

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200414019**

Release Date: 4/2/04

Index Number: U.I.L. No.: 1381.00-00

Person To Contact:

,

Telephone Number:

Refer Reply To:

CC:PSI:B05 PLR-149154-03

Date:

December 15, 2003

Legend

Coop =

State A =

Dear :

This is in response to your letter dated August 15, 2003, submitted on behalf of Coop requesting a ruling on the federal income tax consequences of a transaction as described below.

Coop was incorporated in as a federated cooperative association under the State A Cooperative Marketing Act. Coop conducts its business in two operating areas. On the output side of the business, Coop has operated as a processing and marketing cooperative, processing and marketing beef and pork products and storing and marketing grain. On the input side, Coop has operated as an agricultural supply cooperative. The agricultural supply business has consisted of three principal product divisions: crop production, petroleum, and feed. The principal products of the crop production division have been nitrogen and phosphate-based fertilizers ("plant foods") and a complete line of insecticides, herbicides and mixed chemicals. Principal products of the petroleum division have been refined fuels, propane, and petroleum refining by-products. Principal products of the feed division have included swine, dairy, pet, beef,

poultry, mineral and specialty feeds, feed ingredients and supplements, animal health products and livestock services.

Throughout the years, Coop recognized significant margins on its patronage sourced business with its members and patrons. In accordance with Coop's bylaws, Coop was required to distribute its patronage sourced margins to its patrons. Coop's bylaws authorize Coop to net patronage income and loss from its various allocation pools, subject to and in accordance with section 1388(j). Coop issued the patronage dividends to its members, associate members, and patrons in the form of common stock, associate member common stock or capital credits. Coop issued the patronage equity predominantly as qualified written notices of allocation within the meaning of section 1388(c)(1), although a portion was issued as nonqualified written notices of allocation. As of August 31, 2002, Coop had approximately \$ of qualified written notices of allocation outstanding and approximately \$ of nonqualified written notices of allocation outstanding. The ruling requested herein only relates to the qualified written notices of allocation issued by Coop.

During the current economic downturn, Coop realized significant economic losses and incurred significant net operating losses under section 172. A substantial portion of such losses are attributable to business done by Coop with or for its members/patrons (the "patronage losses"). As a result of these losses and a resulting lack of liquidity to finance its continued operations, Coop filed for bankruptcy on

in the Federal Bankruptcy Court in the ("Court"). Coop has filed its amended reorganization plan ("Plan"). The Plan provides that Coop will liquidate all of Coop's assets and distribute the liquidation proceeds to Coop's creditors in accordance with the provisions of the Bankruptcy Code. To the extent creditors are not paid in full, the unsatisfied portion of the creditor's claims will not be discharged.

The Plan provides that the holders of Coop's common stock, associate member common stock, and capital credits will not receive or retain any property under the Plan on account of Coop's common stock, associate member common stock, and capital credits. However, the Court will not actually cancel any of Coop's common stock, associate member common stock, and capital credits. The implementation of the Plan, and any element thereof, is subject to the Court's approval. Although Coop's qualified written notices of allocation in the form of Coop common stock, associate member common stock, and capital credits will remain outstanding following the Plan's implementation, Coop will not continue to conduct any business operations.

As explained above, based upon the Plan, the holders of Coop's equity will not receive any distribution with respect to their patronage equity. The patronage equity will not be cancelled at the end of the bankruptcy.

On the basis of the foregoing information, Coop requests the following ruling:

Coop will not recognize any income if Coop's patronage equity holders do not receive consideration equal to the face amount of their outstanding Coop patronage equity issued as qualified written notices of allocation, when Coop completely liquidates its assets to pay its creditors and does not actually cancel its patronage equities.

Coop is organized and operates as a cooperative. As a cooperative, Coop conducts its operations with the purpose of operating at cost with respect to the business Coop conducts with or for its members. When Coop realizes a profit on the business it does with or for its members, Coop is required by its bylaws to distribute such profit to its members through the payment of a patronage dividend. Coop claimed a patronage dividend deduction for Federal income tax purposes upon the issuance of its patronage equity in the form of qualified written notices of allocation.

As stated above, the Plan will provide that Coop will liquidate all of its assets to satisfy the claims of its creditors. The liquidation proceeds on Coop's sale of its assets will be insufficient to satisfy all of the creditor's claims. To the extent liquidation proceeds are not available to satisfy all of the creditor's claims, the Bankruptcy Code provides that the unsatisfied creditor claims will not be discharged. In addition, to the extent liquidation proceeds are not available to satisfy the patronage equity, the Bankruptcy Code provides that the unsatisfied patronage equity will remain outstanding. However, the Plan provides that the holders of Coop's common stock, associate member common stock, and capital credits will not receive or retain any property under the Plan on account of Coop's common stock, associate member common stock, and capital credits. However, the Court will not actually cancel any of Coop's common stock, associate member common stock, and capital credits.

The bankruptcy proceedings will not alter the legal rights and obligations that Coop and its patronage equity holders have with respect to the outstanding Coop patronage equity. Thus, Coop should not recognize any gain or loss with respect to the patronage equity. In situations in which a cooperative has redeemed its patronage equity from its patronage equity holders at a discount, the Service position is that the cooperative must recognize income in an amount equal to the discount under the tax benefit rule. However, Coop herein will not be canceling the patronage equity. Coop will not be recovering for itself the amount that it previously deducted, since all amounts will be paid to Coop's creditors in partial settlement of the amount due Coop's creditors.

Therefore, because the patronage equity will not be cancelled or redeemed for less than its face value, Coop will not recognize any tax benefit income.

Accordingly based solely on the foregoing we rule that:

Coop will not recognize any income if Coop's patronage equity holders do not receive consideration equal to the face amount of their outstanding Coop patronage equity issued as qualified written notices of allocation, when Coop completely liquidates its assets to pay its creditors and does not actually cancel its patronage equities.

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 Coop.

Sincerely yours,

Walter H. Woo
Senior Technician Reviewer
Branch 5
Office of the Assistant Chief Counsel
Passthroughs and Special Industries