

Appeal of J. H. Jonson and Sons, Inc.

Appellant, a California corporation engaged in farming, was incorporated on July 2, 1970. It is on an accrual basis of accounting. Appellant reported a net loss for its first income year, ended June 30, 1971. During that period, appellant did not receive notice of any **noncash** patronage allocations made to it by farmers' cooperative associations. Appellant first received notice of such allocations in December of 1971, and included their face Value **as** income in its return for the income year ended June 30, 1972. Such allocations and subsequent ones were reported in that **year**, and the next two years as follows:

Income Year - Ended -	Allocation <u>Amount</u>
6/30/72	\$2,009
6/30/73	1,736
6/30/74	5,093

Thereafter, respondent received a federal audit report which indicated disallowance in the amount of \$5,000 of appellant's expenses for the income year ended June 30, 1974. Respondent issued a proposed assessment based upon the **federal** action.

Appellant duly protested, advising that a refund claim had already been filed with respondent for the income year ended June 30, 1974. In this claim, appellant had indicated agreement with respondent's action by deleting the **expenses** of \$5,000, **but** also indicated that it had previously reported the allocations **of** \$5,093 as income in error, and that it had actually intended to exclude them from income until the year they were redeemed or realized upon. Appellant similarly filed refund claims for the two income years preceding the income year ended June 30, 1974 by deleting the previously reported allocations.

At the protest level, appellant claimed it had thereby effectively elected to defer reporting the **allo-**cations as income, pursuant to section 24273.5 of the Revenue and Taxation Code, and thus could offset the amount previously erroneously reported against the proposed assessment. Respondent nevertheless affirmed its action.

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Section 24273.5 of the Revenue and Taxation Code provides, in part:

(a) **Noncash** patronage allocations from a farmers' cooperative and mutual associations ... **may**, at the election of the taxpayer,, be considered as income and included in gross income for the income year in which received.

(b) If a taxpayer exercises the election provided for in subdivision (a), the amount included in gross income shall be the face amount of such allocations.

(c) If a taxpayer elects to exclude **noncash** patronage allocations from gross income for the taxable year in which received, such allocations shall be included in gross income in the year that they are redeemed or realized upon.

(d) If a taxpayer exercises the election provided for in subdivision (c), the face amount of such **noncash** patronage allocations shall be disclosed in the return made for the income **year in which such noncash patronage** allocations were received.

(e) If a taxpayer exercises the election provided for in subdivision (a) or (c) for any income year, then the method of computing income so adopted shall be adhered to with respect to all subsequent income years unless with the approval of the Franchise Tax Board a change to a different method is authorized.

Respondent's regulations provide, in part:

Elections. If a taxpayer includes in its gross income, for its first income year beginning after December 31; 1956, any amount attributable **to noncash** patronage allocations, it shall be deemed to have elected to include the face amount of such allocations in gross income for such year and all subsequent income years. ...

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.A taxpayer shall be deemed to have elected to exclude **noncash** patronage allocations from gross income if it omits the amount of such allocations' from gross income for the first income year beginning after December 31, 1956, during which any **noncash** patronage allocations are **received**. The amount of patronage **allocations** which are excluded must be disclosed in the return or by a written statement filed with the returns. If such written statement has not previously been filed, it must be filed before a taxpayer will be permitted to exclude **noncash** patronage allocations from gross income. ...

Once an election has been made, it may be changed only with the consent of the Franchise Tax Board. Application for permission to change an election shall be filed within 90 days after the beginning of the income year to be covered by the return. (Cal. Admin. Code, tit. 18, reg. 24273.5, subd. (c).)

Once an election has been made as to the method of reporting and **paying** tax on a certain transaction pursuant to a statutory provision, the choice made is generally regarded as binding,, (Pacific National Co. v. Welch, 304 U.S. 191 [82 L. Ed. 1282] (1938).) An election is afforded as a matter of legislative grace and therefore must be made in the manner and time prescribed by the Legislature. This rule also applies with respect to methods of reporting which bind taxpayers for subsequent years. We have specifically applied this rule with respect to the method of reporting allocations such as those involved here. (Appeal of Raymond and Juanita M. Carignani, Cal. St. Bd. of Equal., Jan. 8, 1968. See also Appeal of Vito J. La Torre and Estate of Lola La Torre Deceased, Cal. St. Bd. of Equal., March 25, 1968.) Otherwise, taxpayers with the benefit of hindsight, in many instances, could shift from one method to another in light of developments subsequent to their original choice. (J. E. Riley Investment Co. v. Commissioner, 311 U.S. 55 [85 L. Ed. 36] (1940).)

