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COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK
INCORPORATED

233 BROADWAY • WOOLWORTH BUILDING • NEW YORK 7, N. Y.

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October 16, 1950

Hon. Mariner S. Eccles
Federal Reserve Board
Washington, D. C.

Dear Mr. Eccles:

It was with great interest that I read in the press a report of your speech before the Cooperative League of the United States, in which you advocated that the cooperatives' tax exemption privileges "must be ended."

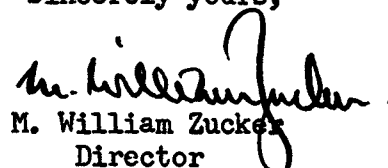
This Association's Committee on Taxation and Public Revenue, after a long study of this subject, prepared a report on tax exemption of cooperatives, which was adopted by the Association's Board of Directors.

For your information, I am enclosing a copy of that report.

The press report on your speech did not indicate the manner in which you believe that patronage dividends of cooperatives, now tax exempt, should be taxable. It was this problem about which our Committee and the Association was most concerned, so as not to confuse the present language of the Internal Revenue Code.

I will greatly appreciate it if you would review our report and particularly the recommendations found on the last page, and give me the benefit of your advice as to the proposals made by the Association in this regard.

Sincerely yours,


M. William Zucker
Director

MWZ:GM
Enclosure

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December 6, 1950.

Mr. M. William Zucker, Director,
Governmental Affairs Department,
Commerce and Industry Association of New York,
233 Broadway, Woolworth Building,
New York 7, New York.

Dear Mr. Zucker:

In response to your letter of October 16, relative to a speech which I made before the Cooperative League of the United States, I advised you in my reply of October 20 that I would have one of our Research men go over and give me his comments on the material which you sent to me.

Our tax man on the staff has gone over the material and given me a very brief memorandum on the report you enclosed. Thinking you may be interested in his comments I am enclosing herewith a copy of his memorandum.

Sincerely yours,

M. S. Eccles.

Enclosure

VE:dls

TAX LIABILITY OF COOPERATIVES



PUBLICATION OF BUREAU OF RESEARCH

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*Members of Special Committee on Cooperatives

FOREWORD

The Committee on Taxation and Public Revenue of the Commerce and Industry Association of New York, Inc., created a special committee to study the subject of tax liability of cooperatives. This special committee, composed of Mr. Thomas N. Tarleau, as chairman, and Messrs. George E. Cleary, Godfrey N. Nelson, C. W. Rivoire and Martin Saxe, devoted a year to preparing this report which was adopted by the Association's Board of Directors on November 12, 1946.

The problem of tax exemption granted cooperatives should not be exaggerated. The cooperatives are growing. However, upon investigation it was found that the total volume of cooperative activity is relatively small in comparison with the gross volume of business conducted in this country. The cooperative movement should not be thwarted, but great care should be taken to guard against unfair discrimination in taxes. Cooperatives which are in competition with private business establishments should not be subsidized at the expense of tax paying businesses.

Practices which place cooperatives at a competitive tax advantage as against private enterprise were considered and specific recommendations are offered.

The report indicates that the cooperatives have extended their activities into fields unrelated to their original purposes by the use of tax exempt reserves which represent undistributed patronage dividends to the members. In its recommendations the report offers an administratively feasible and equitable method of meeting this problem.

No recommendations as to the taxing of patronage dividends or credits as earnings of the cooperatives are offered. The report states that tax exemption of patronage dividends is not created by statute but results from court rulings and administrative regulations. To disturb the present exemption would result in changing recognized business practices where discounts or rebates are given to reflect the reduced costs or the results of cumulative quantity sales or purchases in a given period.

The report was made comprehensive in order to present the history of the cooperative movement and its expansion, indicate the problems which have arisen through the tax exemption granted the cooperatives, outline the arguments advanced by the opponents and supporters of the present tax exemption, and recommend corrective measures where they seem to be required.

Laurence Arnold Tanzer,
Chairman

COMMITTEE ON TAXATION AND PUBLIC REVENUE

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Commerce and Industry Association of New York, Inc.
233 Broadway, New York 7, N. Y.

I. INTRODUCTION

During recent years attention has been directed to certain tax exemption features included in the Internal Revenue Code with respect to cooperative societies. A considerable volume of literature and data have been released, both pro and con, with respect to the operations of cooperatives and the position of cooperatives in competition with private business.

Essentially, a cooperative is an organization of producers pooling their products to save money in marketing them, or an association of purchasers pooling their buying power to save money by buying goods as nearly as possible at cost.

Although the House Ways and Means Committee, in its report on the Revenue Bill of 1943, did not specifically mention cooperatives, it did call attention to the fact that many organizations which originally were granted tax exemption upon the theory that they were not operated for profit were now in direct competition with taxpaying businesses.

The Committee further reported that the tendency was becoming more widespread and was affording a loophole for tax evasion and tax avoidance which would not be closed until more adequate information on the subject was obtained.

As a result of the Committee's report, Congress required non-profit organizations, with the exception of religious, educational and charitable organizations, to file information returns for all taxable years beginning after December 31, 1942.

A report of the Commissioner of Internal Revenue concerning these returns was released in November, 1945. The data were tabulated from annual returns received through December 31, 1944, of 84,647 organizations, of which 24,045 returns were from organizations whose primary functions are business activities and 60,602 organizations whose primary functions are non-business activities.

The business organizations filed returns which reflected total gross income and receipts of \$3,206,572,000 and total disbursements of \$3,089,071,000. Included among the tax-exempt organizations whose primary functions are business activities are: mutual savings banks, building and loan associations, cooperative banks and credit unions, cemetery companies and associations, mutual rural electrical organizations, mutual insurance companies, and farmers' marketing and purchasing cooperatives.

The non-business organization returns showed an aggregate gross income and receipts of \$1,803,047,000 and aggregate disbursements of \$1,534,591,000. Tax-exempt organizations whose primary functions are non-business activities consist of such types as: labor organizations; educational, religious and charitable organizations; chambers of commerce, business leagues, boards, etc.; social welfare leagues; and fraternities, sororities, rotaries, social clubs, etc.

Farmers', fruit growers', livestock and dairy cooperatives, and like associations, organized and operated on a cooperative basis for the purpose of marketing and purchasing products and supplies filed 4,397 returns, or 18.29 per cent of the organizations whose primary functions are business, and reported total gross income and receipts of \$2,233,904,000 (69.67 per cent of reporting business organizations), and total disbursements of \$2,211,854,000 (71.60 per cent of reporting business organizations).

