

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-94 (4) C
Corporation Tax
February 18, 1994

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C930921B

On September 21, 1993, a Petition for Advisory Opinion was received from Select Sires, Inc., 11740 U.S. 42, P.O. Box 143, Plain City, Ohio 43064.

The issue raised by Petitioner, Select Sires, Inc., is whether it is subject to unrelated business income tax under Article 13 of the Tax Law for the years ended December 31, 1987 through December 31, 1989.

Petitioner is an Ohio corporation subject to tax as a cooperative under Subchapter T (sections 1381-1388) of the Internal Revenue Code (hereinafter "IRC"). Petitioner is taxed under section 185 of Article 9 of the New York State Tax Law Membership in the cooperative is limited to cooperative associations, their affiliates, subsidiaries or divisions engaged in the business of artificial insemination of livestock.

Petitioner's amended Articles of Incorporation states that "[t]he purpose or purposes for which [Petitioner] is formed are to engage on a non-profit cooperative basis for the mutual benefit of its member common shareholders as producers of agricultural products and any activity in connection with the conducting of a general breeding business ..." (Emphasis added.) Its amended Code of Regulations similarly provides that "[t]he corporation shall be an agricultural cooperative corporation, operated without profit for the mutual benefit of its member patrons." (Emphasis added.)

Consistent with that purpose, Petitioner provides bull semen and artificial insemination services to its members. Petitioner also sells such inventory and services to nonmembers. Petitioner sells its inventory and services internationally. In the United States, sales are made primarily through 12 member cooperatives. Sales in the northeast United States, including those in New York State, are made by company salespersons.

As provided in Petitioner's amended Articles of Incorporation and amended Code of Regulations, all net savings or margins not necessary for reasonable reserves are used to pay dividends on its common stock or credited as patronage refunds. During 1987, Petitioner paid \$1,338,124 in patronage refunds to its members; during 1988, it paid patronage refunds of \$1,023,448; and during 1989, it paid patronage refunds of \$642,895.

The New York State tax on unrelated business income is imposed pursuant to section 290 of Article 13 of the Tax Law which states, in pertinent part:

For every taxable year or part thereof, every organization described in paragraph two of subsection (a) of section five hundred eleven of the internal revenue code of nineteen hundred fifty-four and every trust described in paragraph two of subsection (b) of section five hundred eleven of such code carrying on an unrelated trade or business in New York shall pay a tax at the rate of nine per centum on its unrelated

business taxable income for such year, or on the portion thereof allocated to this state, as provided in section two hundred ninety-three, or two hundred fifty dollars, whichever is greater.

Corporations described by section 511(a)(2) of the IRC are those that are exempt from Federal income taxation by reason of section 501(a) of the IRC, which defines exempt organizations by reference to several sections, including section 501(c) of the IRC.

Section 501(c)(5) of the IRC provides tax exempt treatment to certain labor, agricultural or horticultural organizations. Section 1.501(c)(5)-1 of the Treasury Regulations clarifies that the only organizations exempted by section 501(c)(5) are those which: (1) have no net earnings inuring to the benefit of any member, and (2) have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations. An organization must satisfy all conditions to qualify for tax exempt status.

In Internal Revenue Ruling 74-195 (Rev Rul 74-195, 1974-1 CB 135), the Internal Revenue Service ruled that a nonprofit organization formed to manage, graze and sell its members' cattle, with net earnings being remitted to organization members, was principally providing a direct business service for its members' economic benefit and the organization did not qualify as an exempt organization under section 501(c)(5) of the IRC. In Rev Rul 66-105, 1966-1 CB 145, the Internal Revenue Service held that an agricultural organization formed with the principal purpose of marketing its members' livestock, and secondary purpose of developing a livestock improvement program, was not exempt from tax under section 501(c)(5) of the IRC. Also, in Rev Rul 70-372, 1970-2 CB 118 the Internal Revenue Service held that an agricultural organization formed to process dairy farmers' production data for comparison with state standards was not exempt from tax under section 501(c)(5) of the IRC because the program was intended to benefit individual farmers.

In Internal Revenue Service General Counsel Memorandum 36513 (December 12, 1975), it was held that an organization formed with the stated purpose of improving the livestock industry by acquiring superior herd sires to be used for artificial breeding purposes was not a section 501(c)(5) of the IRC tax exempt organization. "The question is whether providing breeding services and selling semen and supplies are exempt activities within the scope of Code section 501(c)(5) ... [the taxpayer's] activities of artificially breeding farmers' cows for a fee and selling semen and supplies to farmers may ultimately improve, and arguably have improved, the livestock industry ... [however, to qualify for the section 501(c)(5) exemption] direct benefits of the activity must not be limited to those buying the supporting services ... because these activities of [the taxpayer] directly benefit only individual dairy farmers rather than dairy farmers generally ... the activities of artificially breeding farmers' cows for a fee and selling semen and supplies to farmers do not serve an exempt purpose under Code section 501(c)(5)."

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Since all of Petitioner's net earnings and efforts inure to the benefit of its members, it does not meet the conditions for tax exemption under section 501(c)(5) of the IRC. Further, Petitioner states that it is an organization taxable as a cooperative under Subchapter T of the IRC. Section 1381 of such Subchapter provides that the cooperative tax treatment does not apply to any corporation operating on a cooperative basis that is exempt from tax under Chapter 1 of the IRC.

Accordingly, Petitioner is not an organization described in section 511(a)(2) or 511(b)(2) of the IRC and, therefore, is not subject to the tax on unrelated business income under Article 13 of the Tax Law.

DATED: February 18, 1994

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.