

## ***Fayette Landmark, Inc. v. Commissioner, T. C. Memo. 1992-246***

Nonexempt cooperatives are not subject to the restrictions of section 277 of the Internal Revenue Code, allowing them to carry back net operating losses from patronage activities.

### **Summary**

Fayette Landmark, Inc. , a nonexempt cooperative, sought to carry back a net operating loss from 1980 to offset its 1977 taxable income. The IRS argued that section 277 prohibited this carryback. The Tax Court held that section 277 does not apply to nonexempt cooperatives, as it conflicts with subchapter T provisions. This ruling allows nonexempt cooperatives to utilize net operating loss carrybacks for patronage activities, aligning their tax treatment with that of exempt cooperatives and ensuring that their special deductions under subchapter T are not undermined.

### **Facts**

Fayette Landmark, Inc. , a nonexempt cooperative formed in Ohio, engaged in grain and agricultural supplies businesses. It voluntarily relinquished its status as an exempt cooperative in 1975 to limit patronage refunds to shareholders. For fiscal year 1977, Fayette reported taxable income of \$99,541, and in 1980, it incurred a net operating loss of \$62,712. Most of the 1980 loss (\$62,624) was from transactions with shareholders. Fayette attempted to carry back this loss to offset its 1977 income, claiming a refund, which the IRS challenged under section 277.

### **Procedural History**

Fayette filed an amended return for 1977, claiming a refund based on the 1980 loss carryback. The IRS issued a refund but later determined a deficiency, asserting that section 277 prohibited the carryback. The case proceeded to the U. S. Tax Court, which ruled in favor of Fayette, holding that section 277 does not apply to nonexempt cooperatives.

### **Issue(s)**

1. Whether section 277 applies to nonexempt cooperatives subject to subchapter T of the Internal Revenue Code.

### **Holding**

1. No, because the application of section 277 to nonexempt cooperatives would conflict with the provisions of subchapter T, leading to absurd or futile results.

### **Court's Reasoning**

The Tax Court analyzed the conflict between section 277 and subchapter T, noting

that section 277 requires separating income and deductions into membership and nonmembership baskets, while subchapter T requires separating them into patronage and nonpatronage baskets. The court found that applying section 277 to nonexempt cooperatives would prevent them from carrying back patronage losses, contradicting section 1388(j)(1), which allows such carrybacks. Furthermore, the court reviewed the legislative history, concluding that Congress did not intend section 277 to apply to nonexempt cooperatives, as it would treat them differently from exempt cooperatives, contrary to the legislative intent of equal treatment. The court also rejected the IRS's arguments based on statutory construction and legislative history, emphasizing the conflict and the resulting absurd outcomes if section 277 were applied.

### **Practical Implications**

This decision allows nonexempt cooperatives to carry back net operating losses from patronage activities, aligning their tax treatment with that of exempt cooperatives. Practitioners should analyze similar cases involving nonexempt cooperatives under subchapter T without applying section 277 restrictions. This ruling may encourage nonexempt cooperatives to utilize loss carrybacks more effectively, impacting their financial planning and tax strategies. Businesses operating as nonexempt cooperatives can now better manage their tax liabilities, potentially affecting their competitiveness in the market. Subsequent cases, such as *Landmark, Inc. v. United States*, have reinforced this interpretation, ensuring consistent application of tax law in this area.