II. BRIEF HISTORY OF COOPERATIVES

IN GREAT BRITAIN

Under British law, genuine "mutual trading societies" may register as co-operatives under specified conditions. Individuals may not own more than £200 of share capital in one society, though the amount of loan capital each may own is unlimited. One society may be a member of another society (e.g., a retail society may be a member of a wholesale society) with no limit set to the amount of share capital each society may supply.

There are five types of cooperative undertakings in Great Britain:

1. Retail societies.
2. Wholesale societies.
3. Federal societies.
4. Productive societies.
5. Agricultural societies.

In the century since 1844, when 28 cotton weavers of the Town of Rochdale, England, with a total capital of £28, sold cooperatively its first supply of flour, sugar, butter and oatmeal, which established the pattern for effective consumer cooperatives, the cooperatives have grown and prospered. During 1944, 1,064 retail cooperatives in Great Britain reported having 9,225,240 members, assets of more than \$1,250,000,000, and annual sales of approximately \$1,500,000,000. Great Britain's two main wholesale cooperative societies reported net sales of approximately \$912,000,000 in 1944, of which total they themselves produced approximately \$257,000,000. Total sales of federal societies amounted to about \$11,000,000 in 1935; and the value of the trade and productive societies was about \$42,000,000 in 1944.

Agricultural cooperative societies in Great Britain have not made great progress. In 1943, there were in England 85 societies with 84,549 members and a total share capital of about \$6,000,000.

During 1942, the proportion of the national retail trade in Great Britain done by cooperatives was 12 per cent of the food and tobacco products; 14.5 per cent of the meat trade; 20 per cent of the coal trade; and 27 per cent of the sugar and preserves trade.

With ample funds available, the cooperative movement in Britain is planning to expand rapidly during the post-war period. Some of this extension will go into traditional forms—the building of more and better retail stores, the development of more production by the wholesale societies—but some will be directed to new outlets. The cooperatives have watched the success in Britain of 5 and 10 stores and other types of chain stores and have spoken frequently of trying to develop this kind of store themselves. The wholesale societies have considered also going into the mail order business; and both retail and wholesale societies have been acquiring centrally located premises to help them in their extension programs. The societies have also been acquiring a few hotels which they may run not only for members but also for the general public.

IN THE UNITED STATES

Cooperation has always been part of the tradition of the American farmer. This has made it possible for farmers to perform tasks efficiently, which would have been impossible if they had worked alone or competed with one another. There are examples of farmer cooperation in the United States as early as 1810, such as a cooperative dairy association in Connecticut, though the greatest development has come in the past fifty years. Farmer mutual fire insurance companies can be traced back to 1820, and mutual irrigation companies were founded by the Mormons in 1847. A group of Ohio livestock purchasers made joint shipments to a terminal market in 1820. A cooperative cheese factory was established in New York State in 1851. By 1856 a cooperative creamery was formed, also in New York State. The first cooperative grain elevator on record was started in Madison, Wisconsin, in 1857. In 1867 there were 400 marketing and processing cooperatives in the United States, and by 1890 there were 1,000 active farmers' cooperative associations.

Most recent statistics of the Farm Credit Administration show that there are 4,390,000 members of 10,300 farmer cooperative associations, who, in 1944 did a business of \$5,160,000,000. Farmer marketing amounted to \$4,430,000,000 and

purchasing amounted to \$730,000,000, the latter figure rising to \$1,010,000,000 when the purchasing business of marketing associations is considered.

ORGANIZATION STRUCTURE

Although there are layers of interlocking societies and corporations, cooperatives, in an over-simplified presentation, fall into four general classifications within the United States:

- (a) CONSUMER COOPERATIVE SOCIETIES, operating retail stores;
- (b) MARKETING COOPERATIVE SOCIETIES, selling collectively the produce of farmers and purchasing supplies and equipment for farmers. These simple original plans are complicated by both (a) and (b) duplicating each other's functions. Next comes
- (c) WHOLESALE COOPERATIVE SOCIETIES, set up by various cooperatives collectively to improve their buying status. In turn these wholesalers have bought
- (d) PRODUCING AND MANUFACTURING FACILITIES in lines usually on which there is a good margin of profit in competition with "capitalistic" corporations.

Throughout the entire set-up of true "Rochdale" type cooperative organizations, from the smallest local cooperative to the largest producer and manufacturing society, each member served by the various enterprises has equal responsibility and control. Neither the amount of capital invested nor the volume of business transacted with or for any member alters the underlying principle of equal authority for each member—i.e., equal voting power.

TYPES OF COOPERATIVE BUSINESS

The *consumer cooperatives* appear to have succeeded in nearly every kind of enterprise—farm supplies, petroleum products, housing, telephone service, electric service, cafeterias, bakeries, credit unions and banking, insurance, book stores, health cooperatives, burial co-ops, eating clubs, cleaning and pressing establishments, recreation and camps. One-sixth of all farm supplies purchased in America are handled by consumer cooperatives.

Marketing cooperative societies grew out of the farmers' economic necessity to find an efficient method of marketing their crops, which also would procure for them a fair price for their products. A substantial number of cooperative marketing associations do purchasing of supplies and equipment for their patrons. Other cooperatives only purchase supplies and equipment. The purchasing function has developed along with marketing and grew out of a situation which appears to be peculiar to the agricultural industry. Prior to the institution of group buying, farmers, particularly small farmers, purchased their supplies and equipment at *retail* prices but sold at *wholesale* prices.

Wholesale cooperative societies and their purchase and operation of *producing and manufacturing facilities* were the natural outgrowth inherent to large volume buying and selling.

SIZE AND VOLUME OF COOPERATIVE BUSINESS

The question naturally arises—"How important a part do cooperatives play in the American economy?" With duplicate memberships eliminated about three out of every five farmers belong to one cooperative or another. Among additions to the movements producing units in 1944 were a \$4,000,000 oil refinery, a half interest in a coal mine, a chick hatchery, and a power company. Real estate added to the producing units included three office buildings and a terminal warehouse.

The cooperatives are the largest single independent petroleum operator and

do approximately a quarter of the petroleum business in rural areas. This, however, is an industry that is not dominated by the independents, and the cooperatives' total sales are only about 2 per cent of the industry's. The cooperatives in the fertilizer and a few other industries may exert significant influence on prices and may be a factor in the development of price policy, but they do not make it.

Included in the total business done by farmer cooperatives are the transactions of independent local associations, federations, large-scale centralized associations, sales agencies, independent service-rendering associations and subsidiaries whose businesses are distinct from the parent organization. It also includes some intra-association transactions. The number of associations and estimated membership engaged in both marketing and purchasing in 1944, with the estimated amount of business of the various products are:

Products	Number of Assns.	Estimated Membership (thousands)	Estimated Amount of Business			
			Total (millions)	Per Cent	Per Association (thousands)	Per Member
Dairy products	2,286	702	\$1,203	23.3	\$ 526	\$1,714
Grain, dry beans and rice	2,311	452	1,178	22.8	510	2,606
Livestock	642	636	747	14.5	1,164	1,175
Fruit and vegetables.....	920	160	638	12.4	694	3,983
Poultry and eggs.....	159	130	196	3.8	1,233	1,508
Cotton and products.....	533	258	189	3.7	355	732
Nuts	48	49	159	3.1	3,313	3,245
Wool and Mohair.....	135	107	39	.7	289	364
Tobacco	11	120	19	.4	1,691	155
Miscellaneous	477	116	62	1.2	131	539
Total Marketing	7,522	2,730	\$4,430	85.9	\$ 586*	\$1,586*
Purchasing	2,778	1,660	730	14.1	263	440
TOTAL	10,300	4,390	\$5,160	100.0	\$ 501*	\$1,175*

*Average

The marketing operations of the 7,522 associations averaged \$586,000 per association, and ranged from an average of \$3,300,000 per association engaged in marketing nuts to an average of \$289,000 by the wool and mohair associations, while the associations marketing miscellaneous products averaged \$131,000 per association. The average net business of the 2,778 purchasing associations was \$263,000 per association. The average marketing business per individual member in 1944 was \$1,586, and the average purchasing was \$440 per member. Members marketing fruits and vegetables cooperatively led with an average per member of \$3,983, while members marketing tobacco received an average of only \$155 per member.

The North Central Area is by far the most important, with 64.0 per cent of the associations, 56.1 per cent of the membership, and 52.3 per cent of the farmer cooperative business of the nation. The marketing of dairy products, grain, dry beans, rice and livestock constituted 60.6 per cent of the total volume of business, and purchasing comprised only 14.1 per cent.

In the New York Times of March 11, 1945, Will Lissner observes that the activities of cooperatives have aided 2,500,000 families, but that they affect certainly less than 2 per cent of normal consumer income under \$25,000 a year and perhaps less than 1 per cent.

The swift growth of the new ramifications of cooperative enterprises shows why important elements in private business are concerned about cooperative competition, and especially about tax exemption of cooperatives. Cooperative operations are of concern to the food industries, oil industry, the grain trade and retail trades, among others. Such business groups feel that competition so formidable as that of the cooperatives today, when aided by tax exemption, becomes grossly unfair and, in local instances, actually ruinous.

III. TAX EXEMPTION ALLOWED BY INTERNAL REVENUE CODE

Certain Federal tax exemptions are allowed agricultural and marketing associations which are denied non-farm cooperatives. The Federal taxes from which qualified cooperatives are exempt, compared with those required to be paid by non-tax-exempt cooperatives, are:

EXEMPT (FARM) COOPERATIVES

1. Income used to pay dividends on capital stock untaxed.
2. No stamp (documentary) taxes.
3. Have advantages under the Unemployment and Security Act, such as payment of employment taxes for an employee whose remuneration does not exceed \$45 during a calendar quarter.
4. Increases to surplus or general reserve untaxed.
5. Patronage dividends untaxed.
6. Patronage dividends held as equity credits on books to member accounts untaxed.
7. A 1944 Act requires the filing of a "Statement of information" (Form 990)

NON-EXEMPT COOPERATIVES

1. Subject to income tax.
2. Capital stock issues, transfers, debenture bond issues, and real estate conveyances subject to stamp tax.
3. Subject to these taxes like ordinary corporations.
4. Subject to taxes as paid by ordinary corporations.
5. Untaxed as with farm cooperatives.
6. Untaxed if evidences of indebtedness are given to patrons.
7. This act requires the filing of an income tax return (Form 1120).

Agricultural marketing and purchasing associations, to qualify for exemption from Federal income taxes under Section 101 (12) of the Internal Revenue Code, must meet certain strict requirements which include:

1. The organization must be a farmers', fruit growers' or like association organized and operated on a cooperative basis for the purpose of
 - (a) marketing the products of members or other producers, or
 - (b) purchasing supplies and equipment for the use of members or other persons.
2. Member and non-member patrons must be treated alike.
3. Value of business done with non-members must not exceed the value of business with members, and the value of purchases of supplies and equipment by persons who are neither members nor producers shall not exceed 15 per cent of the value of purchases by all patrons.
4. Permanent records of the patronage and equity interest of all members and non-members must be maintained.
5. Financial reserves are restricted to those required by State laws or to those that are reasonable and necessary.
6. If the association is organized on a capital share basis substantially all of the voting stock must be held by producers who are currently patronizing the association.
7. Dividend rate on capital shares must not exceed the legal rate of interest in the state of incorporation or 8 per cent per year based on the value of the consideration for which the capital share was issued.
8. The legal structure of the organization must be cooperative in character and contain no provisions inconsistent with these requirements, and the association must be actually operated in the manner and for the purposes outlined in the requirements.

The term "like associations", in (1) above has been construed to include roadside markets or farmers' markets operated by farmers' organizations for the benefit of their members.

"Marketing" may include related operations performed for the purpose of facilitating the distribution of patrons' products. Marketing operations may include harvesting, hauling, manufacturing, packaging and processing farm products for farmers.

Both agency-type organizations and organizations taking title to products received from or sold to patrons may qualify as exempt associations. An exempt association may borrow funds and extend credit when these activities are normally related to its marketing and purchasing operations.

Exempt agricultural organizations may engage in a variety of activities and maintain their tax-exempt status. Among these activities are dusting, fumigating, spraying, other production services; grinding of grain or other collateral services, including the manufacture of farm supplies and equipment; the operation of oil wells and the extraction of crude petroleum; the renting of frozen food lockers and the furnishing of processing and other services relating to such storage. An exempt organization may own and operate a subsidiary corporation for carrying on activities that it could perform directly without losing its exemption, and, under certain conditions, federated types of cooperatives may be declared exempt by the Commissioner of Internal Revenue.

Exempt marketing and purchasing associations are required to allocate any net operating savings to all patrons, both members and non-members, on an equitable basis at least once annually. Allocation of savings of exempt marketing and purchasing cooperatives must be made among all patrons according to the proportionate volume of business done by the association with each patron. This allocation may be based on product units or dollar value. All net savings, after provision for limited dividends on capital shares, must be allocated on a patronage basis to all patrons.

While it has been indicated that probably about 50 per cent of farmers' cooperatives have established their exemptions from the payment of Federal taxes, even though no reliable information is available, the proportion of the dollar value of farmers' cooperative business conducted through exempt organizations is not known.

Neither is there information available on which to base an acceptable estimate of the proportion of the nation's farm business which is conducted through farmers' cooperative associations. At best, any estimates of the relative proportions of farmers' marketing and purchasing cooperatives in relation to total farm business are rough approximations. The Farm Credit Administration believes that, at the present time, the percentage of agricultural products marketed cooperatively ranges between 15 and 20 per cent of the total cash receipts from marketing by farmers with a qualification that it is much more accurate to state that farmers' cooperatives perform one or more services incident to the marketing of a maximum of 15 to 20 per cent of the total cash receipts from marketing by farmers of crops, livestock and livestock products. In the opinion of the Farm Credit Administration the amount of farm production supplies bought by farmers through farmers' cooperatives comprises less than 15 per cent of the total farm production supplies purchased by all farmers.

IV. MAJOR POINTS OF DISAGREEMENT REGARDING COOPERATIVE ENTERPRISES

The principal points of disagreement between the proponents and opponents of tax exemption for cooperatives involve:

1. Cooperative patronage refunds (also known as patronage dividends);
2. Reserves;

3. Special credit facilities;
4. Exemption from Federal income taxes; and
5. Corporate structure.

(I) PATRONAGE REFUNDS

O Clement M. Biddle, in the Biddle Survey of December 18, 1944, observed: the jargon of co-operatives, the margin between (1) billing price, and (2) cost plus overhead is called 'savings' and not 'profits.' It is from this margin that patronage refunds or dividends are distributed to patrons either in cash or some evidence of liability. No taxes are paid on these by the cooperatives.

ASSERTIONS OF PROPONENTS

According to the cooperatives, the patronage refund, whether large or small, does not represent income to the cooperatives. It represents an overcharge which is not subject to tax and which does not belong to the cooperative as an agent, but to the patrons. The patron, of course, must take these patronage refunds into consideration in preparing his individual income tax return.

Randolph E. Paul, former General Counsel of the Department of the Treasury, in a report prepared for the Farmers' Union Grain Terminal Association, January 19, 1945, stated:

"Perhaps cooperative activity could be analogized to the not uncommon situation existing where the selling or purchasing functions of an unincorporated business are carried on by a subsidiary corporation. The subsidiary pays no income tax because it has no income; the subsidiary's owner has a higher income than, and a competitive advantage over, those who pay a middleman's profit. Middlemen, of course, are deprived of their profits on the activities carried on by the subsidiary.***

"If the theory of cooperatives were to be completely disregarded, it might be possible to characterize patronage dividends either paid or withheld as the income of the cooperative and to subject them to tax in the hands of the cooperatives. Such a view would, of course, do great violence to the basic principles upon which cooperatives are organized. The sole object of their existence is to act as agent for their patron-owners in selling and purchasing. Any attempt to subject to tax in the hands of cooperatives the sums payable as patronage dividends would ignore this basic legal relationship between the cooperative and its owners which has been widely recognized and implemented by state laws." The cooperatives claim that:

1. if a corporation, which sells exclusively to large mail order houses, makes contracts to sell a certain article at a stated price, later on finds that through unexpected volume the price can be reduced and adjusts the contracts to a lower price, thereby refunding part of the invoices already paid, such price adjustment is not income to the manufacturing corporation; or
2. when a farmer cooperative adjusts its price to its patrons by making a price adjustment refund, which in the language of the trade is misnamed "patronage dividend", such price adjustment is not taxable income to the cooperative.

As these price adjustment refunds are not considered as income, legal counsel of cooperatives claim that legislation cannot be secured which will make these price adjustments taxable income to the cooperatives without securing a constitutional amendment.

Patronage refunds of cooperatives may be made in cash, stock shares, participation certificates, etc. Cooperatives, however, do not and cannot retain any money owing to their patrons and members unless the patrons and members authorize

this procedure. It has been stated that if Congress could and should pass a law taxing patronage refunds, consumer cooperatives declare that they would eliminate their patronage refunds by reducing their prices, while marketing cooperatives would pay farmers more for their products and eliminate in this manner their patronage refunds. No one has questioned their legal right to do this. Patronage refunds are small in groceries (about 2.2 per cent), but are up to 10 per cent on some lines in which cooperatives are dealing. Cooperatives emphasize that by reducing their prices they would attract more members and cut further into private business as well as eliminate all savings and remove them from the incidence of taxation.

The National Association of Cooperatives, Inc.—in its publication “A Reply to National Tax Equality Association Propaganda”—makes this observation with respect to patronage refunds:

“The right to charge off patronage refunds is not limited to co-operatives; it is equally open to all corporations and is almost universally in use in the form of trade discounts. Neither is the right dependent on departmental ‘rulings’. The courts have recognized that when a corporation obligates itself to return all or part of its net margins to its patrons, those refunds are not income to the corporation, but are income to the patrons.”

ASSERTIONS OF OPPONENTS

Those protesting tax exemption claim that patronage refunds are “profits” and not “savings.” Ben C. McCabe, President of the National Tax Equality Association, stated:

“The freedom of patronage dividends from tax liability is the main issue of the controversy between income-taxpaying business and the income-tax-free co-operatives.

“Taxpaying businessmen point out that *** (the) money is earned by the same process of buying, selling and manufacturing as in the case of a regular corporation, partnership or an individual proprietorship; that huge amounts are involved, and that patronage dividends are actually no more than a device for returning earnings to owners and patrons without first being subject to Federal income tax.

“Taxability of earnings should be determined by the way these earnings are created, and not by the disposition that is made of them.”

In a memorandum to the Royal Commission on Taxation of Cooperatives Canada, The Income Taxpayers Association stated:

“(The patronage dividend) is part of the profit from doing business in pooled, joint ventures, and in its nature is identical with the profit of any other corporation. If the funds paid out in such dividends are not taxed in the hands of the co-operative, every such organization will retain the power and privilege of deciding for itself exactly what contribution, if any, it will render to the state in taxes. Also, in that event, similar rights to pay patronage dividends must be accorded to all corporations.

“The argument of co-operatives to the effect that, if assessed for income tax, they can avoid the same by doing business at cost, is not an answer to the present problem and should not be allowed to govern their claim to exemption from income tax.

“The effect of the present inequality and discrimination is to channel business organizations into one or other of the tax exempt methods thereby eliminating and tending to destroy our freedom of choice in respect of our various ways of doing business. Freedom of choice is an essential element of a free enterprise economy or of a political democracy. The insistence of this trend is measured by the growth of tax inequality.

“The present exemption fosters a feeling of intense dissatisfaction and even injustice and as a consequence has become an unhealthy symptom

in an otherwise wholesome economy. It is important not only that justice should be done but that justice should also appear to be done."

In connection with hearings of the Canadian Royal Commission, Mr. W. H. Howard, a Montreal tax specialist, noted:

"There is a great deal of confusion of thought in respect of the exact nature of a 'patronage dividend'. This confusion is increased by the practice, recently developed by co-operatives, of designating patronage dividend payments or allocations as 'excess charges refunds', 'over-payment refunds', 'savings', and so forth. The implication intended to be conveyed by the use of these terms is that the co-operative concerned is only an agent that is remitting to its principals certain moneys which have come into its hands but which belong to them—in other words, that the remittance or allocation is simply an accounting to such principals."

In the case of "an agent for sellers or buyers of a commodity on a basis which precludes any remuneration, gain or profit to the agent, *** the agent's activities are exclusively for the account and for the *profit or loss*, as the case may be, of its principals. Whatever the agent receives belongs to the principals, and if the agent sustains a loss, the principals are liable. Remittances made by such an agent to its principals are not patronage dividends, as only the moneys of the principals are involved. There can be no patronage dividends unless the payer remits funds to which it has the legal title.

"However, the primary problem in respect of the taxation of co-operatives is not related to those that function only as agents for their members.

"*** although it is contended that co-operatives have no separate existence from their members, it is most unusual to find that the actual facts of any particular case support the theory of a simple agency relationship.

"A fundamental element that is almost invariably absent is that of the continuing liability of the principals, namely, the members, in cases where the co-operatives suffer losses in their operations. When a co-operative becomes involved in financial difficulties, the agency theory is no longer asserted, and creditors of the co-operative are obliged to be content with the proceeds of realization of the assets of the co-operative.

"A co-operative is either an agent or it is not. If it is, its status must be of a permanent and consistent character, and must be established by the actual effect of its administration and operations. Its agency status cannot be proved by assertions when its deeds or the circumstances make it clear that it is carrying on a trade or business for its own account and risk.

"The fact that there may be an obligation, express or implied, of a co-operative to make remittances to its members at some future time or under certain circumstances is not conclusive proof of agency.

"The relationship between a co-operative and its members is usually similar to that which exists between any joint stock company and its shareholders. The co-operative is engaged in an effort to make an over-all gain or profit for its members as a whole. It may have an agreement with such members, express or implied, to distribute or allocate such gain or profit to them. But, the agreement relates to the profit of the co-operative, not to any profit or loss it may make or suffer for the account of its members respectively.

"The profit or gain derived from particular purchases or sales, or the losses sustained as a result of such transactions are not known at the time of a member's sale or purchase and are not subsequently ascertained. Such details are irrelevant, as every member shares and shares alike in profit distributions, i.e., patronage dividends, on the theory, usually quite erron-

eous, that his dealings with the co-operative have provided, bushel for bushel, or dollar for dollar, or quart for quart, their precise *pro rata* share of the co-operative's distributable income or profits.

"The fact that such income or profits usually include revenues from investments, profits made on business transacted with people who are not members, and income from other sources in no way related to current member 'contributions', is glossed over or entirely ignored by those who support the agency theory."

(2) RESERVES

The reserves of consumers' cooperatives are subject to the same taxes as ordinary corporations, except that refunds held as equity are untaxed if evidences of indebtedness are given patrons.

With respect to tax exemption of farmers' cooperative marketing and purchasing associations, one provision of Section 101 (12) of the Internal Revenue Code is that exemption shall not "be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose." Under this provision such cooperatives may retain and reinvest, without loss of tax exemption, certain amounts which are not allocated to patrons as retained patronage dividends.

The Commissioner of Internal Revenue exercises the discretion of determining whether the reserve is reasonable and whether it covers any necessary purpose. In a ruling, dated July 9, 1931, the Commissioner stated:

"The phrase 'reasonable reserve for any necessary purpose' has been construed to include reserves accumulated or maintained to meet the capital expenditures of such associations. Where such an association has investments in buildings, machinery, and other property which, due to depreciation through use in the operations of the association, eventually reach a point where their usefulness is exhausted, such depreciation in a given year is properly chargeable against the patrons of the association as a part of the 'necessary marketing expenses' of that year, and a reserve for the replacement of such property set up ratably over the period of the useful life of the property will be recognized as a necessary purpose within the meaning of the statute and the departmental regulations."

He further stated with regard to a reserve required by State law, "that it must be a reserve required by a State law; a reserve permitted but not required does not meet this test of exemption." The cooperative statutes of states make it mandatory for cooperatives to accumulate a contingent reserve varying from 30 per cent to 50 per cent of the paid-up capital, so that the effect of this provision will differ from state to state.

Other reserves he may regard as necessary include general reserves providing for possible losses in future years, working capital reserves, reserves for financing or capitalizing necessary assets, reserves for definitely known contingencies such as a pending lawsuit, reserves for education expenditures, and reserves for post-war declines in inventory values.

Outside of the percentages set in the several state statutes, there are no set percentages which the Commissioner follows in determining the maximum limits permitted in reserves, but he decides each case on its own merits according to the hazards and necessities involved.

Such farmer cooperatives must pay patronage dividends to all producers on the same basis but may, instead of paying such amounts to non-members in cash, keep permanent records from which the amount due each non-member can be determined and apply these credits toward the purchase of a share of stock or membership in the association. These amounts are treated just as if they were paid out and reinvested in the association and form one source from which the capital of the cooperative may be increased.

If a farmer cooperative does not qualify for the tax exemption, the cooperative

is required to file income tax returns and is subject to all of the rules and regulations and limitations which apply to any taxpaying corporation.

Mr. Howard, the Canadian tax specialist, to whom reference was made previously, also noted:

"The larger of the agency type of cooperatives do not content themselves with merely withholding sums from the proceeds of sale of products or working capital and the acquisition or construction of necessary plant and equipment—they withhold money from members for purposes which are quite remote from their marketing function. So-called reserves and other moneys so withheld are used in many instances, for instance, to assist other cooperatives, to solicit and obtain new members, to buy out other businesses, to pay principal and interest of indebtedness incurred in prior periods, and even to carry on trading activities which, while designed to be profitable, are not necessarily incidental to their duties as selling agents of their members.

"The withholding of money for such purposes, or any of them, operates to prove that no agency relationship exists between the co-operative concerned and its members, and, obviously, any profit or gain derived from the use to which such money is put can be distributed to members only as patronage dividends. No such profit or gain bears any resemblance to the proceeds of realization of products received from members nor to over-payments for goods purchased by members from the co-operatives.

"Sooner or later, the benefits derived by such co-operative from the use of this casual working capital must be reflected in its remittances to members, and to that extent, such remittances will then include a patronage dividend because they will include a profit or gain derived by the co-operative from the use of an earning asset.

"It is because of this state of affairs that we contend that any co-operative asserting an agency status must promptly account to its members. Otherwise, its remittances must be treated as including some amount which is a patronage dividend."

An article in the August, 1945, issue of "Fortune" states:

"The decision concerning the legality and wisdom of taxing co-operative withholdings will be much closer. Cooperatives have a generally perfect record of investing their withheld savings, rather than letting them lie idle, and this is important to the economy. But withholdings inevitably work for the aggrandizement of the cooperative in competition with the ordinary corporation, and this may be unfair if the withholdings of the corporation are heavily taxed as they are at present. A tax on cooperative withholdings would hamper only the small, growing cooperative since the well-established ones would be able to borrow back from their members, or elsewhere, all the money they want."

The cooperatives generally pay interest on reserves retained for capital purposes. The interest rates vary in different localities, but it is estimated that the average rate on a country-wide basis is 3 per cent. In the event of liquidation of a cooperative, the assets are first used to repay all capital stock outstanding at the par value thereof or the consideration at which it was issued if non-par. The balance of assets is ratably distributed to the patrons on the basis of patronage.

It has been stated by a responsible representative of large cooperatives that Section 101 could well be revised to be more specific with respect to permissible accumulations in reserves:

1. As to valuation reserves, the position of the tax-exempt cooperative and the taxpaying corporation are identical.
2. With respect to expense reserves, namely, the mandatory additions to statutory reserves or the equivalent contingent reserves, it is believed that this statute should establish definite limits uniform throughout the United States, such as a percentage of paid in capital, and make it

unnecessary for the Commission to determine what is "any necessary purpose."

3. The statute might permit the accumulation of reasonable reserves for specific known contingencies provided the patrons' equities in such special reserves are clearly earmarked and any balance in such reserves not needed to meet the contingency be distributed to the patron promptly when the contingency has been met.
4. With respect to all other net margins which may be retained for capital purposes, the statute should make clear that there must be distributed in some form of evidence of equity so that they will be taxable to the patron as retained by the cooperative. There are responsible cooperative leaders who believe that no accumulations for capital purposes, beyond the contingent or expense reserve, should be permitted except as the patron voluntarily reinvests his distributed share of the net margins in this cooperative.

The tax exemption afforded certain farmers' cooperatives is intended to encourage them as a matter of policy. To carry out such a policy it seems necessary to permit such tax-exempt cooperatives the right to accumulate some amounts for operation and expansion in addition to the funds available through the sale of preferred stock and the retention of patronage dividends applied by the patrons to purchase stock or membership in the association. To the extent that such accumulations are permitted without loss of tax exemption such cooperatives are given an advantage over ordinary business corporations with which the cooperatives may be in competition as ordinary corporations must pay the corporate tax on all profits reinvested in the business. It is, therefore, important that the statute clearly specify the extent to which there may be such accumulations without loss of tax exemption, and that the limit set be such as to permit such exempt farm cooperatives to thrive and grow without giving them an undue advantage over ordinary business corporations.

(3) FAVORABLE LEGISLATIVE TREATMENT AND SPECIAL CREDIT FACILITIES ALLOWED COOPERATIVES

Farmers' non-profit marketing associations have been exempt from the income tax from almost the beginning of modern income tax history, and farmers' purchasing associations have been similarly exempted since the Revenue Act of 1921. Favorable legislative treatment of these organizations, corporate and otherwise, has not been limited to the taxing statutes. Farmers' marketing organizations were, for example, specifically stated not to be unlawful organizations in restraint of trade under the anti-trust laws by the Clayton Act; the exemption was clarified and expanded to cover certain cooperatives which had capital stock, by the Capper-Volstead Act; a special division was created in the Department of Agriculture to assist cooperatives by the Cooperative Marketing Act; credit facilities for cooperatives through Banks for Cooperatives were provided by the Farm Credit Act and its amendment in 1935; and the Motor Carrier Act exempted vehicles operated by farmers' cooperatives from many provisions of that act.

It has been stated by the cooperatives that any assumption that cooperatives require encouragement in the form of Federal and state subsidies is erroneous. There are no grants of Federal or state funds to cooperatives. Often the cooperatives are able to borrow operating capital from commercial banks at lower rates of interest than those charged by the Banks for Cooperatives. Thirteen Banks for Cooperatives have been established by the Farm Credit Administration, and lend money to farm cooperatives at the following rates: 4 per cent a year for facility loans; 2½ per cent for operating capital loans; and 1½ per cent for commodity loans. The fixed capital is furnished by the farmer patron. It is claimed that the cooperative operation is the very antithesis of Government subsidy.

The cooperatives believe that if the Government has encouraged cooperatives, it has also encouraged other producers. They cite as illustrations the early protec-

tive tariffs, and grants of free land to railroads, the Reconstruction Finance Corporation and the Home Owners Loan Corporation of the 30's, tax-exempt securities, the percentage depletion allowances to natural resource industries, and "Section 722" of the tax law which gives "relief" to a large extent in tax refunds.

(4) EXEMPTION FROM FEDERAL INCOME TAXES

Because patronage refunds have been considered neither income nor profits belonging to the cooperative, but savings made for the members by their common agent either through marketing or purchasing goods for them, patronage refunds of cooperatives are exempt from corporate income taxes.

The income tax status of patronage dividends, and unallocated savings or reserves of the three general types of cooperatives are summarized:

Class of Co-op	Patronage Refunds in hands		Unallocated Savings or Reserves
	Of Co-op	Of Patron	
Farm Product— Marketing Co-ops	Not taxed ¹	Taxed ²	Not taxed ⁴
Farm Supply— Purchasing Co-ops	Not taxed ¹	Taxed ²	Not taxed ⁴
Consumer Goods— Purchasing Co-ops	Not taxed ¹	Not taxed ³	Taxed

¹No cooperative pays income taxes on patronage refunds because they are not considered as either income or profits; they are considered as savings made for and returned to the members and patrons.

