

RVL:rs

913:OLC,45

OP. 57-88

August 21, 1957

Honorable Earl W. Fase
Tax Commissioner
Territory of Hawaii
Honolulu, Hawaii

Dear Sir:

Reference is made to the correspondence which you forwarded to this office concerning the following:

It is proposed that several agricultural cooperatives, formed under chapter 176, R.L.H. 1955, organize a business corporation of which the agricultural cooperatives will be the stockholders. This business corporation will be formed for the purpose of serving as a retail outlet for the agricultural products of the members of the agricultural cooperatives. The business corporation also will be a source of supply for materials and supplies for the agricultural cooperatives and their members. Such materials and supplies will be sold to the general public as well.

You have asked for our comment on the effect of this arrangement so far as the net income tax and general excise tax of the Territory are concerned.

It is assumed for the purposes of this letter that each agricultural cooperative will continue to market the agricultural products of its members, even though all such products are sold to the business corporation in which the agricultural cooperative holds stock instead of to retailers generally. It also is assumed for the purposes of this letter that the material and supplies needed by the members will be obtained by each agricultural cooperative from the business corporation and by it distributed to the members.

It further is assumed for the purposes of this letter that the receipts of each agricultural cooperative from the business corporation will be distributed only on the basis of patronage, except for the permitted 8% dividend on the capital stock or membership capital of the agricultural cooperative.

So far as the general excise tax law is concerned the results are as follows:

August 21, 1957

(a) Each producer-member of the agricultural cooperative is taxable at 1% upon the gross proceeds of the sales of his produce by the agricultural cooperative to the business corporation. This situation as governed by section 117-20(j) and sections 117-17 and 117-17.1 (The latter section was added by section 11(i) of Act 34, S.L. 1957.) Pursuant thereto the gross proceeds of sales upon which the producer must pay the 1% rate cannot be less than the true value of the products, corresponding to the gross proceeds of sales of similar products to other retailers.

(b) The business corporation is subject to the tax of 3 1/2% upon the materials and supplies which go to the members of the agricultural cooperatives, as well as those sold to the general public.

With respect to the net income tax the question of the authority of the agricultural cooperative to hold the stock in the business corporation becomes important. Under section 176-10(b)(5) such stockholding is permissible if "necessary or proper" within the meaning of subsection (a) of section 176-10. I am puzzled as to why this proposed business corporation is being formed instead of another agricultural cooperative association under chapter 176, since pursuant to section 176-11 the members of such a cooperative association may in turn be agricultural cooperatives as contemplated here. Lacking the facts as to why the business corporation form is being used, I am not able to say whether the "necessary or proper" limitation will be complied with.

If the agricultural cooperative is obligated to distribute to its patrons its receipts in excess of costs in such manner that the patronage dividends really are additional payments for produce or rebates on purchases of supplies and materials, then the net income tax exemption concerns only the amount of income of the agricultural cooperative added to reserves or needed to pay the dividends on capital stocks or membership capital. If the exemption of such amounts is important, then I would be glad to go into this matter further but feel it would be necessary to obtain further facts as above noted.

Respectfully,

RHODA V. LEWIS
Deputy Attorney General