

1976 S.C. Op. Atty. Gen. 266 (S.C.A.G.), 1976 S.C. Op. Atty. Gen. No. 4414, 1976 WL 23031

Office of the Attorney General

State of South Carolina

Opinion No. 4414

August 2, 1976

*1 (1) A member of a cooperative does not have taxable income under South Carolina law upon receiving notification that an equity account has been credited with earnings of the cooperative where such member is restricted as to the redemption and transfer of such equity.

(2) A cooperative does not have a deduction for earnings which it credits to an equity account for its members where the members are restricted as to the redemption and transfer of such equity.

TO: Mr. C. H. Brooks

Director

Income Tax Division

QUESTIONS

1. Does a cooperative have a deduction for 'patronage refunds' when notices of allocated reserves or notified equity letters are issued to participating members in accordance with its bylaws?
2. Do the recipient members have taxable income in the taxable year that the notices of allocated reserves or letters of notified equity are issued?

STATUTE

Chapter 5 of Title 65, South Carolina Code of Laws.

DISCUSSION

Heretofore the Tax Commission ruled that cooperative associations must pay income taxes on the income which is accumulated from business with members and nonmember patrons. The questions set forth above are responded to on the assumption that this ruling can be supported as a proper conclusion of law.

We are advised that the particular cooperative in issue is a farm cooperative that is incorporated under the laws of South Carolina. It has filed corporate income tax returns with the South Carolina Tax Commission and has reported income from business with members and nonmember patrons. In calculating the amount of tax due to the State, patronage refunds from another cooperative in which it is a member have been included in its income and patronage refunds made to members have been deducted from income. We are advised that such 'patronage refunds' take three forms—cash, revolving fund certificates (similar to bank drafts) and notices of allocated reserves for the benefit of members (notified equity).

Under the Internal Revenue Code, patronage refunds or dividends are specifically treated. [26 U.S.C., Section 1385, et seq.](#) There are, however, no specific South Carolina provisions or statutes relating to the treatment to be afforded such

items, therefore the general income taxing statutes, namely those found in Chapter 5 of Title 65 of the South Carolina Code are relied upon by the Commission.

In response to Question 1, we find no authority defining or qualifying patronage refunds made in the form of allocations to reserve accounts or credited as members' equity as deductible items for tax purposes. Under the bylaws of the cooperative, the crediting of such an account provides for an accumulation of earnings for business reasons. There is a well-established rule that deductions are allowed as a matter of legislative grace and a taxpayer claiming a deduction must come squarely within the terms of the statute expressly authorizing it. [Southern Weaving Co. v. Query](#), 206 S. C. 307, 34 S. E. 2d 51. We therefore conclude that a transfer of earnings by crediting a member's equity account will not constitute a deduction for tax purposes.

*2 Responding to Question 2, we have concluded that a member of the cooperative here in issue does not have income which is taxable under South Carolina law upon the crediting of earnings to a member's equity account. Under the bylaws of the cooperative, a member is restricted as to redemption or transfer of equity. It has been held that income must be taken in the ordinary sense of gain or profit. Therefore with the particular restrictions provided in the bylaws, a member has received no ascertainable income which is taxable. [Southern Weaving Co. v. Query](#), supra, and [Etiwan Fertilizer Co. v. South Carolina Tax Commission](#), 217 S. C. 354, 60 S. E. 2d 682.

CONCLUSION

1. A member of a cooperative does not have taxable income under South Carolina law upon receiving notification that an equity account has been credited with earnings of the cooperative where such member is restricted as to the redemption and transfer of such equity.
2. A cooperative does not have a deduction for earnings which it credits to an equity account for its members where the members are restricted as to the redemption and transfer of such equity.

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