

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 297

April 23, 1965

### COOPERATIVE: YEAR OF INCLUSION OF ADVANCES TO MEMBERS

#### Syllabus:

The bylaws of a farmers' cooperative, require each member to enter into a marketing agreement, cast in language of sale, by which title to the member-grower's rice is vested in the cooperative upon harvest. Members are prohibited from marketing their crop through any source other than the cooperative.

Paddy rice is usually harvested during the fall of each year. Some rice is immediately delivered to the cooperative for processing but the bulk is either placed in public warehouses in the name of the cooperative, or retained by the member in farm storage. Storage charges are paid by the cooperative to the public warehouse or member, whichever case may be.

The bylaws require the cooperative to make an initial cash advance to members, based upon \$1.25 per 100 lbs. of rice, when the crop is harvested and placed in storage. Payment is made immediately upon receiving the warehouse receipt, or notification of the amount of rice in farm storage, from the member. When rice is stored in a public warehouse, the warehouse usually informs the cooperative of the delivery.

Most members submit their warehouse receipts, or a report on the amount of rice in farm storage, upon harvest and delivery and are promptly paid the initial advance of \$1.25 per 100 lbs. of rice. These advances are reported by the members as income for the year in which received. However, some members delay submitting the warehouse receipt or request the cooperative not to make payment until the following year. The practice of the cooperative is to honor these requests but not to postpone payment of the initial advance beyond January 15, since on that date an additional advance of \$1.25 per 100 lbs., called an equalization payment, is paid to members. By resolution of the board of directors, an extra advance of \$.75 per 100 lbs., in addition to the initial and equalization payment, "may be paid" upon request of the member at any time after harvest and delivery of the rice.

Beginning in March, monthly progress payments are made to members until October when final settlement for the prior year's crop is made by a patronage dividend. All advances are financed by loans obtained by the cooperative from lending institutions. Payments on these loans are made from the receipts from sales of rice during the months that follow. Prior to 1961 the cooperative

charged its members interest on the initial advance, equalization payment and extra advances up to the final settlement date. However, all such interest was returned to members as part of the patronage dividend. In 1961 the cooperative discontinued the charging of interest on all but the extra advances.

It has been the practice of the Board to consider the initial advance as income at the time of delivery, even though the member had actual payment of the initial advance deferred until the following year. The propriety of this treatment has been questioned by some of the cooperative's members on the ground that the advances are loans. However, for the reasons stated below it is our opinion that such practice is correct.

(1) Did the advances constitute income rather than proceeds from a loan?

(2) Assuming the advances were income, were the deferred initial advances (\$1.25 per 100 lbs.) constructively received by members upon harvest and delivery of the rice crop?

(1) Whether the advances to members were received (actual or constructive) as income or loans is important since proceeds from loans are not income, Oliver v. U. S., 193 F. Supp. 930 (1961). The Oliver case is similar to the present case since it involved whether an advance was made in 1958 by a cooperative to a rice grower was income constructively received upon delivery of the rice in 1957. In denying the government's motion for a judgment notwithstanding the jury's verdict, the court indicated that as a matter of general law the relationship between cooperative marketing associations and its members is that of principal and agent. Consequently, since the cooperative had borrowed funds with which to pay the advance, the advance would constitute a loan in the hands of a member.

In California, however, members of nonprofit cooperatives are not, personally liable by statute for the debts, liabilities or obligations of the corporation. Corporations Code §§ 9610, 12205; Agricultural Code § 1219. Accordingly, in this State, the relationship between a cooperative and its members is not that of principal and agent as a matter of general law. On the contrary, the relationship is the same as that of stockholders in any other private corporation. This was made clear by the California Supreme Court in California Employment Commission v. Butte County Rice Growers Assn., 25 C 2d 624, a matter involving taxation, by holding that a cooperative corporation is not a mere instrumentality of its members but is wholly independent of the farmers comprising its membership.

While as a matter of general law the agency theory does not apply, the problem remains as to the relationship between the members and the cooperative created by the marketing agreement. If the marketing agreement constituted a sale, the advance is income to the member. On the other hand, if the agreement created an agency relationship the advance would not be income since the

advances are made from capital of the cooperative rather than receipts from the marketing of the rice.

It is generally recognized that there are two kinds of cooperative marketing agreements, sales and agency, and that the determination of whether a particular agreement is to be classified as one or the other depends upon the intention of the parties. In California, cooperative marketing agreements have been classified as contracts of agency even when, as in this case, they contain language of sale. Irvine Co. v. McCoolgan, 26 C 2d 160. However, the court there indicated that such classification is not conclusive. See also 98 ALR 1413.

In the present case the language used in the marketing agreement indicates the parties intended a sale of the rice to the cooperative. The fact that the cooperative treats the advances as an item of cost of goods sold and the members have consistently reported the advances as income in the year of receipt also supports this view. Furthermore, the general principle that exemptions from taxation are to be construed against the taxpayer is applicable. White v. U. S., 305 U. S. 281. Accordingly, it is concluded that the marketing agreement resulted in a sale, therefore, the advances constituted income to the members.

(2) The doctrine of constructive receipt was conceived in order to prevent a taxpayer from choosing the year in which to report income merely by choosing the year in which to reduce it to possession. McIntyre v. U. S., 58-1 USTC 9355. The doctrine is well established and is to the effect that income which is unqualifiedly available and subject to the demand of a taxpayer is treated as having been received at the time it became available regardless of the time of actual receipt. Reg. 17571(b).

In Oliver v. U. S., supra, it was held that the members and the cooperative had a right to modify the agreement as to the time for payment of advances if such modification was made in good faith and is supported by consideration. It was found that the agreement as modified was supported by consideration in that the grower had the right to delay delivery of his rice until the year following harvest. When the grower delivered the rice in 1957 on the strength of the cooperative's agreement not to pay him until 1958 he did something he was not required to do. Consequently, the agreement was supported by consideration and created a binding contract under which the grower did not have the right to receive the advance in 1957. In the case at hand, however, the members are obligated to make delivery of the rice immediately upon harvest. In making delivery they did nothing more than they were required to do, consequently, the agreement to delay payment is not binding for lack of consideration.

Thus, any delay in receipt of the initial advance (\$1.25 per 100 lbs.) was due solely to the members' own failure to turn in the warehouse receipt, or

request to defer payment. Since members had the right to receive the advances upon harvest and delivery of the rice in storage, the doctrine of constructive receipt is applicable and the advance is income to members regardless of whether they see fit to enjoy it or not. Zeltzman, 34 T.C. 85, aff'd 283 F. 2d 514.

The mere fact that interest was charged members on advances for years prior to 1961 does not constitute a substantial limitation or restriction upon the members' right to receive the income since such interest was returned to members as part of the patronage dividend. However, the doctrine does not apply to the extra advance (\$.75 per 100 lbs.) for which the member is required to submit a request. The resolution authorizing the payment provides such advances "may be made" and is construed to be permissive rather than mandatory. Hughes Bros. v. Rawhide Gold Mining Co., 16 CA 299. Therefore, since the member did not have an unqualified right to receive the extra advance, there can be no constructive receipt.