BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
RETAILERS CREDIT ASSOCIATION OF)
ALAMEDA COUNTY)

Appearances:

For Appellant: D. A. Sargent, Certified Public Accountant

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of the Retailers Credit Association of Alameda County, a corporation, to the Commissioner's proposed assessment of additional tax in the amount of $151.27 for the taxable year ended December 31, 1935, based upon the income of the corporation for the year ended December 31, 1934.

The Appellant was organized in May, 1917, under Title XX, Division 1, Part IV of the Civil Code of California which provided for the organization of cooperative associations which might operate thereunder on a profit or a non-profit basis. It has no stockholders but is composed of members, each of whom pays a membership fee of Five Dollars to join and receives a certificate of membership. The members are retailers, dentists, doctors and other professional men whose practice makes it desirable for them to inquire into the credit standing of patients or clients. Appellant's by-laws provide that any profits realized from its operations shall be used first, to pay the debts of the Appellant; second, to improve its plant, equipment and service ; third, to pay dividends in equal amounts to the members. No dividends have ever been paid by Appellant to its members.

The purposes of Appellant, briefly stated, are to furnish reports on the credit rating of individuals, firms and corporations; to act as the agent of members of Appellant in collection; to act as assignee of claims due such members, and in its own name to sue on, collect and compromise such claims; to carry on the business of a general mercantile credit agency; to encourage prompt payment of accounts and to, promote more efficient credit business; to gather information affecting the credit standing of persons, firms and corporations and to report it to members; to assist in securing legislation which will encourage better credit conditions and to aid enforcement

thereof; to acquire, own, hold, lease, mortgage and sell real and personal property desirable or convenient to carry out the purposes of the corporation; and to acquire own, hold, sell, transfer and pledge stock or other securities of any other corporation necessary convenient or desirable for the furthering of the best interests of the corporation.

The Appellant furnishes credit reports on individuals to its members only. A charge is made to a member for each such report, the amount of the charge having been changed from time to time. The Appellant also makes collections for its members, receiving a commission for this service. In addition to these activities, the Appellant renders certain services to-its members for which no charge is made and from which it, accordingly, derives no income. These services include conducting advertising campaigns advocating the prompt payment of debts, arranging and executing group settlements, furnishing "reciproca reports for members, issuing information to members on marriages divorces, deaths, bankruptcies and other matters affecting credit, conducting classes for the education of members' employees on credit practices and actively supporting or opposing legislation affecting credit matters. The income derived by the Appellant from the furnishing of credit reports and the making of collections exceeds the costs incurred in the rendering of those services, the excess of that income over those costs being expended in the performance of the non-income producing services rendered by Appellant to its members or set aside for new equipment or additions to service. Should income be realized or funds be accumulated in excess of the Appellant's reasonable needs, the charge made for credit reports is reduced.

The only question presented by this appeal is the operation of Section 8(l) of the Bank and Corporation Franchise Tax Act in the determination of Appellant's tax liability under that Act. Section 8(l) provides as follows: "In computing "net income" the following deductions shall be allowed: "In the case of other associations organized and operated in whole or in part on a cooperative or a mutual basis, all income resulting from or arising out of business activities for or with their members, or with nonmembers, done on a nonprofit basis." The Appellant contends that all income arising from its business activities with its members should be excluded from the measure of the tax inasmuch as it is a cooperative association doing business with its members on a nonprofit basis. The Commissioner contends, on the other hand, that the Appellant's operations do not bring it within Section 8(l) inasmuch as it conducts a portion of its activities on a profit basis, the income resulting from such activities having been used by the Commissioner as the measure of his proposed additional tax.