The provisions of section 24273.5 are clear and unequivocal. An election under section 24273.5 is binding with respect to all subsequent years unless a change to a different method is authorized. In accordance with

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respondent's regulations, consent to a change in the reporting method may only be given if application for permission to change the method is filed with respondent within 90 days after the beginning of the year to be covered by the return. (Cal. Admin. Code, tit. 18, reg. 24293.5, subd. (c), supra.)

The farmers' cooperative from whom the allocations were received maintains its **accounts on** the basis of income years ended May 31. In December of each year after the cooperative has had an opportunity to close its books and make the proper allocations, it issues a statement of equity setting forth the **noncash** amounts allocated to its members as of the previous **May 31**. Because of this factual **background**, appellant relies upon section 24404 of the Revenue and Taxation Code which provides for a special deduction by cooperatives of amounts allocated to members during the income year of the cooperatives. For purposes of the deduction by the cooperatives, this section provides in part that allocations made after the close of the income year and on or before the fifteenth day of the ninth month following the close of such year shall be considered as made on the last day of such income year to the extent the allocations are attributable to income derived before the close of such year.

It is appellant's view that if an accrual-basis member elects to include the patronage dividends as income when received, the dividends thus subsequently allocated by an accrual-basis **farmer's** cooperative to its preceding year should likewise be considered as income of the member at that earlier time. Appellant then urges that since it did not report the allocations as income for the income year ended June 30, 1991, **the alleged** proper year of receipt under this concept, it thereby made an original election to exclude the allocations from gross income until redeemed or realized upon. It maintains that the reporting in subsequent years was an error effectively corrected by the filing of amended returns, i.e. the refund claims, within the period allowed by the statute of limitations.

Appellant concedes that originally the election to exclude was not properly made because the amount of the excluded allocations was not mentioned in the 1991 return, as required by the regulations. It contends, however, that this error was effectively remedied by the information disclosed in the 1992 amended return, and also by a written statement which appellant has provided during the course of

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this appeal, formally declaring the election to exclude the allocations for the year ended June 30, 1971, disclosing their amount, and directing that it be attached to the 1971 return. Appellant points out that respondent's regulations **authorize** filing of such a written statement subsequent to the filing of the return in which the election was made.

If appellant is nevertheless to be considered as bound by an election to include the allocations when received, it is appellant's alternative contention that the allocations were received and correctly attributable to the income year ended June 30, 1973, for the reasons **previously** indicated, and thus should not be included in income **for** the year in question.

Notwithstanding appellant's contentions, we must conclude that a binding election was made in the 1972 return to **include** the allocations in gross income when received, and that no application to change the election was made within the period required by the regulations. As soon as **appellant** received notice of any allocations it treated them as income by including them in gross income for the 1972 fiscal year. Such conduct clearly manifested an original intent to **treat the** allocations as income when received. They were not included in the prior fiscal year's income simply because appellant did not receive notice of any allocations until December of 1971; it was not because of any intent to exclude the allocations from income when received. Appellant's conduct **constituted, the exercise of** an original election to include them in income within the meaning **of** the applicable statutory and regulatory provisions. Such election was clearly not changed within the period required in the regulations.

Moreover, we do not agree with appellant's contention that the allocations of which appellant received notice in December are to be considered as received by it in the prior income **year** ended June 30. Such allocation was actually received by appellant, and became a liability of the cooperative after the previous June 30. Pursuant to the language of section 24404, it is only the cooperative which is authorized to consider the allocation as made in its prior fiscal year.

For the foregoing reasons,, we must sustain respondent's action.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of J. H. Jonson and Sons, Inc., against a proposed assessment of additional franchise tax in the amount of \$449.47 for the income year ended June 30, 1974, be and the same is hereby sustained.

Done at Sacramento, California, this 16th day of August, 1979, by the State Board of Equalization.

Holloman W. Bennett, Chairman

John W. Hering, Member

John R. Kelly, Member

_____, Member

_____, Member