BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CALIFORNIA PINE BOX DISTRIBUTORS)

Appearances:

For Appellant: Valentine Brookes, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; Burl D. Lack, Chief Counsel; Paul L. Ross, Associate Tax Counsel

O P IN I ON

This appeal is made pursuant to Section 2'7 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in denying the claim of California Pine Box Distributors for a refund of tax in the amount of $994.23, plus interest thereon of $164.81, for the income year ended November 30, 1941.

Appellant is a nonprofit cooperative marketing association subject to the provisions of Chapter 4 of Division 6 of the Agricultural Code (Sections 1190 to 1221, inclusive). Such an association is "deemed 'nonprofit'" since it is not organized to make any profit for itself or its members as such but only for its members as producers (Section 1192). It was empowered by law among other things, to engage, as an agent, in any activity in connection with the marketing of the products of its members; to own such property "as may be necessary or convenient for the conduct and operation of any of the business of the association, or incidental thereto;" and to do everything "necessary, suitable or proper" for the accomplishment of its purposes (Section 1194). It could also deal in the products of nonmembers, but not in an amount "greater in value than such as are handled by it for its members"(Section 1194).

Under its articles of incorporation Appellant is given broad authority to act as selling agent for its members in the marketing of their products "and to turn back to them the proceeds of its sales less the necessary selling expenses...." It is specifically authorized by such articles to "buy or otherwise acquire, own, hold and keep, and to sell, mortgage, pledge, exchange or otherwise dispose of and to deal in, box shook and boxes of all kinds and other materials of all kinds in any way connected with box shook or boxes, or the manufacture, sale or other disposition thereof....??

Section 1208 of the Agricultural Code authorizes the execution of marketing agreements between associations and their members, and such agreements are expressly required by Section 3 of Article II of Appellant's By-laws. Each agreement entered int between Appellant and one of its members provides for the marketing by Appellant of box shook manufactured by the member for use in the making of packing boxes for vegetables, fruits and other commodities. Other provisions require the return to the member of the profits received from sales of his products, less deductions for a bad debt reserve, a contingent reserve and Operating 'expenses.

In the year here involved (referred to hereinafter simply as "1941"), Appellant, in addition to selling box shook for its members also sold shook, veneer covers, excelsior, hampers, bracing, papers and sawdust purchased from nonmembers. One reason for the purchase of the nonmember shook was that most of the members' shook output and their milling facilities had been appropriated by the Government for defense purposes, with the result that Appellant had to obtain shook from other sources in order to continue to supply and retain its customers. The purchase and sale of the other nonmember products, while, according to Appellant, incidental to its primary function of selling member shook, was nevertheless considered necessary in the interest of supplying Appellant's customers with "an integrated product." The amount of nonmember products sold in 1941 represented approximately 15.1% of all of Appellant's sales in that year, and net profits were made on such nonmember products, although none was returned by way of patronage dividends or otherwise to the nonmembers. Appellant also sold an automobile in 1941 which it had used in carrying on its activities and from the sale of which it realized a profit of $1,469.

The issue presented is whether the income derived from the sales of the nonmember products and the automobile was includible in the measure of Appellant's tax for its taxable year ended November 30, 1942. The Commissioner included it in his computation of the tax on the strength of subdivisions (1) and (m) of Section 8 of the Bank and Corporation Franchise Tax Act, which, for the purpose of computing net income, allow the following deductions from gross income:

> "(1) In the case of farmers, fruit growers, or like associations organized and operated in whole or in part on a cooperative or mutual basis, (1) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, which may include reasonable reserves, on the basis of either the quantity or the value of the products furnished by them...., all income resulting from or arising out of such business activities for or with their members carried on by them or their agents; or when done on a nonprofit basis for or with nonmembers.

> "(m) 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."

It is the Commissioner's contention that the words "or with nonmembers, done on a nonprofit basis" in 8(m) or the language "or when done on a nonprofit basis for or with nonmembers" in 8(l) require the inclusion for tax purposes of any income derived by a nonprofit cooperative association from any and all nonmember business done on a profit basis and, accordingly, he regards as taxable the net income derived from the sale by Appellant Of nonmember products. He also argues that the income from the sale of the automobile is includible on the ground that it did not arise out of any business activity for or with Appellant's members. lie has conceded, however, that his determination of Appellant's income includible within the measure of the tax was excessive to the extent of $508.26 and that a refund is, therefore, due it in the amount of $20.33.

Appellant maintains that it was incapable of having any income of its own, since, as a cooperative, any income accruing through its efforts belongs to its members (citing Bogardus v. Santa Ana Walnut Growers Association, 41 Cal. App. 2d 939, 946-949; Mountain View Walnut Growers Association v. Calif ornia Walnut Growers Association, 19 Cal. App. 2d 227; Reinert v. California Almond Growers Exchange, 9 Cal. 2d 281) and, consequently, it has no income in respect to which a tax may be levied against it. It also asserts that even if the Commissioner were correct as to the income from the nonmember shook, the income from the sales of the other nonmember products and the gain from the sale of the automobile were not includible for the reason that those sales were merely incidental to the regular member business.

Considering, first, the income from the sales of the nonmember products, it is our opinion that the Commissioner's position with respect to such income must be sustained.