It is to be observed that Section 8(l) of the Bank and Corporation Franchise Tax Act does not exempt from the tax all associations organized in whole or in part on a cooperative or mutual basis or authorize the deduction from gross income of all the income of such associations from business activities with their members, The deduction from gross income authorized

by the section is limited to the income of such associations from or arising out of their business activities done on a nonprofit basis for or with their members or with nonmembers. The Appellant contends, however, that the entire provisions of Section 8 must be considered in determining the legislative intent respecting the nature of the deduction available to cooperative associations under subdivision (1) of that section and directs our attention to the deduction provided in the case of farmers cooperative marketing associations which may, under subdivision (k), deduct from gross income "...all income resulting from or arising out of such business activities for or with their members..." It is Appellant's position that Section 8, considered as a whole, indicates a legislative intent to authorize a deduction under subdivision (1) to "other cooperative associations" similar to that available to farmers cooperative marketing associations under subdivision (k). This position, however, is clearly unsound. The inclusion in subdivision (1) but not in subdivision (k) of the phrase "done on a nonprofit basis" unmistakably indicates a legislative intent to provide a different basis for the deduction available under subdivision (k) to farmers cooperative associations from that available under subdivision (1) to other cooperative associations (Schrader v. City of Los Angeles (1937) 19 Cal. App. (2d) 332, 334; Brainard v. Brainard (1936) 17 Cal. App. (2d) 520, 524) and definitely precludes the adoption of the construction urged by the Appellant The fact that the Appellant may be organized and operated on a cooperative basis does not, accordingly, establish its right to a deduction from its gross income of all income resulting from or arising out of business activities for or with its members, the deduction being limited to its income from business activities done or conducted on a nonprofit basis.

It appears to be the intent of Section 8(1) to authorize the deduction by a cooperative association of the income received by the association from members or nonmembers for services rendered to them at rates or charges so arranged as to return to the association an amount approximately equal to the expenses incurred by it in rendering those services. We do not believe that a deduction is authorized thereunder in a case in which the rates or charges are fixed at amounts expected to result in the realization of income at least in excess of the expenses incurred in the performance of the services from which the income is realized and which in fact result in the realization of income in excess of all expenses incurred by the association when the amount of that excess may be returned in dividends in equal amounts to the members or expended in the production of services rendered to the members without charge and without regard to the amounts paid by the various members for other services performed for them.

It is apparent that the Appellant's charges for the furnishing of credit reports and the making of collections were fixed at amounts which were expected to result in the realization of income substantially in excess of the expenses incurred in the rendering of those services and that those services were, accordingly, conducted on a profit basis for otherwise it would

be impossible for the Appellant to render the non-income producing services to its members. In fact, during the year involved herein the Appellant realized income in excess of the total expenses incurred in the rendering of the income producing as well as the non-income producing services. The fact that dividends, payable either in cash or in property, have not been distributed to its members does not establish that the income received by the Appellant resulted from business activities conducted on a nonprofit basis. While the matter of the distribution of dividends may not be material to the question presented herein, it may nevertheless be observed that activities may be conducted by a corporation at a profit and that profit realized by the members *or* stockholders in another way or manner than by the actual payment of dividends to them (Northwestern Municipal Association, Inc. v. United States (1938) 22 F. Supp. 18, Fort Worth Grain and Cotton Exchange (1933) 27 B.T.A. *983; see* also Retailers Credit Association of Alameda County v. Commissioner of Internal Revenue (1937) 90 F. (2d) 47, 111 A.L.R. 152, and cases cited in the American Law Report Annotation thereto at page 158, holding that the Appellant herein and other similar associations are not exempt from the federal income tax as business leagues) as, for example, in the instant case, through the performance of services without charge and without regard to the payments made by the members for other services rendered to them.

We have concluded, accordingly, that the income of the Appellant resulting from or arising out of its business activities with its members is not deductible from its gross income under Section 8(1) of the Bank and Corporation Franchise Tax Act. The action of the Commissioner in overruling the Appellant protest to his proposed assessment of additional tax is, therefore, sustained.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Hon. Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of the Retailers Credit Association of Alameda County, a corporation, to a proposed assessment of additional tax in the amount of $151.27 for the taxable year ended December 31, 1935, based upon the income of said corporati for the year ended December 31, 1934, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustaine

Done at Sacramento, California, this 22nd day of June, 1938.

R. E. Collins, Chairman
Fred E. Stewart, Member
John C. Corbett, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary