STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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August 16, 2002

Mr. C--- B. C---
Chief Financial Officer
A--- A---
Administrative Office
Post Office Box XXXX
--- ---, California XXXXX-XXXX

Re: A--- A---
(Formerly P--- C--- F--- C--- S---, A---)
No Permit Number

Dear Mr. Call:

This is in response to your letter of May 1, 2002 addressed to Mr. John Butterfield of the Board of Equalization. Your letter was referred to me for response.

You state:

> "In August of 1996, you issued an opinion on the application of sales and use tax to sales of our organization (see attached letter). At that time we operated under the name of P--- C--- F--- C--- S---, A---. Effective January 1, 20XX we changed our name to A--- A---, A---. This was a change in name only; there were no changes to the operating conditions or structure of the organization. We have since had difficulties in getting vendors to accept our sales tax exempt status because the name on the 1996 letter is different tha[n] our current name. In at least one instance, a vendor contacted the State Board of Equalization and was told that we would be required to get an updated opinion letter using our current name before they would accept our exempt status.
>
> "As a result, I am writing to request that you provide A--- A--- with an updated opinion letter based on the same facts and circumstances that existed for us in 1996. Again, the only thing that has change[d] is our name."

Preliminarily, we note that our August 23, 1996 letter stated that P--- C--- F--- C--- S---, A--- was a "merged association" as authorized by 12 U.S.C. section 2279c-1, resulting from the

merger of a federal land bank association and several production credit associations, and was referred to in its charter as an "Agricultural Credit Association."[1] Based upon your representation that the organization in question has changed in name only (from P--- C--- F--- C--- S---, A--- to A--- A---, A---), we understand and assume that A--- A---, A--- ("A--- A---") is a "merged association" referred to in its charter as an "Agricultural Credit Association."

The Board's August 23, 1996 letter concluded that sales to your organization, P--- C--- F--- C--- S---, A--- (now named A--- A---), were exempt from the application of tax. You request that we provide you with an updated letter to that effect, reflecting the fact that the name of the organization has changed, but that the organization itself retains the same structure, and thus the same exemption from application of tax.

However, in light of the recent United States Supreme Court opinion in *Director of Revenue of Missouri v. CoBank ACB* (2001) 531 U.S. 316, we conclude that sales to A--- A---, a "merged association" are not exempt from the application of tax. We emphasize that our opinion is based upon the Supreme Court's interpretation of federal statutes governing the taxability of production credit associations, and thus merged associations, as set forth below, and is entirely independent of the name change in the organization. In other words, even if your organization was still named P--- C--- F--- C--- S---, A---, our conclusion would be that sales to it are no longer deemed exempt from the application of tax due to the Supreme Court's recent ruling in the *CoBank* case. Our legal analysis follows.

As a starting point, California imposes a sales tax on a retailer's gross receipts for the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax is imposed on the sales price of the property purchased from a retailer for the storage, use or other consumption of that property in California. (Rev. & Tax. Code §§ 6201, 6401.)

Revenue and Taxation Code section 6352 provides that where federal law or the United States Constitution prohibit taxation, the gross receipts from such sale, or use, storage or other

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[1] Our August 26, 1996 letter stated that the term "agricultural credit association" did not appear in either the text of the Agricultural Credit Act of 1987, Public Law 100-233, or in federal statutory language, and assumed that the term had been adopted by the Farm Credit Administration upon the adoption or amendment of regulations pertinent to "agricultural credit associations" in 12 C.F.R. sections 600 et seq.

We now note that "agricultural credit associations" are in fact defined in 12 C.F.R. 619.9015 as "associations created by the merger of one or more Federal land bank associations or Federal land credit associations and one or more production credit associations and which have received a transfer of authority to make and participate in long-term real estate mortgage loans pursuant to section 7.6 of the [Farm Credit] Act." An agricultural credit association possesses the combined lending authority of a production credit association and a federal land credit association (or federal land bank association), i.e., the authority to make short term and long term loans directly to farmers (*Buckeye Production Credit Assn. v. United States* (1990 D.C. Dist.) 792 F. Supp. 827, 829). We further note that the term "agricultural credit association" was used, but was not defined, in Public Law 102-552, Title IV, § 401(a), Oct. 28, 1992, 106 Stat. 4116, which amended section 410 of Public Law 100-233, as amended by Public Law 100-399, Title IV, § 402, Aug. 17, 1988, 102 Stat. 999.

consumption of tangible personal property in this state are exempt from tax. Revenue and Taxation Code section 6381 further provides that an exemption applies to the gross receipts from the sale of any tangible personal property to the United States, its unincorporated agencies and instrumentalities, and any incorporated agency or instrumentality of the United States wholly owned by the United States or by a corporation wholly owned by the United States. Regulation 1614, which further explains and implements Revenue and Taxation Code section 6381, states that sales of tangible personal property to incorporated federal instrumentalities not wholly owned by the United States are also exempt from sales tax unless federal law permits taxing the instrumentality. (Reg. 1614 (a)(4).) Regulation 1614 also states that the application of use tax to the storage, use of other consumption of tangible personal property by agencies or instrumentalities of the United States is prohibited unless federal law permits taxing the agency or instrumentality. (Reg. 1614 (a), ¶ 2.)