Unlike the Federal law (Internal Revenue Code, Section 101(12)), there is no express provision in the Bank and Corporation Franchise Tax hct exempting cooperative marketing associations from the tax imposed (See Section 4(6)). In view of such omission, it can only be concluded that such associations are, therefore, taxable to the extent of all their income in the absence of other provisions in the law conferring immunity. Some such provisions are Found in the deductions specified in subdivisions(l) and (m) of Section 8. The deductions are limited however, and in so far as they pertain to nonmember business income, are allowable only if the income has been derived from business activities performed on a nonprofit basis. Nonmember income from business done on a profit basis is not mentioned, and consequently, must be deemed to be nondeductible. The rule applicable in this respect is that a deduction will not be

allowed unless there is explicit statutory authority therefor.. Fullerton Oil Co. v. Johnson, 2 Cai. 2d 162; People v. Richardson, 37 Cal. App. 2nd 275.

An adherence to Appellant's argument that a nonprofit cooperative marketing association has no income of its own as to which a tax may be levied against it would be tantamount to giving no effect to the implications contained in the language of subdivisions (1) and (m) of Section 8 regarding nonmember business done on a profit basis. It the Legislature did not intend to tax associations with respect to income from that kind of business, it is difficult to understand why it went to the. trouble of incorporating in the law the subdivisions mentioned, It would have been far simpler either to have added two more items to the list of exempt corporations in Section 4(6), or to have omitted entirely the language "done on a nonprofit basis" from subdivisions (1) and (m) of Section 3. It must be assumed that the Legislature intended to accomplish something by adopting those subdivisions and it appears to us that it intended thereby to impose a tax on nonprofit cooperative marketing associations measured by any net income derived from profitable nonmember business. Pertinent in this connection is the general rule that a law should be construed so as to "leave no part useless, or deprived of all sense and meaning...." 23Cal. Jur. 759.

The following statements in McLaren and Butler's "California Tax Laws of 1929", at pp. 114 and 115, are in accord with out view of the matter:

> "It was originally proposed that the special treatment of cooperative associations should be covered in an exempting clause instead of in the deductions section. Inasmuch, however, as the suggested exemption was limited to income arising out of business carried on with members, or done on a non-profit basis with nonmembers, it was *not* an exemption of the association itself but the authorization of an additionai deduction. For this reason it was deemed logical to incorporate the cooperative association clause in the general deduction section.
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> "The treatment given cooperative associations under the California law departs from the federal plan which grants full exemption....
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> "The Franchise Tax Act is not so liberal. It requires that all profitable transactions carried on with or for nonmembers shall be taken into account in computing the tax." (Emphasis added.)

See also 17 California Law Review, pages 493 and 494, wherein it is stated that the language of former Section 8(k), now S(1), *of* the Bank and Corporation Franchise Tax Act, supports the view that it was intended to bring non-profit cooperative associations under the law for tax purposes.

Appellant cites California Pine Box Distributors v. Commissioner of Internal Revenue; a Tax Court Memorandum Opinion, Docket No. 111763, dated July 29, 1943, to the point that Appellant has no income of its own. While the Tax Court did so hold in respect to income derived from the handling of member products in connection with a question concerning the propriety of deductions for credits to reserves claimed by Appellant in its Federal income tax returns for 1938 and 1939, we do not believe that that holding, or San Joaquin Valley Poultry Producers Association v. Commissioner, 136 Fed. 2d 382, also cited by the Appellant in this connection, is pertinent in view of subdivision: (l) and (m) of Section 8, which have no counterpart in the Federal law. Irrespective of the nature of the relationship between a cooperative, such as Appellant, and its members for other purpose: or even for Federal income tax purposes, the above-quoted provisions of Section 8 of the State Act require the conclusion, in our opinion, that as respects that Act a cooperative is taxable with respect to the profit derived from its business activities involving dealings in products of non-members on a profit basis.

Whether the Appellant's sales of non-member products other than box shook, i.e., veneer covers, excelsior, hampers, bracing, papers and sawdust, and the sale of the automobile are merely incidental to its primary activity of selling shook is, we believe immaterial and not determinative of its tax liability. Subdivisic (1) and (m) of Section 8 of the Act do not distinguish between income derived from such non-member business as may be incidental to the primary activity of a cooperative and that derived from any other type of business? In fact, it is rather unlikely that a cooperative, such as Appellant, would ordinarily conduct any non-member business which was not in some way incidental to its primary activities on behalf of its members.

The position of the Commissioner must, accordingly, in our opinion be sustained except in so far as he has conceded that a refund is due Appellant in the amount of $20.33.

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, pursuant to Section 27 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) that the action of Charles J. McColgan, Franchise Tax Commissioner, in denying the claim of California Pine Box Distributors for a refund of tax in the amount of $994.23, plus interest thereon of $164.81, for the income year, ended November 30, 1941, be and the same is hereby modified; the Commissioner is hereby directed to refund tax in the amount of $20.33 to said California Pine Box Distributors; in all other respects the action of the Commissioner is hereby sustained.

Dbne at Sacramento, California, this 15th day of September, 1949, by the State Board of Equalization.

George R. Reilly, Chairman
J. I-I. Quinn, Member
J. L. Seawell, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary