Independent Cooperative Milk Producers Association, Inc. v. Commissioner, 76 T. C. 1001 (1981)

A cooperative's noncash patronage dividends are not deductible unless members explicitly consent in writing to include them in income.

Summary

Independent Cooperative Milk Producers Association, a farmers' cooperative, sought to deduct patronage dividends allocated to its members via certificates of equity. The Tax Court held that the cooperative could not deduct these dividends for members joining after 1967 because they did not provide written consent to include the dividends in their income as required by section 1388(c)(2)(A) of the Internal Revenue Code. The court found that neither the membership agreements nor the endorsement of dividend checks constituted valid written consents, emphasizing the need for explicit language on the face of the document consenting to the inclusion of noncash dividends in income.

Facts

Independent Cooperative Milk Producers Association, a farmers' cooperative, allocated its net annual earnings as patronage dividends to its members based on the weight of milk sold. For the years 1973 and 1974, the cooperative paid 20% of these dividends in cash and issued certificates of equity for the remaining 80%. The cooperative amended its bylaws in 1967 to include a consent provision, but did not distribute copies of these bylaws to members joining after that date. Members signed agreements to abide by the cooperative's rules and regulations, and endorsed checks for the cash portion of their dividends.

Procedural History

The Commissioner of Internal Revenue disallowed deductions for the noncash patronage dividends allocated to members who joined the cooperative after 1967. The cooperative petitioned the Tax Court for a redetermination of the deficiencies. The Tax Court upheld the Commissioner's determination, ruling that the cooperative failed to obtain the necessary written consents from its post-1967 members.

Issue(s)

1. Whether the membership agreements signed by the cooperative's post-1967 members constitute written consents under section 1388(c)(2)(A) of the Internal Revenue Code to include noncash patronage dividends in income.
2. Whether the endorsement and cashing of dividend checks by the cooperative's post-1967 members constitute written consents under section 1388(c)(2)(A) to include noncash patronage dividends in income.

Holding

1. No, because the membership agreements do not contain explicit language on their face consenting to the inclusion of noncash patronage dividends in income.
2. No, because the endorsed checks do not contain the required statement that endorsing and cashing the check constitutes consent to include the noncash dividends in income.

Court's Reasoning

The court strictly construed section 1388(c)(2)(A), requiring that written consents explicitly state on their face that the signer agrees to include noncash patronage dividends in income. The court rejected the cooperative's arguments that the membership agreements and endorsed checks, when considered with other documents, constituted valid consents. The court noted that the legislative history of subchapter T aimed to eliminate uncertainty and ensure symmetrical tax treatment of patronage dividends. It found that the cooperative's failure to comply with the explicit consent requirement meant that the noncash dividends were not deductible. The court also emphasized that the consent provisions were designed to ensure patrons were aware of and agreed to the tax consequences of their allocations.

Practical Implications

This decision requires cooperatives to obtain explicit written consents from members for noncash patronage dividends to be deductible. Practitioners must advise cooperatives to include clear consent language in membership agreements or on dividend checks. The ruling may affect how cooperatives structure their dividend policies and could lead to increased administrative burdens to ensure compliance. Subsequent cases, such as *Farmland Industries, Inc. v. Commissioner*, have followed this precedent, emphasizing the need for explicit consents. Businesses in other sectors using similar allocation methods should also review their practices to ensure compliance with analogous tax provisions.