TAX REPORTING OF ALCOHOL CREDIT PASS-THROUGH FROM COOPERATIVE

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Synopsis: Investors in limited liability companies and members of cooperatives with ethanol plants may receive various tax forms reporting income and losses, and credits. The tax consequences differ depending on the investment activity.

Introduction

The small ethanol producer tax credit (SEPTC), which some cooperatives are passing through to their patrons, has tax preparers wondering how it should be reported on the patron’s individual tax return. The tax treatment varies depending on the type of investment made by the patron and the activity of the cooperative.

The American Jobs Creation Act of 2004 and the Energy Policy Act of 2005 contained several provisions affecting ethanol operations and ethanol production in general. The acts provide a 10¢ per gallon credit for the first 15 million gallons of ethanol produced by a “small producer.” A “small producer” is defined as a production facility that has an annual capacity of less than 60 million gallons.

Situation 1.

John Jones, an active farm producer, is a patron of XYZ Cooperative. XYZ builds an ethanol plant and reports a profit in 2006. XYZ meets the requirements to receive the SEPTC and elects to pass a portion of the credit through to its patrons.

Jones receives Form 1099-PATR shown below.

Because John Jones is an active farm producer, he will report the amount shown in Box 1 on his Schedule F on lines 5 (a) and (b). This will be combined with his other farm income and be included in both taxable income and self-employment income (SE).
The SEPTC reported in Box 10 of the Form 1099-PATR will be reported on line 5 of Form 6478, Credit for Alcohol Used as Fuel. This amount will be allowed as a credit against both the income tax and any alternative minimum tax (AMT), but will not be used against his SE tax.

Any unused SEPTC may be carried backward one year and then forward up to 10 years beyond the statutory expiration date of the credit. Any amount of unused credit becomes an income tax deduction after the carryforward period expires. Form 3800, General Business Credit, is used for the carryforward.

**Situation 2.** Bill Smith is a member of ABC Cooperative, a different cooperative. ABC also built an ethanol plant. Once the plant was completed, ABC Cooperative sold the plant to a corporation. Smith received three payments from ABC. The first is a patronage dividend based upon the profits of the cooperative. The second is a cash liquidating distribution which represents his sale of stock to the cooperative. The third is an ordinary dividend from the cooperative. ABC told Smith that the cash liquidation portion of his distribution represented 30% of his stock. Smith receives a 1099-PATR and a 1099-DIV from ABC Cooperative which are reproduced below:
The amount in Box 1 of Form 1099-PATR represents Smith’s patronage dividend and is reported on Schedule F on lines 5 (a) and (b). The amount in Box 1 of Form 1099-DIV is an ordinary dividend. It is reported on line 5 of Schedule B Interest and Ordinary Dividends. This is not a qualifying dividend and does not qualify for the special capital gains tax rate.

The amount in Box 8 of Form 1099-DIV represents Smith’s share of the sale of the ethanol plant. He will report this amount on his Sch. D, Capital Gains and Losses. This will be either a long-term or short-term capital gain depending on whether he held the stock for more than one year.

Smith is entitled to deduct his basis in the portion of the stock which was sold. In this case, ABC Cooperative notified him that the sale represented 30% of his stock.

A third situation can exist when the producer invests in an ethanol limited liability company (LLC). In this case he is treated as a partner in the LLC. He will receive a Sch. K-1, Partner’s Share of Income, Credits, Deductions, etc., from the LLC. Depending on the LLC’s income, the producer will report the amounts shown on various forms when he files his federal income tax return. One difference in the LLC investment is that the producer is a passive investor, assuming he does not participate in the management of the LLC. Therefore, he is subject to the passive loss limitations rules if the LLC reports a loss.

The treatment of the distributions from all three of these situations discussed is complicated and may vary from taxpayer to taxpayer and investment to investment. Producers who find themselves in these situations should seek the help of a competent tax professional.