²Patronage refunds in the hands of the patron are subject to income taxes when made on products marketed or farm supplies purchased because they increase the farmer's net income by having decreased his production expenses.

³A consumer cooperative patron does not pay taxes on the refund he receives because it is considered as a reduction in the cost of the consumer articles he purchased.

⁴In order to help agriculture (not cooperatives, as such) at the time of its severe depression the Capper-Volstead Act of 1922 exempted farmer-owned and farmer-controlled cooperatives from income taxes.

At the present time available data do not permit of an accurate estimate of the revenue which would be payable to the Treasury if patronage refunds were subject to corporate income taxes. Congressman Jerry Voorhis of California, in an address delivered to the House of Representatives on February 5, 1945, stated in part:

"It is doubtful if due to this tax exemption more than \$10,000,000 of revenue is lost to the Federal Treasury per year." (Congressional Record, Appendix A493)

(5) CAPITAL STRUCTURE OF COOPERATIVES

In addition to the proceeds from the sale of non-voting preferred stock, cooperatives frequently expand their capital structures by withholding payment of patronage refunds which are treated on the company records as reserve funds.

Neither Federal statutes nor regulations establish any fixed restrictions on investments of reserve funds by cooperatives. Under some state statutes, limitations are placed upon investments by cooperatives, but such limitations are very rare. As a practical matter, however, it has been found that very few cooperatives invest funds held in reserves in either government or corporate securities. These funds are actively used for current operations by the cooperatives.

Dividends paid on non-voting preferred stock are treated by the cooperatives the same as dividends on stock are treated by corporations generally. The courts have held that dividends paid by cooperatives have the same quality and character as dividends on capital stock by commercial organizations.

V. TAX STATUS OF COOPERATIVES IN CANADA AND EUROPEAN COUNTRIES

CANADA

A measure to tax cooperatives was passed August 13, 1946, by the Ottawa Parliament. In general, cooperatives will be taxed as to interest on share capital, earnings arising from non-member business if paid to members, and any unallocated earnings or reserve retained.

The present Canadian tax measure originated with the Finance Ministry after hearings by a Royal Commission. The six basic features of the measure are:

1. Cooperatives are to be considered on a different basis from profit business.
2. In paying patronage refunds or "dividends," cooperatives may distinguish between members and non-members, as in a difference in rate.
3. Three per cent of "employed capital" is taxed at a rate beginning at about 35 per cent before distribution of earnings, but interest paid on any borrowed money is first deducted from the 3 per cent, and this tax may be thus eliminated. "Employed capital" is total assets less monies borrowed from banks.
4. Cooperatives have until twelve months after the current tax year to allocate earnings.
5. Monies from current earnings used to redeem certificates of indebtedness are tax free.
6. Patronage dividends left with the cooperative with the written authorization of members, to be applied to share or loan capital, are tax free.

The measure also provided that credit union federations and cooperative credit societies were tax exempt.

GREAT BRITAIN

Contrary to the situation in the United States and Canada, where farm cooperation bulks the largest, consumers' cooperatives are most important in Great Britain. The Cooperative Wholesale Society is one of the largest business organizations in the world, and engages in wide-flung production, transportation and other manufacturing activities in furtherance of its primary distributive function. From time to time opposition to exemption of Britain's cooperatives under the Industrial and Provident Societies Act has come from private business. Three separate investigations were made of the question—in 1905, 1920 and 1932. The latter two, unlike the first, reported roughly similar conclusions that: "any part of the net proceeds which is not actually returned to members as a 'dividend' or 'discount' is a profit which should be charged to income tax." The Finance Act of 1933 established the present rule under which cooperatives are taxed in the same manner as ordinary corporations but can deduct from taxable income all proceeds paid or payable as patronage dividends.

SWEDEN

Cooperatives in Sweden are taxed according to the same general principles as in Great Britain and the United States; that is, rebates to members of consumer cooperatives are, for the purpose of taxation, regarded as costs of operation, not as taxable income.

The Swedish Courts have regularly interpreted the laws concerning the taxation of cooperatives in a liberal manner. Not only has it been established that a cooperative society, in the agreed meaning of the term, has the right to dispose of the preceding year's operational profits as rebates (or increment payments in the case of producer societies) but it is also accepted that in making tax declarations the societies may deduct from their taxable income the whole sum thus disposed of.

If, however, this sum is not paid out in its entirety, owing to some receipts not being produced, the undistributed remainder must be counted as income in the next year's declarations.

Another allowance in favor of the cooperatives, also made at their special request, is the authorities' practice of never inquiring whether rebates have taken the form of cash payments or have remained to increase the members' holdings in the society. Whichever way the dividends are treated, they are still deductible from taxable income. This has naturally had enormous effect on the accumulation of capital within the cooperative movement.

The reason these "dividends" of cooperatives are allowed to be deducted from taxable income is that in the case of consumer societies they are regarded as price rebates, and in the case of producer cooperatives as post-payments. Thus in each case they are considered as operational costs. Similarly the rebates paid to purchasers from consumer societies are considered to be savings on the purchases and, therefore, not assessable as income in the individual's tax returns, provided the goods are consumed by the purchasers and not used in any commercial transaction. This principle, however, causes rebates paid by the central wholesale Kooperativa Forbundet to the local societies to be declarable as income by the latter. But the Kooperativa Forbundet wholesale may deduct them from taxable income. Members of producer cooperatives, on the other hand, have to include increment payments ("dividends") made at the end of the bookkeeping year as income in their tax declarations.

Taxation of cooperatives has been a much discussed question in Sweden, both within and without the Riksdag. The Taxation Committee of 1936, however, making its final report in 1939, declared that "no change in the regulations regarding the right (of cooperatives) to deduct rebates and increment payments from taxable income is called for." The committee pointed out that the system of rebates had become so extensively developed by private traders that it would be actually unfair to cooperatives to change the law so as to apply to them alone. The only change that has, in fact, been made is to render funds of cooperatives and other similar associations liable to taxation as capital or insofar as they exceed the capital put up by the members. The general Swedish system is that individuals are subject to capital (or property) tax to the extent that 1/100 of the value of their capital is added to income for declaration purposes. Corporations are not liable to this form of taxation. As the funds of the cooperatives are not, as a rule, disposable to members (reverting to the central organization on dissolution of a society), their capital fund increases would not otherwise be taxable. In order to put cooperatives on as nearly a footing as possible with corporations, it was decided that the cooperatives should add to their income an amount corresponding to 1/200 of their capital additions in making tax declarations.

