**Opinion Letter**

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| **Letter Number:** | **O-2015-003** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Agricultural Credit Association - Farm Credit System** |
| **Keywords:** |  |
| **Effective Date:** | **12/21/2015** |
| **Approval Date:** | **12/21/2015** |

**Body:**

December 21, 2015

XXXX
XXXX
XXXX

RE: Your letter request received
April 28, 2015

Dear XXXX:

Thank you for your e-mail. Farm Agricultural Credit Association ("FACA"), headquartered in Dogjaw, Kansas, is an independently owned and operated "agricultural credit association" ("ACA") that is part of the Farm Credit System. FACA is owned by its customers, governed by a board of directors primarily elected from borrower-owners, and shares profits with its borrower-owners through patronage dividends.

FACA receives funds for its loans from AgriBank, which is owned by FACA and 16 other local ACAs. The ACAs are also AgriBank's customers. AgriBank is one of four regional wholesale banks in the nation, along with AgFirst, CoBank, and Farm Credit Banks of Texas. These wholesale banks are funded by the Federal Farm Credit Banks Funding Corporation, and insured by the Farm Credit Insurance Corporation.

ACAs, like the FACA, may be organized by 10 or more farmers, ranchers, or producers/ harvesters of aquatic products who want to borrow funds from a farm credit bank. *12 U.S.C. § 2071(b).*ACAs are statutorily limited to making short- and intermediate-term loans to farmers, ranchers, aquatic producers/harvesters, rural residents for housing financing, and custom cutters and others who furnish on-farm agricultural services to farmers and ranchers. *12 U.S.C. § 2075(a) (1994).*ACAs operate on a cooperative basis and are capitalized by their borrower-shareholders. *12 C.F.R. § 615.5220 (2001); 12 C.F.R. § 615.5230 (2001).*

The voting stock of an ACA may only be held by borrowers who are farmers, ranchers, producers/harvesters of aquatic products, and certain other farm credit institutions. *12 U.S.C. § 2154a(c) (1994).*ACAs are statutorily required to apply their net income, first, to the restoration of the impairment of capital, second, to the establishment and maintenance of surplus accounts, and, third, to distributions, subject to the general direction of the Farm Credit Administration, in stock, participation certificates, or cash. *12 U.S.C. § 2074(b) and (c).*

You claim FACA qualifies as a federal land bank, and accordingly is exempt from paying sales tax on it purchases. This does not appear to be entirely accurate. FACA is an ACA, which are the product of a merger of federal land banks and production credit organizations under 12 U.S.Code, Section 2279c-1. The merger was approved by the Farm Credit Administration Board, which is a Federal agency. As an ACA, FACA is a new entity that is neither a federal land bank nor a production credit organization, as those terms are defined in federal farm credit laws. The merger of the two entities into a new entity is significant since, prior to their merger, Congress had exempted federal land banks from state taxation, but had not exempted production credit associations from state taxation. See *Federal Land Bank v. Bismarck Lumber Co.*, 314 U.S. 95, 97 (1941).

Under 12 U.S.Code, Sec. 2279c-1, an ACA possesses all powers and succeeds to all obligations of the merging associations. Division (b)(2) of the statute empowers 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.” The Farm Credit Administration issued regulations to implement 12 U.S.Code, Sec. 2279 that refers to the merged organizations as “agricultural credit association[s].” The Farm Credit Administration also chartered ACAs as “Federally chartered instrumentalit[ies].” See *Farm Credit Serv. of Mid-America v. Zaino,* 91 Ohio St.3d 564,747 N.E.2d 814, 2001 (2007). Federal instrumentalities are generally exempt from State tax pursuant to *McCulloch v. Maryland,*4 Wheat. 316, 4 L.Ed. 579(1819). *("Chief Justice Marshall ruled Maryland may not tax the bank, that was a federal instrumentality, without violating the Constitution.").*

Nevertheless, the Federal statutes themselves do not declare that ACAs are federal instrumentalities, and do not specifically grant them Federal immunity from state taxation. The conflict created by the Farm Credit Administration's regulations and charters and the absence of the federal statutes that specifically grant tax immunity to ACAs generated considerable litigation over whether Congress granted Federal immunity from State taxation to the four regional wholesale banks --- AgFirst, AgriBank, CoBank, and Farm Credit Banks of Texas --- and to the ACAs including FACA .

In *Missouri Director of Revenue v. CoBank ACB,* 531 U.S. 316 (2001) *("CoBank"),* the United States Supreme Court reviewed the history of the Farm Credit System, and declared that CoBank and the other three regional wholesale banks were not entitled to claim exemption from state income tax; It concluded:

By contrast, since their creation in 1933, banks for cooperatives have been granted only limited exemptions from taxation. Had Congress intended to confer upon banks for cooperatives the more comprehensive exemption from taxation that it had provided to farm credit banks and federal land bank associations, it would have done so expressly as it had done elsewhere in the Farm Credit Act. Thus, 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.