As we have noted, our August 26, 1996 letter stated that P--- C--- was a "merged association" within the meaning of 12 U.S.C. section 2279c-1, created by the merger of a federal land bank association and several production credit associations. Our letter stated that federal statutes specifically designated production credit associations and federal land bank associations as federally chartered instrumentalities of the United States. (12 U.S.C. §§ 2071 and 2091.) That letter further stated that federal statutes specifically addressed the taxation of these entities or their property, stating, for example, that "except for taxes on real estate, each federal land bank association is 'exempt from Federal, State, municipal and local taxation…' (12 U.S.C. § 2098)." Our previous letter cited, but did not quote, 12 U.S.C. section 2077 regarding taxation of production credit associations.

Our August 26, 1996 letter reasoned that, unlike the federal statutes concerning production credit associations or federal land bank associations, there was no equivalent federal statute designating merged associations or agricultural credit associations as instrumentalities of the federal government, or specifically addressing taxation of these entities or their property. Our previous letter then concluded "[g]iven that P--- C--- was created from the merger of two or more entities which have been specifically designated by Congress as federal instrumentalities [i.e., a federal land bank association and several production credit associations], we agree that your client is also properly classified as an incorporated federal instrumentality not wholly owned by the United States. Accordingly, we believe sales tax does not apply to P--- C---."

As we have previously indicated, the United States Supreme Court's opinion in *Director of Revenue of Missouri v. CoBank ACB*, *supra*, 531 U.S. 316, requires us to revise this conclusion. In *CoBank*, the high court held that banks for farm cooperatives are subject to state corporate income taxation, because, in light of the specific grant of tax immunity to other institutions within the Farm Credit System, Congress' silence with respect to banks for cooperatives indicates that such banks are subject to taxation. The Supreme Court stated that banks for cooperatives were designated by Congress as a " 'federally chartered instrumentality of the United States' " (12 U.S.C. § 2121), as were production credit associations (12 U.S.C § 2071) and federal land bank associations (12 U.S.C. § 2091); and that the Farm Credit Act also addresses the taxation of each of these institutions. (*Id*. at 318.) The provision concerning

taxation of banks for cooperatives, at issue in *CoBank*, is 12 U.S.C. section 2134. (*Id*. at 318-319.)

Of central importance to our analysis, the high court stated that the statutory provisions and history with respect to taxation of banks for cooperatives (e.g., 12 U.S.C. § 2134) and production credit associations (e.g., 12 U.S.C § 2077) are "virtually identical." (*Id*. at 321.) We note that production credit associations are a component of the merged association at issue here. In fact, the United States Supreme Court granted certiorari in *CoBank* in order to resolve the conflict between the Missouri Supreme Court's opinion that banks for cooperatives were exempt from state taxation, and the New Mexico Court of Appeals and the Indiana Supreme Courts' conclusions holding that production credit associations were subject to state taxation. (*Id*. at 320-21.)

In *CoBank*, the bank for cooperatives urged that it held implied immunity from state taxation. The Supreme Court did not reach the issue of implied immunity, stating:

> "Implied immunity becomes an issue only when Congress has failed to indicate whether an instrumentality is subject to state taxation. In this case, Congress has provided that banks for cooperatives are subject to state taxation. To be sure, Congress did not include an express statement in the current version of § 2134. However, nothing in the statute indicates a repeal of the previous express approval of state taxation, and the structure of the Farm Credit Act indicates by negative implication that banks for cooperatives are not entitled to immunity." (*Id*. at 321-22.)"

The high court explained that banks for cooperatives, upon their creation in 1933, were subject to state income taxation except during periods when the United States held stock in the banks. The court quoted a portion of the Farm Credit Act of 1933, as enacted, which provided " 'Such banks, …and their income, shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority…. The exemption provided herein shall not apply…with respect to…any…Bank for Cooperatives, or its property or income after the stock held in it by the United States has been retired.' " (Farm Credit Act of 1933, § 63, 48 Stat. 267.) The high court noted that under this provision, as soon as governmental investment in a bank for cooperatives was repaid, the bank had to pay state income taxes because the exemption from such taxation no longer applied.