SOVIET UNION

In the Soviet Union special assistance in financing is extended to cooperative organizations by the state-owned Trading Bank and newly-formed cooperatives are exempted from all taxation for their first two years of operation.

OTHER COUNTRIES

A report of "Cooperative Enterprise in Europe" made by a committee appointed by President Roosevelt in 1937, said that tax treatment of cooperatives in Norway corresponded in general to their treatment in Sweden.

In Czechoslovakia cooperatives dealing only with members were taxed at the rate of 0.2 per cent of their paid-up capital, compared with the rate of 8 per cent for private business.

France appears to be the only important country of Europe in which no substantial advantages are held out to cooperative organizations by the government.

VI. RECOMMENDATIONS

No recommendations are offered regarding the taxation of patronage dividends or credits as earnings of the cooperatives. The present exemption is not one which is provided for by Section 101, but is made by court ruling and administrative regulation. It should be pointed out, however, that the patronage dividends, although exempt to the cooperative from Federal corporate income taxes, ultimately will be reflected in increased income of the recipients of the patronage dividends either through the increased price the recipients receive for the products or through the decreased costs of doing business. Increased incomes of the recipients are subject to federal income taxes.

Private corporations frequently adjust prices of both sales and purchases after transactions have been consummated. In many cases of renegotiation discount rates are revised to reflect reduced costs or the results of cumulative quantity sales (or purchases) in a given period or season. In practice such adjustments are considered as costs of operation to the corporation and not as distributions of earnings.

Any decision to construe patronage dividends as income to the cooperative while price adjustments by private corporations are recognized as costs of operations would result in confusion of existing practices.

The following recommendations are made regarding the taxation of cooperatives in the United States:

1. Require all cooperatives to furnish the Bureau of Internal Revenue with detailed information as to each member's or patron's interest in the cooperative's earnings (margins) whether such earnings are distributed or withheld by the cooperatives. Such information returns would serve purposes similar to those now achieved by information at the source returns filed by ordinary business concerns.
2. A certificate or other evidence of all amounts retained in capital reserves should be issued to each patron indicating the amount of his equity or investment, which amount, if income, must be reported for tax purposes by the patron.
3. Revise Form 990, which is required to be filed by tax-exempt corporations under Section 54 (f) of the Internal Revenue Act as amended in 1943, to show in detail the amount of member and non-member business, the amount of reserves, the allocation of reserves, the manner in which patrons' equity and capital is evidenced, and other data which would indicate readily a compliance or non-compliance with the exemption restrictions.
4. Permit exempt farmer cooperatives to establish reserves from income (margins) derived from current operations which would be exempt from corporate income taxes if the amount does not exceed "reasonable reserves" for "necessary purposes." The use of subjective tests in order to determine what constitutes "reasonable reserves" for "necessary purposes" has not proved satisfactory. The determination of "reasonable reserves" should be made by Congress based on objective tests such as, for example, a reasonable percentage of the original paid-up capital. This determination should be made after a study by Congress as to the financial needs and the size of the cooperative's operation. Income taxes at corporate rates would apply to any balance of reserves established in excess of this restricted amount.



COMMERCE AND INDUSTRY ASSOCIATION
OF NEW YORK, INC.

233 BROADWAY

NEW YORK 7, N. Y.

Form F. R. 511

TO

~~Mr. Koch~~

Mr. Grungdane

FROM

Gov. Eccles

Friday, Oct. 20, 1950.

REMARKS:

I will appreciate it if you will have someone go over these studies on taxing cooperatives and let me have ~~the~~ memoranda of comments and suggestions. Would appreciate your comments on each being made separately in order to be attached to individual letters.

M.S.E.

CHAIRMAN'S OFFICE

October 20, 1950.

Mr. M. William Zucker, Director,
Governmental Affairs Department,
Commerce and Industry Association of New York,
233 Broadway, Woolworth Building,
New York 7, New York.

Dear Mr. Zucker:

I appreciated receiving your letter of October 16, relative to my recent speech before the Cooperative League of the United States and a copy of your organization's report on tax exemption of cooperatives.

I have not yet had an opportunity to read the report as I am trying to get my desk cleared prior to leaving for the West this weekend.

I am sure I will find the report very interesting. During my absence I am having one of our Research men go over the report and give me his comments on it as I do not expect to return to Washington until the latter part of November.

My address before the Cooperative League was extemporaneous and, therefore, I do not have a written copy of it. However, I do have a press release covering it with the exception of what I said about taxing cooperatives. Thinking you may be interested in seeing it I am enclosing a copy of the release herewith.

Sincerely yours,

M. S. Eccles.

Enclosure
VL:dlb

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 1, 1950.

To Governor Eccles

From R. W. Lindholm

Subject: Comments concerning tax study
of Commerce and Industry Association of
New York, Inc. of tax liability of co-
operatives.

The legislative recommendations of the Commerce and Industry Association of New York, Inc, appear to be a fair attempt to compromise the cooperative tax exemption problem. The two major weaknesses of the proposal as an acceptable solution are (1) failure to deduct at the source (the cooperative) the normal rate income tax liability on patronage dividends paid to farmers and businesses and (2) failure to tax dividends on capital stock above a minimum of 3 or 4 per cent at the corporate tax rate applicable.

The recommendation of tax treatment of reserves is satisfactory and should prevent cooperatives from benefiting from a tax advantage over corporations in the use of internal funds for expansion. The recommendation of continued tax exemption of patronage dividends is generally acceptable but additional restrictions on the withholding of these dividends should be provided and application of the term patronage dividends should be very carefully restricted so that it includes only that income which arises from purchases from the cooperative by the member or sales made for the member by the cooperative.

Tax legislation formulated primarily to tax corporations or partnerships and single proprietorships cannot be readily modified to fit the cooperative. This difficulty was not important under the low tax rates existing when the tax treatment of cooperatives was originally determined. The situation is drastically different today.

The efficient collection of high tax rates is possible only if each taxpayer is reasonably certain that his position is not greatly different from that of other taxpayers similarly placed. This requires raising the tax collections from the economic activities of cooperatives as well as the tax payments of other economic groups such as life insurance companies, oil companies, and economic activities organized under the control of educational and charitable organizations.

