

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of
CONSUMERS COOPERATIVE OF BERKELEY, INC, }

Appearances:

For Appellant: J. Richard Johnston
Attorney at Law

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to sections 25667 and 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Consumers Cooperative of Berkeley, Inc., against proposed assessments of additional franchise tax in the amounts of \$1,232.95, \$2,110.43 and \$2,335.44 for the income years ended September 30, 1956, 1957 and 1958, respectively, and in denying its claims for refund in the amounts of \$4,184.00, \$5,146.00 and \$7,643.00 for the income years ended September 30, 1959, 1960 and 1961, respectively.

Appellant is a cooperative corporation engaged primarily in the sale of food at retail. During all of the years on appeal, appellant operated in Berkeley, California, a large food store, a hardware-variety store and a gasoline service station. In 1957, appellant opened a modern super-market and service station in Walnut Creek. Another super-market was opened by appellant in 1960 in Berkeley.

Appellant's total sales during the years under review were as follows: Grocery, \$20,827,910; Produce, \$5,277,111; Meat, \$9,634,237; Coffee Bar, \$306,455; Hardware-Variety, \$3,428,553; Pharmacy, \$188,892; and Service Station, \$2,458,053. On the basis that 20 percent of its grocery sales were non-food items, appellant estimates that 75 percent of its total sales from all categories were food items.

This appeal presents the question of whether, pursuant to section 24405 of the Revenue and Taxation Code,

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appellant is entitled to deduct income derived from business for or with its members,, It is undisputed that prior to 1955 appellant qualified for such a deduction under section 24121n. In 1955 the Legislature re-enacted that provision as section 24405 (Stats, 1955, p. 1587) and later added the following amendment:

... provided, however, that the deduction allowable under this section shall not apply to such cooperative or mutual associations whose income is principally derived from the sale in the regular course of business of tangible personal property other than agricultural products. (Stats, 1955, p. 2232.)

The instant assessments are based upon the Franchise Tax Board's determination that, aside from meat and produce, most of the grocery-food items sold by appellant are processed to such an extent that they do not qualify as "agricultural products" within the meaning of section 24405.

The definition of "agriculture" found in Webster's Third New International Dictionary (1961) is as follows:

a: the science or art of cultivating the soil, harvesting crops, and raising livestock ... b: the science or art of the production of plants and animals useful to man and in varying degrees the preparation of those products for man's use and their disposal (as by marketing).

"Agricultural products" have been defined as those which have a situs of their production upon the farm and which are brought into condition for the uses of society by the labor of those engaged in agricultural pursuits as distinguished from manufacturing or other industrial pursuits. (In re Rodgers, 134 Neb. 832 [279 N.W. 800].)

Simply stated, agricultural products are the products of agricultural labor. When such articles are treated or altered by a nonagricultural enterprise they become the products of that enterprise and, in a strict sense, are no longer agricultural products. Yet the treatment or alteration may be so minor as to leave the product substantially unchanged. Within limits, then, an item may reasonably be considered an agricultural product even though it has been processed after leaving the hands of the farmer. Any effort to draw the line

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at which the transformation occurs must be more or less arbitrary, but the line must be drawn at some point.

For purposes of the question before us, it is pertinent to note that section 24405, in granting a deduction of income, is equivalent to an exemption from tax. As such, it should be strictly, though reasonably, construed to avoid undue enlargement. (Cedars of Lebanon Hosp. v. County of L. A., 35 Cal. 2d 729 [221 P.2d 311.]) Settled principles of statutory construction require that any doubt be resolved against the right to the exemption,, (Estate of Simpson, 43 Cal. 2d 594 [275 P.2d 467].)

We have examined a number of sections of the Agricultural Code which have been cited by appellant in support of its position that the phrase "agricultural products" should be interpreted broadly. (See for example, Agr. Code, § 1300.12 subd. (c), §§ 1190 et seq., and § 2596.) These sections define "agricultural products," expressly or by implication, in terms varying from section to section, embracing a variety of products which have been processed to a greater or lesser extent. The definitions, however, are for specific purposes and do not purport to convey the ordinary meaning of the phrase in question.,,

Respondent has cited federal cases which interpret a statute exempting from regulation vehicles engaged in transporting "ordinary livestock, fish (including shell fish) or agricultural (including horticultural) commodities (not including manufactured products thereof)," (East Texas Lines, Inc. v. Frozen Food Express, 351 U.S. 49 [100 L. Ed., 917]; Frozen Food Express v. United States, 148 F. Supp. 399, aff'd, 355 U.S. 6 [2 L. Ed, 2d 22].)

To distinguish agricultural commodities from the manufactured products thereof, the federal courts adopted a "continuing substantial identity" test. This test was applied in Frozen Food Express v. United States, (supra), to numerous items of agricultural origin. Under an admittedly liberal interpretation urged by farming interests and motor carriers, the court held that frozen foods were agricultural commodities even though the freezing process was extensive and complicated. Canned goods, however, were held to be outside the scope of the exemption.'

Respondent has construed the phrase "agricultural products" as used in section 24405, in general accord with the above judicial interpretations. Under its construction, for example, fresh and frozen meats, fruits and vegetables would fall within the term, but canned foods, cottage cheese and butter would not. As the agency charged with administering the law, respondent has adopted a reasonable and judicially

