

(e) *Reduction in pass-thru for tax imposed on capital gain.* See section 1366(f)(2) for a special rule reducing the S corporation's long-term capital gains and the corporation's gain from sales or exchanges of property described in section 1231 for purposes of section 1366(a) by an amount of tax imposed under section 1374 and this section.

(f) *Examples.* The following examples illustrate the principles of this section and assume that a tax will not be imposed under section 1375:

*Example 1.* Corporation M is an S corporation for its taxable year beginning January 1, 1983. For 1983, M has an excess of net long-term capital gain over net short-term capital loss in the amount of \$30,000. However, its taxable income for the year is only \$20,000 as a result of other deductions in excess of other income. Thus, although the excess of the net long-term capital gain over the net short-term capital loss exceeds \$25,000 and also exceeds 50 percent of taxable income, M is not subject to the tax imposed by section 1374 for 1983 because its taxable income does not exceed \$25,000.

*Example 2.* Corporation N is an S Corporation for its 1983 taxable year. For 1983, N has an excess of net long-term capital gain over net short-term capital loss in the amount of \$30,000, and taxable income of \$65,000. Thus, although N's net capital gain (\$30,000) exceeds \$25,000, it does not exceed 50 percent of the corporation's taxable income for the year (50 percent of \$65,000, or \$32,500), and therefore N is not subject to the tax imposed by section 1374 for such year.

*Example 3.* Assume that Corporation O, an S corporation, is subject to the tax imposed by section 1374 for its taxable year 1983. For 1983, O has an excess of net long-term capital gain over net short-term capital loss in the amount of \$73,000, and taxable income within the meaning of section 1374, which includes capital gains and losses, of \$100,000. The amount of tax computed under paragraph (b)(1) of this section is 28 percent of \$48,000 (\$73,000—\$25,000), or \$13,440. Since this is lower than the amount computed under paragraph (b)(2) of this section, which is \$25,750 (\$3,750+\$4,500+\$7,500+\$10,000), \$13,440 is the amount of tax imposed by section 1374.

*Example 4.* Assume that in example (3) the taxable income of O for 1983 is \$35,000. This results from an excess of deductions over income with respect to items which were not included in determining the excess of the net long-term capital gain over the net short-term capital loss. In such case, the amount of tax, computed under paragraph (b)(2) of this section, is \$5,550. Since this is lower than the amount computed under paragraph

(b)(1) of this section, \$5,550 is the amount of tax imposed by section 1374.

*Example 5.* Corporation P, an S corporation, for its taxable year 1983 has an excess of net long-term capital gain over net short-term capital loss in the amount of \$65,000 and has taxable income of \$80,000. P's election under section 1362 has been in effect for its three immediately preceding taxable years, but P, nevertheless, is subject to the tax imposed by section 1374 for 1983 since it has an excess of net long-term capital gain over net short-term capital loss (in the amount of \$20,000) attributable to property with a substituted basis. The tax computed under paragraph (b)(1) of this section, \$11,200 (28 percent of \$40,000 (\$65,000—\$25,000)), is less than the tax computed under paragraph (b)(2) of this section, \$17,750. However, under the limitation provided in paragraph (c) of this section which is applicable in this factual situation, the tax imposed by section 1374 for 1983 may not exceed \$5,600 (28 percent of \$20,000, the excess of net long-term capital gain over net short-term capital loss attributable to property with a substituted basis).

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## COOPERATIVES AND THEIR PATRONS

### Tax Treatment of Cooperatives

#### § 1.1381-1 Organizations to which part applies.

(a) *In general.* Except as provided in paragraph (b) of this section, part I, subchapter T, chapter 1 of the Code, applies to any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons.

