Internal Revenue Service	Department of the Treasury
Number: **200341017** Release Date: 10/10/2003 Index Number: U.I.L. No. 1381.00-00	Washington, DC 20224
	Person to Contact:
	Telephone Number:
	Refer Reply To: CC:PSI:5 PLR-124895-03
	Date: July 3, 2003

Legend

Coop =

Dear

This is in response to your request for a ruling dated April 8, 2003, submitted on behalf of Coop by its authorized representative.

Coop is a federated cooperative subject to taxation under subchapter T of the Internal Revenue Code. Coop is in the business of processing and marketing member and patron products as well as providing members and patrons with necessary supplies.

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)of the Code. Coop issued 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 Coop had approximately $ million of qualified written notices of allocation outstanding and approximately $ million of nonqualified written notices of allocation outstanding.

During the current economic downturn, Coop realized significant economic losses and incurred significant net operating losses under section 172 of the Code. A substantial portion of such losses are attributable to business done by Coop with or for its members/patrons (the "patronage losses") and the remainder are attributable to other Coop business (the "non-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 ("Court"). Coop is presently preparing its reorganization plan ("Plan") and anticipates filing the Plan with the Court in the near future. Implementation of the Plan, or any element thereof, is subject to the approval of the Court.

A significant element of the Plan involves the sale of substantially all of the assets of Coop's supply business. The Court recently approved the sale of substantially all of the assets of Coop's division and purchasers for other assets are actively being sought. In addition, a significant portion, and potentially substantially all, of the assets of its processing and marketing will also be sold.

Following the implementation of the Plan, Coop may not continue to operate and, if it continues to operate, it shall do so as a substantially smaller enterprise involved solely in the processing and marketing of products. If Coop continues to operate, it will not operate on a cooperative basis.

Coop believes that there is little or no chance that the proceeds of the sales of assets anticipated under the Plan will be sufficient to satisfy the claims of its various creditors. Accordingly, Coop does not anticipate that there will be further distributions made with respect to its patronage equity, either as part of the Plan or otherwise. Coop believes that such equity has little or no current value and will not likely have value in the future.

Section of the Article of Coop's bylaws grants Coop's board of directors broad discretion in the handling and disposition of patronage sourced losses. This section provides that:

"The Board of Directors of this Association shall have complete discretion to determine the handling and ultimate disposition of the Association's patronage sourced net losses (including allocation unit losses) and the form, priority and manner in which such losses or portions thereof shall be taken into account, retained, and ultimately disposed of or recovered. The Board may retain such losses of the Association and subsequently (i) dispose of them by offset against the net earnings of the Association of subsequent years, (ii) apply such losses to prior years' patronage allocations at any time in order to dispose of them by means of offset and cancellation against members' and patrons' equity account balances, (iii) select and use any other method of disposition of such losses as the Board of Directors, in its sole and absolute discretion, shall from time to time determine."

Under the Plan, Coop will seek approval of the Court to utilize its patronage sourced net operating losses through the cancellation of a significant portion of its patronage equity. The proposed cancellation of the qualified written notices of allocation will be effected by the Coop board of directors pursuant to clause (ii) above, subject to the approval and consent of the Court.

In accordance with Section Article of Coop's bylaws, Coop's board of directors will dispose of Coop's current year patronage sourced losses and patronage sourced net operating loss carryforwards by allocating such losses to offset a portion of the qualified written notices of allocation, subject to such action being approved by the Court.

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, Coop realized significant losses with respect to the business that Coop does with or for its members. In accordance with Section of Article of its bylaws, Coop is authorized to recover these patronage sourced losses through Coop's cancellation of previously issued patronage equity. The Service recognized this procedure in revenue Ruling 70-407, 1970-2 C.B. 52. In that ruling, a cooperative cancelled member patronage equities to offset a net patronage sourced loss.

Accordingly, based solely on the forgoing, we rule that:

Coop may utilize its patronage sourced loss by canceling an equal amount of currently outstanding qualified notices of allocation. Coop will not otherwise recognize any taxable income upon the cancellation of such patronage equity.

This ruling is directed solely to the taxpayer that requested it. Section 6110 (k) of the Code provides that it may not be used or cited as precedent. In accordance with a power of attorney on file with this office, a copy of the letter is being sent to your authorized representative.

Sincerely yours,

Walter Woo
Senior Technician Reviewer
Branch 5
Office of the Associate Chief
Counsel (Passthroughs and Special
Industries)

cc: