

OREGON COOPERATIVES AND TAXATION

by

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INTRODUCTION

"We must all hang together, or assuredly we shall hang separately" are famous words spoken by Benjamin Franklin at the signing of the Declaration of Independence in 1776.¹ That attitude of working together resulted in the founding of the United States of America. The establishment and growth of the cooperative form of business in the United States has been derived from much the same attitude of working together for the mutual benefit of the ones who are cooperating.

The cooperative enterprises in this country have had much of alternating success and failure. From the Granger movement of the 1860s and 1870s until the present, there have been various attempts by farm groups to better their lot by cooperative handling of their products and wants. At the present time, the cooperative enterprises have a considerable influence in the business of some regions.

There has been a general tendency of the Congress to assist the farm groups in the first half of the present century. Included is governmental assistance to cooperative organizations among the farmers through the extension services of the state colleges and through Department of Agriculture information. Through a government-sponsored

¹John Bartlett, Familiar Quotations (Boston: Little, Brown and Co., 1957), p. 227.

Bank for Cooperatives, through the Farm Credit Administration, and by means of income tax exemptions, the continued operation of these cooperative businesses has been assisted. The depression of 1930 to 1933 saw the mushrooming of farm cooperatives, in attempts to offset the extreme financial reverses suffered by the farm peoples in general during that period of monetary crisis. The growth of farm cooperatives, including regional wholesale organizations, as well as the establishment of urban cooperatives in some areas, has continued to the present.

In the last decade, there has been developing opposition to what is considered a favored position granted to cooperatives by laws of taxation, particularly in the federal income tax laws. There have been special committees set up by the House of Representatives to investigate the inroads and effect of cooperatives upon the small businesses of the country. In November, 1947, the Committee on Ways and Means of the House of Representatives held hearings regarding the tax treatment of cooperatives, with attempts being made to hear all aspects of the taxation of cooperatives. This series of hearings was just one portion of the hearings in connection with the tax revisions at that meeting of Congress. While the hearings have resulted in no changes in the federal income tax laws, the whole discussion was significant in covering the relationship of cooperatives to taxation on a national level.

An organization titled the National Tax Equality Association has been directing much of its activity since its formation in 1943 toward

the changing of the exemptions and privileges being used by cooperative organizations under the income tax laws. In trying ostensibly to do away with any and all inequities of the tax structure, the tax advantages of the cooperatives have come under the most vigorous attentions of the Association, usually designated the NTEA.

The regional and national organizations of cooperative associations have countered this activity of the NTEA by forming a National Association of Cooperatives (NAC) for the purpose of propagandizing the viewpoint that cooperatives are not now deriving any particularly important tax advantage by the present exemptions.

Other national organizations besides the NTEA and the NAC have also had some say in the controversy, with the result of much information and misinformation, along with some accusations, personal and businesswise, appearing in numerous national publications. Opinions as to any tax advantage or disadvantage of cooperative organizations seem to vary rather consistently with the viewpoint of the one making the statement of opinion.

In Oregon, the development of cooperative organizations has been consistent with the national trend, except that the lack of strictly consumer cooperatives in the cities would indicate that the farm groups are more active cooperatively here than in the more urban-populated sections elsewhere. Since the cooperative activity in Oregon is of considerable importance, it is to be expected that any decision in Congress resulting in a change of income tax procedures relating

to cooperatives will have its effects on the cooperatives in this state.

The writer's purpose in preparing this paper was two-fold. He wished to learn what the effect of various proposed changes in the income tax laws would have on cooperatives in Oregon. Also, he wished to determine the approximate business being done by the cooperatives in the state. To obtain this information, a questionnaire was sent to all of the known business cooperatives in Oregon. The returns from this questionnaire appear in chapter four.

The proposed changes in federal income tax laws, mentioned above, were mainly those mentioned during the Congressional hearings during November, 1947. Consideration for and against these proposals were made and an attempt was made to determine which proposed change, or combination of changes, would be more equitable tax-wise than the present federal income tax laws. State income taxes and other business taxes were considered also.

CHAPTER I

HISTORY AND PRESENT STATUS OF COOPERATIVES

Cooperatives, in the sense known today, originated in a store founded by a group of twenty-eight impoverished weavers in Rochdale, England. In 1843, the lot of the worker in the mills of industrial England was that of much want and privation. The nick-name "the hungry forties" was indeed apt for the working class, for the progress of the industrial revolution had not yet reached the pocketbooks of the common laborer. Over a period of a year, these twenty-eight weavers saved their pennies until the very modest sum of about \$140.00 had been accumulated. With that amount, a small stock of staple goods was placed on the shelves, and the Rochdale Society of Equitable Pioneers was in business, in December, 1844.

There had been other cooperative enterprises before this time, but prior efforts had failed for various reasons. The Rochdale group built a lasting business, however. The endurance of this cooperative was due largely to the very complete, yet simple, principles set forth for the operation of the cooperative store. The Rochdale Principles are as follows:

- Rule 1. Open membership. No one to be excluded because of race, creed or color.
- Rule 2. One member, one vote. No voting by proxy.

- Rule 3. Share capital to be paid a moderate, fixed return.
- Rule 4. Surplus of an association to be returned to a member in ratio to his purchases.
- Rule 5. Neutrality of the Co-op in religion and politics.
- Rule 6. Trading on a cash basis.
- Rule 7. Education of members with reference to Consumer Co-operative Principles.¹

These principles were prepared for the use of consumer cooperative enterprises, but they have also been adapted to the use of producer cooperatives, thus applying the cooperative principles of business both to enterprises purchasing merchandise for their members and enterprises marketing the goods produced by their members.

Since the small beginnings of the Rochdale Society, the cooperative movement has reached a world-wide growth. In some areas it has become an important factor in the business being done. The International Cooperative Alliance, founded in London in 1895 for the purposes of uniting the consumers and producers of the whole world, now includes representatives of cooperative organizations in more than thirty-five countries, more than 100,000 cooperative societies, and more than 45,000,000 members of cooperatives.²

The Scandinavians have made more use of the cooperative form of business than have people in other areas. Before the Second World War, the Consumers' Movement in Denmark handled thirty per cent of the country's retail grocery trade, and nearly fifty per cent of the population was

¹ Bertram B. Fowler, The Co-operative Challenge (Boston: Little, Brown and Company, 1947), p. 12.

² World View of Cooperatives (Chicago: Cooperative League of the U. S. A., undated mimeographed papers), p. 1.

served by Consumers' Societies. In Finland, one-third of the national retail trade and over one-third of the wholesale trade were handled by the two Consumers' Movements.¹ It is estimated that almost one-third of the population in Norway are served by Consumers' Societies. During World War II the Cooperative Consumers' Movement was the only Norwegian democratic institution which was not dissolved or placed under control.² Sweden's cooperative movement is well known for its fight against cartels and monopolies and has reduced the general level of prices to consumers, especially in areas of high monopolistic profits. The Consumers' Movement is estimated to reach nearly thirty per cent of the population and handles over twenty per cent of the nation's food trade.³

In other sections of the world also, cooperatives have grown to a place of some influence, although their progress is not as well known as in Scandinavia. The Nazi and Fascist controlled countries apparently eliminated the cooperative societies early in the dictatorial regimes.⁴ There are cooperatives throughout the world, but it is difficult to evaluate the entire influence of this form of business organization, particularly in this time of post-war rebuilding and lack of the best governmental cooperation.

¹Ibid., p. 2.

²Ibid., p. 4.

³Ibid., p. 4.

⁴Ibid., pp. 2, 3, 4.

Although there was some cooperative activity before the Civil War, the largest nineteenth century cooperative activity in the United States was brought about by the Granger movement in the period from 1870 to 1875. Expansion on too rapid a scale plus an emphasis on price-cutting involved these Grange-originated farmer cooperatives in price wars that often proved fatal. A few cooperatives survived, but the cooperatives in the nineteenth century were generally not successful in the United States.¹

In the early part of the twentieth century, there were various attempts made to promulgate a cooperative movement in America. With a very few exceptions, these efforts were doomed to failure. The reasons apparently were several. Prior to World War I, Americans had an unlimited frontier. While the frontier lasted, there was not as great a need for the cooperative movement as there had been in Europe. There was a tendency by those fostering cooperative organizations to try to "do something big" with a resulting over-expansion of the business enterprises being opened. Instead of the methodical plodding of the successful cooperatives in Europe, over-expansion, in an America not yet ready for extensive cooperative organizations, proved the downfall.

¹Ellis Cowling, Co-operatives in America (New York: Coward-McCann, Inc., 1943), pp. 80-90.

of nearly all of the early cooperatives of this century.¹

After World War I, the farm groups found themselves in the position of oppression economically in the United States. Farm organizations such as the Farmers' Union, Grange, and Farm Bureau, were leaders in organizing stores for the purpose of saving in the items which farmers had to purchase. In areas where the farm organizations were not particularly active, cooperatives among farmers also began to flourish. Since 1920, and spurred on with the advent of National Cooperatives, in 1933, and United Cooperatives, in 1937, there has been a strong and building cooperative movement. Both of these organizations are nation-wide in scope and are affiliations of wholesale cooperatives of all regions of the United States.²

In addition to the purchasing associations and affiliations of the two national cooperative federations named above, many of the marketing associations have purchasing departments for their members, even though marketing associations were organized originally and primarily for the purpose of obtaining higher prices for their members for products marketed.

Marketing associations are to be found in almost every type of agricultural activity. The cooperative activities of the marketing associations amount in dollar value to a much larger sum than that of associations engaged in purchasing. This can be seen by the data in Table 1, for the marketing season 1948-49, the latest figures available

¹Ibid., pp. 95-114.

²Ibid., pp. 115-131.

TABLE 1

Farmers' Marketing and Purchasing AssociationsEstimated Business with Percentages1948-49 Marketing Season

| <u>Type of Association</u> | <u>Estimated Business</u> | <u>Percent</u> |
|----------------------------|---------------------------|----------------|
| Marketing | \$7,700,000,000 | 82.6 |
| Purchasing | <u>1,620,000,000*</u> | <u>17.4</u> |
| Totals | \$9,320,000,000 | 100.0 |

*After combining the marketing business of all associations and the purchasing business of all, the estimated total for marketing was \$7,297,560,000 or 78.3 percent, and for purchasing \$2,022,440,000 or 21.7 percent.

Source: Cooperative Research and Service Division, Farm Credit Administration, Preliminary report for 1948-49.

at this time.

In Table 2 will be seen a recently prepared summary of essentially all types of cooperative endeavor in the United States today. It can be seen that the cooperative form of business activity is versatile and has reached considerable size.

The 1940 census, with data of merchandising stores, revealed the figures shown in Table 3 for the groups as classified. It can be seen that the proportion of retail sales made through cooperatively operated stores is small, about one-third of one percent. The same census report listed 231,400 wholesale establishments, doing a total business of \$59,073,548,000, of which 5,540 were cooperative businesses, doing a total volume of \$1,647,356,000.¹ These wholesale cooperatives, doing 2.8 percent of the volume shown, are listed in Table 4.

It is rather difficult to determine the importance of cooperatives on a national scale, as to dollar value of business done and as to the proportion of the entire business. Sources of statistics can be found with information as to the total national business, but these figures are not necessarily on the same basis as amounts available for the total cooperative business activity. The national income for 1946, per United States Department of Commerce survey, is stated as \$178,204,000,000.²

¹John H. Davis, An Economic Analysis of the Tax Status of Farmer Cooperatives (Washington: American Institute of Cooperation, 1950), p. 18.

²W. Nelson Peach and Walter Krause, Basic Data of the American Economy (Chicago: Richard D. Irwin, Inc., 1948), p. 8.

TABLE 2

Co-ops in U. S.--January 1, 1951

(All figures rounded)

| <u>People's Need</u> | <u>Filled by (Type of co-op)</u> | <u>No. of such Cooperatives</u> | <u>Their Membership</u> | <u>Volume of Business</u> |
|---------------------------|---|-------------------------------------|-----------------------------|--|
| Thrift, Credit | Credit Unions* | 13,000 | 6,000,000 | \$1,000,000,000 Assets |
| Farm and Home Supplies | Rural Consumer- Purchasing Co-ops | 3,000 | 2,500,000 | \$2,000,000,000 |
| Household Supplies | City Consumer Co-ops | 1,000 | 500,000 | \$100,000,000 |
| Security | Co-op Insurance Companies** | 13 | 4,500,000 | \$130,000,000 Assets \$85,000,000 Premium Income |
| Medical Care | Group Health Plans*** | 70 | 800,000 | \$15,000,000 Health Services Rendered |
| Rural Electric- ity | Rural Electric Co-ops | 1,000 | 3,000,000 | \$200,000,000 Annual Energy Charges |
| Farm Credit | Production Credit Associations | 500 | 450,000 | \$900,000,000 Loans Outstanding |
| Home Ownership | Housing Cooperat- ives | 50 | 30,000 | \$9,000,000 monthly payments by members |

TABLE 2 (CONTINUED)

| <u>People's Need</u> | <u>Filled by (Type of co-op)</u> | <u>No. of such Cooperatives</u> | <u>Their Membership</u> | <u>Volume of Business</u> |
|----------------------|--------------------------------------|-------------------------------------|-----------------------------|---------------------------|
| Education | Student Co-ops | 500 | 50,000 | \$10,000,000 |
| Fair Prices | Farm Marketing Cooperatives | 7,000 | 4,000,000 | \$7,300,000,000 |
| Decent Burial | Funeral Co-ops | 44 | 40,000 | \$500,000 |

*Credit Union figures are for the U. S. and Canada.

**Insurance figures include only those companies associated with the Insurance Conference of the Cooperative League and do not include many hundreds of genuinely cooperative farmers' mutuals scattered through many of the counties of the country.

***Figures for health cooperatives do not include trade union health plans, despite certain obviously cooperative features of those plans. Were they included, the membership of such plans would probably exceed 5,000,000.

Source: The Cooperative Consumer, Vol. XVIII, (January 17, 1951), p. 5.

TABLE 3

Retail Establishments - 1940

| <u>Type of Business</u> | <u>Number</u> | <u>Sales</u> |
|--------------------------|---------------|------------------|
| Sole Proprietorships | 1,357,403 | \$16,524,970,000 |
| Partnerships | 189,681 | 5,198,901,000 |
| Corporations | 210,570 | 19,810,302,000 |
| Cooperative Associations | 3,230 | 144,723,000 |

Source: The Sixteenth Census of the United States: 1940, Census of Business, Volume I, Retail Trade: 1939, Part I; cited by John H. Davis, An Economic Analysis of the Tax Status of Farmer Cooperatives.

TABLE 4

Wholesale Cooperative Establishments - 1940

| <u>Type</u> | <u>Number</u> | <u>Volume</u> |
|-------------------------------------|---------------|---------------|
| Retailer-Cooperative Warehouses | 222 | \$222,996,000 |
| Petroleum-Cooperative Bulk Stations | 665 | 37,962,000 |
| Cooperative Marketing Associations | 2,583 | 611,029,000 |
| Cooperative Sales Agencies | 191 | 578,939,000 |
| Cooperative Country Grain Elevators | 1,483 | 196,430,000 |

Source: The Sixteenth Census of the United States: 1940, Census of Business, Volume I, Retail Trade: 1939, Part I; cited by John H. Davis, An Economic Analysis of the Tax Status of Farmer Cooperatives.

Accepting a 1945-46 estimate (see Table 5) of \$6,070,000,000 for the business of farm cooperatives as being on a comparable basis, 3.4 percent of the total national income for that period was farm cooperative business.

According to the Bureau of Agricultural Economics, United States Department of Commerce, the total cash farm income for 1946 was \$25,322,900,000.¹ Again assuming the figures to be approximately of a comparable basis, the \$6,070,000,000 of farm cooperative business would represent 24 percent of the total farm income.

In some phases of agricultural activity, the proportion of business done by cooperatives is considerably larger. As early as 1929, it was estimated that approximately 40 percent of the milk sold to urban consumers was marketed by cooperative associations. Also, about one-third of the butter and one-third of the cheese manufactured in this country were marketed cooperatively.² Thus, the dairying phase of agriculture showed even then a large amount of cooperative activity.

Estimates of the proportion of the total dairying activities being done by cooperative organizations in 1943 showed an even higher amount of cooperative activity. It was estimated (Farm Credit Administration figures) that 40 percent of the butter, 25 percent of the cheese, and 50 percent of the fluid milk distributed on urban markets, were handled

¹Peach and Krause, *op. cit.*, p. 13.

²Cooperative Marketing Makes Steady Growth (Washington: Federal Farm Board Bulletin No. 9, April, 1932), p. 48.

TABLE 5

Farmers' Marketing and Purchasing AssociationsEstimated Business for Specified Periods1913 to 1948-49

| <u>Period*</u> | <u>Marketing</u> | <u>Purchasing</u> | <u>Total</u> |
|----------------|------------------|-------------------|----------------|
| 1913 | \$ 304,385,000 | \$ 5,928,000 | \$ 310,313,000 |
| 1915 | 624,161,000 | 11,678,000 | 635,839,000 |
| 1921 | 1,198,493,000 | 57,721,000 | 1,256,214,000 |
| 1925-26 | 2,265,000,000 | 135,000,000 | 2,400,000,000 |
| 1927-28 | 2,172,000,000 | 128,000,000 | 2,300,000,000 |
| 1929-30 | 2,310,000,000 | 190,000,000 | 2,500,000,000 |
| 1930-31 | 2,185,000,000 | 215,000,000 | 2,400,000,000 |
| 1931-32 | 1,744,000,000 | 181,000,000 | 1,925,000,000 |
| 1932-33 | 1,199,500,000 | 140,500,000 | 1,340,000,000 |
| 1933-34 | 1,213,000,000 | 152,000,000 | 1,365,000,000 |
| 1934-35 | 1,343,000,000 | 187,000,000 | 1,530,000,000 |
| 1935-36 | 1,586,000,000 | 254,000,000 | 1,840,000,000 |
| 1936-37 | 1,882,600,000 | 313,400,000 | 2,196,000,000 |
| 1937-38 | 2,050,000,000 | 350,000,000 | 2,400,000,000 |
| 1938-39 | 1,765,000,000 | 335,000,000 | 2,100,000,000 |
| 1939-40 | 1,729,000,000 | 358,000,000 | 2,087,000,000 |
| 1940-41 | 1,911,000,000 | 369,000,000 | 2,280,000,000 |
| 1941-42 | 2,360,000,000 | 480,000,000 | 2,840,000,000 |
| 1942-43 | 3,130,000,000 | 600,000,000 | 3,730,000,000 |
| 1943-44 | 4,430,000,000 | 730,000,000 | 5,160,000,000 |
| 1944-45 | 4,835,000,000 | 810,000,000 | 5,645,000,000 |
| 1945-46 | 5,147,000,000 | 923,000,000 | 6,070,000,000 |
| 1946-47 | 6,005,000,000 | 1,111,000,000 | 7,116,000,000 |
| 1947-48 | 7,195,000,000 | 1,440,000,000 | 8,635,000,000 |
| 1948-49** | 7,700,000,000 | 1,620,000,000 | 9,320,000,000 |

*Statistics now compiled on the basis of the marketing season.

**1948-49 data from Preliminary report, obtained from Farm Credit Administration.

Source: Historical and Statistical Section, Cooperative and Research Division, Farm Credit Administration.

cooperatively.¹

Not all phases of agricultural activity have had cooperatively formed businesses for as long a time or for as successful operations as the dairy industry. Nevertheless, there is now much being done by cooperative organizations in all phases of agricultural marketing and purchasing.

An idea as to the growth of agricultural cooperative activity can be seen in Table 5, which reports the estimated business of farm cooperatives from 1913 to date. This table does not take into consideration the changing price levels since that time, however, so that the picture shown by Table 5 would be distorted to the extent that rising prices account for part of the dollar increase.

For further analysis of the trend of cooperative business, Table 6 transcribes the data from Table 5 into percentage trends, to counteract the distortion mentioned above. Note that the purchasing associations have increased their business more, proportionately, since 1935 than have the marketing associations.

By referring to Tables 7, 8, and 9, the trend of farm cooperative business growth can be compared with the trends of prices, both in general and relative to farm receipts and payments. It is seen in these tables that the growth of farm cooperatives' business has been much faster than even the change in price levels could cause.

¹Cooperatives in the Dairy Industry of the United States (Chicago: National Tax Equality Association, October, 1945), pp. 1-2.

TABLE 6

Farmers' Marketing and Purchasing AssociationsIndex of Business, fromBase Year 1935-36

| <u>Season</u> | <u>Marketing Associations Percent of 1935-36</u> | <u>Purchasing Associations Percent of 1935-36</u> | <u>All Associations Percent of 1935-36</u> |
|---------------|--|---|--|
| 1935-36 | 100 | 100 | 100 |
| 1936-37 | 119 | 123 | 119 |
| 1937-38 | 129 | 138 | 130 |
| 1938-39 | 111 | 132 | 114 |
| 1939-40 | 109 | 141 | 114 |
| 1940-41 | 120 | 145 | 124 |
| 1941-42 | 149 | 189 | 154 |
| 1942-43 | 200 | 236 | 206 |
| 1943-44 | 279 | 288 | 281 |
| 1944-45 | 305 | 319 | 306 |
| 1945-46 | 324 | 363 | 330 |
| 1946-47 | 379 | 437 | 387 |
| 1947-48 | 454 | 567 | 469 |
| 1948-49 | 485 | 638 | 506 |

Source: Data in Table 5 placed on percentage basis, marketing season 1935-36 considered base year, equals 100 percent.

TABLE 7

Farmers' Marketing and Purchasing AssociationsIndex of Business Compared WithWholesale Price Index

| <u>Season</u> | <u>Cooperative Associations Percent of 1935-36*</u> | <u>Wholesale Price Index Percent of 1935*</u> |
|---------------|---|---|
| 1935-36 | 100 | 100 |
| 1936-37 | 119 | 101 |
| 1937-38 | 130 | 108 |
| 1938-39 | 114 | 98 |
| 1939-40 | 114 | 96 |
| 1940-41 | 124 | 98 |
| 1941-42 | 154 | 109 |
| 1942-43 | 206 | 123 |
| 1943-44 | 281 | 129 |
| 1944-45 | 306 | 130 |
| 1945-46 | 330 | 132 |
| 1946-47 | 387 | 151 |
| 1947-48 | 469 | 190 |
| 1948-49 | 506 | 206 |

*Calendar year 1935 considered comparable to marketing season 1935-36 for purposes of this table. The same relationship is maintained for later years.

Source: Cooperative Associations Percent from Table 6. Wholesale Price Index adapted from index of wholesale prices, all commodities, Federal Reserve Bulletin, June, 1950, p. 733.

TABLE 6

Farmers' Marketing Associations
Index of Business Compared With
Prices Received by Farmers

| <u>Season</u> | <u>Marketing Associations Percent of 1935-36*</u> | <u>Prices Received by Farmers Percent of 1935*</u> |
|---------------|---|--|
| 1935-36 | 100 | 100 |
| 1936-37 | 119 | 104 |
| 1937-38 | 129 | 112 |
| 1938-39 | 111 | 89 |
| 1939-40 | 109 | 87 |
| 1940-41 | 120 | 92 |
| 1941-42 | 149 | 114 |
| 1942-43 | 200 | 146 |
| 1943-44 | 279 | 176 |
| 1944-45 | 305 | 179 |
| 1945-46 | 324 | 185 |
| 1946-47 | 379 | 214 |
| 1947-48 | 454 | 255 |
| 1948-49 | 485 | 263 |

*Calendar year 1935 considered comparable to marketing season 1935-36 for purposes of this table. The same relationship is maintained for later years.

Sources: Marketing Associations Percent from Table 6. Index of Prices Received by Farmers from U. S. Department of Agriculture, Agricultural Statistics, 1949, p. 621.

TABLE 9

Farmers' Purchasing Associations
Index of Business Compared With
Prices Paid by Farmers

| <u>Season</u> | <u>Purchasing Associations Percent of 1935-36*</u> | <u>Prices Paid by Farmers Percent of 1935*</u> |
|---------------|--|--|
| 1935-36 | 100 | 100 |
| 1936-37 | 123 | 99 |
| 1937-38 | 138 | 109 |
| 1938-39 | 132 | 100 |
| 1939-40 | 141 | 98 |
| 1940-41 | 145 | 99 |
| 1941-42 | 189 | 105 |
| 1942-43 | 236 | 119 |
| 1943-44 | 288 | 130 |
| 1944-45 | 319 | 138 |
| 1945-46 | 363 | 139 |
| 1946-47 | 437 | 154 |
| 1947-48 | 567 | 187 |
| 1948-49 | 638 | 204 |

*Calendar year 1935 considered comparable to marketing season 1935-36 for purposes of this table. The same relationship is maintained for later years.

Sources: Purchasing Associations Percent from Table 6. Index of Prices Paid by Farmers from U. S. Department of Agriculture, Agricultural Statistics, 1949, p. 622.

Cooperatives In Oregon

The earliest organizations in Oregon that apparently were the forerunners of cooperatively operated business activities were the Agricultural Societies, begun as early as 1853. These resulted more in the holding of fairs and farm exhibitions than in actual business activities.¹

Probably the first cooperative business was at Fairfield, in Marion County, in 1870, but there seems to be no record of its existence other than its filing at the county courthouse.² By 1872, Farmers' Clubs were being organized, with some limited activity in marketing grain, mainly to combat discriminating freight charges.³ These were absorbed by the Granger movement in 1874.

The first Grange in Oregon was organized in 1872, with the state Grange being established in 1873.⁴ The Grange set up a central agency in Portland in December, 1873, and began conducting business in 1874.⁵ By 1879 this had failed, through internal and organizational strife.⁶ The local Granges were also attempting the formation of associations,

¹Edna A. Scott, The Grange Movement in Oregon, 1873-1900 (Eugene: University of Oregon Thesis, June 1, 1923), p. 3.

²Iver W. Masterson, A History of the Consumers' Co-operatives in Oregon Prior to 1900 (Eugene: University of Oregon Thesis, June, 1938), p. 6.

³Scott, op. cit., p. 5.

⁴Masterson, op. cit., p. 5.

⁵Ibid., p. 8.

⁶Ibid., pp. 14-15.

but the more prosperous of these did not start until after the State enterprise had failed.¹ The Grange organization continued on into this century, and Oregon is still a stronghold of the national Grange organization.²

Although there was a lapse of general activity in the organizing of cooperatives after the failure, in the main, of the Grange efforts, the present cooperative movement in Oregon is represented mainly by farm groups. This includes both purchasing and marketing associations. Some of the larger marketing associations have a long and prosperous record of service for their members. In the marketing of fruits and dairy products, particularly, there are several cooperative organizations that had their beginnings prior to World War I. For example, the Eugene Fruit Growers Association was organized in 1907;³ the Tillamook County Creamery Association in 1909;⁴ the Mount Angel Cooperative Creamery in 1912;⁵ and the Apple Growers Association of Hood River in 1913.⁶ Other marketing associations, in these and other fields of

¹Ibid., p. 16.

²Scott, op. cit., p. 15.

³John H. Lister, Cooperative Purchasing of Farm Supplies in Oregon-1933 (Washington: Government Printing Office, 1935), p. 4.

⁴The Story of Tillamook Cheese (Tillamook: Tillamook County Creamery Association, undated), p. 2.

⁵Sister Joeine Darrington, The Mt. Angel Cooperative Creamery (Eugene: University of Oregon thesis, 1941), pp. 11-12.

⁶Lister, op. cit., p. 7.

agriculture, were begun in the 1920s. Main products marketed included poultry, berries, nuts, cherries, and grains.

Except as branch departments in some of the above indicated marketing associations, cooperative purchasing of supplies by farm groups now in operation did not have its beginnings quite so early. The Farmers Union Cooperative Warehouse at Dallas was organized in 1916.¹ Others, in Eugene, Hermiston, Roseburg, and Junction City, began operations in the years 1920 to 1924,² mostly under the sponsorship of the established farm organizations of the Farmers' Union and the Farm Bureau. The associations for the purchasing of oil cooperatively for their members were being first organized in the early 1930s.³ The organization in 1934 of the Pacific Supply Cooperative,⁴ headquarters at Walla Walla, Washington, and serving as a wholesale firm for local cooperatives engaged in purchasing for members, has aided materially the development of cooperative activity, mainly among farm groups, in Oregon and the entire Pacific Northwest.

Estimating the proportion of the total business in Oregon that is being done through cooperative organizations is rather difficult, due to the lack of adequate and comparable data for both cooperative and non-cooperative businesses. Table 10 gives the latest available figures for business as a whole in Oregon.

¹Ibid., p. 6.

²Ibid., pp. 7-8.

³Ibid., p. 6.

⁴Ibid., p. 3.

TABLE 10

1948 Census of Business in Oregon
Business and Number of Establishments

| | <u>Number of Establishments</u> | <u>1948 Sales and Receipts (\$1000)</u> |
|---|-------------------------------------|---|
| Retail trade, total | 17,471 | \$1,590,621 |
| Food group | 3,874 | 359,979 |
| Eating and Drinking places | 3,685 | 114,165 |
| General Merchandise group | 748 | 231,053 |
| Apparel Group | 882 | 71,408 |
| Furniture-home furnishings-appliance group | 840 | 78,151 |
| Automotive group | 1,019 | 281,096 |
| Gasoline Service stations | 2,409 | 90,292 |
| Lumber-building-hardware group | 1,225 | 150,824 |
| Drug and Proprietary stores | 540 | 38,818 |
| All other retail stores | 2,249 | 174,835 |
| Wholesale trade, total | 2,544 | 1,886,737 |
| Merchant wholesalers, total | 1,483 | 954,371 |
| Groceries, confectionery, meat | 143 | 112,064 |
| Farm products, edible | 118 | 78,003 |
| Tobacco | 37 | 26,149 |
| Furniture, home furnishing | 21 | 11,597 |
| Automotive supplies | 205 | 45,551 |
| Electrical merchandise | 61 | 66,662 |
| Hardware, plumbing, heating | 67 | 57,720 |
| Lumber, construction materials | 143 | 197,862 |
| Machinery, equipment, industrial supplies | 330 | 129,510 |
| All other merchant wholesalers | 358 | 229,233 |
| Manufactures sales branches, offices | 223 | 367,671 |
| Petroleum bulk plants, terminals | 435 | 168,101 |
| Agents, brokers (merchandise) | 227 | 252,200 |
| Assemblers of farm products | 176 | 144,394 |
| Selected service trades, total | 5,586 | 94,547 |
| Personal services | 3,164 | 43,283 |
| Business services | 312 | 13,210 |
| Automotive repairs & services | 1,339 | 25,235 |
| Other repairs & services | 1,041 | 12,819 |
| Hotels | 462 | 19,667 |
| Tourist courts and camps | 1,189 | 7,039 |
| Amusements | 533 | 21,988 |

Source: 1948 Census of Business in Oregon (Retail, Wholesale, and Service)
cited in Oregon Business Review, Vol. IX (July, 1950).

Comparable figures for the business of cooperatives during the same year of 1948 are difficult to obtain. The estimates of the Farm Credit Administration for the marketing period 1948-49 are probably somewhat comparable as to source data. This estimate of the total marketing and purchasing operations of farmer cooperatives in Oregon totals \$155,370,000, of which \$20,500,000 is the estimate for purchasing cooperatives, the balance for cooperative organizations whose main activity is marketing. (see Table 11)

Mr. Paul Carpenter, Secretary of the Agricultural Co-operative Council of Oregon, stated in that group's latest meeting that ". . . . 224 agricultural co-operatives handle a gross business of approximately \$115,000,000." in Oregon.¹ The more than fifty members of the Agricultural Co-operative Council of Oregon account for about eighty per cent of the total business being done by cooperatives in Oregon.²

A questionnaire sent to the business cooperatives in Oregon included a request for data as to the gross annual business transacted by each organization. Not all of the businesses replied to the request, but enough replies were received to provide a quantity of usable data. This data has been supplemented from several sources. Current newspaper information has revealed business data for many additional cooperatives. The author's personal knowledge of the scope of numerous other farm co-

¹"Republican Gains Declared No Menace to Farm Co-ops," Oregonian, (November 10, 1950), p. 9.

²Paul Carpenter, Extension Economist, Oregon State College, Interview, December 28, 1949.

TABLE 11

Farmers' Marketing and Purchasing Associations in Oregon
Estimated Membership and Estimated Business
Marketing Seasons 1935-36 through 1948-49

| <u>Season</u> | <u>Marketing Associations</u> | | <u>Purchasing Associations</u> | | <u>Total</u> | |
|---------------|-------------------------------|-----------------|--------------------------------|-----------------|-------------------|-----------------|
| | <u>Membership</u> | <u>Business</u> | <u>Membership</u> | <u>Business</u> | <u>Membership</u> | <u>Business</u> |
| 1935-36 | 31,230 | \$22,940,000 | 8,500 | \$1,670,000 | 39,730 | \$24,610,000 |
| 1936-37 | * | * | * | * | * | * |
| 1937-38 | 30,400 | 40,400,000 | 11,000 | 3,400,000 | 41,400 | 43,800,000 |
| 1938-39 | 27,780 | 36,260,000 | 10,800 | 3,100,000 | 38,580 | 39,360,000 |
| 1939-40 | 29,700 | 32,660,000 | 11,000 | 3,800,000 | 39,700 | 36,460,000 |
| 1940-41 | 29,990 | 41,815,000 | 12,500 | 3,520,000 | 42,490 | 45,335,000 |
| 1941-42 | 34,500 | 52,295,000 | 14,000 | 4,450,000 | 48,500 | 56,745,000 |
| 1942-43 | 33,500 | 64,600,000 | 16,000 | 5,300,000 | 49,500 | 69,900,000 |
| 1943-44 | 34,400 | 98,540,000 | 17,500 | 6,700,000 | 51,900 | 105,240,000 |
| 1944-45 | 37,600 | 91,260,000 | 19,000 | 9,000,000 | 56,600 | 100,260,000 |
| 1945-46 | 40,800 | 101,600,000 | 23,100 | 10,700,000 | 63,900 | 112,300,000 |
| 1946-47 | 41,900 | 127,650,000 | 27,400 | 13,800,000 | 69,300 | 141,450,000 |
| 1947-48 | 42,000 | 128,540,000 | 40,000 | 17,000,000 | 82,000 | 145,540,000 |
| 1948-49 | 41,760 | 134,870,000 | 42,600 | 20,500,000 | 84,360 | 155,370,000 |

*Data for 1936-37 not published by Farm Credit Administration for Oregon.

Source: Statistics of Farmers' Marketing and Purchasing Associations, Farm Credit Administration Miscellaneous Reports, 1937 to 1950. Data for 1948-49 obtained by direct correspondence with Farm Credit Administration.

operatives assisted in filling many gaps in the consolidation of information. A complete summary of the data of the business done by all cooperatives in Oregon for the year 1949 (including a few organizations whose fiscal year ended in 1950) shows the amount to be \$192,300,000. This total includes both marketing and purchasing cooperatives and includes a few whose activities are not primarily for farm groups.

A summary of the growth of the business of farmer cooperatives in Oregon during recent years can be seen in Table 11. The difference between the figures shown and those of the author's survey can be accounted for by the use of a slightly different base, plus the inclusion of some cooperatives in the survey that may not be included in the estimates of the Farm Credit Administration's Statistician. The growth in dollar amount of business noted in Table 11 is considerable. Since the general price index has also risen, Tables 12 and 13 analyze the dollar volume of business in the light of the farmers' price indexes. It is assumed that the Oregon price index curves follow the trend generally of the national price trends.

It is interesting to note the trend of cooperative business in Oregon as compared with the trend nationally. The percentages for Oregon in Tables 12 and 13, as checked for the same years in Table 6 for cooperative business on a national scale, show a much larger gain in Oregon. Part of this larger increase in Oregon would be because of the greater rate of increase in population in Oregon than was the case in the country as a whole. Without the figures available for the annual

TABLE 12

Farmers' Marketing Associations in Oregon
Change in Amount of Annual Business
Compared With Prices Received by Farmers

| <u>Marketing Associations</u> | | <u>Prices Received by Farmers</u> | |
|-------------------------------|-------------------------------|-----------------------------------|----------------------------|
| <u>Season</u> | <u>Percent of 1935-36</u> | <u>Year</u> | <u>Percent of 1935</u> |
| 1935-36 | 100 | 1935 | 100 |
| 1936-37 | * | 1936 | 104 |
| 1937-38 | 176 | 1937 | 112 |
| 1938-39 | 158 | 1938 | 89 |
| 1939-40 | 142 | 1939 | 87 |
| 1940-41 | 182 | 1940 | 92 |
| 1941-42 | 228 | 1941 | 114 |
| 1942-43 | 282 | 1942 | 146 |
| 1943-44 | 430 | 1943 | 176 |
| 1944-45 | 398 | 1944 | 179 |
| 1945-46 | 433 | 1945 | 185 |
| 1946-47 | 557 | 1946 | 214 |
| 1947-48 | 561 | 1947 | 255 |
| 1948-49 | 588 | 1948 | 263 |

*Data for 1936-37 not published by Farm Credit Administration.

Sources: Marketing Association percentages determined by comparing later seasons with base year, 1935-36, as per data in Table 11. Percentages of Prices Received by Farmers adapted from index numbers of prices received by farmers, U. S. Department of Agriculture, Agricultural Statistics, 1949, p. 621.

TABLE 13

Farmers' Purchasing Associations in OregonChange in Amount of Annual BusinessCompared With Prices Paid by Farmers

| <u>Purchasing Associations</u> | | <u>Prices Paid by Farmers</u> | |
|--------------------------------|-------------------------------|-------------------------------|----------------------------|
| <u>Season</u> | <u>Percent of 1935-36</u> | <u>Year</u> | <u>Percent of 1935</u> |
| 1935-36 | 100 | 1935 | 100 |
| 1936-37 | * | 1936 | 99 |
| 1937-38 | 204 | 1937 | 109 |
| 1938-39 | 186 | 1938 | 100 |
| 1939-40 | 228 | 1939 | 98 |
| 1940-41 | 211 | 1940 | 99 |
| 1941-42 | 267 | 1941 | 105 |
| 1942-43 | 317 | 1942 | 119 |
| 1943-44 | 401 | 1943 | 130 |
| 1944-45 | 539 | 1944 | 153 |
| 1945-46 | 641 | 1945 | 179 |
| 1946-47 | 826 | 1946 | 154 |
| 1947-48 | 1018 | 1947 | 187 |
| 1948-49 | 1228 | 1948 | 204 |

*Data for 1936-37 not published by Farm Credit Administration.

Sources: Purchasing Association percentages determined by comparing later seasons with base year, 1935-36, as per data in Table 11.

Percentages of Prices Paid by Farmers adapted from Index numbers of prices paid by farmers, U. S. Department of Agriculture, Agricultural Statistics, 1949, p. 622.

changes in population for Oregon during the years covered, the effect of this element cannot be judged.

CHAPTER II

PRESENT TAX STATUS OF COOPERATIVES, OTHER THAN UNDER FEDERAL INCOME TAX LAWS

Businesses in Oregon are subject to many of the taxes to be found in the various states and communities of the nation. Since the Federal Income Tax is subject to much current controversy, it will be treated separately in Chapter IV of this paper. In this chapter, many of the various other taxes to which businesses are subject will be discussed. They are divided into three groups, for convenience: namely, Sundry Taxes-Federal; Sundry Taxes-State; and State Excise (Income) Tax.

Sundry Federal Taxes

The status of cooperative associations relative to Federal taxes other than the income tax depends upon its status under the income tax laws. Unless an agricultural cooperative marketing or purchasing association is exempt from the payment of Federal income taxes, it is subject to the payment of all other Federal taxes to the same extent and on the same basis as other business corporations.¹ Non-agricultural cooperatives are by law not exempt from Federal income taxes and thus would

¹L. S. Hulbert, Agricultural Cooperatives and Federal Income Taxes, (Washington: Farm Credit Administration Miscellaneous Report No. 44, November, 1941), p. 1.

be subject to all other Federal taxes applying to business corporations.

If a cooperative association is exempt from the payment of Federal income taxes, it is also exempt from payment of excess profits taxes, capital stock taxes, documentary stamp taxes on the issue and transfer of stocks, bonds, certificates of indebtedness and other securities, and also to a limited extent from the payment of social security taxes.¹

The Internal Revenue Code states relative to the Excess Profits Taxes that there shall be exempted "Corporations exempt under section 101." Identical wordings appear in this regard for the wartime Excess Profits Tax, repealed as of 1946,² and the new Excess Profits Tax, effective after June 30, 1950.³ Cooperative associations exempt from the Corporation Income Tax under section 101 of the Internal Revenue Code (see Appendix) will also be exempt under the Excess Profits Taxes. It is presumed that in the case of non-exempt corporations, rulings permitting the exclusion of patronage refunds from taxable income will also be applicable.

The Federal Capital Stock Tax was repealed as of June 30, 1946. This tax carried the same provision as the Excess Profits tax for exemption of "any corporation enumerated in section 101."⁴

¹Ibid., p. 1.

²Internal Revenue Code (Chicago: Commerce Clearing House, Inc., 1946-50), p. 1654.

³Ibid., p. 952.

⁴Ibid., p. 2611.

Under the portion of the Code relating to taxation of the issue and transfer of capital stock and other securities, the exemptions enumerated include "Stocks and bonds and other certificates of indebtedness issued by any farmers' or fruit growers' or like associations organized and operated on a cooperative basis for the purposes, and subject to the conditions, prescribed in paragraph (12) of section 104."¹

The various so-called Social Security taxes are now applicable to nearly all types of business employment. There are two main employment taxes, under the Federal Insurance Contributions Act, and under the Federal Unemployment Tax Act. The bases for exemptions are different under the two acts, with exemptions for agricultural labor being the major one under consideration here, since that exemption would be the one most likely to concern the bulk of the cooperative associations in Oregon.

Under both the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) those cooperatives exempt from federal income tax are here also exempted on wages of \$50.00 or less per quarter (\$45.00 per quarter prior to January 1, 1951).²

The definition of employment, for the purposes of FICA, prior to 1951 was stated not to include agricultural labor.³ In turn, the

¹Ibid., p. 3111.

²Creed V. Brattain, Head, Wage and Excise Tax Division, Portland, Oregon, Office of the Collector of Internal Revenue, correspondence with author, April 18, 1951.

³Internal Revenue Code, op. cit., p. 2811.

definition of agricultural labor included all service performed ". . . . In the employ of a group of operators of farms (other than a cooperative organization). . . ." in packing, handling, processing, etc., farm products.¹ Since the cooperative organizations were specifically not included in the agricultural exemption, it follows that such cooperatives were generally subject to FICA taxes. If employees of cooperative associations were performing services that would have been customary in handling farm products, the same as the individual farmer would have performed, the employees' wages would be exempt in the same manner as if the work had been performed for the individual owners of the farm.²

The revision of the FICA provisions which became effective January 1, 1951, eliminated the former general exemption for agricultural labor, and these wages are now subject to tax the same as wages paid by commercial employers.³

In order for cooperative associations to be classed as "agricultural labor" under FUTA, the work of the employees must be of the same kind as the individual members would have to perform in the marketing of their farm grown products. Services performed must be incidental to ordinary farming operations, a pre-requisite to marketing the agricultural or horticultural product in the unmanufactured state. A coopera-

¹Ibid., p. 2815-3.

²Creed V. Brattain, op. cit.

³Ibid.

tive (or any commercial handler of such commodities) that can meet the qualifications of agricultural labor is not subject to FUTA. It is to be noted that the exemption is for the nature of the employment, not the form of business operation.¹ However, most of the cooperatives in Oregon are of an agricultural nature; hence some of them may qualify for consideration under this exemption provision.

The numerous other Federal taxes do not seem to provide for any exemptions that would apply to cooperative associations in any different way than another form of business organization engaged in the same type of business. Some exemptions are noted in several of the excise taxes, but any such exemptions are related to the type of product, not to the type of organization producing or handling the product or taxable item.

Sundry State Taxes

The primary tax exemption granted by the State of Oregon relative to cooperatives is that of the State Excise, or Income, Tax. That tax will be considered in a later section of this chapter. In this section, other state and local taxes that have any application to general business will be observed as to their relation to cooperative organizations. The taxes to be discussed here include real and personal property, motor

¹U. S. Treasury Department, Bureau of Internal Revenue, Employer's Tax Handbook, Circular E, Revised January, 1951, p. 6.

vehicle license, motor vehicle carriers, individuals' withholding, unemployment, corporation fees, gasoline, timber severance, and personal income tax.

Property exempt from taxation, according to the Oregon Compiled Laws, includes generally the property of the United States and its agencies, of the State of Oregon, counties, cities, other minor civil subdivisions and public or municipal corporations, of literary, benevolent, charitable and scientific institutions, of houses of public worship, of public libraries, of burial places, of Indians on reservations, and of household furniture.¹ The only exemption accorded specifically to any sort of cooperative association is found in paragraph 110-202 of Oregon Compiled Laws. This paragraph follows:

All real and personal property consisting of improvements, fixtures, equipment or supplies, owned by any association of persons, wholly mutual or cooperative in character, whether incorporated or unincorporated, used exclusively in storing, conveying and distributing water to the members of such association for domestic use or irrigation, where such association has no other business or purpose and its operations are conducted without profit in money, shall be exempt from taxation; provided, however, that this exemption shall not include nor apply to any parcel of land owned by any such association, which land shall be assessed and apportioned by the state tax commission in accordance with existing law.²

There is no apparent provision for exemption of cooperative assoc-

¹"Revenue and Taxation Code," portion of Oregon Compiled Laws Annotated, 1944-1947 Secondary Pocket Part for Volume 7 (Portland: Binford & Mort, 1947), pp. 161-162.

²"Revenue and Taxation Code," portion of Oregon Compiled Laws Annotated, Vol. VII (Portland: Binford & Mort, 1940), p. 1092.

iations in general, and it appears that there can be no exemptions construed under the portions of the law stating the coverage of property to be taxed. In paragraphs 110-308 through 110-312 of the Oregon Compiled Laws are provisions for assessment of personal property of individuals, partnerships, and corporations. Also, merchandise for sale, and capital and machinery for use, are taxable, either to the owners or to the person or corporation who shall have charge of or possess the same.¹

That cooperative associations are subject to, and do pay, real and personal property taxes can be seen by the data in Tables 14 and 15.

One provision for partial exemption of merchandise being marketed on a pool basis should be noted here. The basis for tax assessment is generally the value of the inventory as of January 1. A marketing association is permitted to file on April 15 a statement of the amount of pool merchandise marketed between January 1 and April 15, the amount so marketed being deducted from the taxable inventory. The merchandise marketed during this period is thus exempt from taxation, since the purchaser of the merchandise is taxed on the basis of his January 1 inventory figure. The remainder of the merchandise in the hands of the cooperative marketing association at April 15 of each year is taxed on the same basis as that of any other type of business

¹Ibid., pp. 1098-1100.

TABLE 14

Top Taxpayers of Umatilla County, Oregon, 1948

| <u>Rank</u> | <u>Firm</u> | <u>Amount</u> |
|-------------|-------------------------------|---------------|
| 1. | Union Pacific Railroad | \$255,869 |
| 2. | Pacific Power & Light | 59,843 |
| 3. | Pacific Telephone & Telegraph | 40,840 |
| 4. | Hoke & Cameron | 19,014 |
| 5. | Northern Pacific Railroad | 15,424 |
| 6. | PENDLETON GRAIN GROWERS | 14,995 |
| 7. | Ingleheart Brothers | 14,209 |
| 8. | Rogers Canning Company | 13,200 |
| 9. | Smith Canning Company | 10,975 |
| 10. | Harris Pine Mills | 10,553 |

Source: Special tabulation for the businessmen of Pendleton, Oregon, cited in Pacific Northwest Cooperator, XIV (May, 1949), p. 9.

TABLE 15

Taxes Paid by Pacific Supply Cooperative
During Fiscal Year Ended June 30, 1950

| <u>Type of Tax</u> | <u>Amount</u> |
|---|-----------------|
| Property (local) | \$51,090.59 |
| State Road tax and truck license fees | 52,503.80 |
| Payroll (State and Federal) company payments only | 23,888.29 |
| Business (Washington and California) | <u>4,502.78</u> |
| Total | \$131,985.46 |

Source: Pacific Northwest Cooperator, XVI (January, 1951), p. 11.

organization. Land, buildings, and equipment are taxed to cooperative associations on the same basis as any other type of business.¹

The exemptions to laws requiring the annual purchase of motor vehicle licenses have no connection with the type of business a firm, or individual, may be operating. The exemptions relative to payment of such licenses are specified as being for vehicles owned by the Federal government, by the State, or other political subdivision, or vehicles not used on the highways. The only apparent partial exemption is that of a rate of one-half of the regular annual license fee for trucks or trailers used exclusively in connection with the truck owner's farm. An opinion of the Attorney General states that "Special seasonal licenses may be issued to individuals only and not to corporations or associations."²

The laws requiring the payment of tax for the use of vehicles, such as trucks and buses, as common carriers, require the securing of special identification plates plus the regular paying of fees. The exemptions under this tax include, among others, vehicles operated by farmers and orchardists. As amended in 1949, the law indicates that "the meaning of the words 'farmer' and 'orchardist' shall not be construed to include associations organized under the provisions of

¹George A. Stock, Lane County Assessor, Interview, April 9, 1951.

²Oregon Tax Reporter (Chicago: Commerce Clearing House, Inc., 1946-1951), p. 5021.

chapter 5, title 77, O. C. L. A."¹ This section contains the laws of cooperative associations. Prior to the amendment in 1949, the Attorney General's opinion was that a cooperative association was entitled to the same exemption as its individual members.

Under the provisions for personal income tax, payable by individuals, a general procedure of withholding of one percent of gross wages paid is required of every employer. Exemptions from this law are quite narrowly construed. It would appear that all cooperatives are subject to the laws requiring withholding of income tax from their employees. Effective May 31, 1949, provision was made to allow employees whose services were entirely on a part-time basis, and in connection with the handling of seasonal crops, to be not subject to the withholding requirements. This partial exemption is not intended to cover all agricultural labor. Before the 1949 amendment, the withholding tax law applied to such casual labor as foreign agricultural workers in the State only for the harvesting season. Employers of permanent agricultural labor are subject to the provisions of the law, and no provisions are noted for excluding cooperative associations as employers in this regard.²

A special bulletin of the State Tax Commission, explaining portions of the 1949 amendment, in connection with the present agricultural labor exemption, states:

¹Ibid., p. 5121.

²Ibid., p. 2040.

Sorting, grading, drying, freezing, or any other further handling of a crop after it has left the field, is normally considered to be "processing." WITHHOLDING IS REQUIRED on wages paid employes engaged in performing this type of work unless such work is on a minor scale and is accomplished on the grower's own property.¹

In the general instructions relative to the withholding tax on wages, the definition of employers states that the term ". . . . includes religious, educational, charitable, and social organizations or societies, even though such organizations are themselves exempt from payment of taxes."²

The definitions and rulings seem to indicate coverage of cooperative organizations, whether exempt or not from any other taxes. The withholding tax law requires no payment of tax by the business for itself; hence any tax paid to the commission would be amounts previously deducted from wages paid to employees.

The Oregon Unemployment Compensation Law includes exemptions for some cooperative organizations but as a portion of the general exclusion from the definition of employment of agricultural labor. The restrictions applying to the type of cooperative included in the exemption can best be seen by stating the portion of the Unemployment Law that applies. The related portions include:

¹Bulletin W-59 (a) (Salem: State Tax Commission, April 25, 1950), p. 1, (Mimeographed).

²Oregon 1% Withholding Tax on Wages, Instructions to Employers, (Salem: State Tax Commission, 1949), p. 1.

The term "employment" shall not include: 1. Agricultural Labor. On and after January 1, 1941, the term "agricultural labor" includes all services performed: (e) In the employ of any farmers' cooperative association, organized under the laws of the State of Oregon and operated for the mutual benefit of its members; provided, that such association does not sell its commodities for nonmembers in any amount greater in value than such as are sold for its members, or does not sell its commodities to nonmembers in any amount greater in value than such as are sold to its members, and all earnings are apportioned as dividends in accordance with the amount of business transacted by each such member through the association.¹

Thus, cooperative associations classified as agricultural, whose business is primarily done with members, and whose earnings are all distributed on a patronage basis, are excluded from the definition of employment subject to the state unemployment law.

The corporation laws of Oregon provide definite schedules of fees to be paid in the procedures of incorporating and in the renewing of the annual license. The comparisons of these fees with respect to corporations for profit and to cooperative associations can be seen in the accompanying Tables 16 and 17. Table 16 gives the scale of rates for profit corporations, which figures should be contrasted to the flat fee of \$10.00 required of cooperative associations for filing their organization papers. Cooperative associations are subject to the specific annual license fees prescribed for them by law. As will be noted in Table 17, the fees required of cooperative associations are exactly one-half the amounts required of profit corporations.

¹Unemployment Compensation Law (Salem: State Unemployment Compensation Commission, 1947), pp. 6-7.

TABLE 16

State of OregonOrganization Fees for Domestic Corporations

| <u>Authorized Capital Stock</u> | <u>Organization Fee Rate</u> | |
|--|------------------------------|--------------------|
| | <u>Profit</u> | <u>Non-Profit*</u> |
| Not to exceed \$5,000 | \$10 | \$10 |
| Exceed \$5,000 but not to exceed \$10,000 | 15 | 10 |
| 10,000 25,000 | 20 | 10 |
| 25,000 50,000 | 25 | 10 |
| 50,000 100,000 | 35 | 10 |
| 100,000 250,000 | 45 | 10 |
| 250,000 500,000 | 60 | 10 |
| 500,000 1,000,000 | 75 | 10 |
| Exceed \$1,000,000, each additional \$1,000,000 or fraction thereof | 75 | - |

*Cooperative associations are subject to a flat fee of \$10.00, no matter what the amount of authorized stock.

Source: Oregon Corporation Laws, compiled by Maurice Hudson, Corporation Commissioner, par. 77-205.

TABLE 17

State of OregonAnnual License FeesDomestic Corporations

| <u>Authorized Capital Stock</u> | <u>Type of Corporation</u> | |
|---|----------------------------|-------------------|
| | <u>Profit</u> | <u>Non-Profit</u> |
| Not to exceed \$5,000 | \$10.00 | \$5.00 |
| Exceed \$5,000 but not to exceed \$10,000 | 15.00 | 7.50 |
| 10,000 25,000 | 20.00 | 10.00 |
| 25,000 50,000 | 30.00 | 15.00 |
| 50,000 100,000 | 50.00 | 25.00 |
| 100,000 250,000 | 70.00 | 35.00 |
| 250,000 500,000 | 100.00 | 50.00 |
| 500,000 1,000,000 | 125.00 | 62.50 |
| 1,000,000 2,000,000 | 175.00 | 87.50 |
| Exceed \$2,000,000 | 200.00 | 100.00 |

Note: No-par stock, for the purposes of computing the basis for annual license fees only, shall be considered as valued at \$10.00 per share, for Profit Corporations.

Sources: Oregon Corporation Laws, compiled by Maurice Hudson, Corporation Commissioner, par. 77-243 and 77-519.

Observing the Oregon laws relative to the gasoline tax, it appears that cooperative associations are subject to all regulations that are applicable to distributors of motor vehicle fuel. Pertinent excerpts include the statements that follow:

Every dealer in motor vehicle fuel in the state of Oregon. . . . shall make an application to the secretary of state for a license authorizing such dealer or person to engage in the business as a dealer. . . . the secretary of state must require such dealer to file. . . . a bond duly executed. . . . which bond shall be payable to the state of Oregon conditioned upon faithful performance of all the requirements of this act, including the payment of all taxes, penalties and other obligations of such dealer. . . .¹

Exemptions to the tax are specified as being in two groups only, for export and for governmental official use.²

Refunds are allowable for the usage, not for the type of organization using the fuel. Essentially, the usage for which refund of tax is provided is for non-highway use, for individuals and corporations, with some specific users, primarily of minor governmental subdivisions, also allowed refund on the tax paid.³ Presumably, any cooperative association whose use of motor vehicle fuel happened to be for non-highway use, or other use for which refund is permitted, would be entitled to the allowable refund, but cooperative associations would be in no different position than any other corporation or individual in the state.

¹Oregon Compiled Laws Annotated, op. cit., p. 1356.

²Ibid., pp. 1363-1364.

³Ibid., pp. 1365-9.

Each person engaged in the business of harvesting timber or other forest products is subject to the Timber Severance tax. The only provision for exemption is a quantitative one, exempting each taxpayer on the first 25,000 board feet harvested each fiscal year.¹ Any corporation engaged in the harvesting of timber products would presumably be subject to the tax and entitled to the quantitative exemption provided.

The discussion of the tax status of cooperatives would not be complete without consideration of the effect upon the taxes of the individuals who are members of the cooperatives.

In general, patronage refunds made to patrons of purchasing cooperatives are not taxable if the refunds pertain to purchases made for household use but would be taxable (as a reduction of the original expense payment) if pertaining to purchases which were deductible as business expenses. All patronage refunds made to patrons of marketing cooperatives are additions to the price received by the patrons for their commodities and would be added to the gross income for products marketed.

The Oregon personal income tax conforms to the general concept of the above. Provision is made, however, for the reporting to the State Tax Commission of patronage refunds made, either by cash or by other distribution, to patrons by cooperative associations. Forms 99-CA and 96-CA (see Appendix D) are required to be filed with respect to any

¹Oregon Tax Reporter, op. cit., p. 4513.

patron receiving a distribution of at least \$100 during a calendar year. These forms correspond in scope to State Forms 99 and 96 (see Appendix D) required for dividend and other payments by other forms of business operation. Using the very realistic approach that small items of payment require more official clerical work than would pay in the receipt of tax money therefrom, none of the above-mentioned forms are required to be furnished if the payments made are less than \$100 during the calendar year under consideration.

A typical form for notification of patrons of allocations made is seen in Appendix J. Presumably a copy of Form 99-CA would give much of the same financial information, if prepared. The Statement of Allocations illustrated gives a much better opportunity for explanation of association procedures to the patrons, however.

It is to be expected that the Tax Commission's use of filed Forms 99-CA would be in the nature of checking tax returns, such as would be done in connection with the filing of Form 99 with respect to payments by businesses other than cooperative associations.

State Excise (Income) Tax

The Oregon Excise Tax of 1929, as adopted, includes as the scope of the law the following:

The statute imposes an excise tax measured by net income on every banking association, bank and financial institution located within the limits of this state, and every mercantile, manufacturing and business corporation doing business

within this state, except certain corporations which are specifically exempted.¹

Although termed an "Excise Tax", the statute actually provides for a tax on income, as indicated in the above passage, and as included in the definitions of the law, Sec. 110-1502, paragraph (e):

The term "excise tax", as herein used, means a tax measured by or according to net income imposed upon national banking associations, all other banks, and financial, mercantile, manufacturing and business corporations for the privilege of carrying on or doing business in this state.²

The excise tax on business corporation incomes corresponds in many ways to its federal income tax law counterpart. Part VIII of the law, concerning Corporations Exempt From Tax, is very similar to the related portion of the federal Internal Revenue Code (Section 101(12)-- see Appendix A). The main portion of the law being considered in this study, Sec. 110-1511 (1) 1., follows:

Farmers' and fruit growers' associations, organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other producers and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the state of incorporation or eight (8) per cent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than non-voting preferred stock,

¹Corporation Excise Tax Law and Regulations (Salem: State Tax Commission, 1946), p. 3.

²Ibid., p. 4.

the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; nor shall exemption 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. Such an association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed fifteen (15) per cent of the value of all its purchases.¹

In Art. 511-i-1 of the Regulations (see Appendix C), clarification of the above section of the law reveals several requirements for the fulfilling of the exemption status of cooperatives. Proceeds of the marketing business must be proportionate, that is, nonmembers must be treated the same as members. It is necessary to keep permanent records of business with members and nonmembers, to show that the association was operating during the year on a cooperative basis in the distribution of patronage dividends to all producers. Although under the law patronage dividends must be paid to producers, this requirement is met if permanent records showing proportionate shares of patronage dividends due to nonmember producers are kept, and such shares are made applicable toward the purchase price of a share of stock or of a membership in the association.²

¹Ibid., pp. 58-59.

²Ibid., p. 62.

The regulations and specifications regarding producers or non-producers are elaborated upon, and the restrictions indicated in the law as to proportions of producers and nonproducers, members and non-members, are closely adhered to.¹

Cooperative associations engaged in the purchasing of supplies and equipment for farmer members are subject to much the same limitations as marketing cooperative associations in order to qualify for exemption. Supplies and equipment are stated to include groceries and all other goods and merchandise used in operation and maintenance of a farm or farmer's household. An additional restriction not placed on the marketing associations is found here, in which purchases made for nonmembers who are not producers must not exceed 15 per cent of the value of all its purchases.²

Both marketing and purchasing cooperative associations must establish that they have no net income for their own account other than reflected in authorized reserves or surplus. Associations engaged both in marketing and purchasing activities must qualify in each of the functions to meet the tax law requirements. They must be both organized and operated in the manner and for purposes specified in the law. Cooperative organizations engaged in occupations dissimilar from those of farmers, fruit growers, and the like are not exempt. Specifically

¹Ibid., pp. 62-63.

²Ibid., pp. 63-64.

mentioned are merchants' associations and associations marketing building materials.¹

Of the 32 states that levy corporation income taxes, nearly all provide some form of exemption for the various types of cooperative organizations. These exemptions have been designed principally to encourage cooperative marketing and purchasing among farmers. As of 1946, Wisconsin was the only state to allow full exemption from taxation of income of consumers' cooperatives. However, patronage refunds must be reported by individual members of consumers' cooperatives as taxable personal income.²

Cooperative associations in Oregon that wish to claim exemption must file with the State Tax Commission an affidavit as to the non-profit character of the organization (see Appendix D). A copy of the articles of association, and by-laws, along with latest financial statements are required to be filed with the affidavits.³

The consideration of the taxation of cooperatives, discussed in Congressional hearings and publicized in periodicals, has had its effect on a state-wide level. Various state legislatures have been faced with measures attempting to modify the exemption provisions as applied to business cooperatives.

¹Ibid., p. 64.

²Thomas K. Ford, Taxation of Cooperatives (Washington: Editorial Research Reports, Jan. 11, 1946), p. 23.

³Corporation Excise Tax Law and Regulations, op. cit., pp. 58-9.

Possible indication of a trend by state legislative assemblies to "tighten up loopholes" of the exemption provisions for cooperative associations may be seen in a measure approved by the North Carolina General Assembly in 1949 (see Appendix G). The North Carolina Act exempts cooperative associations if the net income, as defined, is distributed to patrons on a patronage basis. The recipients of such patronage savings, whether distributed in cash or credit, are required to include the same in their individual gross income figures for the year. Cooperatives are required to file with the State Department of Revenue the names and addresses of all patrons and shareholders whose patronage refunds or interest on stock amount to \$50.00 or more. It would appear that the members of the North Carolina legislature are not trying so much to tax the cooperative associations as they are trying to make sure that the individual patrons of cooperatives include the patronage refunds in their personal tax returns. The new law would tax cooperative organizations that do not distribute their net savings on a patronage basis.

The Montana legislature in current session defeated by close vote a measure that would have taxed the gross receipts of all Montana cooperatives.¹

A measure introduced during the 1949 session of the Oregon Legislature would have terminated in the state excise tax law the exemptions

¹"Farmers Gain By Vetoes of Montana Law," Pacific Northwest Cooperator, Vol XVI (April, 1951), p. 6.

applicable to cooperatives. The measure (Senate Bill 202) was referred to the Committee on Assessment and Taxation and was not recalled during the remainder of the session;¹ hence, the proposed changes were not effected. The measure re-stated section 110-1511, O. C. L. A., in essentially its entirety, with the addition, following section 110-1511-i-1, of the following:

. . . provided, however, that the exemption herein specified shall cease and terminate on December 31, 1948, and shall be of no force and effect with respect to taxable years beginning on or after January 1, 1949, and that portion of any fiscal taxable year extending into the calendar year 1949.²

The above addition would have immediately followed the present law, as quoted on pages 51-52 of this paper. Since no final action was taken during the Legislative Assembly in 1949, the proposed measure is, of course, inoperative. It is, however, indicative of possible other legislative action to arise in the future.

During the present legislative session in Oregon, only one measure has been introduced that would have any effect upon the taxation of cooperatives under the corporation excise tax. This measure (see Appendix F) would terminate the exemptions for all types of associations and organizations now exempt, not only cooperatives in business, but other associations of nonprofit and nonbusiness nature. This measure

¹Senate Calendar (Salem: Forty-Fifth Legislative Assembly of Oregon, April 14, 1949), p. 34.

²Senate Bill No. 202 (Salem: Forty-Fifth Legislative Assembly, 1949), p. 3.

was referred to committee, and a substitute measure (House Bill 620) offered in its place.¹ The substitute bill did not change the present exemption given cooperative associations, but was concerned with some other types of exempt corporations.² This substitute measure failed to pass in the House of Representatives of the Legislature.³

¹House Calendar (Salem: Forty-Sixth Legislative Assembly of Oregon, April 23, 1951), p. 22.

²House Bill No. 620 (Salem: Forty-Sixth Legislative Assembly, 1951), pp. 4-10.

³House Calendar, op. cit., p. 92.

CHAPTER III

CONTROVERSY OF FEDERAL INCOME TAX STATUS OF COOPERATIVE ORGANIZATIONS

The 61st Congress of the United States in 1909 adopted the sixteenth amendment to the Constitution, which states: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." This amendment was ratified and made a part of the Constitution by February, 1913.¹ Since its adoption, the income tax has become the primary basis for tax financing of the Federal Government.

From the start, there was some exemption for certain types of nonprofit concerns, including "agricultural organizations." In succeeding revenue acts, exemption provisions were augmented and clarified, with exemption eligibility being broadened for agricultural organizations. In 1926, Congress revised the entire section concerning exemption of farmers' cooperatives. With but minor changes since, the exemption provisions stand as per the 1926 revisions.²

¹Are You An American? (New York: Charles Scribner's Sons, 1943) p. 88.

²George J. Waas and Daniel G. White, Application of the Federal Income Tax Statutes to Farmers' Cooperatives (Washington: Farm Credit Administration, Bulletin No. 53, November, 1942), p. 10.

With the increased rates to which corporations were subject during the course of World War II, attempts are being made to close various "loopholes" in the Internal Revenue Code, the Code which contains the income tax provisions. The Treasury Department has, since the end of World War II, been making studies of various phases of the Code, for use by Congressional committees as bases for possible revision of all tax laws. In Congressional hearings in 1947, a representative from the Department of the Treasury named 31 different studies, covering many phases of the tax laws. One of these studies concerned farm cooperatives,¹ This study was a portion of hearings held before the Committee on Ways and Means of the House of Representatives in November, 1947, considering the exemption of cooperative associations.

Present Status

Section 101 of the Internal Revenue Code contains exemption provisions for numerous types of organizations, primarily non-profit in their activities. In Section 101 (12) is found the exemption granted to farmers', fruit growers', or like organizations organized and operated on a cooperative basis for marketing products of members or for purchasing supplies and equipment for the use of members. Various qualifications and requirements to qualify for the exemption are named. (See Appendix A)

¹Hearings before the Committee on Ways and Means, House of Representatives, Tax-exempt Organizations (Cooperative Organizations) (Washington: Government Printing Office, 1948), pp. 1872-74.

Although those cooperative organizations qualifying for exemption are not subject to the federal income tax, there are two procedures necessary to obtain and maintain Bureau of Internal Revenue grant of the exemption. An Exemption Affidavit Form 1028 (see Appendix B) must be filed by Farmers', Fruit Growers', or like associations claiming the exemption under Section 101 (12). Upon filing this affidavit, the Commissioner of Internal Revenue will determine whether or not such exemption will be granted. Upon receiving such determination of exemption, no further returns of income will be required, other than an annual information return on Internal Revenue Form 990 (see Appendix B). Form 990 is an Annual Information Return of Organizations exempt from income tax under section 101 of the Code. It is to be noted that all organizations coming under the provisions of section 101, whether farm cooperatives or not, are required to file form 990, but that the exemption affidavit (form 1028) is specified as being applicable only to those qualifying for exemption under Section 101 (12) of the Internal Revenue Code.

The present treatment of farm cooperatives, in effect since the early days of the Federal income tax, includes benefits that are twofold. The exemption itself applies to income used to pay dividends on capital stock, on amounts retained in certain reserves, and on non-operating income. Also, patronage dividends distributed to members and patrons are excludable in computing the net income of the cooperative, if paid in accordance with a contractual obligation in effect at the

time of the transaction.¹

In order for a cooperative organization to be exempt from the Federal income tax statutes, the following conditions must be met by the association:

(a) must be organized and operated on a cooperative basis by farmers; (b) must be formed for the purpose of marketing the products of members or other producers and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or for the purpose of purchasing supplies or equipment for the use of members or other persons and turning over such supplies and equipment to them at actual cost, plus necessary expenses; (c) if organized with capital stock "substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends)" must be owned "by producers who market their products or purchase their supplies and equipment through the association"; (d) in fixing a dividend on such stock, it may not exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued; (e) may accumulate and maintain only reserves that are required by State law, or that are reasonable reserves for a necessary purpose; (f) must treat member and nonmember patrons alike in business dealings; (g) must operate so that the value of the products marketed for nonmembers will not exceed that of products marketed for members and so that the value of the supplies and equipment purchased for nonmembers will not exceed the value of the supplies and equipment purchased for members, provided that the value of the purchases made for persons who are neither members nor producers shall not exceed 15 percent of the value of all its purchases.²

Thus, in order to enjoy tax exemption, cooperative associations must be controlled by their farmer patrons and must do most of their

¹Ibid., p. 3129.

²L. S. Hulbert, Legal Phases of Cooperative Associations, (Washington: Farm Credit Administration Bulletin No. 50, May, 1942), p. 251.

business with them. Business with the Federal Government or its agencies is disregarded in determining the right to exemption.¹

In 1946, of the 10,125 farmers' marketing and purchasing associations listed,² 6,009 filed Form 990 returns, indicating their exempt status.³ Thus, less than sixty percent of supposedly eligible farm cooperatives were claiming the exemption.

In order to qualify for the exemption, it is not required that a cooperative be incorporated,⁴ but it must conform to the regulations set forth in the Internal Revenue Code.

General Basis of Controversy

The controversy relative to the tax exemption of cooperative business organizations has been a recent development. During the war years of 1941 through 1945, corporation tax rates reached an all-time high, due to the excessive needs of the federal government in an all-out war. The corporations were, thus, rather limited in the expansion possibilities, through their inability to accumulate the added capital required.

Cooperative organizations grew at a rapid rate, spurred on by regional wholesale organizations, during the period since about 1935.⁵ Most

¹Committee on Ways and Means, op. cit., pp. 3138-3139.

²John H. Davis, op. cit., p. 7.

³Ibid., p. 60.

⁴Creed V. Brattain, op. cit.

⁵See Table 6, p. 19.

of the cooperatives were organized as corporations, and many, although not all, have been exempted from the payment of federal corporation income taxes under Sections 101 (12) and 101 (13) of the Internal Revenue Code. Although numerous cooperative organizations built up their rather extensive physical plants during the years before the increased tax rates, many other cooperative organizations have greatly enlarged the scope of their operations in recent years.

The capitalization of the larger cooperatives has increased very much in recent years. This has resulted in claims that the cooperatives have an unfair advantage over ordinary corporations, not only through the specific exemptions granted, but also through rulings favorable to cooperatives relative to the distribution of patronage refunds. Spokesmen for the cooperative side of the controversy counter with denials of any real tax advantage. They maintain that the different form of business organization that is the cooperative, along with restrictions to the cooperatives to qualify for the tax exemption, eliminate the favoritism and so-called unfair position of the cooperative organization.

Spearheading the groups demanding the taxation of cooperatives is the National Tax Equality Association, which claims to represent two million businesses, both large and small.¹ The National Tax

¹Thomas K. Ford, *op. cit.*, p. 19.

Equality Association (NTEA) came into existence in 1943, ostensibly to work toward the equality of taxation by the Federal Government. So far, much of the activity of this organization has been directed toward elimination, or adjustment, of the exemptions presently being granted to certain cooperative organizations and businesses. In addition, the NTEA is making recommendations regarding the tax handling of the patronage refunds of both exempt and non-exempt cooperative organizations.

The cooperative organization leaders seemed to feel that an attempt was being made to put the cooperatives out of business, and formed the National Association of Cooperatives to oppose activities of the NTEA that appeared detrimental to the field of cooperative enterprise.

The controversy has reached a high enough pitch to have warranted several sessions of committee hearings. A House Select Committee on Small Business considered the matter in 1946. A renewal of this Committee (but under Republican Congressional control this time) again considered the matter in 1947. The most extensive hearing to date was before the House Committee on Ways and Means in November, 1947. Additional hearings before this committee were held in 1950 and early in 1951.

Except for the requirement, passed by Congress in 1943, of the filing of an annual information return by cooperatives, along with other nonprofit associations and organizations, no basic change in

the tax status of cooperatives has been made. There have been measures introduced in Congress each of the last two years to eliminate the exemptions granted to cooperatives (see Appendix E), but none of these measures has gone beyond their Committee designations.

A major point of dispute, in addition to the exemption itself, is the question of the real nature of patronage refunds, or dividends. The problem arising is whether a refund made to patrons on the basis of business conducted with the cooperative is a distribution of profits, as claimed by those working for taxation of cooperatives, or an adjustment of price, as maintained by the spokesmen for the cooperatives.

Wilfrid E. Rumble, an attorney for various cooperative groups, makes a good presentation of the cooperative viewpoint relative to patronage refunds in the following:

Cooperative associations vary in their actual methods of operation. Generally, however, the marketing cooperative agrees to market all the agricultural products of the type handled by it produced and delivered to it by its patrons, and to pay each patron the entire marketing proceeds after deduction of expenses. When a patron delivers products to the cooperative for sale, the amount to which he will finally be entitled cannot be known, so the cooperative pays to the patron a substantial part of the estimated sales price. At the end of the year, when the products have been sold and the costs determined, the cooperative distributes the remainder of the proceeds to its patrons in proportion to the products marketed for them. This distribution is called a patronage refund, but in reality it is further payment of the sales price. . . .

A purchasing cooperative agrees to buy and deliver to its patrons farm supplies and other goods at cost. Since the actual cost of each purchase cannot be determined in advance, the cooperative usually charges and collects from the patron an amount more than sufficient to

cover the expected cost price plus estimated operating expense. At the end of the accounting period the actual cost of goods purchased plus cost of operation is determined, and any excess amount collected from the patrons is returned to them in proportion to their purchases. The amount so returned to the patrons is a true patronage refund.¹

Albert W. Adcock, General Counsel for the National Tax Equality Association, refutes the argument that a patronage refund is a rebate, or price adjustment, in another article in the same issue of the Law and Contemporary Problems. He cites several examples of instances in which patronage refunds were considered as distributions of profits, in governmental rulings. Under the National Industrial Recovery Act, in the middle 1930s, such distributions were stated as being distributions of profits, since under the NIRA rebates were contrary to the codes set up.² Treasury Department rulings are also considered, as in the case of a non-exempt cooperative which was permitted to deduct patronage dividends before computing the applicable income tax rates. The ruling did not allow the deduction because of a price adjustment, but rather the deduction was allowed because the net income was distributed on a patronage basis.³

Mr. Adcock presents the example of a patron who limits his

¹Wilfrid E. Rumble, "Cooperatives and Income Taxes," Law and Contemporary Problems, Vol. XIII (Summer, 1948), pp. 535-6.

²Albert W. Adcock, "Patronage Dividends: Income Distribution or Price Adjustment," Law and Contemporary Problems, Vol. XIII (Summer, 1948), p. 510.

³Ibid., p. 511.

purchases from a cooperative to "loss-leader" items, on which no net profit would be made. This patron would still be entitled to patronage refunds, of the over-all net margins, or net profit, even though there were no profits arising on his particular purchases.¹

It is clear to Mr. Adcock that cooperative corporations "possess all of the essential attributes of ordinary business corporations except as to the basis of distributions of their net earnings. . . ." since the business corporation distributes its profits among the shareholders in proportion to the shares owned, whereas a cooperative corporation distributes its profits in proportion to the volume of the members' purchases or sales.² The contention is that the profits should be taxed accordingly, and under the same basis, whether a business corporation or a cooperative corporation, regardless of the methods used for distributing these profits.

A further matter of controversy relates to the procedure of making distributions, or allocations, of patronage refunds on a basis other than cash. This would include the issuance of capital stock, the issuance of certificates of indebtedness or other form of note, or the distribution by means of a revolving fund, the actual cash to be paid at a definite period later, five years, for example. These procedures, say the ones striving for taxation of cooperatives, allow

¹Ibid., p. 522.

²Ibid., p. 524.

the accumulation of funds that would be taxable to the ordinary business cooperative. Court rulings defend the practice, however, on the basis that the distributions, whether by cash or by allocation, are reportable for tax purposes by the individuals receiving such distributions.

The controversy between the two sides to the question has grown to such an extent that even name-calling and accusations have been brought forth. Cooperative spokesmen and periodicals have stated that the groups active in the work toward eliminating tax exemptions are actually using that approach to do away with cooperatives entirely.¹ Some of those opposing the tax exemption for cooperatives have gone so far as to accuse some cooperative leaders of attempting to absorb private business² and of working toward a Communistic form of government.³ All in all, the controversy has reached sizeable proportions and is worthy of the analysis being made here.

National Tax Equality Association Position

The National Tax Equality Association has as its position regarding the taxation of cooperative associations that of eliminating all exemptions and other "liberalities" accorded by the Treasury Department

¹Jerry Voorhis, "The People's Business," Pacific Northwest Cooperator, Vol. XVI (April, 1951), p. 18.

²"Protests Inequity of Tax-Free Status for Co-ops," National Petroleum News (July 5, 1944), p. 7.

³"More Leftist Thunder," Electrical West (June, 1947), p. 101.

and the courts to the cooperatives. The NTEA opinion is stated in the following:

In order to correct the present tax injustice, two things will have to be done: First, it will be necessary to repeal Section 101 (12) and 101 (13) of the Internal Revenue Code because these sections grant absolute tax-exemption to cooperatives and corporations organized by them to finance co-op corporations. Second, it will be necessary to close the tax loopholes created by Treasury rulings. This can be done by a law making it clear that cooperative corporations are to be taxed like other corporations on their full income, including that part of their income which is subsequently distributed as a dividend on patronage. H. R. 5064. . . would bring about tax equality by accomplishing these two steps.¹

It is maintained by NTEA that there should be no businesses exempt from taxation; hence the first item above, the repeal of the pertinent sections of the Code relative to cooperative associations. No other exemptions from taxation have as yet come under the surveillance of the Associations, but presumably such would be considered in the future.

The "tax loopholes" referred to above are Treasury Department and Tax Court rulings that allow cooperative corporations to deduct or exclude from their taxable income the amounts that are allocated or distributed as a dividend on patronage in accordance with the provisions of their charter, bylaws, or contracts. The Treasury Department justifies this exclusion upon the ground that it represents a rebate or an additional cost of goods sold.²

¹How Cooperatives Escape the Income Tax, (Chicago: National Tax Equality Association, 1950), p. 12.

²Ibid., p. 5.

The viewpoint of the NTEA is that the rulings permitting the exclusion of dividends distributed on a patronage basis are in error. A court opinion of the Circuit Court of Appeals for the Seventh Circuit in the case of In Re Wisconsin Cooperative Milk Pool, 119 F. (2d) 999, stated relative to cooperative corporations:

Such corporations differ from others not in corporate function but only in that the profits, instead of being distributed to stockholders, are allotted to patrons ratably in proportion to the amount of business transacted with the latter.¹

Since a group of patrons and a group of stockholders are approximately the same, it would make little difference whether amounts received are as a dividend on patronage or a dividend on stock.²

It is apparently the elimination of the deductions of all patronage dividends that is the aim of the NTEA, as it is stated that "The extra advantage gained by full compliance with the terms of Section 101 (12). . . . is, on the whole, negligible. . . . Treasury rulings permit them to exclude from taxable income patronage dividends, either paid or allocated, and to pay little or no tax."³

Further opinions viewed by the NTEA, regarding proposals for change not to the full extent outlined above, will be considered later.

¹A. W. Adcock, National Tax Equality Association General Counsel, correspondence with the author, March 16, 1951, citing In Re Wisconsin Cooperative Milk Pool, 119 F. (2d) 999.

²A. W. Adcock, correspondence with author, March 16, 1951.

³Legal Tax Dodging and Its Effects on Growth and Competition (Chicago: National Tax Equality Association, 1947), p. 10.

National Association of Cooperatives Position

The National Association of Cooperatives was organized for the purpose of counteracting what has been termed the attacking of cooperatives by propaganda.¹ It is the purpose of NAC to publicize the "true" picture of cooperative activity and the relationship of cooperative organizations to income taxes.

The position of the spokesmen for the cooperative enterprises is that a non-profit business operation cannot be taxed on profits that are not there, and that the distinction between cooperatives and other businesses is not what they do, but the objective behind their operations. The primary objective of "old-line" businesses is to make a profit for the owner, or owners, of the business, whereas the cooperatives' purpose is not to make profits for itself, but to realize the most benefit for the patrons, as distinguished from the owners. Thus, since the income realized by cooperatives is not for itself, but for others, the cooperative has no income that is taxable.²

It has been stated that "If cooperatives could forecast all expenses, with unerring accuracy, and could pre-determine their own exact business volumes, it would then be possible to quote prices to patrons

¹Davis Douthit, Taxes and Co-ops (Chicago: National Association of Cooperatives, undated, p. 14.

²R. Wayne Newton, National Association of Cooperatives Manager, correspondence with author, December 29, 1947, pp. 1-2.

that would result in their operating exactly at cost."¹ Under such ideal circumstances there could not be any tax liability accruing. With the afore-mentioned forecasting of expenses being not practicable, the general practice is to charge (in the case of purchasing cooperatives) the going retail prices, and refund the excess after the end of the year, when the amounts of the overcharges are determinable. Where the co-op has bargained away its right to these overcharges before receiving any of these sums, it does not own any of these sums, and thus can not have income arising from them. "Mere inability to determine the exact value of the property in advance of the closing of its books does not alter the fact that the patron's title is above question and attaches from the moment the property comes into the possession of the co-op."²

The cooperative viewpoint is that the cooperative organizations are of the same nature as individual and partnership forms of business, that the business itself has no income, but that the individual participants are taxed upon the income received by them individually. The way to have tax equality is to have it on every form of business. As it has been stated:

. . . either each business unit must pay tax on its net business income while each individual pays a second tax on his share of distributed earnings, or we must remove the

¹R. Wayne Newton, Corporation Income Taxes as Applied to Co-ops (Washington: National Tax Association, 1945), p. 5.

²Ibid., pp. 10-11.

present severe handicap of double and multiple taxation which now applies to some but not all corporations.¹

This would mean either the taxing as business entities all types of business enterprise, including those not now taxed, such as partnerships, or the elimination of the double tax on corporations. Since spokesmen for business have asked for the elimination of double taxation of distributed corporate earnings, and the cooperative leaders are not opposed to this procedure, the real issue is pointed out as being the ". . . over-taxation of those concerns which still pay full corporate rates while their stockholders pay again on the dividends they receive."²

The solution offered as a cure would not be the enactment of more penalty taxes on business, but the elimination of the burdens which now over-penalize a part of business.³

The exemption itself is not considered a particularly important part of the dispute from the cooperatives' viewpoint, since "any cooperative could adopt practical and known methods and still remain as tax-free outside the amendment as it is today inside."⁴

The closing of such loopholes as do exist are more in the line of

¹R. Wayne Newton, Co-ops and Income Tax Exemptions (Chicago: National Association of Cooperatives, reprinted from the Philadelphia Business Almanack, October, 1947), p. 3.

²Ibid., p. 3.

³Ibid., p. 3.

⁴R. Wayne Newton, correspondence with the author, December 29, 1947, pp. 2-3.

administrative attention needed than legislative action.¹ It is not questioned that there are likely abuses to the present exemption laws by cooperatives and others purporting to be operating as cooperatives.

Other Stated Positions

In addition to the positions of the National Association of Cooperatives and of the National Tax Equality Association considered previously, other groups and persons have presented viewpoints regarding the problem of the taxation of cooperative organizations. These viewpoints vary from the mild chastisement of those cooperative associations and organizations whose financial practices may deviate from the restrictions provided by the tax exemption statutes to positions varying only slightly from that of the NTEA. The next section of this chapter will consider the specific proposals being made, with the differences being shown. In this section will be presented various of the opinions being offered, some before Congressional Committee hearings, some independent of any particular legislative urgency.

In 1942 the House of Representatives created a Select Committee on Small Business. Among other purposes, it was created to investigate the tax exemption of cooperatives and the relation of this cooperative exemption to private business. The first interim report of this committee was presented to the House of Representatives April 9, 1946,

¹Newton, Corporation Income Taxes as Applied to Co-ops, op. cit., p. 11.

under the explanation "An examination of charges that cooperatives enjoy tax exemption and other privileges not enjoyed by other forms of business enterprise and constitute, therefore, an alleged threat to private enterprise in the United States."¹ The committee report considers the existing statutes related to the taxation of cooperatives, the operation of various types of cooperative organizations, and comparison of cooperatives with other types of business. The Committee's conclusions were several, and from the conclusions and recommendations (see Appendix H) some items are noted.

It was conceded that farmer cooperatives have some advantage over competitive businesses in the exemption of some reserves and dividends on stock but that the stock was not rated attractive to investors; hence the exempted reserves were a substitute for capital markets available to other businesses. The non-profit character of the cooperatives was recognized as eliminating income for itself; hence could not be subject to a tax on the incomes of others.

Recommendations included clarification of some of the regulations contained in the exemption statutes. Also, it was recommended that a single governmental agency be directed to maintain records upon the cooperative enterprises. Some changes of procedure and some definitions were also recommended.

The Committee of Small Business, portions of whose report are indicated above, was under the chairmanship of Rep. Patman (D., Texas).

¹Committee on Small Business, House of Representatives, The Competition of Cooperatives with Other Forms of Business Enterprise (Washington: Government Printing Office, 1946), cover page.

The Committee was continued in the next session of Congress under the chairmanship of Rep. Ploeser (R., Missouri). The report of the new Committee chairman before the hearings of the Ways and Means Committee in November, 1947, presented opinions rather different from those of the prior Committee report. Considerable discussion in the hearings was had regarding the value of the prior report, as it was stated that the entire committee did not concur in that report. The new Committee on Small Business did not have a committee report. The data and statement presented in the hearings were the report by the chairman alone as to the results of the committee investigations up to the date of the Ways and Means Committee hearings.¹

The Committee on Small Business under the chairmanship of Rep. Ploeser attempted to investigate the details of cooperatives, some specific cooperatives being examined in minute detail regarding their financial operations. A portion of the results of this investigation is given in Appendix H.

Rep. Ploeser's committee attempted to differentiate between the farm cooperatives and the urban cooperatives and to see the place of each in the economy of the country. The points in summary that were suggested by Rep. Ploeser included: a clear definition of deductible reserves, permit deduction by all corporations of cash dividends of any type, exempt non-cash refund distributions only when an option is

¹Committee on Ways and Means, op. cit., pp. 2940-42.

given as to redeeming in cash the evidence of debt, and consider an exemption of \$25,000 on earned net income for all corporations. This last recommendation is intended to eliminate the double taxation of small corporations and put them on the same basis as other small businesses.

In addition to the views presented by the two different committees on Small Business, other groups, independently or in conjunction with the Ways and Means Committee's hearings, have prepared statements regarding the handling of the taxation of cooperative organizations. An organization claiming to represent the manufacturers of 85 percent of all the goods America uses, the National Association of Manufacturers, has prepared as the official statement of the organization a pamphlet "NAM AND COOPERATIVES," a speech by Morris Sayre, a Director of the NAM, approved by the Executive Committee for publication. This statement lists the "NAM POSITION on cooperatives in relation to other forms of business enterprise with particular reference to agricultural cooperatives."¹

The proposed tax policy of the Association follows.

The Government's tax policy with reference to the cooperatives and other corporations as a form of business enterprise should involve the recognition of the following (which should be considered in combination):

- (1) No justification is found for taxing at the source patronage refunds paid to customers of cooperatives. Amount available for, but not distributed to, patrons as patronage dividends should be taxed as earnings.
- (2) All double taxation of earnings applied to dividends to

¹Morris Sayre, "Agricultural Cooperatives" (New York: National Association of Manufacturers, 1946), p. 1.

stockholders of all types of corporations, including cooperatives, should be eliminated. Manufacturing and agricultural interests should join in a vigorous effort to bring this about.

- (3) The income status of patronage dividends as presently defined means that to the receiver patronage dividends (including stock dividends to patrons) are either (1) a source of income in connection with sales of farm produce; or (2) a deduction from expenses for goods bought for production purposes; or (3) they are not income in the case of goods purchased for personal consumption. The question of administration of the tax law to give effect to that definition is a matter resting with the Internal Revenue Bureau. It is suggested, however, that revision of individual income tax forms to provide for specific inclusion of such items would be a proper first step before requiring the payer to report to the Internal Revenue Bureau patronage dividend payments which represent income to the recipient. In the event any regulations were issued to require reports on patronage dividends; they should apply to all corporations which distribute such patronage refunds.

These tax proposals do not of themselves overcome difficulties that might arise if we should run into a period where excess profits taxes, or some other similar device, might have to be used to mop up fortuitous gains in an emergency period. Careful study should then be given to the problem in order that fairness be accorded to all business organizations.¹

The Commerce and Industry Association of New York, Inc., including many industrial leaders of the metropolitan area, does considerable research for the furthering of the position of its members. The Committee on Taxation and Public Revenue of the Association created a special committee to study the subject of tax liability of cooperatives. After a year of study, the special committee's report was presented to and adopt-

¹Ibid., p. 9.

ed by the Association's Board of Directors in November, 1946.¹

The report includes a brief history of cooperatives, a discussion of the points of disagreement relative to the taxation of co-ops, consideration of the tax status in other countries, and recommendations by the committee as to the Association's stand on the matter. These recommendations are here included.

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.

¹Tax Liability of Cooperatives (New York: Commerce and Industry Association of New York, Inc., 1947), p. 3.

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 patron's 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 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.¹

The information returns referred to in recommendation number one above are federal forms 1099 and 1096 (see Appendix B), or similar forms adapted for the use of cooperative organizations.

The foreword of the pamphlet includes the opinion that the problem of tax exemption granted to cooperatives should not be exaggerated, since the total volume of cooperative activity is small in comparison

¹Ibid., p. 20.

with the total business conducted in this country and suggests that care should be taken to guard against unfair tax discrimination.¹

In November, 1947, during the course of the hearings before the House Committee on Ways and Means, many opinions, briefs, and statements relative to the taxation of cooperative organizations were presented. While many of the opinions voiced were repetitions of the basic differences given by the National Association of Cooperatives and the National Tax Equality Association, there were some shades of difference presented, and some of the more significant of these differences will be presented in the remainder of this section.

A representative of the Ohio Chamber of Commerce, George D. Brabson, presented the results of a study by the organization. It was suggested that gross income be redefined to include "patronage dividends, rebates, or allocations." The repeal of Section 101 (13) of the Internal Revenue Code was advocated. Cooperatives would be required to furnish information as to "each member's or patron's interest in the cooperative's earnings (margins)" whether distributed or withheld. In order to return to the original purpose of the tax exemption and to prevent abuses to the exemption, the following suggestions also were included:

That Section 101 (12) of the Internal Revenue Code be amended so as to limit membership in cooperative associations for all tax exemption purposes to actual farmers, fruit growers, and like persons engaged in agricultural pursuits.

That the same section be amended so as to exempt from taxation only such organizations whose income arises exclusively from actual transactions with or on behalf of its own members.

¹Ibid., p. 3.

That the same section be amended so as to permit the accumulation of reserves only for the purposes of depreciation, depletion, and bad debts, which in no case should exceed the annual charges allowed to private corporations engaged in the same or similar business.¹

Mr. W. G. Wysor, General Manager of Southern States Cooperative, in the question period of his testimony, in answer to the question placed by a committee member "Could you indicate just what are the tax advantages, favors, and exemptions that are enjoyed by the Southern States Cooperative?", stated the following:

I think we enjoy favoritism in two respects, both of them having to do with the Federal income tax. The income which we use to pay dividends on outstanding capital stock is taxed once in the hands of the recipients of those dividends. They are not taxed twice as is the income of non-exempt corporations. So there is discrimination there in that the dividend money is taxed once, but not twice.

. . . Then there is discrimination. . . with respect to any income which our board of directors may choose to put into. . . reserve funds, unallocated reserves, which we may hold as working capital as long as we see fit, and some of it. . . we intend to keep more or less permanently. That income. . . is neither taxed in the hands of the corporation nor is it taxed in the hands of the patron.²

The radio commentator, Fulton Lewis, Jr., a critic of the above-named Southern States Cooperative, referred to the reserves mentioned above upon which no Federal corporation income tax had ever been paid. He stated:

It is abundantly clear to me that if the tax exemption for farm cooperatives were removed, and Congress were to declare that the annual margin between the costs of operation and the income of the cooperative is to be

¹Committee on Ways and Means, op. cit., p. 2354.

²Ibid., p. 2539.

considered profit, in the same sense that it is considered profit in private enterprise, the whole problem would be solved. The cooperative would then be subject to the same taxes on income that is sidetracked into these reserves, that any private corporation would have to pay on similar income placed in similar reserves, and all competitive tax advantages of the cooperative would be eliminated.¹

During the questioning of Mr. Lewis, he made the statement that

"The patronage dividends that go to the membership in cash unquestionably should be subject to taxation at the level of the individual."²

In further discussion, and in reply to questioning by a member of the Committee, Mr. Lewis said:

. . . .Is it your idea there are many people who think that the net profits, the net margins, should be taxed as corporate incomes are taxed, at the corporation level, and then the refunds retaxable to the recipient at the individual personal income-tax level? With that I could not agree.³

To clarify further his point, the statement was made by Mr. Lewis that ". . . .to tax dividends that actually are returned to the public in cash would be to impose an added burden on the cooperatives over and above the burdens that are imposed on private enterprise."⁴

Walter L. Bradley, a Certified Public Accountant, who has been chairman of the committee on cooperatives of the American Institute of

¹Ibid., p. 2077.

²Ibid., p. 2086.

³Ibid., p. 2087.

⁴Ibid., p. 2087.

Accountants,¹ testified on more or less a "pro-cooperative" basis. The suggestions made by Mr. Bradley were essentially the same as were stated in a previous article appearing in the Harvard Business Review. His viewpoint was that no legislation is necessary, since that would not satisfy those who object to the exclusion of patronage refunds in determining taxable net income. His suggestions include these remarks:

. . . the ends of economic justice would be served, and without injury to the established practices of proprietary commercial business, if matters could be so arranged that there could be definite assurance that all margins realized by any cooperative organization, whether an exempt agricultural association or a cooperative association serving proprietary commercial business, would be taxed to someone at a definite time. The realization of this purpose should be simple of attainment. Opportunities for evasion and abuse could be removed through amendment of Treasury regulations, spelling out definite measures pertaining to:

- (1) Classification of reserves which an exempt association might accumulate.
- (2) The setting of definitive limits to such permitted reserves.
- (3) Definitive rules with respect to the taxability of amounts retained in reserves, as income of the patrons.
- (4) Provisions for reporting information at the source with respect to patronage refunds paid or credited to patrons by cooperative associations.²

Some of the suggestions mentioned in this portion of the study are being considered in the next section, and in connection with the survey made relative to cooperatives in Oregon.

¹Walter L. Bradley, Audits of Agricultural Cooperatives (Philadelphia: American Institute of Cooperation, June, 1946), p. 2.

²W. L. Bradley, "Taxation of Cooperatives," Harvard Business Review (Autumn, 1947), pp. 585-6.

Proposed Changes in Federal Income Tax Laws and Regulations

Whenever a controversy reaches the stage of suggesting possible changes in the law, very often it will be found that the number of suggested changes will be nearly as large as the number of people who are considering changes. That situation seems to be no less true in the case of the proposed changes in the Federal income tax laws as related to cooperative organizations.

During the course of Congressional hearings on the subject in 1947, there were no less than 19 different proposals made for changing the present regulations regarding cooperatives. Some of the plans, or opinions, were not capable of analysis, such as the one that the big co-ops be taxed and the little ones go free, in which no definition of "big" was made. Other items made reference to slight revisions of some of the forms to be filed, to allow for coverage of cooperative organizations. By sifting through the various proposals, a list of twelve proposed changes was derived, these changes being concrete enough to warrant consideration. These will be stated in the same order as they will be considered in the later analysis of questionnaire data.

1. REPEAL THE PRESENT EXEMPTION. This would eliminate the current exemption granted to farm cooperatives, and would make subject to tax dividends on stock, amounts retained in reserves, and nonoperating income.

2. TERMINATE THE EXCLUSION (FROM INCOME) OF ALL PATRONAGE REFUNDS. This proposal would require cooperatives to pay tax on all net margins

including those distributed in dividends on a patronage basis, whether in cash or otherwise.

3. TAX NONCASH PATRONAGE DIVIDENDS. In this proposal, only that portion of patronage dividends not paid in cash would be subject to tax, with patronage distributions in cash being excluded for tax purposes, from income, as per present court rulings.

4. NO EXEMPTIONS, AND NO EXCLUSIONS OR DEDUCTIONS FOR PATRONAGE REFUNDS. All margins of cooperatives would be taxed to the cooperative, no matter what the disposition made of the margins.

5. TAX DIVIDENDS ON STOCK, AND AMOUNTS RETAINED IN CAPITAL AND RESERVES (INCLUDING NON-CASH PATRONAGE DIVIDENDS). This is similar to number 3, in effect, with the addition of dividends on stock as being subject to tax. Cash patronage dividends would not be subject to tax on the cooperative.

6. TAX RESERVES NOT ALLOCATED TO MEMBERS. Any net savings, or margins, not distributed, or allocated, to members, would be subject to income tax.

7. TAX SAVINGS NOT CREDITED TO MEMBERS (NONMEMBER SAVINGS). The present exemption requires that nonmembers be treated the same as members. Presumably, under this proposal, these savings would be taxed even though distributed to nonmembers on the same basis as to members.

8. TAX NONCASH DIVIDENDS AS INCOME - ALLOW \$25,000 NET INCOME TAX EXEMPTION FOR ALL CORPORATIONS (WHETHER COOPERATIVE OR NOT). This is intended to aid all "small" businesses, and the small local cooperatives would be included.

9. LIMIT EXEMPTION TO TRANSACTIONS FOR MEMBERS, DEFINE GROSS INCOME AS INCLUDING ALL DIVIDEND DISTRIBUTIONS, LIMIT EXEMPTION TO FARMERS' COOPERATIVES. This is apparently intended to preserve the exemption for farmer cooperatives in their dealings with members, but to subject all other cooperatives to taxation on their net savings, whether distributed to members or not, and regardless of procedure.

10. SPECIAL TAX ON GROSS RECEIPTS, OR GROSS SALES. This is of the nature of the gross receipts tax of the state of Indiana, a tax on all gross business. This, nationally, would be applied to cooperatives in lieu of any income tax and would have effect whether or not there were losses or gains.

11. SPECIAL TAX ON INVESTED CAPITAL. This, also, would be a special tax on cooperative organizations, based on the amount of capital invested.

12. EXEMPT ALL CORPORATIONS ON EARNINGS DISTRIBUTED AS DIVIDENDS. This would apply to all corporations, whether cooperative or not. No distinction was made regarding whether dividends not made in cash were to be distinguished from cash dividends and would attempt to eliminate the present double taxation of ordinary corporate dividends.

It is not expected that all of the above-named proposals will meet

with serious enough consideration to be introduced for adoption by the Congress. Some of the proposals are not feasible as far as being equitable is concerned, although all have been suggested as possible solutions to the controversy of taxation of cooperatives. Most of the items proposed have not as yet reached the state of coming before the sessions of Congress, but there have been some measures introduced that incorporate some of the ideas expressed.

In 1949, H. R. 5064 (see Appendix E), as introduced, would have repealed the exemption of farm cooperatives, Section 101 (12) and (13) of the Internal Revenue Code. The measure would also have required that income of cooperative corporations be determined without any subtraction of patronage dividends, paid or payable. For marketing cooperatives, only amounts other than patronage dividends would be used in computing costs of products handled (or the option provided of using either prevailing market price or costs plus patronage dividends, whichever is lesser, as the amount used as cost). This measure seems comparable to proposal No. 4, as stated above. Other corporations, of any nature, exempted under Code section 101 would be subject to tax on all business income. Cooperatives would be required under the measure to file a return of its payments of patronage refunds to members.

H. R. 7343, introduced in 1950, included essentially the identical wording of H. R. 5064, but included, in addition, a provision for credit to the recipient of patronage dividends for tax paid by farmer cooperatives (see Appendix E). This was apparently intended to alleviate the

effect of double taxation of the income of farmers cooperatives and its members on patronage dividends.

In 1949, H. R. 4431 (see Appendix E), as introduced, would have allowed to essentially all corporations an exemption of \$25,000 for income tax purposes, and would have provided that the combined normal tax and surtax rate of thirty-eight per cent be applied to all corporate income above the exemption. This measure provided for the exemption mentioned in proposal number eight above but did not make any distinction between cooperatives and other types of corporations. Presumably this measure as introduced would have had no effect upon the taxation of exempt cooperative organizations, but would have provided for nonexempt cooperatives (as for all corporations) a \$25,000 exemption before applying the income tax rates as revised.

H. R. 8703, introduced in 1950, consisted of identical provisions to those of H. R. 4431. This measure was, also, referred to the Committee on Ways and Means.¹ No action was taken other than the referral.

The "suggestions with respect to the taxation of farmer cooperatives" (see Appendix E) were prepared by "a number of outstanding cooperative leaders at the request of Senator George of the Senate Finance Committee." This recommendation is essentially that of the proposal number six above. Mr. R. D. Barker, of the Apple Growers Association, is of the opinion that this suggestion will probably serve as a basis for legislation

¹H. R. 8703 (Washington: 81st Congress, 2d Session, June 5, 1950), pp. 1-3.

whenever suggestions get to that point.¹

There were no amendments relative to the taxation of farmer cooperatives in the measure H. R. 8920 as adopted.²

Thus far in 1951, there has been no change made in the treatment of farmer cooperatives. The House Committee on Ways and Means has held additional hearings, on Feb. 22 and 23, 1951,³ and on March 2 and 3, 1951. The copies of the hearings are not yet available, but from reports noted, results of the hearings indicate that ". . . farm co-op leaders felt it 'unlikely' that the committee will recommend any change in tax treatment of cooperatives' patronage savings."⁴

The various proposals for change in the federal income tax laws all have some merit, at least as far as the view of the one presenting the proposal is concerned. The author has noted some definite opinions relative to these proposals, through comments accompanying returned questionnaires, by remarks made in the Congressional hearings, and from other sources. It would be well here to consider some of the aspects of each of the propositions mentioned earlier. The sequence used will be as per the prior listing in this chapter.

¹R. D. Barker, Treasurer, Apple Growers Association, correspondence with the author, August 14, 1950.

²Revenue Act of 1950 With Explanation (Chicago: Commerce Clearing House, Inc., 1950), 79.

³"House Committee Extends Co-op Tax Hearings for 'New Evidence,'" Pacific Northwest Cooperator, Vol. XVI (March, 1951), p. 1.

⁴"'Tax Equality' Crowd Gets Grilling Before Committee," The Cooperative Consumer, Vol. XVIII (March 15, 1951), p. 1.

The value of the present exemption, whose repeal is the essence of the first proposal, has been considered earlier in the discussions of the viewpoints of the National Tax Equality Association and of the National Association of Cooperatives. Those representing the opposite views of these two organizations are in agreement that the repeal of the exemption, and nothing else, would result in no great change in the taxability of funds in the hands of the cooperatives. It is seen that in actual practice the exemption is not of such great monetary importance, since ". . . it is entirely possible for. . . associations to be organized and operated in such a way as to have little, if any, taxable income."¹

Opinions received from the several Oregon cooperative association officers who answered page two of the questionnaire (see Appendix I) varied regarding the tax exemption by itself. Some indicated it made little or no difference to their cooperative. One writer said that cooperatives should be taxed as corporations (but that the tax on distributed dividends should be eliminated for all corporations). One who did not favor repeal of Section 101 (12) of the Internal Revenue Code stated the reason that it would probably subject cooperatives to securities exchange regulations which did not appear to be necessary. Another comment received was that some amendments would take care of certain abuses practiced by a few cooperatives.

¹George J. Waas and Daniel G. White, op. cit., p. 11.

Regarding the second proposal listed, which would terminate the exclusion from income of all patronage refunds, the cooperative replies received were unanimous in opposing the taxation of patronage refunds, primarily on the basis that such refunds did not belong to the cooperatives and hence could not be taxed to them. One reply questioned how patronage refunds could be taxed without taxing a lot of other refunds. One writer outlined the probable result of any of the proposals that would tax patronage refunds. In a marketing association, it would be seen to it that the current pool returns were up to the maximum throughout the year. In a purchasing cooperative, the merchandise would be invoiced to the members at cost plus actual operating expenses. In both cases, there would, if computations were accurate, be no patronage refunds to be considered.

The National Tax Equality Association reply to this proposal was that it would result almost in tax equality, but that the large cooperatives would qualify for the exemption and thus not be subject to any large amount of tax.

The third listed proposed change, which would tax only the noncash patronage dividends, brought out no additional comments from the cooperative representatives beyond those already made in connection with the proposal just previous.

The NTEA reply relative to this proposal was that it was meaningless because of court decisions making the definition of a cash dividend. Comment was made that in numerous instances, and not necessarily in

connection with cooperative associations, dividend distributions not made by cash were so considered by the courts. These included stock dividends, issuing of pre-endorsed checks payable to the corporation and to be immediately endorsed by the recipients as capital contributions, and other similar transactions.

Even assuming that the cash payments were actually payments in cash and without restriction, the NTEA reply did not recognize any difference between the payment of cash dividends by cooperatives and profit corporations, calling the exclusion from income of cooperatives cash dividends paid a special privilege.

Proposal number four, the application of tax rates before any deductions, is the goal of the National Tax Equality Association, and the NTEA viewpoint has been discussed earlier in the chapter, in the special section regarding the position of the NTEA.

The replies from the questionnaire sent to the cooperative associations were unanimous in opposing this proposal.

The fifth proposed change listed is similar to the third, except that specific items to be taxed are named to include some other items in addition to non-cash patronage dividends. Dividends on stock, and amounts retained in capital and reserves are included under taxable items. This fifth proposal was not included among the proposals sent as part of the survey questionnaire. It is quite similar in general effect to the third proposal, since for many cooperatives it would result in the mere taxing of noncash dividends, as that seems to be the

main distribution procedure used.

The NTEA suggestions in the Congressional hearings mentioned this proposal as one that might be put forth and gave reasons for its not being acceptable to the association, on the basis primarily that the cash dividends would be excluded, and that is contrary to the policy of NTEA.¹

Proposal number six would provide for taxation to the cooperative of funds retained as property of the cooperative, and not in any way distributed, or allocated, to the patrons. This was, also, not included in the survey list.

