

§ 1.522-3

§ 1.521-1 amounts allocated during the taxable year to patrons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether such amounts are paid 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 to him. For this purpose, allocations made after the close of the taxable year and on or before the 15th day of the ninth month following the close of the taxable year shall be considered as made on the last day of such taxable year to the extent that such allocations are attributable to income derived during the taxable year or during years prior to the taxable year. As used in this paragraph, the term *income not derived from patronage* means incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association. For example, income derived from the lease of premises, from investment in securities, from the sale or exchange of capital assets, constitutes income not derived from patronage. Business done with the United States shall constitute income not derived from patronage. In order that the deduction for income not derived from patronage may be applicable, it is necessary that the amount sought to be deducted be allocated on a patronage basis in proportion, insofar as is practicable, to the amount of business done by or for patrons during the period to which such income is attributable. Thus, if capital gains are realized from the sale or exchange of capital assets acquired and disposed of during the taxable year, income realized from such gains must be allocated to patrons of such year in proportion to the amount of business done by such patrons during the taxable year. Similarly, if capital gains are realized by the association from the sale or exchange of capital assets held for a period of more than one taxable year income realized from such gains must be allocated, in proportion insofar as is practicable, to the patrons of the taxable years during which the asset was owned by the association, and to the

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amount of business done by such patrons during such taxable years.

**§ 1.522-3 Patronage dividends, rebates, or refunds; treatment as to cooperative associations entitled to tax treatment under section 522.**

(a) *General rule.* Patronage dividends, refunds, or rebates, allocated by a cooperative association entitled to tax treatment under section 522 to a patron shall be taken into account in computing the gross income of such association for the taxable year, as an increase in its other cost of goods sold in the case of an association marketing products for patrons, or as a reduction in its gross receipts, in the case of an association purchasing supplies and equipment or performing services for patrons, as the case may be, if:

(1) The allocation is made in fulfillment and satisfaction of a valid obligation of such association to the patron, which obligation was in existence prior to the receipt by the cooperative association of the amount allocated, and

(2) The allocation is made on or before the 15th day of the ninth month following the close of the taxable year in which the amounts allocated were received by the cooperative association.

For the purpose of subparagraph (1) of this paragraph, amounts allocated by a cooperative association entitled to tax treatment under section 522 will be deemed allocated in fulfillment and satisfaction of a valid enforceable obligation, if made pursuant to provisions of the bylaws, articles of incorporation, or other contract, whereby the association is obligated to make such allocation after the retention of *reasonable reserves* and after payment of dividends on capital stock or other proprietary capital interests. Notwithstanding the provisions of subparagraphs (1) and (2) of this paragraph, amounts allocated as patronage dividends, refunds, or rebates during the taxable year, on or before the 15th day of the ninth month following the close of such year, with respect to patronage for years preceding the taxable year, shall be taken into account as an increase in its other cost of goods sold, or as a reduction in gross receipts, for the taxable year, as the case may be, where retention as

*reasonable reserves* of the amounts so allocated beyond the year in which earned was proper in accordance with the provisions of section 521 and where the allocation is made to the patron on a patronage basis is proportion insofar as is practicable, to the amount of business done by such patrons during the taxable year or years in which the retained amounts were received by the cooperative association.

(b) *Examples.* This section may be illustrated by the following examples:

*Example 1.* E, a cooperative association entitled to tax treatment under section 522, organized without capital stock, is engaged in the business of marketing products for its patrons on a non-pool basis. The by-laws of Cooperative E provide that there shall be allocated to patrons as patronage dividends within a reasonable time following the close of the year all of the gross returns from sales, less expenses of operation for the year and amounts retained as *reasonable reserves* necessary to the operation of Cooperative E. At the close of the taxable year, 1954, it is determined that from the gross returns from sales less operating expenses and all taxes for such year, \$5,000 is to be retained as *reasonable reserves* for various necessary purposes of Cooperative E. It is assumed that the retention of such amount is proper in accordance with the provisions of section 521. Such \$5,000 is apportioned on the books of Cooperative E to patrons of 1954 on a patronage basis, or permanent records are kept from which an apportionment to such patrons can be made. On March 1, 1955, pursuant to the terms of the by-laws, \$200,000, the balance of the gross returns for the taxable year, is allocated to patrons of 1954 on the basis of patronage. \$100,000 of such \$200,000 is allocated in cash. The remaining \$100,000 is allocated in *retain certificates*, bearing no interest and redeemable in the discretion of the Board of Directors of Cooperative E. There may be added to the cost of goods sold by Cooperative E for 1954, \$200,000 (\$100,000 in cash, \$100,000 in retain certificates), the total amount allocated as patronage dividends, rebates, or refunds in fulfillment and satisfaction of the obligation of the by-laws, on March 1, 1955, before the 15th day of the ninth month following the close of 1954. There may not be added to the cost of goods sold by Cooperative E for 1954, \$5,000, the amount retained as reserves apportioned on the books, but not allocated as patronage dividends, rebates, or refunds.

*Example 2.* The facts are the same as example 1, it additionally appearing that at the close of 1955 it is determined by Cooperative E to allocate as cash patronage dividends, rebates, or refunds to patrons of 1954, \$5,000,

the amount retained as *reasonable reserves* for 1954 in accordance with the provisions of section 521. On March 1, 1956, such amount is allocated. There may be added to the cost of goods sold by Cooperative E for 1955, \$5,000, the amount allocated with respect to patronage of a preceding year, 1954, properly maintained as a reserve under section 521.

#### § 1.522-4 Taxable years affected.

Section 522 and §§ 1.522-1, 1.522-2, and 1.522-3, are applicable to taxable years beginning before January 1, 1963, and also to amounts paid during taxable years beginning after December 31, 1962, the tax treatment of which is not prescribed in section 1382 and the regulations thereunder.

[T.D. 6643, 28 FR 3163, Apr. 2, 1963]

#### § 1.527-1 Political organizations; generally.

Section 527 provides that a political organization is considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes. A political organization is subject to tax only to the extent provided in section 527. In general, a political organization is an organization that is organized and operated primarily for an exempt function as defined in § 1.527-2(c). Section 527 provides that a political organization is taxed on its political organization taxable income (see § 1.527-4) which, in general, does not include the exempt function income (see § 1.527-3) of the political organization. Furthermore, section 527 provides that an exempt organization, other than a political organization, may be subject to tax under section 527 when it expends an amount for an exempt function, see § 1.527-6. The taxation of newsletter funds is provided under section 527(g) and § 1.527-7. A special rule for principal campaign committees is provided under section 527(h) and § 1.527-9.

[T.D. 8041, 50 FR 30817, July 30, 1985]

#### § 1.527-2 Definitions.

For purposes of section 527 and these regulations:

(a) *Political organization*—(1) *In general.* A *political organization* is a party, committee, association, fund, or other