While *CoBank* rejected the claim of entitlement to Federal immunity from State taxation that was made by regional wholesale banks, *Farm Credit Serv. of Mid-America v. Zaino,*747 N.E.2d 814, 817-18, 91 Ohio St.3d 564, 566-67 (2001), rejected the claim of entitlement to federal immunity made by an ACA. The Ohio Supreme Court rejected the ACA's claim, reasoning:

Congress has exempted federal land banks from Ohio's franchise tax but has not exempted production credit associations. We have, however, neither of these entities before us; we have an agricultural credit association (“ACA”), the product of the merger of several federal land banks and a production credit \*567 association. Congress has not expressed an immunity from taxation for an ACA. Under *CoBank,* therefore, we must decide whether Farm Credit Services has an implied immunity from the franchise tax.

We discussed implied immunity under the Supremacy Clause in *NLO, Inc.*:

“In *United States v. New Mexico, supra* [1982], 455 U.S. [720] at 735, 102 S.Ct. [1373] at 1383, 71 L.Ed.2d [580] at 592, the court concluded that a state cannot levy a tax ‘on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned.’ ” 66 Ohio St.3d at 394, 613 N.E.2d at 197.

In*New Mexico*, the United States Supreme Court reviewed the “much litigated and often confused field” of Supremacy Clause rulings. *United States v. Detroit* (1958), 355 U.S. 466, 473, 78 S.Ct. 474, 478, 2 L.Ed.2d 424, 429. According to the *New Mexico* court, the language quoted in *NLO, Inc.* sets forth the latitude each form of government needs in maintaining sovereignty. A private taxpayer, moreover, must stand in the shoes of the federal government to be immune. Quoting from*United States v. Detroit,* the *New Mexico* court explained that the language “[c]omports with the principal purpose of the immunity doctrine, that of forestalling ‘clashing sovereignty,’ *McCulloch v. Maryland*[1819], 4 Wheat. [316], at 430, 4 L.Ed. 579, by preventing the States from laying demands directly on the Federal Government. \* \* \* At the same time, a narrow approach to governmental tax immunity accords with competing constitutional imperatives, by giving full range to each sovereign's taxing authority. \* \* \*”

“Thus, a finding of constitutional tax immunity requires something more than the invocation of traditional agency notions: to resist the State's taxing power, a private taxpayer must actually ‘stand in the Government's shoes.’ ” 455 U.S. at 735-736, 102 S.Ct. at 1383, 71 L.Ed.2d at 592-593.

We conclude that Farm Credit Services, as an ACA, is a privately owned business benefiting private interests. Private shareholders own the association, and private borrowers benefit from the loans that the association distributes. Farm Credit Services is a commercial enterprise that performs no governmental duty. It does not stand in the federal government's shoes and, thus, is not “so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned.”*Id.*at 735, 102 S.Ct. at 1383, 71 L.Ed.2d at 592. Ohio can, consequently, impose the franchise tax on it.
We also dismiss Farm Credit Services' argument that language in the statute, asserting that merged associations possess all powers and assume all obligations of the merging associations, passes tax immunity to the successor association. According to normal usage, “powers” refers to the activities and actions the predecessor entities may undertake, and “obligations” refers to the debts, contractually and otherwise acquired duties that the predecessor entities have undertaken. Black's Law Dictionary (7 Ed.Rev.1999) 1189-1190, 1102-1103.

Taxation is the rule, exemption the exception. *Vought Industries, Inc. v. Tracy* (1995), 72 Ohio St.3d 261, 264, 648 N.E.2d 1364, 1366. As Justice Thomas, writing for the majority, observed in *CoBank,* Congress knows how to exempt federal instrumentalities from taxation. 531 U.S. at ----, 121 S.Ct. at 946, 148 L.Ed.2d at 837. If Congress does not explicitly do so, the Supremacy Clause does not supply an implicit exemption to a privately owned entity that lends funds to private individuals.

Accordingly, we agree with the commissioner's denial of the request for refunds and affirm the BTA's decision

The Ohio Supreme Court decision works in harmony with*In re Farm Credit Services of Central Kansas, et al.,* 271 Kan. 805, 26 P.3d 695 (2001) and *CoBank*. Accordingly, no grant of federal immunity has been extended to FACA or any other ACA. The Kansas county treasurer was correct in rejecting the exemption claim that FACA submitted for its purchase of motor vehicle when it registered the vehicle for highway use. FACA was required to pay the sales tax that had previously gone unpaid on the vehicle.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 12/22/2015 Date Modified: 12/22/2015**