

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 312

August 25, 1966

TAX EXEMPT BUSINESS LEAGUE

Syllabus:

Taxpayer was organized as a nonprofit corporation under the laws of another state. It has no stockholders, but is composed of members. The members are owners of motels located in the western states. Since its organization, taxpayer's only office has been located in California.

Taxpayer's principal purposes, as stated in its articles of incorporation, include the following: foster the interest of its members and the motel industry; encourage high business standards among its members; provide for the fair and equitable treatment of the traveling public and disseminate highway and travel information to them, establish and maintain uniformity and equity in the customs of the motel trade; acquire, preserve and disseminate information to its members; and stimulate and cultivate closer relationship among those engaged in the motel industry.

Each qualified member pays taxpayer an entrance fee based upon the amount of traffic over the highway on which the motel is located; the number of rental units in the motel up to fifty units; and rent for an emblem sign. Each member also purchases at cost guides listing the name and location of all member motels which are given to all guests. Taxpayer employs investigators who periodically inspect the motels to see that the established standards are maintained. Each member is entitled to one vote in the election of the members of the Board of Directors and Board of Governors.

Except for its first year of operations, taxpayer's receipts from entrance fees, annual dues, sign rentals, and other miscellaneous sources, exceeded its expenses. Taxpayer's articles provide that none of the members shall receive pecuniary gain or profit and in the event of dissolution any remaining assets shall be distributed to some nonprofit educational or charitable organization. Neither taxpayer's articles nor bylaws provide for the distribution of the excess receipts to its members.

Is taxpayer an association organized and operated in whole or in part on a cooperative or mutual basis within the meaning of Section 24405?

With certain exceptions not material here, Section 24405 allows to associations not covered under Section 24404 a special deduction for all income resulting from or arising out of business activities for or with members or

business done for or with nonmembers on a nonprofit basis. To qualify for the deduction the association must be organized and operated in whole or in part on a cooperative or mutual basis. Neither the law nor the applicable regulations define the words "cooperative or mutual basis."

It appears that taxpayer was organized under the nonprofit corporation statute of its state of incorporation with the aim of obtaining a complete tax exemption as a business league. Taxpayer does not qualify as a tax exempt business league for the reason that its services are performed for specific persons. Evanston-North Shore Board of Realtors v. U.S., 320 F.2d 375, cert. denied, 376 U.S. 931; Underwriters' Laboratories, Inc. v. Commissioner, 135 F.2d 371. The statute under which a corporation is organized, however, does not preclude it from the status of a cooperative providing it was organized and operated on a cooperative basis. American Box Shook Export Association, 4 T.C. 758, aff'd 156 F.2d 629; United Cooperatives, 4 T.C. 93.

A fundamental characteristic of a true cooperative is the existence of a legal obligation, incurred before the receipt of income, on the part of the association to return to the members all funds in excess of costs and expenses in proportion to their participation in the cooperative. American Box Shook Export Association, supra; Puget Sound Plywood, Inc., 44 T.C. No. 30. In the instant case no legal obligation exists on the part of taxpayer to return the excess funds to its members. Nor is there any requirement that taxpayer furnish the services to the members at cost. In view of the lack of these factors it is our opinion that taxpayer does not qualify as an association organized and operated on a cooperative or mutual basis. It is accordingly concluded that taxpayer is not entitled to the deduction provided under Section 24405.