(b) *Exceptions.* Part I of such subchapter T does not apply to:

(1) Any organization which is exempt from income taxes under chapter 1 of the Code (other than an exempt farmers' cooperative described in section 521);

(2) Any organization which is subject to the provisions of part II (section 591 and following), subchapter H, chapter 1 of the Code (relating to mutual savings banks, etc.);

(3) Any organization which is subject to the provisions of subchapter L (section 801 and following), chapter 1 of the Code (relating to insurance companies); or

(4) Any organization which is engaged in generating, transmitting, or otherwise furnishing electric energy, or which provides telephone service, to persons in rural areas. The terms *rural areas* and *telephone service* shall have the meaning assigned to them in section 5 of the Rural Electrification Act of 1936, as amended (7 U.S.C. 924).

[T.D. 6643, 28 FR 3153, Apr. 2, 1963]

**§ 1.1381-2 Tax on certain farmers' cooperatives.**

(a) *In general.* (1) For taxable years beginning after December 31, 1962, farmers', fruit growers', or like associations, organized and operated in compliance with the requirements of section 521 and § 1.521-1, shall be subject to the taxes imposed by section 11 or section 1201. Although such associations are subject to both normal tax and surtax, as in the case of corporations generally, certain special deductions are provided for them in section 1382(c) and § 1.1382-3. For the purpose of any law which refers to organizations exempt from income taxes such an association shall, however, be considered as an organization exempt under section 501. Thus, the provisions of section 243, providing a credit for dividends received from a domestic corporation subject to taxation, are not applicable to dividends received from a cooperative association organized and operated in compliance with the requirements of section 521 and § 1.521-1. The provisions of section 1501, relating to consolidated returns, are likewise not applicable.

(2) Rules governing the manner in which amounts paid as patronage dividends are allowable as deductions in computing the taxable income of such an association are set forth in section 1382(b) and § 1.1382-2. For the tax treatment, as to patrons, of amounts received during the taxable year as patronage dividends, see section 1385 and the regulations thereunder.

(b) *Cross references.* For tax treatment of exempt cooperative associations for taxable years beginning before January 1, 1963, or for taxable years beginning after December 31, 1962, with respect to payments attributable to patronage occurring during taxable years beginning before January 1, 1963, see section 522 and the regulations thereunder. For re-

quirements of annual returns by such associations, see sections 6012 and 6072(d) and paragraph (f) of § 1.6012-2.

[T.D. 6643, 28 FR 3153, Apr. 2, 1963]

**§ 1.1382-1 Taxable income of cooperatives; gross income.**

(a) *Introduction.* Section 1382(b) provides that the amount of certain patronage dividends (and amounts paid in redemption of nonqualified written notices of allocation) shall not be taken into account by a cooperative organization in determining its taxable income. Such section also provides that, for purposes of the Internal Revenue Code, an amount not taken into account is to be treated in the same manner as an item of gross income and as a deduction therefrom. Therefore, such an amount is treated as a deduction for purposes of applying the Internal Revenue Code and the regulations thereunder and, for simplicity, is referred to as a deduction in the regulations under such Code. However, this should not be regarded as a determination of the character of the amount for other purposes.

(b) *Computation of gross income.* Any cooperative organization to which part I, subchapter T, chapter 1 of the Code, applies shall not, for any purpose under the Code, exclude from its gross income (as a reduction in gross receipts, an increase in cost of goods sold, or otherwise) the amount of any allocation or distribution to a patron out of the net earnings of such organization with respect to patronage occurring during a taxable year beginning after December 31, 1962. See, however, section 1382(b) and § 1.1382-2 for deductions for certain amounts paid to patrons out of net earnings.

[T.D. 6643, 28 FR 3154, Apr. 2, 1963]

**§ 1.1382-2 Taxable income of cooperatives; treatment of patronage dividends.**

(a) *In general.* (1) In determining the taxable income of any cooperative organization to which part I, subchapter T, chapter 1 of the Code, applies, there shall be allowed as deductions from gross income, in addition to the other deductions allowable under chapter 1 of the Code, the deductions with respect