As considered in the hearings before the Ways and Means Committee, a distinction was made between the keeping of the funds, or margins, and the distribution of such margins to patrons, only to have the patrons indicate their willingness for the cooperative to reinvest the funds as capital rather than accept the cash dividend payments immediately.²

The replies to proposal seven, the taxation of nonmember savings, show divided opinions among the representatives of the cooperatives. Comments received indicated that some thought it incorrect that the exemption should apply to business done with and for members only -- treat everyone alike. Other returns pointed out the fact that numerous

¹Committee on Ways and Means, op. cit., pp. 2302-3.

²Ibid., pp. 2854, 2861.

cooperatives have given up their exempt status in order to make patronage refunds, and hence the excluded portion of their margins, to members only, with tax being paid on nonmember business. It was pointed out that the present nonexempt cooperatives operate on approximately that condition, although the writer of that reply did not mention the application of the present tax exemption to dividends on capital stock, which would not be exempt even to members under the present laws affecting nonexempt cooperatives.

The reaction of NTEA to this proposal was that it was a meaningless gesture, since the cooperatives made their own definitions of members and could so define the term to include anyone who was doing business with it.

The taxation of noncash patronage dividends provided for in the eighth proposal is the same as number three, with the addition of the provision for a flat exemption of \$25,000 to apply to all corporations. This particular provision has been introduced into the Congress, (see Appendix E) but has not proceeded further than delegation to a committee. It was developed as a portion of the recommendations of the House Committee on Small Business under the chairmanship of Rep. Ploeser (see Appendix H).

The comments from cooperatives included such as that one abuse could not be corrected by adding another, and that no corporation could ever grow in competition with another corporation already large.

From NTEA an objection is raised to allowing cash dividends not to

be taxed, as per proposal three. The double taxation of corporations is considered as inequitable, but disadvantages of this proposal included the probability that large corporations would divide into numerous small corporations in order to get more \$25,000 deductions. Also, with Congress now trying to get more taxes, the proposals would not have any present significance. It was also stated that it was doubtful if a \$25,000 corporate income tax exemption would be allowed without a withholding tax, of perhaps twenty percent, placed on the stockholders for a pre-payment of income tax on dividends distributed.

The ninth proposal would not provide for repeal of the present exemption, but would limit the exemption to transactions for members and to farmers' cooperatives. Gross Income would be defined as including all dividend distributions, also. As will be seen in the following chapter, this proposal is practically a duplication of number seven as far as its effect on Oregon cooperatives is concerned. The limitation of the exemption to farmers' cooperatives has very little significance here because very nearly all of the cooperatives in the state are farmer sponsored.

As presented in the Congressional hearings, the intent was to return the law to its original meaning, the aiding of farmers, fruit growers, and the like, in the transacting of their business and the marketing of their products.¹

¹Ibid., p. 2353.

Proposals ten and eleven were not included in the survey questionnaire, mainly because they were not seriously under consideration in the Congressional hearings. These were both special taxes to be applied to cooperatives. The tenth proposal would be a special tax on gross receipts or gross sales, while a special tax on invested capital was the proposal listed number eleven by the author. Both these suggestions were included in the report to the Ways and Means Committee by the Treasury Department as possible alternative means of imposing taxes of a comparable nature to other corporations.

Objections to both were that their imposition would have no relation to income and ability to pay, as well as the problem of determining a rate that would be comparable.¹

For the tax on gross receipts, the problem would include the great variance of the amount of net income per dollar of sale between many types of businesses, not only in different lines of business, or between wholesalers and retailers in the same lines, but between two different businesses of comparable nature.

It was thought that a tax on invested capital would bear more heavily upon the weaker businesses than upon the strong and that a tax rate comparable to the income tax would be nearly impossible to determine. The problem of defining satisfactorily the amount of invested capital was cited as being very difficult to solve under the excess-profits tax

¹Ibid., p. 1887.

and would be no less complex in the case of the cooperatives.

The last listed proposal, with the distribution of all dividends being exempted, was considered likely not to be successful because of the unsatisfactory experiences had in the older laws imposing a tax on the undistributed profits. The result at that time was that many corporations made dividend distributions when the capital structure could not afford to let the working capital go. This sort of tax would tend to regulate the dividend policies of corporate taxpayers.

The proposal itself was made for the purpose of eliminating the present double taxation of corporate profits generally which are distributed as dividends, with both the corporation and the recipients being taxed.

One cooperative association response was to the effect that if the corporations fighting cooperatives would spend as much time trying to put all businesses on the same basis, they would be far more successful and the entire setup would be much fairer.

Another response cited the fact that the Treasury Department allows interest as a deduction, but did not treat dividends the same way; hence many corporations finance too great a portion through the use of interest-bearing securities rather than through the use of stock.

CHAPTER IV

COOPERATIVE SURVEY QUESTIONNAIRE

Scope of Survey

Much of the information published regarding cooperatives is on the basis of estimates. Because of this, a questionnaire was sent to the business cooperatives in the state of Oregon in order to obtain first-hand information as to the business being transacted. Also, certain items of financial data were needed to make an analysis of the effects on Oregon cooperatives of proposed changes in the income tax laws. (See Appendix I for questionnaire and covering letter.)

It was intended that the questionnaire be simple enough that the information requested could easily be transferred from financial reports to the provided form. However, it was recognized that many cooperative managers or accountants might not have the time to enter the requested data themselves; hence the covering letter sent to the cooperative organizations included a statement to the effect that a copy of the cooperative's latest financial report would provide the information for the needs of the questionnaire. Also, correspondents were requested to return the blank forms even if they were unable

to furnish any data for the survey.

Letters and questionnaires were sent to every known business cooperative organization in the state of Oregon. From the office of the State Corporation Commissioner was obtained a list of the agricultural cooperatives in Oregon as of 1946.¹ The list included 235 Oregon cooperative associations in the various classifications named. The classifications made were on the basis of type of business activity. Duplicate listings were eliminated for those organizations named in more than one classification. The list was further reduced by omitting the names of organizations known to be nonbusiness. Current directories provided names of additional cooperatives whose business activities had commenced after the compiling of the source list. The compiled list included 131 Oregon cooperatives. The questionnaire and accompanying materials were sent to each of the cooperatives on the final list. Table 16 lists the returns from these questionnaires.

In addition to thirty-one satisfactory financial reports received by direct return of the questionnaires or annual financial reports, partial reports of financial data were obtained of twenty-seven cooperatives whose questionnaire reports were blank or were not returned.

¹Paul Carpenter and Mary Holthouse, Oregon Agricultural Cooperatives, Marketing - Purchasing (Corvallis: Oregon State College, December, 1946), pp. 1-11, (mimeographed).

TABLE 18

Cooperative Survey Questionnaire Returns

| <u>Information Received</u> | <u>Number</u> | <u>Percent</u> |
|---|---------------|----------------|
| Satisfactory Reports (completed forms, or the cooperative's financial reports included) | 31 | 23.6 |
| Blank Questionnaires Returned by Cooperatives* | 16 | 12.2 |
| Returned Forms, marked "out of business" or "not a co-op" | 5 | 3.8 |
| Cooperatives That Did Not Reply | <u>79</u> | <u>60.4</u> |
| Totals | 131 | 100.0 |

*One such report was of a nonbusiness cooperative. This report included good comments but no financial data.

One financial report included not only the data of the organization contacted but the complete financial reports of fourteen affiliated cooperatives not included in the original list. Available and usable information considered may be seen in Table 19. With data on hand from approximately one-half of the known business cooperatives in Oregon, it was felt that the results to be obtained from analyzing this large sample should be of significance for the purposes of this paper.

A number of cooperatives did not wish to take the time to analyze their financial reports; hence they sent copies of their annual reports. Many of these were in printed or mimeographed form. Several sent their typewritten audit reports from the auditors of the books of the respective organizations. In cases where it was so requested, financial or audit reports were returned to the cooperatives as soon as the data was obtained for the writer's needs.

Upon receiving reports from cooperatives, or upon obtaining data regarding cooperatives from other sources, a tally card (see Appendix I) was prepared for each cooperative report. For the analysis of the tally cards, relative to the effect of proposed changes in federal income tax laws, columnar sheets were used (see Appendix I). After computing the income tax under each proposed change, these computations were combined in order to reach totals for the various proposals. The results determined by these analyses appear in the following section.

TABLE 19

Data Available for Use in
Questionnaire Analysis

| <u>Type of Data Available</u> | <u>Number</u> | <u>Percent</u> |
|--|---------------|----------------|
| Satisfactory Reports | 31 | 21.4 |
| Additional Reports for Affiliated Cooperatives | 14 | 9.6 |
| Cooperatives from Which Some Data Are Available from Sources Other than the Questionnaire | <u>27</u> | <u>18.6</u> |
| Total Cooperatives with Available Data | 72 | 49.6 |
| Cooperatives from Which no Direct Data is Available | <u>73</u> | <u>50.4</u> |
| Total Known Active Business Cooperatives | 145 | 100.0 |

Analysis of Data

The data requested on the questionnaire (see Appendix I) was of two types: financial data, and questions to be answered. Before considering the financial data and the application of this data to proposed changes in the federal income tax laws, the answers to the questions will be analyzed. As with most of the financial data, the replies to questions will be considered as of 1949.

The first question was whether the cooperative organization being polled was a corporation. Of reports received, the following is revealed:

| | |
|--------------------------------|----------|
| Corporations. | 30 |
| Not Corporations | 0 |
| Question Not Answered. | <u>2</u> |
| Total | 32 |

There were no cooperative organizations replying that were not corporations. It is apparent that nearly all of the business cooperatives in Oregon are organized under the state corporation laws for cooperative associations.

The question as to whether the cooperative, if a corporation, was exempt or not exempt from federal income taxes was answered as follows by those stating that their organization was of corporate form:

| | |
|--|----------|
| Exempt from Federal Income Taxes. | 26 |
| Not exempt from Federal Income Taxes | <u>4</u> |
| Total | 30 |

If the proportion of exempt or nonexempt cooperatives shown here can be assumed to hold throughout the state, then it would seem that the proportion of exempt cooperative corporations in Oregon is much higher than the national trend. Joseph G. Knapp states regarding the exemption applicable to agricultural cooperatives that ". . . little more than half of them take this exemption."¹

The final question regarding procedures of the reporting cooperatives was relative to the treatment of nonmember patrons. Of the organizations answering the questions, the results of this question appear as follows:

| | |
|---|----------|
| Nonmember patrons awarded patronage refunds on the same basis as members. | 24 |
| Nonmember patrons not on the same basis | 3 |
| No nonmember patrons (added statement). | <u>3</u> |
| Total | 30 |

It seems to be a general plan, among the reporting organizations, to treat nonmember patrons on the same basis as members. Only three reporting cooperatives replied that nonmembers did not receive equal treatment with members relative to distribution of patronage refunds. Specific examination of the returned questionnaires reveals that two of the three whose treatment of nonmembers is not the same as members are cooperatives not exempt from federal income tax. That lack of identical treatment would appear to be a reason for nonexemption of these cooperatives. The other reporting cooperative that indicated

¹Joseph G. Knapp, "Answering Tall Tales About Co-ops," News for Farmer Cooperatives, Vol. XVII (October, 1950), p. 6.

not equal treatment of members and nonmembers was an exempt marketing cooperative. It is presumed that nonmember business was negligible in this case.

Of the four cooperatives not exempt from federal income taxes, two were of the organizations that did not accord nonmembers the same patronage refund treatment as members. One of the other nonexempt cooperatives indicated there were no nonmember patrons, with the fourth indicating the same treatment given nonmembers as members.

As indicated in Table 19, data from seventy-two cooperatives will be considered. Financial data received includes both from the questionnaires and from other sources. The data from sources other than returned questionnaires included generally the two items of gross business and net savings, or margins.

Table 20 shows the size of the cooperatives in Oregon, based on the gross business transacted.

The net savings, or margins, resulting from the operations of these cooperatives are shown in Table 21. There is not necessarily any connection between the amount of net savings and the total volume of business done, although obviously the largest amounts of net margins will have to come from those cooperatives with the larger volumes of business.

TABLE 20

Gross Annual Business
Cooperatives in Oregon

| <u>Gross Business</u> | <u>Number of Cooperatives</u> |
|------------------------------|-------------------------------|
| Less than \$100,000 | 9 |
| \$100,000 to \$200,000 | 7 |
| \$200,000 to \$500,000 | 20 |
| \$500,000 to \$1,000,000 | 16 |
| \$1,000,000 to \$2,000,000 | 9 |
| \$2,000,000 to \$5,000,000 | 4 |
| \$5,000,000 to \$10,000,000 | 5 |
| \$10,000,000 to \$25,000,000 | 2 |
| Over \$25,000,000 | <u>0</u> |
| Total Cooperatives | 72 |

Sources: Data returned with Cooperative Survey Questionnaire;
Pacific Northwest Cooperator, Vol. XIV-XVI, various
issues.

In the consideration of the various proposals, the cooperative organizations will be divided into groups that fit the graduated scale of the federal corporation income tax rates for the year 1949 (since that is the year of most of the data being used). This scale is as shown below, with the tax computation procedures given. The normal tax and the surtax are combined in all cases, since the basis for both is identical, so far as is known, for every cooperative whose data is under consideration.

| | |
|--|----------------------|
| Less than \$5,000 taxable income | 21% |
| \$5,000 to \$20,000 | \$1050 plus 23% |
| \$20,000 to \$25,000 | \$1500 plus 25% |
| \$25,000 to \$50,000 | \$5750 plus 53% |
| Over \$50,000. | 38% of entire income |

In all cases, it was assumed that the figures shown on the questionnaire or financial reports examined for net margins or savings would be comparable, without adjustment, to the operating figures for income tax purposes of similar businesses operating for profit.

The data to be used in the following analyses will be confined to those cooperatives whose questionnaire returns were complete, so as to insure comparability of data and computations for the various proposals under consideration. Although there are additional data available relative to some of the propositions, the results would not show their true significance if only partial data were considered from some cooperatives and full reports from others.

TABLE 21

Net Annual Savings
Cooperatives in Oregon

| <u>Net Savings (or Margins)</u> | <u>Number of Cooperatives</u> |
|---------------------------------|-------------------------------|
| Net Loss | 5 |
| Less than \$5,000 | 13 |
| \$5,000 to \$10,000 | 9 |
| \$10,000 to \$25,000 | 14 |
| \$25,000 to \$50,000 | 12 |
| \$50,000 to \$100,000 | 6 |
| \$100,000 to \$200,000 | 2 |
| \$200,000 to \$400,000 | 1 |
| \$400,000 to \$600,000 | 3 |
| Over \$600,000 | <u>0</u> |
| Total Cooperatives | 65 |

The first proposal listed in the preceding chapter would provide for the repeal of the present exemption allowed certain agricultural cooperatives that qualify under the Internal Revenue Code. This would require tax rates to be applied to dividends paid on stock, amounts retained in the reserves not allocated to members, and non-operating income.

In analyzing the data, it was noted that many cooperatives would not be affected, since there seemed to be few that reported any of the items for which the exemption was provided. The results of the analysis under this proposal are shown in Table 22.

Proposal number two would end the exclusion, or deduction, from income of all dividends distributed on a patronage basis. No distinction was made in this proposal as to the handling of dividends paid in cash or distributed in some other manner, such as by certificates of indebtedness, capital stock, or other noncash items.

This proposal would mean the continuance of the provisions of exemption for cooperative organizations at present exempt from taxation. It was assumed, however, that this proposition would be applicable to all cooperatives to the extent provided in the statement of the proposal. Table 23 gives the results of the data analysis relative to this proposal.

TABLE 22

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 1

| <u>Divisions of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-------------------------------------|-----------------------------------|------------------------------|
| No taxable amount | 31 | \$ - |
| Less than \$5,000 | 12 | 7,597.49 |
| \$5,000 to \$10,000 | 1 | 8,236.30 |
| \$10,000 to \$20,000 | 1 | 18,261.46 |
| \$20,000 to \$50,000 | 0 | - |
| \$50,000 to \$100,000 | 0 | - |
| Over \$100,000 | <u>0</u> | <u>-</u> |
| Totals | 45 | \$34,095.25 |

TABLE 23

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 2

| <u>Divisions of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-------------------------------------|-------------------------------|--------------------------|
| No taxable amount | 6 | \$ - |
| Less than \$5,000 | 21 | 43,203.31 |
| \$5,000 to \$10,000 | 6 | 46,945.83 |
| \$10,000 to \$20,000 | 4 | 52,673.55 |
| \$20,000 to \$50,000 | 3 | 94,026.24 |
| \$50,000 to \$100,000 | 1 | 60,450.40 |
| Over \$100,000 | <u>4</u> | <u>646,375.65</u> |
| Totals | 45 | \$943,674.98 |

The third proposal for tax change of cooperatives is similar to the second, with the exception that patronage dividends paid in cash would be excluded, for tax purposes, from income to the cooperative. The assumptions made relative to tax exemption in the previous proposal are applied here, also, in the data as presented in Table 24.

Proposal number four would tax, in effect, the entire net margins, or savings, of cooperatives as income to the cooperative, without any consideration as to the disposition of these net margins. The analysis of this proposal is based on the assumption that the net margins, or savings, as shown on the annual reports of the considered cooperative associations are the same figures that would be subject to tax were the proposal put into effect. The analysis of this proposal appears in Table 25.

The fifth proposal here considered is similar to the third in effect. The primary taxable items here are the noncash patronage dividends plus the dividends paid on capital stock. Mainly, this plan would tax the entire net margins, or savings, except for that part paid out in cash distributions. For many cooperatives, who do not make any payments of dividends on stock, the data considered for them in Table 26 is the same as under Table 24.

It would be well to state here, also, that for those cooperatives whose entire net margins or savings are allocated to patrons in a non-cash patronage refund, the effect will be identical under proposals two, three, four, and five.

