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1958

Break for the Farmers A Further Word

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Recommended Citation
William W. Schwarzer, *Break for the Farmers A Further Word*, 33 *California State Bar Journal* 290 (1958).
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Forum

A Break For Farmers

A Further Word*

By William W Schwarzer of San Francisco

The farmers' marketing cooperative has for many years been recognized as a valuable means of self-help for the farmer and, therefore, as being in the public interest. The tax laws have taken account, not only of the public interest in these cooperatives, but also of their peculiar character as a vehicle for group action by farmers. The tax laws contemplate first, that the cooperative will receive and pay over to the farmers the proceeds from their products, and, second, that a portion of these proceeds will be retained by the cooperative to finance its operations.[1] It has been the prevailing practice among cooperatives since time immemorial, first, to pay over the major part of the farmers' proceeds to them, and, second, to revolve the retained portion of the proceeds as rapidly as possible within the limits of economic feasibility so that current patrons will be paying for current operations. Amounts retained by the cooperative are generally allocated to the patrons, allocation being evidenced by a certificate, letter of advice, credit to the farmers on the cooperative's books or some other means.

The recent announcement of the Internal Revenue Service[2] that it will follow the *Long Poultry Farms*[3] and *Carpenter*[4] cases ends years of uncertainty respecting the tax treatment by patrons of such allocations. As a result taxpayers on a cash basis will now have to report as taxable income only cash paid to them or certificates issued to them having an ascertainable fair market value. Taxpayers on an accrual basis will report an allocation as income in the year in which the right to receive payment of the amount allocated becomes reasonably definite and certain. As a prac-

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*See Richardson, "A Break for Farmers," 33 Cal. S.B.J. 124 (March-April, 1958).

[1] I.R.C., secs. 521, 522.

[2] Internal Revenue Service TIR-69, Feb. 14, 1958.

[3] *Long Poultry Farms, Inc.* v. *Commissioner*, 249 F.2d 726 (4th Cir. 1957).

[4] *Commissioner* v. *Carpenter*, 219 F.2d 635 (5th Cir. 1955).

tical matter, this means that both cash basis and accrual basis taxpayers will report withholdings or retains as income in the year in which the withholdings or retains are revolved out to the patron.

The rules announced by these cases and now acquiesced in by the government are salutary, logical and should result in no hardship to the government or the taxpayer for the following reasons:

1. To tax cash basis patrons on noncash allocations would be arbitrary and burdensome. The tax would be imposed with respect to amounts which the taxpayers will not receive for some years, and it would have to be paid although the taxpayer has not received the amounts out of which he would be expected to pay it. As a result, cooperatives would find it very difficult to withhold the amounts needed to finance their operations. Cooperative patrons would be under a substantial disadvantage compared to farmers who are not dealing with cooperatives. And the policy of aiding and encouraging farmers' cooperatives would obviously be subverted.

2. To tax patrons on noncash allocations is unnecessary. It is not a fact that the amounts represented by noncash allocations would forever escape taxation. First, most California marketing cooperatives as a matter of practice revolve out the amounts retained in a relatively short time, generally in less than ten years. The theory underlying cooperatives is that current financing requirements will be withheld from *current* earnings. In practice cooperatives would lose much of their appeal if patrons did not have a reasonable expectation of receiving their funds within a few years. Second, the theory that noncash allocations must be taxed either to the cooperative or the patron in the year in which they are made in order to prevent their escaping taxation is fallacious. In the ordinary case, the patron realizes on these allocations within a few years at which time the tax is paid. If, on the other hand, the cooperative does not ultimately redeem the allocation, it may then be taxed and the patron who has paid tax on the allocation is entitled to a deduction for his loss. There is certainly no basis for concluding that there will be a loss of revenue or that the earnings of cooperatives have now been rendered substantially free of income tax.

