20 T.C. 603 (1953)

Revolving fund certificates issued by a cooperative to its members are not taxable income when the certificates have no fair market value and the member has no real dominion or control over the funds.

Summary

B.A. Carpenter challenged the Commissioner's determination that revolving fund certificates issued by a fruit growers' cooperative and stock in Pasco Packing Company were taxable income. The Tax Court held that the revolving fund certificates, lacking fair market value and control by the member, were not taxable. However, the court sided with the Commissioner regarding the Pasco stock, finding that Carpenter's right to the stock vested in the year the purchase was made by the cooperative, not when the stock certificate was physically received. The court reasoned the cooperative acted as an agent for its members.

Facts

Carpenter, both individually and as a member of a partnership, marketed fruit through Fosgate Growers Cooperative. The Cooperative retained amounts from fruit settlements for capital purposes, issuing revolving fund certificates to members as evidence of patronage dividends. These certificates bore no interest, were retirable at the directors' sole discretion, and were subordinate to all other debts of the cooperative. Separately, the Cooperative purchased Pasco Packing Company stock on behalf of its members as a condition of Pasco processing the Cooperative's fruit. Carpenter received notification of his entitlement to Pasco stock in May 1949 and the stock certificate in July 1949, which he reported as income in his fiscal year ending February 28, 1950.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies in Carpenter's income tax for several years, including adjustments for the revolving fund certificates and the Pasco stock. Carpenter petitioned the Tax Court, contesting the Commissioner's determinations. The Tax Court addressed the taxability of the certificates and the timing of income recognition for the stock.

Issue(s)

1. Whether the Commissioner erred in increasing the petitioner's income by amounts representing his share of revolving fund certificates issued by the Cooperative.

2. Whether the Commissioner erred in increasing the petitioner's income for the year ended February 28, 1949, by the value of stock in Pasco Packing Company allegedly received by the petitioner in that year.

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Holding

1. No, because the revolving fund certificates had no fair market value and the petitioner lacked control over the funds represented by them.

2. Yes, because the petitioner's right to the stock vested when the Cooperative purchased it on behalf of its members, not when the stock certificate was physically delivered.

Court's Reasoning

Regarding the revolving fund certificates, the court emphasized that the certificates had no fair market value. The court stated that the petitioner never had any real dominion or control over the funds represented by the certificates and the decision to retain the funds rested solely with the directors. Referring to prior cases such as *P. Phillips, 17 T.C. 1027*, the court reiterated that patronage dividends are taxed depending on whether or not they have a fair market value. The court rejected the Commissioner's arguments for "constructive receipt" or "assignment of income."

Concerning the Pasco stock, the court determined that the Cooperative acted as an agent for its members in purchasing the stock, as evidenced by the member's agreement. The court noted: "*The petitioner's right became fixed at the time of the contract, which was before the year in which the stock certificate was actually delivered to the petitioner and returned as income by him.*" Therefore, the petitioner's right to the stock vested when the purchase was made, making it taxable in that year, regardless of when the stock certificate was received. Dissenting, Judge Arundell argued that the stock should only be taxed in the year the taxpayer actually received the shares, as he was a cash-basis taxpayer who had no prior knowledge of the transaction.

Practical Implications

This case clarifies the tax treatment of revolving fund certificates issued by cooperatives, emphasizing the importance of fair market value and the member's control over the funds. It highlights that mere issuance of certificates does not automatically trigger taxable income. Legal practitioners should carefully examine the terms of the certificates and the degree of control the member has over the underlying funds. Furthermore, the case underscores that the timing of income recognition is determined by when the right to receive the income becomes fixed, regardless of when actual possession occurs, particularly when an agency relationship exists. This principle extends beyond cooperative contexts and applies to various scenarios where income is earned through an intermediary.

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