***89 T.C. 682 (1987)***

For a farmers cooperative association to qualify for tax-exempt status under 26 U.S.C. § 521, there is no minimum percentage of business a shareholder-producer must conduct with the cooperative; any amount of patronage is sufficient to meet the statutory requirement that stock be owned by producers who market products or purchase supplies through the cooperative.

**Summary**

Farmers Cooperative Company sought tax-exempt status as a farmers cooperative association under 26 U.S.C. § 521. The IRS, relying on a revenue procedure, argued that to qualify, each shareholder-producer must conduct at least 50% of their patronage with the cooperative. The Tax Court had previously upheld an 85% ownership test for 'substantially all' stock to be held by producers. On remand from the Eighth Circuit regarding the 85% test, the Tax Court considered the validity of the IRS's 50% patronage requirement. The Tax Court rejected the IRS's 50% minimum patronage test, holding that any amount of patronage by a shareholder-producer satisfies the statute. The court reasoned that the statute's intent is qualitative, ensuring cooperatives operate for producers' benefit, not quantitatively mandating a specific patronage level.

**Facts**

Farmers Cooperative Company, a farmers cooperative association, sought to qualify as tax-exempt under 26 U.S.C. § 521. The IRS, in Revenue Procedure 73-39, established a guideline requiring shareholder-producers to market more than 50% of their products or purchase more than 50% of their supplies through the cooperative to be considered 'producers who market their products or purchase their supplies and equipment through the association.' The IRS argued this 50% patronage test was necessary for the cooperative to maintain its exempt status. Farmers Cooperative Company challenged this 50% test, arguing it was not supported by the statute or congressional intent.

**Procedural History**

The Tax Court initially ruled against Farmers Cooperative Co., applying an 85% test for stock ownership but not addressing the patronage requirement. The Eighth Circuit Court of Appeals affirmed in part and reversed in part, remanding the case to the Tax Court to consider the patronage issue after finding Farmers Cooperative Co. met the 85% stock ownership test for one of the years in question. On remand, the Tax Court addressed the IRS's 50% minimum patronage requirement.

**Issue(s)**

1. Whether the IRS's 50% minimum patronage requirement, as outlined in Revenue Procedure 73-39, is a valid interpretation of 26 U.S.C. § 521 for

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determining if a farmers cooperative association qualifies for tax-exempt status.
2. Whether any minimum level of patronage is required by 26 U.S.C. § 521 for a shareholder-producer to be considered as marketing products or purchasing supplies 'through the association'.

**Holding**

1. No, because the 50% minimum patronage requirement is not supported by the language or intent of 26 U.S.C. § 521 and is therefore rejected.
2. No, because 26 U.S.C. § 521 does not specify any minimum quantity of patronage; any amount of marketing or purchasing through the cooperative by a shareholder-producer is sufficient to meet the statutory requirement.

**Court's Reasoning**

The Tax Court reasoned that the central purpose of 26 U.S.C. § 521 is to ensure that exempt cooperatives operate as a conduit for producers, facilitating their marketing and purchasing activities on a non-profit basis. The 'substantially all' stock ownership requirement and the patronage language were intended to maintain this conduit-like function, not to impose quantitative restrictions on individual producer-shareholder activity. The court stated, "We find the purpose of the patronage requirement to be qualitative and not quantitative… We find that the congressional intent would be served if 'substantially all such stock * * * is owned by producers who market [any] of their products or purchase [any] supplies and equipment through the association.'" The court found no evidence in the statute's history or purpose to justify a minimum patronage percentage. The court noted the IRS's 50% test was a relatively recent administrative creation, first appearing in a 1973 Revenue Procedure, and lacked the force of law or clear statutory basis. The court emphasized that imposing a minimum patronage requirement could restrict producers' flexibility and profitability, contrary to the statute's aim to aid farmers.

**Practical Implications**

This case clarifies that the IRS cannot impose a rigid minimum patronage percentage for farmers cooperatives to maintain tax-exempt status under 26 U.S.C. § 521. The decision limits the IRS's ability to use Revenue Procedures to create quantitative tests for cooperative exemption not explicitly found in the statute. For legal practitioners advising farmers cooperatives, this case confirms that as long as shareholder-producers engage in some level of patronage with the cooperative, the cooperative's exempt status is not jeopardized solely due to a lack of a specific patronage volume. This ruling emphasizes a qualitative approach to assessing cooperative exemption, focusing on whether the cooperative functions for the benefit of producers, rather than strictly measuring the percentage of each producer's business conducted through the cooperative. Later cases would rely on this to interpret the scope of permissible restrictions the IRS could place on

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cooperative exemptions.

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