3. To tax patrons on noncash allocations is not required for the sake of consistency. As the court said in *Commis-*

sioner v. *Carpenter,* 219 F.2d 635 (5th Cir. 1955), at pages 636-7:

> It is fundamental in income taxation that, before a cash basis taxpayer may be charged with the receipt of income, he must receive cash or property having a fair market value, or such cash or property must be unqualifiedly subject to his demand.

Nor can an accrual basis taxpayer be charged with the receipt of income on account of a contingent credit on the cooperative's books where the amount and time of payment are left to future determination by the cooperative's directors. See *Long Poultry Farms, Inc.* v. *Commissioner,* 249 F.2d 726 (4th Cir. 1957). In addition to the instances where income cannot be said to have been received, there are several situations in which the tax laws permit the deferral of the tax. Among these are the reporting of income on the "installment" method (I.R.C., sec. 453), corporate reorganizations (I.R.C., sec. 351), the sale of a residence (I.R.C., sec. 1034), pension plans and profit sharing trusts (I.R.C., secs. 401-404), and transactions between cash basis and accrual basis taxpayers. Finally, the California Legislature has adopted the same rule as that which the Revenue Service will follow. Under section 17117.5 of the Revenue and Taxation Code, passed in 1957, a taxpayer receiving noncash allocations from farmers' cooperatives may at his election report them as income when received or when redeemed or realized upon. The taxpayer is required, however, to report at face value all noncash allocations when received although, at his election, he may exclude them from taxable income until redeemed or realized upon, and an appropriate extension of the statute of limitations is provided for. Once an election as to the method of reporting is made, it may not be changed without the consent of the Franchise Tax Board.

The Revenue Service's ruling substantially adopts the theory of the California statute. Although undoubtedly improvements could be made upon the present situation, for example, by eliminating the uncertainty with respect to the taxable fair market value of certificates and by clearly giving a taxpayer an election as to the method of reporting so as to avoid the doubling up of taxable income in some years (see Rev. & Tax. C., sec. 17117.5), the announcement of the Internal Revenue Service is nevertheless a step in

the right direction, supported by reason and policy. Those taxpayers who have previously paid tax on noncash allocations have no reason to expect that the new policy would result in double taxation of those allocations with respect to years now barred by limitations. Nothing in the *Long Poultry* and *Carpenter* cases or elsewhere suggests that if the tax is paid on a noncash allocation, tax would again have to be paid when the allocation is realized upon. Nor is there any reason why this clarification of the tax status of patrons should necessitate any change in the tax treatment of the cooperatives themselves.

ADMINISTRATIVE REGULATIONS

The Division of Administrative Procedure has published in the *California Administrative Register* (supplementary to the California Administrative Code) regulations filed with the Secretary of State during March and April, 1958, by the agencies named:

Title Number	*Agency*	*Register*
2	State Personnel Board	58, Nos. 5, 7 & 8
2	State Board of Control	58, No. 5
2	State Allocation Board	58, No. 5
2	State Lands Commission	58, No. 5
3	Agriculture	58, Nos. 4, 5, 6 & 7
4	Dept. of Alcoholic Beverage Control	58, No. 6
4	California Horse Racing Board	58, No. 8
4	Bureau of Furniture and Bedding Inspection	58, No. 6
5	Education	58, No. 5
8	Division of Industrial Safety	58, No. 7
8	Division of Labor Law Enforcement	58, No. 7
8	Industrial Relations—Office of Director	58, No. 7
10	Insurance Commissioner	58, No. 4
14	Fish & Game Commission	58, Nos. 4 & 6
14	Division of Beaches and Parks	58, Nos. 5 & 8
14	Division of Small Craft Harbors	58, No. 5
16	State Board of Dry Cleaners	58, No. 5
16	Board of Vocational Nurse Examiners	58, No. 4
17	Dept. of Public Health	58, No. 5
18	Board of Equalization	58, No. 5
21	Dept. of Public Works—Highways	58, No. 7
23	Dept. of Water Resources	58, No. 7

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