Lamesa Cooperative Gin v. Commissioner, 78 T. C. 894 (1982)

A cooperative's board has discretion to allocate patronage dividends based on current patronage, even for gains from asset sales, if the allocation is not inequitable.

Summary

Lamesa Cooperative Gin, an exempt farmers' cooperative, sold equipment in 1974, reporting the gain as ordinary income. The cooperative allocated this gain and patronage dividends solely based on 1974 patronage, not attempting to allocate to past patrons. The Tax Court held that this allocation was not inequitable, given the stable membership and practical difficulties in allocating to past years. The court also upheld the cooperative's allocation of net margins from a minor purchasing operation to all patrons, emphasizing the board's discretion in making equitable allocations.

Facts

Lamesa Cooperative Gin, an exempt farmers' cooperative, primarily ginned cotton and marketed cottonseed. From 1964 to 1974, it acquired equipment used by patrons, which was depreciated. In 1974, the cooperative sold this equipment, reporting a gain of $61,081. 50 as ordinary income under section 1245. The cooperative allocated this gain and patronage dividends based solely on 1974 patronage, without attempting to allocate to past patrons. Additionally, the cooperative operated a minor purchasing operation, selling supplies to patrons at cost, and included any gains from this operation in the overall patronage dividend allocation.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the cooperative's federal income tax for the taxable year ending July 31, 1974. The cooperative petitioned the United States Tax Court, which heard the case and subsequently ruled in favor of the cooperative.

Issue(s)

1. Whether it was inequitable for the cooperative to allocate the gain from the sale of equipment in 1974 solely to its 1974 patrons, rather than also to past patrons.
2. Whether it was inequitable for the cooperative to allocate net margins from its purchasing operation to all patrons based on marketing patronage, without maintaining separate accounts for the purchasing operation.

Holding

1. No, because the allocation to current patrons was not inequitable given the stable

membership and practical difficulties in allocating to past years.
2. No, because the allocation was not inequitable given the minor nature of the purchasing operation and the substantial overlap of patrons between the marketing and purchasing functions.

Court's Reasoning

The court emphasized the discretion of the cooperative's board in making patronage dividend allocations. It found that allocating the gain from the sale of equipment to current patrons was not inequitable, considering the stable membership over time, the difficulty in determining past patronage and depreciation, and the absence of patron complaints. The court rejected the Commissioner's argument that the gain should have been allocated to patrons in the years depreciation was claimed, noting that such an allocation would not have been significantly more accurate. The court also upheld the allocation of net margins from the purchasing operation to all patrons, noting the minor nature of this operation and the practical difficulties in maintaining separate accounts. The court cited prior cases to support its view that the board's discretion should be respected unless the allocation is clearly inequitable, particularly to nonmember patrons.

Practical Implications

This decision allows cooperatives flexibility in allocating gains from asset sales and net margins from minor operations, as long as the allocation is not inequitably discriminatory. It emphasizes the importance of the board's discretion and the practical considerations in making allocations, rather than strict adherence to theoretical principles of allocation. The ruling may affect how cooperatives structure their accounting and allocation methods, potentially reducing the need for complex record-keeping for minor operations. It also reinforces the principle that courts should defer to a cooperative's board unless there is clear evidence of inequitable treatment, particularly to nonmember patrons. This case has been cited in subsequent decisions involving cooperative allocations, such as *Ford-Iroquois FS, Inc. v. Commissioner*, further solidifying its impact on cooperative tax law.

