

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
CREDIT UNION, CALIFORNIA TEACHERS )  
ASSOCIATION, SOUTHERN SECTION )

**Appearances:**

**For Appellant:** V. G. Skinner and Leo H. Shapiro,  
Attorneys at Law

**For Respondent:** Burl D. Lack, Chief Counsel;  
Wilbur F. Lavelle, Assistant Counsel

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O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Credit Union, California Teachers Association, Southern Section, to proposed assessments of additional franchise tax in the amounts of \$226.45 and \$317.09 for the income years 1952 and 1953,

Appellant is a credit union organized on a cooperative basis. Its membership is limited to teachers. Members may invest money in the credit union and they may borrow funds from it. The credit union collects interest on the loans. Out of the interest collected, the credit union pays the expenses of operation and pays a dividend to the members who invest money in the credit union,

At times the loan demand will be less than the funds the credit union has available for loans and it will invest such excess funds in various outside investments. Such outside investments are limited to those legal for savings banks and in practice the outside investments are usually limited to short term obligations of the Federal Government.

Appellant filed returns indicating no net income and paid the minimum tax of \$25. Respondent has concluded that Appellant's net income consists of income from outside investments less expenses allocable to that activity,

Section 24121n (now 24405) of the Revenue and Taxation Code allows an association organized and operated on a cooperative basis a deduction from gross income for "all income resulting from or arising out of 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."

Appeal of Credit Union, California Teachers Association, Southern Section,

The parties agree that the gross income includes interest earned on loans to members and interest earned on outside investments. They also agree that Section 24121n is applicable to Appellant and permits a deduction for interest earned on loans to members. Appellant contends that Section 24121n also allows a deduction for interest earned on outside investments. Respondent contends no such deduction is allowable.

Appellant contends that interest earned on outside investments serves to pay a portion of the operating expenses, thereby increasing the dividends on members' investments. It reasons therefore that such interest arises "out of business activities for ... members." Respondent contends that such interest does not arise out of business activities for members and that it does arise out of business with nonmembers on a profit basis.

In Appeal of Woodland Production Credit Association, Cal. St. Bd. of Equal., Feb, 1958 (2 CCN Cal. Tax Cas., Par. 200-847), (2 P-H State & Local Tax Serv., Cal., Par. 13,176), we held that a cooperative's income from investments in bonds of the United States was not from business for members and was not deductible. The Attorney General of California, in an opinion dated April 29, 1955, reached the same conclusion with respect to credit unions, specifically, All business activities of a cooperative are for its members in the broad sense that the members are benefited by the income from the activities, yet it is obvious that Section 24121n does not contemplate a deduction of all income. The construction advanced by Appellant would give, no effect to the legislative restriction as to the deductibility of income from activities for or with nonmembers. As an example of deductible income from activities conducted directly for members, the Attorney General in his opinion specified income from the sale of a member's products by a cooperative organized to market such products for its members. In contrast, the interest on the investments by Appellant was from business activities with nonmembers, conducted for profit, and for the members only indirectly in the sense that the members ultimately benefited through increased dividends. In accordance with our decision in the Woodland appeal and with the opinion of the Attorney General, we conclude that this interest was not deductible\*

Appellant next contends that its entire expenses of operation are deductible. The expenses far exceed the interest earned on outside investments and therefore if Appellant's contention is accepted it would have no net income. Respondent contends, however, that expenses allocable to interest earned on loans to members are not deductible because they are expenses allocable to "income not included in the measure of the tax imposed by this part." Section 24201d (now 24425) of the Revenue and Taxation

Appeal of Credit Union, California Teachers Association, Southern Section.

Code provides that no deduction shall be allowed for an amount allocable to "income not included in the measure of the tax imposed by this part."

Since this appeal was submitted for decision, the California Supreme Court has had occasion to consider a question identical to that here presented. The court concluded, contrary to Appellant's position, that cooperatives may not deduct those expenses that are allocable to income from business with their members. (Security-First Nat'l Bank v. Franchise Tax Board, 55 A.C. 409.) Although the court was concerned with the problem as it bore upon the calculation of the rate of tax on banks, rather than with the tax liability of a cooperative directly, the foregoing conclusion was material to the decision and represents the considered opinion of the court. Consistently with the view of the court, we find that Respondent was correct in disallowing the deduction of expenses allocable to interest on loans to members,

O R D E R

Pursuant to the view 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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Credit Union, California Teachers Association, Southern Section, to proposed assessments of additional franchise tax in the amounts of \$226.45 and \$317.09 for the income years 1952 and 1953, be and the same is hereby sustained.

Done at Sacramento, California, this 19th day of July, 1961,  
by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Richard Mevins, Member

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ATTEST? Dixwell L. Pierce, Secretary