31 T.C. 674 (1958)

To qualify as a true patronage dividend, the allocation must be made from profits earned from transactions with the particular patrons for whose benefit the allocation is made and must be equitable.

Summary

Pomeroy Cooperative Grain Company, a non-tax-exempt Iowa farmers' cooperative, sought to exclude patronage dividends from its gross income. The Tax Court examined whether allocations to members only, derived from compensation for handling and storing grain for the Commodity Credit Corporation (CCC) and from storing grain for non-member persons and organizations, qualified as patronage dividends. The court held that the allocations from the CCC did not qualify because the CCC was not a member, and the grain was owned by the CCC. Regarding the storage of grain for non-members, these also did not qualify. However, the court held that allocations from storage fees received from members could qualify as patronage dividends if allocated proportionately to the storage business of the members.

Facts

Pomeroy Cooperative Grain Company (Petitioner) was an Iowa corporation operating as a farmers' cooperative. It was not tax-exempt under the Internal Revenue Code. The cooperative had two departments: grain and merchandise. The grain department handled grain in three ways: direct purchases from producers, handling and storing grain for the Commodity Credit Corporation (CCC) under government loan programs, and storing grain for others. The cooperative allocated patronage dividends only to its members. The Commissioner of Internal Revenue (Respondent) determined deficiencies in the Petitioner's income taxes, challenging the exclusion of patronage dividends from gross income, especially those related to grain handling and storage. The key factual dispute concerned whether income from storing grain for the CCC and for non-members could be treated as patronage dividends for members.

Procedural History

The Commissioner determined deficiencies in Pomeroy's income taxes for the years ending June 30, 1953, 1954, and 1955. Pomeroy challenged these deficiencies in the United States Tax Court. The court considered whether certain allocations of income constituted patronage dividends, which could be excluded from gross income. The court considered facts that were stipulated by both parties.

Issue(s)

1. Whether compensation received by Pomeroy from the Commodity Credit Corporation (CCC) for handling and storing grain, where the grain producers

included both members and nonmembers, could be considered a patronage dividend for members.
2. Whether compensation received by Pomeroy from non-members for storing grain owned by them could be considered a patronage dividend.
3. Whether the amounts allocated for members only, out of compensation received from members for storing grain owned by them, qualify as true patronage dividends.

Holding

1. No, because the CCC was not a member of the cooperative, and the grain was owned by the CCC.
2. No, because the compensation came from non-members.
3. Yes, to the extent that the amounts allocated to the particular members who stored the grain were proportionate to their shares of the total member storage business which produced the compensation allocated.

Court's Reasoning

The court cited that because this was a Federal tax problem, it was controlled by Federal law. The court held that the exclusion of patronage dividends by nonexempt cooperatives is an established administrative practice, based on the idea that patronage dividends are corrective price adjustments. To qualify as a true patronage dividend, the allocation must be made pursuant to a preexisting legal obligation, out of profits realized from transactions with the particular patrons for whose benefit the allocations were made, and equitably. The court distinguished between compensation for handling and storing grain for the CCC (where the grain was owned by the non-member CCC), and compensation for storing grain for members. Since the CCC was not a member, and the income came from it, the amounts did not constitute patronage dividends. Similarly, income derived from storing grain for non-member organizations did not qualify. However, allocations from storage fees received from members, which represented their proportionate shares of total member storage business, could be considered patronage dividends.

The court stated that "true patronage dividends are, in reality, either (a) additions to the prices initially paid by the cooperative to its patrons for products which the patrons had marketed through the cooperative, or (b) refunds to patrons of part of the prices initially paid by them for merchandise or services which they had obtained through the cooperative." Furthermore, the court stated that "in order for an allocation of earnings by a cooperative association to qualify as a true corrective and deferred price adjustment, and hence as a true patronage dividend, at least three prerequisites must be met… the allocation must have been made out of profits or income realized from transactions with the particular patrons for whose benefit the allocations were made…"

Practical Implications

This case provides guidance on the requirements for non-exempt cooperatives to treat certain allocations as patronage dividends and exclude them from gross income. It underscores the importance of tracing income to its source and ensuring that allocations are made only to those patrons whose patronage generated the income. Furthermore, it is crucial that any allocations are equitably distributed based on the specific activity generating the income. This has significant implications for how cooperatives structure their financial transactions, calculate patronage dividends, and comply with tax regulations. Legal practitioners advising cooperatives must understand these requirements to advise on the tax implications of revenue allocation and distribution practices.

