

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

GREENWOOD FARMERS CO-OP,  
A Nebraska Cooperative Company,

Petitioner,

vs.

DONNA KARNES, State Tax  
Commissioner, State of  
Nebraska, Department of  
Revenue,

Defendant.

Docket 394 Page 200

O R D E R

Dept. of Justice

APR 9 1986

State of Nebraska

This matter came before the Court on December 19, 1985. Petitioner appeared by attorney Robert Guenzel. The defendant appeared by Assistant Attorney General L. Jay Bartel. Exhibit No. 1 was received into evidence and the matter was then argued and submitted to the Court on briefs. The Court now being fully advised finds and orders as follows:

1. This is an appeal pursuant to the provisions of §77-27,127 (Supp. 1984) and §84-917, Revised Statutes of Nebraska, from the findings and order of the State Tax Commissioner dated May 7, 1985, which sustained deficiency assessments against the petitioner for its corporate franchise or income taxes for the tax years ending August 31 of 1975, 1976, and 1977.

2. The Nebraska Department of Revenue audited the corporate franchise or income tax liability of the petitioner for the above stated tax years and issued a notice of deficiency determination on August 24, 1979. During each of the years of the audit,

petitioner made payments in money to its patrons or customers to redeem "qualified written notices of allocation" which had been issued in prior years. The net income upon which petitioner reported Nebraska corporate franchise or income tax liability for these years reflected the deduction of such payments. The department's auditors calculated petitioner's tax liability on its net income without allowing deduction of those redemption payments. The tax deficiencies involved in this appeal are solely attributable to the disallowance of these cash payments.

3. This appeal involves an interpretation of §77-2734(2), Revised Statutes of Nebraska as amended in 1974 by LB 691. This section was amended again by LB 382 in 1976. This appeal involves only those taxable years controlled by §77-2734(2) between the effective date of LB 691 and the effective date of LB 382.

4. That §77-2734(2), as amended by LB 691, provided in part that:

For the purpose of computing the franchise or income tax levied in this section, the net income of cooperative organizations shall be the entire net income derived from all sources within the state, including distributions of earnings and profits of the cooperative to members or patrons such as dividends paid on capital stock, nonpatronage income allocated to patrons, or patronage dividends attributable to this state as shall be excludable or deductible by such corporation for federal income tax purposes; provided, that the cooperative may deduct such distributions, not to include redemption of prior years' nonqualified notice of allocation, to members or patrons that are paid in money.  
(Emphasis supplied.)

5. That at issue here is the question of whether cooperative organizations may deduct or exclude from their net income, for purposes of Nebraska's income or franchise tax, payments made to members or patrons in redemption of qualified notices of allocation. At the time in question, the state did not authorize such deduction or exclusion.

6. That §77-2734(2) authorized the deduction of distributions excludable or deductible for federal income tax purposes if such distributions were paid in money. Patronage dividends paid in money were excludable from income for federal income tax purposes pursuant to 26 U.S.C. §1382. Both parties agree that such dividends were deductible under §77-2734(2).

7. That qualified written notices of allocation, as defined in 26 U.S.C. §1388(c) were excludable for federal income tax purposes in the years issued pursuant to 26 U.S.C. §1382, but were not deductible under §77-2734(2) because they were not paid in money. In the year when they are redeemed, they are paid in money, but they are not excludable or deductible by the cooperative for federal income tax purposes, and therefore did not qualify for deduction under §77-2734(2); provided, however, that portion of the qualified allocation paid in cash in the year declared was deductible by cooperatives.

8. That LB 691 permitted the deduction of patronage dividends paid in money, but denied such deduction to both qualified and nonqualified notices of allocation both in the year issued and

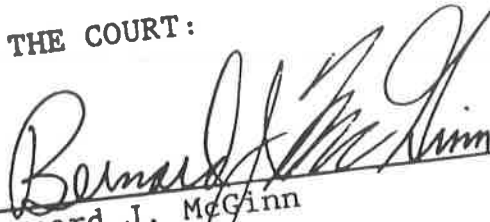
in the year redeemed. Section 77-2734, as amended by LB 691, provided, that all income, including distributions deductible or excludable for federal income tax purposes, was to be included in the cooperative's income. Secondly, it made an exception for distributions that were (1) deductible or excludable for federal income tax purposes, and (2) paid in cash. Third, it excepted from the exception the redemption of prior years' nonqualified notices of allocation.

9. It was not necessary, and would have been redundant, to include in the exclusionary clause of §77-2734(2) the redemption of prior years qualified notices of allocation, since such redemptions are not deductible or excludable under federal statutes, and they therefore did not qualify for deduction under §77-2734(2) except for that portion paid in cash in year of allocation. To have excluded the redemption of qualified notices of allocation would have been to exclude something which was not included in the first place.

WHEREFORE, IT IS ORDERED, ADJUDGED AND DECREED that the findings and order of the State Tax Commissioner dated May 7, 1985, which sustained the deficiency assessments against the petitioner for its corporate franchise or income taxes for the years ending August 31 of 1975, 1976, and 1977, should be and is hereby affirmed. Petitioner's petition on appeal is dismissed at petitioner's costs.

DATED AND SIGNED this 7<sup>th</sup> day of April, 1986.

BY THE COURT:

  
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Bernard J. McGinn  
District Judge