***14 T.C. 162 (1950)***

Purchase rebates or patronage dividends issued by a cooperative purchasing association in the form of registered redeemable interest-bearing promissory notes are accruable income to the participating members in the years the notes are issued.

**Summary**

The Tax Court addressed whether patronage dividends issued as promissory notes by a cooperative to its members were taxable income when the purchases were made, when the notes were issued, or not at all. The court held that the notes were taxable as income in the year they were issued because the members' right to receive the dividend became fixed at that time, even though the notes' redemption was contingent on the cooperative's financial condition. This case illustrates the application of accrual accounting principles to cooperative dividends.

**Facts**

The petitioners were partners in a retail grocery chain and members of Associated Grocers Co-op (Co-op), a cooperative purchasing association. The Co-op issued purchase rebates or patronage dividends to its members in the form of registered, redeemable promissory notes bearing interest. These notes were issued pursuant to the Co-op's bylaws, which allowed the board of trustees to pay dividends in the form of notes redeemable upon liquidation or earlier if the board deemed it appropriate to maintain working capital. The partnership did not report these notes as income on their tax returns.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies against the petitioners, asserting that the patronage dividends should have been included in their gross income for the years the purchases were made. The petitioners contested this determination in Tax Court. The Commissioner later argued the dividends were taxable when the notes were issued. The cases were consolidated because they involved the same issue.

**Issue(s)**

Whether purchase rebates or patronage dividends issued by a cooperative purchasing association in the form of promissory notes were accruable income to the contributing members in the years when the purchases on which they were computed were made, or in the years when the notes were issued, or whether, in the circumstances, they were accruable at any time?

**Holding**

Yes, the patronage dividends are accruable income to the members in the years

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when the notes were issued because the issuance of the notes determined the time of the income accrual since the members' rights to a definite amount became fixed at that time.

**Court's Reasoning**

The court reasoned that the notes represented the partnership's proportional share of earnings already realized by the Co-op, which it was required to distribute to the partnership. While the Co-op had the right to issue notes instead of cash, this discretion did not prevent the income from accruing when the notes were issued. The court distinguished these notes from ordinary corporate dividends, noting that the distributions were based on patronage, not stock ownership. The court also found that the notes had value when issued, as they bore interest, and the Co-op was financially sound. The court stated, "The partnership's rights to definite amounts of income became fixed when the notes were issued." The court rejected the Commissioner's initial theory that the income accrued when the purchases were made because the amount of the rebates was not ascertainable until the end of each half-year accounting period.

**Practical Implications**

This case clarifies the tax treatment of patronage dividends issued by cooperatives to their members, particularly when those dividends are in the form of promissory notes. It establishes that, for accrual basis taxpayers, the income is generally recognized when the notes are issued, not necessarily when the underlying purchases occur. Attorneys advising cooperatives and their members should consider this timing rule when structuring dividend distributions and planning for tax liabilities. This ruling emphasizes the importance of determining when the right to receive income becomes fixed and reasonably ascertainable for accrual accounting purposes. Later cases would likely distinguish this case if the notes had no ascertainable value or if the cooperative's financial stability was questionable.

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