Congress subsequently amended the Farm Credit Act in 1971, but did not change the rule that banks for cooperatives are subject to state taxation unless the United States holds stock in the banks. Congress did include a provision that the Governor of the Farm Credit Administration had authority on behalf of the United States to purchase stock in banks for cooperatives under very limited circumstances. In 1985, Congress enacted various amendments to the Act, which among other changes, eliminated the position of the Governor of the Farm Credit Administration, discontinued the Farm Credit Administration's authority to own stock in banks for cooperatives, and included numerous technical and conforming amendments. One of

these technical and conforming amendments was the deletion of the two sentences in 12 U.S.C. section 2134 that exempted a bank for cooperatives from state taxation, and limited that exemption to periods when the Governor held stock in the bank. The high court concluded that there is no indication that Congress intended to change the taxation of banks for cooperatives with these 1985 amendments, noting that since 1933, the states could collect revenue from banks for cooperatives. The high court further stated that nothing in the 1985 amendments expressly changed this, and "…it would be surprising indeed if Congress had eliminated this important fact *sub silentio*." (*Id*. at 323.)

The Supreme Court reasoned that the structure of the Farm Credit Act confirms that banks for cooperatives are subject to state taxation. (*Id*. at 324.) It noted that, with respect to each lending institution in the Farm Credit System, the Act contains a taxation provision that specifically delineates the immunity from taxation enjoyed by that entity. For example, the court specifically stated that federal land bank associations receive immunity from state taxation, and quoted 12 U.S.C. section 2098, which sets forth that tax immunity as follows: " 'Each Federal land bank association and the capital, reserves, and surplus thereof, and the income derived therefrom, shall be exempt from Federal, State, municipal and local taxation…' " *(Id. at 324-25.)* In contrast, the high court noted that banks for cooperatives have been granted only limited exemptions from taxation. Had Congress intended to confer upon banks for cooperatives the more comprehensive exemptions from taxation provided to federal land bank associations, it would have done so expressly as it had elsewhere in the Farm Credit Act. The Supreme Court concluded that, in light of the structure of the Farm Credit Act, and the explicit grant of immunity to other institutions within the Farm Credit System, Congress' silence with respect to banks for cooperatives indicates that banks for cooperatives are subject to state taxation.

As we stated above, the Supreme Court in *CoBank* specifically noted that the statutory provisions and history with respect to production credit associations (e.g., 12 U.S.C § 2077) are virtually identical to those regarding banks for cooperatives (e.g., 12 U.S.C. § 2134.) Accordingly, the *CoBank* decision stands for the proposition that production credit associations are subject to state taxation for the same reasons which support that conclusion for banks for cooperatives, i.e., in light of the structure of the Farm Credit Act, and the explicit grant of immunity to other institutions within the Farm Credit System, Congress' silence with respect to production credit associations indicates that production credit associations are subject to state taxation.

Thus, we note that federal land bank associations and production credit associations, the merging predecessors of A--- A---, are both federally chartered instrumentalities of the United States, under 12 U.S.C. sections 2091 and 2071, respectively. Production credit associations, however, as clarified in *CoBank* are not exempt from state tax. Federal land bank associations, as confirmed in *CoBank*, are exempt from state taxation.

Under 12 U.S.C. section 2279c-1, Congress authorized mergers, as specified, of federal land bank associations and production credit associations. Under this statute, the merged association possesses all powers and succeeds to all obligations of the merging associations. 12

U.S.C. section 2279c-1(b)(2) authorizes the Farm Credit Administration to "issue regulations that establish the manner in which the powers and obligations of the associations that form the merged association are consolidated and, to the extent necessary, reconciled in the merged association." These statutes do not declare the merged association to be a federal instrumentality, and they do not provide immunity or exemption from state taxation to the merged association.

In view of the *CoBank* decision holding that production credit associations, which are merging components of A--- A---, are not exempt from state taxation; and the fact that merged associations themselves are not exempt from state tax by federal statute, we have concluded that tax applies to sales to A--- A---, a merged association.

Accordingly, as of the date of your receipt of this letter, A--- A--- will not be able to rely upon the previous written advice in our August 26, 1996 letter stating that sales to P--- C--- F--- C---S---, A--- are not subject to tax. (Rev. and Tax. Code § 6596; Reg. 1705.)

Please feel free to write us again if you have further questions.

Sincerely,

Carla J. Caruso
Senior Tax Counsel

CJC/ds
Enclosures: Revenue and Taxation Code section 6596; Regulations 1614 and 1705

cc: --- --- District Administrator (--)

bc: Mr. Ramon J. Hirsig (MIC: 43) (as discussed between Assistant Chief Counsel Janice L. Thurston and you)

Ms. Charlotte Paliani (MIC: 92) (Per Deputy Director Ramon J. Hirsig, please consider whether you should distribute the information contained in this letter to all production credit associations and banks for farm cooperatives.)

Mr. David E. Rosenthal (MIC: 50) (per Assistant Chief Counsel Janice L. Thurston, please annotate this letter and delete any published annotations that conflict with it.)