Uniform Printing & Supply Co. v. Commissioner, 33 B.T.A. 1073 (1936)

Patronage dividends paid by a cooperative are excluded from the cooperative's gross income only to the extent that the cooperative was legally obligated to pay them to its patrons at the time the income was received; amounts that could have been distributed as dividends to shareholders are taxable income to the cooperative.

Summary

Uniform Printing & Supply Co., an agricultural cooperative, contested the inclusion of patronage dividends in its gross income for tax years 1937-1939. The company argued it was a mere conduit for its patrons' money. The Board of Tax Appeals held that patronage dividends were excludable from gross income to the extent the cooperative was legally obligated to pay them, but amounts the cooperative could have distributed to shareholders as dividends were taxable income. The case clarifies the tax treatment of cooperative earnings distributed as patronage dividends.

Facts

Uniform Printing & Supply Co. was incorporated under Indiana's General Corporation Act to supply farm equipment to member agricultural cooperatives and farmers. The company operated on a cooperative basis, with member stockholders equally represented on the board of directors, limited returns on invested capital (8%), and one vote per member. Most business was conducted with members, but even non-member agricultural cooperatives received patronage dividends. The company's bylaws dictated how net income was distributed after dividends and depreciation reserves.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies against Uniform Printing & Supply Co. for income and excess profits taxes for the fiscal years ended October 31, 1937, 1938, and 1939. The company appealed to the Board of Tax Appeals, contesting the inclusion of patronage dividends in its taxable income.

Issue(s)

Whether patronage dividends distributed by the petitioner to its patrons are properly included in the petitioner's taxable income, or whether such dividends constitute rebates which are excludable from gross income.

Holding

No, not entirely. The Board held that patronage dividends are excludable from the cooperative's gross income to the extent the cooperative was legally obligated to pay them at the time the income was received. However, the portion of the patronage dividends that could have been distributed to shareholders as dividends, at the discretion of the board of directors, is taxable income to the cooperative because the cooperative was not legally obligated to distribute those funds as patronage dividends.

Court's Reasoning

The Board of Tax Appeals determined that the company operated as an agricultural cooperative. Normally, patronage dividends are treated as rebates and excluded from gross income (citing I.T. 1499, et al.). However, this exclusion is limited to situations where the right to the dividends arises from the corporate charter, bylaws, or contract. If the corporation isn't legally obligated to distribute the money when it's received, it's considered gross income. The Board analyzed the company's charter and bylaws and found that patrons were entitled to a distribution of net income as defined in the bylaws. However, the board of directors had the power to allocate funds for dividends to shareholders. The Court reasoned, "Thus the amounts to be distributed to patrons pursuant to the petitioner's bylaws could not be ascertained until after the petitioner's board of directors had acted with regard to dividends and reserve, or had refrained from acting." Therefore, only the portion of the patronage dividends exceeding what could have been paid as shareholder dividends was excludable. The Court distinguished *Cooperative Oil Association, Inc. v. Commissioner* (115 Fed. (2d) 666) based on differing facts and *Juneau Dairies, Inc.* (44 B. T. A. 759) because distributions there were limited to shareholders only.

Practical Implications

This case clarifies the tax treatment of patronage dividends in cooperative organizations. Legal professionals advising cooperatives must carefully examine the organization's charter and bylaws to determine the extent of the cooperative's legal obligation to distribute patronage dividends. If the cooperative's board retains discretion over the distribution of funds that could be paid as shareholder dividends, those amounts will be considered taxable income to the cooperative. The case highlights the importance of clear and binding contractual obligations within cooperative structures to ensure favorable tax treatment of patronage dividends. Later cases would continue to refine the definition of a cooperative's obligation to distribute patronage dividends, often focusing on the timing and binding nature of the obligation.

