BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
IMPERIAL HAY GROWERS ASSOCIATION)

Appearances:

For Appellant: O. A. Henning and
A. Milton Coate
Certified Public Accountants

For Respondent: Peter S. Pierson
Counsel

OPINION

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 Imperial Hay Growers' Association against a proposed assessment of additional franchise tax in the amount of $3,724.98 for the income year ended February 28, 1965.

Appellant Imperial Hay Growers' Association is a farmers' cooperative which was organized and incorporated under California law in 1932. The association markets hay and alfalfa products and purchases supplies. These business activities are primarily done for or with members of the cooperative.

During the year in question appellant disposed of two plants which had become surplus due to changes in the industries involved. A loss of $57,442.06 was sustained when a seed plant, located in Brawley, California, was abandoned and demolished. The other facility, used in connection with hay marketing and located in Paramount, California, was sold to a nonmember. Gain of $131,905.81 was realized from this transaction. During the year on appeal the association refunded $34,039.77 to its members.

A schedule which was attached to appellant's return for this year indicates that $31,352.31 of this amount was allocated from baled hay and growers' supplies margins which arose from business for or with members. The remaining $2,687.46 was allocated from a growers' supplies margin which resulted from business done on a profit basis with nonmembers.

In its return for the year in question and in subsequent computations submitted to this board the association in effect deducted large portions of the Brawley plant loss, and the refunds to members, from the Paramount plant pain. After audit the Franchise Tax Board determined that none of the plant loss could be so deducted. Also that board concluded that $31,352.31 of the refunds to-members must be disallowed as a deduction from the plant gain. Whether these disallowances were correct is the issue presented by the instant appeal.

Section 24401 of the Revenue and Taxation 'Code provides that "... there shall be allowed as deductions in computing taxable income the items specified in this article." Section 24404 then states:

> In the case of farmers,. fruit growers, or like associations organized and operated in whole or in part on a cooperative or mutual basis, (a)- 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, or (b) for the purpose of purchasing, or producing, supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses, (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.)
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> For the purposes of this section "all income resulting from or arising out of such business activities for or with their members" shall include all amounts, whether or not derived from patronage, allocated to members during the income year. Amounts allocated include cash, merchandise, capital stock, revolving fund certificates, certifi-

> cates of indebtedness, retain certificates, letters of advice, or written instruments which in some other manner disclose to each member the dollar amount allocated to him. Allocations made after the close of the income year and on or before the fifteenth day of the ninth month following the close of such year shall be considered as made on the last day of such income year to the extent the allocations are attributable to income derived before the close of such year.'

Section 24421 of the Revenue and Taxation Code provides that "[i]n computing 'net income' of taxpayers under this part, no deduction shall be allowed for the items specified in this article." One of those nondeductible items is described in section 24425 as follows:

> Any amount otherwise allowable as a deduction which is allocable to one or more classes of income not included in the measure of the tax imposed by this part, regardless of whether such income was received or accrued during the income year.

Can't take deduct as to income not includable

With respect to the disallowance of the deduction of the Brawley plant loss, the Franchise Tax Board contends that the loss was allocable to income arising out of business activities for or with members. Since such income is deductible under section 24404, that board concludes that the deduction of the loss is disallowed by section 24425.

However, we believe that respondent's classification of the Brawley plant loss was erroneous. In the recent Appeal of San Antonio Water Company, Cal. St. Bd. of Equal., decided July 1, 1970, which involved the sale of land to a member, we held that the gain from the sale was outside the scope of the deduction statute. This decision was based upon analogous federal law which denies special tax treatment to cooperatives with respect to nonoperating income, and with respect to transactions with a member which were not on a cooperative basis. The nonoperating loss involved here, which did not result from a cooperative activity of the association, must also be classified as outside the scope of the deductible categories of income specified in section 24404. Therefore the deduction of the Brawley plant loss is not disallowed by section 24425.

The assocation bases its deduction of the

$31,352.31 of refunds to members on the provision contained in the second paragraph of section 24404. This provision allows farmers' cooperatives to deduct income resulting from business with members if such income is allocated to members within a certain period. (Appellant has the burden of establishing that the refunds were made from the gain realized upon sale of the Paramount plant. (White v. United States, 305 U.S. 281 [83 L. Ed. 172].) However the only evidence which has been submitted with respect to these refunds, the schedule attached to the association's return, indicates that the refunds were made from income other than gain from the plant sale. We must conclude that appellant has failed, to carry its burden of proof, and therefore the deduction of these refunds was properly disallowed.

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, Appeal of Imperial Hay Growers' Association

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 Imperial Hay Growers' Association against a proposed.assessment of additional franchise tax in the amount of $3,724.98 for the income year ended February 28, 1965, be and the same is hereby modified in that the deduction of the Brawley plant loss be allowed. In all other respectsthe action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 14th day of September, 1970, by the State Board of Equalization.

Geo R Reilly, Chairman

John W. Lynch, Member

Richard Nevins, Member

________________, Member

________________, Member

ATTEST: W W Freeman, Secretary