17 T.C. 1526 (1952)

A member of a tax-exempt cooperative reports as income the fair market value of preferred stock received as patronage dividends, but does not realize income from amounts merely credited to a capital reserve account until those amounts are made available.

Summary

Petitioners, members of a tax-exempt farmers' cooperative, received patronage dividends in the form of preferred stock and credits to a capital reserve account. The Tax Court addressed whether these distributions constituted taxable income. The court held that the fair market value of the preferred stock was taxable income in the year received because the stock had a determinable value and the patrons could transfer it. However, the court determined that the credits to the capital reserve account were not taxable income until the funds were made available to the patrons, as the cooperative retained control over those funds for its capital needs.

Facts

William A. Joplin, Jr., Joseph F. Kohn, and S. Crews Reynolds were members of the Osceola Products Company, a tax-exempt agricultural cooperative. The cooperative processed cotton seed and soybeans, distributing net earnings to its patrons based on patronage. Distributions were made in the form of credits to a capital reserve account and the issuance of preferred stock. The cooperative's by-laws allowed it to retain a portion of net earnings for capital purposes. The preferred stock was transferable and paid non-cumulative dividends. A loan agreement with St. Louis Bank for Cooperatives restricted the cooperative's ability to pay cash dividends without the bank's approval.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax, arguing that the patronage dividends were taxable income. The petitioners contested this determination. The cases were consolidated in the Tax Court.

Issue(s)

1. Whether the allocation of net earnings to the members' capital reserve accounts in a tax-exempt cooperative constitutes taxable income to the members in the year the allocation is made.
2. Whether the issuance of preferred stock as patronage dividends by a tax-exempt cooperative constitutes taxable income to the members in the year the stock is received, and if so, to what extent.

Holding

1. No, because the cooperative retained control over the funds credited to the capital reserve account, and these funds were not yet available to the patrons.
2. Yes, because the preferred stock had a fair market value at the time of receipt. The taxable income is equal to the fair market value of the preferred stock when it was issued.

Court's Reasoning

The court reasoned that the capital reserve credits were not constructively received by the patrons. The cooperative had the right to retain a portion of its net earnings for operating capital, as permitted by its charter, by-laws, and section 101 (12) of the Code. As the court stated, "[U]nless at some time the earnings of the cooperative were made available to or were subject to the control of the patron," the constructive receipt doctrine should not apply. With respect to the preferred stock, the court relied on *Estate of Wallace Caswell, 17 T.C. 1190*, holding that members realize income upon receipt of certificates representing interests in the cooperative's capital reserve to the extent of their fair market value. The court determined the preferred stock's fair market value was equal to its par value of $25 per share, rejecting the taxpayer's argument that it was worth only half that amount. The court emphasized that the stock was transferable, paid dividends, and could be redeemed at par value, indicating a fair market value equivalent to par.

Practical Implications

This case clarifies the tax treatment of patronage dividends distributed by tax-exempt cooperatives. It establishes that while actual distributions of stock or cash are taxable when received (to the extent of their fair market value), mere credits to a capital reserve account are not taxable until the patron has access to the funds. Attorneys advising cooperatives and their members should carefully consider the form of patronage distributions. If a cooperative retains control over funds allocated to patrons (e.g., through capital reserve accounts), the members will not be taxed until the funds are actually distributed or made available. Conversely, distributions of stock or other property with a readily determinable fair market value will trigger taxable income to the member in the year of receipt, regardless of whether the cooperative is tax-exempt.

