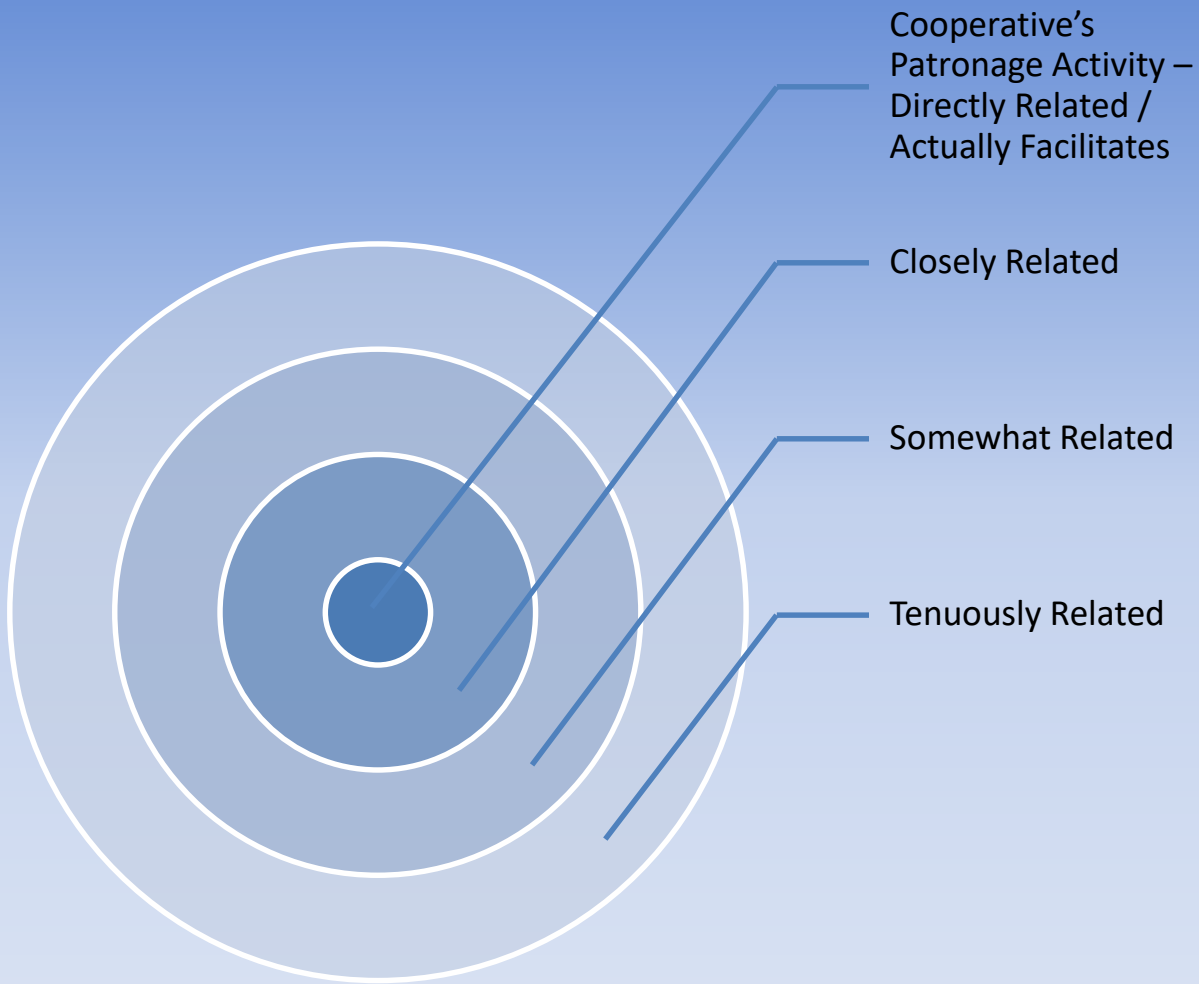
- Statutory and Regulatory Exclusions:
 - Non-patronage earnings
 - Earnings from patrons who do not receive patronage dividends
 - Earnings from patrons who receive less patronage dividends on substantially identical transactions

Patronage Determinations: Exclusions

- Regulatory Definition of “Non-Patronage”
 - “[I]ncidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association.”
 - Examples: lease of premises, investment in securities, and capital gains

Patronage Determinations: Rev. Rule. 69-576

- 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.



Patronage Determinations: Categories of Earnings

- Interest
- Rent
- Dividends and Distributions
- Partnership and Flow-Through Income
- Capital Gains
- Consolidated Income
- Reorganizations, Liquidations, and Consolidations

Patronage Determinations: Examples

- Coop has excess cash but needs to use the cash to cover upcoming expenses. It invests the cash in a short-term instrument until needed. It generates interest income on the investment.
- Is the interest patronage-sourced earnings?

Patronage Determinations: Examples

- Coop is a supply/purchasing cooperative that purchases materials at wholesale and sells to patrons. Its primary supplier indicated it would be unable to perform without a loan. Coop agreed to loan funds to the supplier with interest.
- Is the interest patronage-sourced earnings?

Patronage Determinations: Examples

- Coop has extra space in its warehouse (equipment) and decides to lease out the extra space (equipment).
- Is the rental income patronage-sourced earnings?

Patronage Determinations: Examples

- Coop does not have resources to continue providing its patrons a service (product). It decides to purchase or invest in a C-corporation subsidiary that is able to provide the service (product). The subsidiary pays dividends.
- Are the dividends patronage-sourced earnings?

Patronage Determinations: Examples

- Same as before, except the subsidiary is taxed as a partnership.
- Is the Coop's distributive share of the partnership's income considered patronage-sourced earnings?

Patronage Determinations: Examples

- Coop decides it's time to sell the C-corporation subsidiary – resulting in a large gain.
- Is the gain considered patronage-sourced earnings?

Patronage Determinations: Examples

- Coop previously acquired equipment to process patrons' produce. Eventually Coop sold the equipment at a large gain.
- Is the gain considered patronage-sourced earnings?
- What if the equipment was never used?

Patronage Determinations: Examples

- Coop is the consolidated parent of an affiliated group of C-corporation subsidiaries. The subsidiaries provide services to the patrons.
- When the Coop reports subsidiaries' income on a consolidated return, is such income patronage-sourced earnings?

Patronage Determinations: Patronage Net Earnings

- Netting Issues:
 - May non-patronage expenses be applied against patronage-sourced income?
 - Whether income and expenses must be allocated between patronage and non-patronage sources?
- Methods of Allocation Between Patronage and Non-Patronage
- Net Operating Losses

Contact

David R. Cook

www.ahclaw.com/cook-cooperative/

770-818-4442

cook@ahclaw.com