TABLE 24

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 3

| <u>Division of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|------------------------------------|-------------------------------|--------------------------|
| No taxable amount | 6 | \$ - |
| Less than \$5,000 | 21 | 37,506.74 |
| \$5,000 to \$10,000 | 7 | 52,650.26 |
| \$10,000 to \$20,000 | 4 | 50,040.65 |
| \$20,000 to \$50,000 | 2 | 63,579.25 |
| \$50,000 to \$100,000 | 1 | 60,450.40 |
| Over \$100,000 | <u>4</u> | <u>640,312.75</u> |
| Totals | 45 | \$904,540.05 |

TABLE 25

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 4

| <u>Divisions of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-------------------------------------|-----------------------------------|------------------------------|
| No taxable amount | 3 | \$ - |
| Less than \$5,000 | 22 | 40,173.78 |
| \$5,000 to \$10,000 | 6 | 43,746.84 |
| \$10,000 to \$20,000 | 4 | 56,616.20 |
| \$20,000 to \$50,000 | 5 | 138,694.79 |
| \$50,000 to \$100,000 | 1 | 60,751.36 |
| Over \$100,000 | <u>4</u> | <u>674,941.99</u> |
| Totals | 45 | \$1,014,924.96 |

TABLE 26

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 5

| <u>Divisions of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-------------------------------------|-----------------------------------|------------------------------|
| No taxable amount | 5 | \$ - |
| Less than \$5,000 | 22 | 38,530.16 |
| \$5,000 to \$10,000 | 6 | 43,518.86 |
| \$10,000 to \$20,000 | 4 | 53,983.32 |
| \$20,000 to \$50,000 | 3 | 92,042.04 |
| \$50,000 to \$100,000 | 1 | 60,751.36 |
| Over \$100,000 | <u>4</u> | <u>658,783.23</u> |
| Totals | 45 | \$947,608.97 |

The considered change listed sixth provides for taxing those reserves not allocated to member-patrons. The analysis for this proposition, as can be noted in Table 27, includes many cooperatives for which there would be no apparent tax effect, since most of the reporting cooperatives have either no nonmember patrons or already make the entire allocation to members.

The seventh proposal, as with the one just prior, finds very few reporting organizations subject to tax. Comments on the returned questionnaires relative to business with nonmembers indicated generally a very small proportion of the total business, or no business, with nonmembers. The very few cooperatives whose report included segregation of member and nonmember business can be seen by Table 28 with the analysis of data for this proposed change in law.

The next possible change, the eighth being considered, is based on the same data as proposal three as far as the amounts subject to taxation are concerned, but has the additional point of allowing an exemption of \$25,000 before computing the tax. Only cooperative organizations are being considered here, of course, but the exemption as stated, and as provided in bills introduced before Congress in past sessions (see Appendix E), would apply to all corporations, to encourage the growth of small corporate organizations.

To conform to the tax rates provided in H. R. 4431, the tax divisions in Table 29 are adjusted accordingly.

TABLE 27

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 6

| <u>Divisions of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-------------------------------------|-------------------------------|--------------------------|
| No taxable amount | 42 | \$ - |
| Less than \$5,000 | 3 | 1,855.30 |
| \$5,000 to \$10,000 | 0 | - |
| Over \$10,000 | <u>0</u> | <u>-</u> |
| Totals | 45 | \$ 1,855.30 |

TABLE 28

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 7

| <u>Divisions of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-------------------------------------|-----------------------------------|------------------------------|
| No taxable amount | 42 | \$ - |
| Less than \$5,000 | 2 | 963.69 |
| \$5,000 to \$10,000 | 0 | - |
| \$10,000 to \$20,000 | 1 | 10,597.91 |
| Over \$20,000 | <u>0</u> | <u>-</u> |
| Totals | 45 | \$11,561.60 |

TABLE 29

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 8

| <u>Divisions of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-------------------------------------|-----------------------------------|------------------------------|
| No taxable amount | 28 | \$ - |
| Less than \$25,000 | 11 | 31,781.38 |
| \$25,000 to \$100,000 | 2 | 79,070.40 |
| Over \$100,000 | <u>4</u> | <u>526,512.75</u> |
| Totals | 45 | \$637,164.53 |

The ninth proposal is, for all the cooperatives being considered in this paper, identical with the seventh. The difference between the two proposals is that of limiting the exemption to farmers' cooperatives. Since all of the reporting cooperatives were of farm origin, the net savings of none of the organizations under consideration are here considered. Hence, the data under analysis would be the same as presented in Table 28, and is not here repeated.

In the tenth proposal, there is a departure from the usual sort of federal taxation procedure, with a tax being applied on the gross sales, or gross business, of the cooperative. It is assumed that such a tax, if adopted, would be applicable to the total turnover of the cooperatives, without any deductions for patronage refunds or any other items not deductible from the gross sales of similar type businesses not of a cooperative nature.

In the introduction of this proposal before the Congressional hearings, no rate of tax was mentioned. For purposes of illustration the writer has taken the rate of tax as in effect in the State of Indiana, one-half of one percent of the gross business. Note that the rate of one-half of one percent is purely arbitrary, chosen only because there is now such a rate in use in one of the states. The tendency in income tax levies is for the Federal rates to be higher than the state rates. The highest corporation income tax rate to be found in any state is the eight percent rate in Oregon.¹ The federal corporation income tax

¹"Quick Facts About State Income Taxes," State Tax Review, Vol. XI (January 5, 1950), p. 1.

rates begin (as of 1949) at twenty-one percent and are graduated to a maximum of thirty-eight percent of corporate net income. Were this trend of higher federal tax rates to be followed in the presently considered proposal, any such higher rates would increase the revenues proportionately; that is, a rate of one percent would mean just twice the revenue shown in Table 30. The breakdown used in Table 30 is the same as that used in Table 20.

As in the previous plan, the eleventh proposal considers an entirely different plan of taxation of cooperative organizations, a special tax on invested capital. In considering this proposal, it was rather difficult to determine just what would be considered invested capital. The writer has attempted to analyze the data at hand on the basis of the definition of equity invested capital used under the wartime excess profits tax. This meant the use of the figure for net worth as invested capital, including money or property paid in, stock distributions, and earnings and profits on hand.¹ There are included, for purposes of analysis, membership reserves, invested capital stock, and other items of surplus as the equity invested capital of the cooperatives. Essentially, this includes the items contained in the ordinary net worth of the cooperatives, the total assets less the liabilities to outside interests.

¹Internal Revenue Code, op. cit., pp. 1636, 1652.

TABLE 30

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 10

| <u>Amount of Gross Business</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|---------------------------------|-------------------------------|--------------------------|
| Less than \$100,000 | 8 | \$ 2,189.81 |
| \$100,000 to \$200,000 | 3 | 2,009.63 |
| \$200,000 to \$500,000 | 12 | 17,793.06 |
| \$500,000 to \$1,000,000 | 7 | 24,478.03 |
| \$1,000,000 to \$2,000,000 | 6 | 46,142.68 |
| \$2,000,000 to \$5,000,000 | 2 | 21,389.12 |
| \$5,000,000 to \$10,000,000 | 5 | 175,677.17 |
| \$10,000,000 to \$25,000,000 | 2 | 186,843.64 |
| Over \$25,000,000 | 0 | - |
| Totals | 45 | \$476,523.14 |

TABLE 31

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 11

| <u>Amount of Invested Capital</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-----------------------------------|-------------------------------|--------------------------|
| Less than \$10,000 | 2 | \$ 323.13 |
| \$10,000 to \$25,000 | 6 | 3,958.14 |
| \$25,000 to \$50,000 | 7 | 9,543.70 |
| \$50,000 to \$100,000 | 8 | 23,911.90 |
| \$100,000 to \$250,000 | 6 | 44,822.44 |
| \$250,000 to \$500,000 | 3 | 98,730.33 |
| \$500,000 to \$1,000,000 | 4 | 127,680.28 |
| \$1,000,000 to \$2,000,000 | 2 | 122,151.40 |
| Over \$2,000,000 | <u>3</u> | <u>397,959.08</u> |
| Totals | 45 | \$829,080.45 |

In Table 31, the division of cooperatives by size is purely arbitrary, attempting to show differences in the sizes of the various cooperative organizations.

As in proposal number ten, no rate of tax, as applied to invested capital, was mentioned. The choice of a rate of four percent was a purely arbitrary one, arrived at by taking one-half of the percent used in the World War II excess profits tax law for the credit to be allowed against the excess profits tax as computed.¹ The assumption made here is that if eight percent is allowed as an excess profits tax credit, and the excess profits tax itself was intended, among other things, to raise additional tax revenue for the federal government, a rate of four percent would probably not be far from what a government decision would call an equitable rate. Any variation from the rate chosen would be directly proportional in the effect upon the estimated revenue to be received (that is, a rate of two percent would result in exactly half the revenue shown here in the four percent rate).

The last proposal to be considered here is that of exempting all corporations, whether cooperative or profit, for earnings distributed as dividends. This would not apply exclusively to cooperative organizations, but they are the only corporations being considered here.

It will be noted by Table 32 that very few cooperatives reporting have failed to distribute their margins as dividends.

¹Ibid.

TABLE 32

Additional Federal Income Taxes
for Oregon Cooperatives
Proposal No. 12

| <u>Divisions of Taxable Amounts</u> | <u>Number of Cooperatives</u> | <u>Amount of Revenue</u> |
|-------------------------------------|-----------------------------------|------------------------------|
| No taxable amount | 41 | \$ - |
| Less than \$5,000 | 2 | 1,444.06 |
| \$5,000 to \$10,000 | 0 | - |
| \$10,000 to \$20,000 | 1 | 13,818.72 |
| \$20,000 to \$50,000 | 1 | 25,760.54 |
| \$50,000 to \$100,000 | 0 | - |
| Over \$100,000 | <u>0</u> | <u>-</u> |
| Totals | 45 | \$41,023.32 |

In a summary analysis of the dozen proposals here considered, Table 33 compares the amounts to be received in additional federal income taxes were each of the proposals to be adopted.

TABLE 33

Additional Federal Income Taxes
for Oregon Cooperatives
Comparison of 12 Proposals

| <u>Proposal Number</u> | <u>Cooperatives* Subject to Tax</u> | <u>Amount of Revenue</u> |
|----------------------------|---|------------------------------|
| 1 | 14 | \$ 34,095.25 |
| 2 | 39 | 943,674.98 |
| 3 | 39 | 904,540.05 |
| 4 | 42 | 1,014,924.96 |
| 5 | 40 | 947,608.97 |
| 6 | 3 | 1,855.30 |
| 7 | 3 | 11,561.60 |
| 8 | 17 | 637,164.53 |
| 9 | 3 | 11,561.60 |
| 10 | 45 | 476,523.14 |
| 11 | 45 | 829,080.45 |
| 12 | 4 | 41,023.32 |

*Data based on information from forty-five Oregon cooperatives in each instance.

CHAPTER V

CONCLUSIONS

During the 1947 hearings relative to tax-exempt cooperative organizations, the chairman of the House Committee on Ways and Means stated that "If we act on this matter [of taxing cooperatives], I am reasonably sure neither side will be satisfied, which will lead me to believe we have done pretty nearly the right thing."¹

It is logical that those whose business is being lost to nearby cooperatives should attempt to eliminate the cause of this disturbance to their business; namely, the cooperative enterprises themselves. The cooperatives cannot very well be eliminated, since most state laws make provision for their formation and operation. In the eyes of the competitors, the next best thing is to attempt to eliminate some of their competition. It appears to the ones opposed to the cooperative form of business that the cooperatives have grown too fast. The blame for this fast growth is placed on government tax exemption subsidies and favorable court rulings.

Logically, the cooperatives' reaction is to oppose anything which they believe will tend to put them out of business. Cooperative leaders seem to be convinced that their elimination from business entirely is

¹Committee on Ways and Means, op. cit., p. 2179.

the aim of their opposition. Thus, the leaders of the cooperatives in this country are putting forth whatever efforts are at their command to maintain approximately the status quo of taxation as far as cooperative organizations are concerned.

Several of the proposed tax changes considered included the point of repeal of the present exemption for agricultural cooperatives. The monetary loss to the cooperatives in Oregon by the repeal of Internal Revenue Code Section 101 (12) and (13) would be relatively small (see Tables 22 and 33). Dropping the exemption would not seem to add a particularly great hardship upon the cooperatives. In fact, some of the cooperatives remove themselves from an exempt status in order to expand more easily. The favorable publicity resulting from the removal of any exemption probably would prove helpful to cooperatives in the long run.

The proposals for special taxes on cooperatives, in lieu of applying income taxes, would seem to be not entirely practicable. Singling out one type of business for a tax on gross receipts, or sales, seems not equitable. It could force out of business the cooperatives that are doing the most for their members by operating with the smallest margins above actual expenses. Such cooperatives would have to pay a tax whether there were any margins or not. Eventually they would fail if they were competing with similar types of business with a comparable margin. In the state of Indiana, cooperative associations are subject to the state tax on gross receipts that is applicable to all businesses.¹ In that case, such a tax is equitable since the basis of the tax is business

¹Ibid., p. 2220.

transacted, no matter what the circumstances. If all businesses were subjected to a gross receipts tax on a national basis, the cooperatives should be subject to such a tax, as the tax would not then be discriminatory.

A tax on invested capital would be even less equitable than the gross receipts tax. Cooperatives not engaged in any business transactions would still be subject to the tax on invested capital. There was one such cooperative with a report in the survey, apparently in the process of closing its affairs. There were no ordinary business transactions during the year whatsoever, but the investment of over \$8,000 would have subjected the cooperative to a tax on invested capital. This sort of tax would appear to be discriminatory. In many cases the tax resulting from this proposal would be not much different (less in some instances) from that computed by other and more equitable means.

In light of the federal government's present desire for new funds during the current emergency, it seems unlikely that all corporation dividend distributions would be made nontaxable, as has been advocated. It seems likely that added taxation might more logically be imposed upon other types of business enterprise, such as partnerships, individual businesses, and the like.

The taxing of reserves not allocated, or savings not distributed, to members would seem to come under the heading of regulation of the cooperatives' capital structures, in insuring that margins or savings are distributed to members and patrons on a truly nonprofit basis. In Oregon, most cooperatives do not transact much business with nonmembers.

Such a regulation would generally prove to make little change in these cooperatives. It is probable that the provisions could help to regulate some nonfarm consumer cooperatives, whose business is usually not restricted to members. There were no such cooperatives that reported in the survey made, and apparently there are very few in Oregon.

The question most subject to controversy is that of the taxation of patronage refunds. Included is the entire amount of patronage refunds, whether distributed by cash or by some other procedure. The National Tax Equality Association representatives are vigorous in their insistence that refunds, or dividends, are mere distributions of profits. They consider it immaterial whether distributions are made on the basis of stock owned or on the basis of merchandise purchased. On the other hand, the National Association of Cooperatives representatives are insistent that refunds distributed on the basis of patronage are adjustments of price and are refunds of overcharges made (in the case of a purchasing cooperative) or of excess expense funds held out (in the case of a marketing cooperative). The overcharges and excesses are necessary because it is physically impossible to determine in advance the exact expenses to be sustained in a season's business operations.

The proponents of taxation of patronage dividends maintain that any such excesses, as just defined, are in reality profits. The fact that such are distributed on a patronage basis is of no consequence, since the patrons and the owners are essentially the same in most cooperatives.

The opponents to taxation of patronage dividends point to the example of a large automotive industrialist who at the beginning of a

year offered prospective purchasers of his product a refund if the total number of vehicles sold during the entire year were to exceed a certain pre-determined and advertised figure. The firm was successful in consummating the sales of more than the specified figure and made the agreed refunds at \$50.00 per vehicle. That refund was deductible from the figure of the sales, since it had been announced before the year began. Any nontaxable association, almost regardless of the way in which it was organized, could make such a refund without paying income taxes on it, provided there was a prior obligation to do so.¹

The refund procedure of cooperatives is likened to the above example. The by-laws of most cooperative associations include the specification that any net margins above expenses are to be returned to the patrons on the basis of purchases made, as soon as the amounts can be determined at the end of the year. These prior obligations, say the cooperators, make such amounts of excesses over actual expenses not the property of the cooperatives, but actually property held in trust for the patrons, and the patrons must so regard the same as far as their own finances are concerned.

The distribution of margins on a patronage basis seems essential to the nonprofit character of any cooperative association. It is the distribution to patrons on the basis of actual patronage that is the

¹Lyman S. Hulbert, General Counsel, Farm Credit Administration, speech before the Twenty-seventh Annual Meeting of the Agricultural Cooperative Council of Oregon, Portland, Oregon, November 15-16, 1948, Minutes (not published--typewritten copy of proceedings courtesy of Paul Carpenter, Secretary), pp. 62-63.

difference between a cooperative and a profit corporation. The corporation for profit is attempting to secure these margins for the owners of the business. Profit corporations can reduce prices to patrons or make refunds on a patronage basis and reduce their own tax liability. It might be thought that there would be no one to pay the taxes if all businesses made patronage refunds and thus avoided the corporation taxes. Taxation would then revert to the individual. Savings made in prices would enable the individuals to pay more taxes, in order to absorb the tax shortage that would develop; hence government functions should not be affected by a more general use of the procedure of making patronage refunds.

The regulations could be altered to require the taxation of margins returned to patrons, whether by cash or not. It seems likely that the cooperative organizations would make adjustments of current prices at very short intervals, to insure a minimum of net margins or savings. This would eliminate the application of the federal income tax upon the cooperatives, and the procedure of adjusting prices for the benefit of the patrons would be retained. There is some risk involved in such a procedure of price-cutting. Unforeseen circumstances could cause financial difficulties with the cooperatives, but efficient management would be able to operate the businesses with a minimum of actual risk.

A criticism of the procedures of cooperative associations is their handling of funds available through price overcharges. These funds are supposed to be refunded to the patrons, but actually the funds often are

not returned but are retained in the business through the procedure of allocation. By this procedure, each member-patron is credited on the books of account for his share of the net margins, but the cash is kept in the business. The membership reserves created by the allocations made are a part of the cooperatives, and each member-patron has his allocated share of the net margins shown on the books as a portion of his investment. It has been proposed by critics that such retentions of funds in the business be subject to tax, since this represents capital accumulations rather than distributions of margins or savings.

This procedure (the retention of funds by allocation rather than making cash payment) seems contrary to the intent of the cooperative principle of patronage distributions. It is recommended that patronage distributions be paid in actual cash within a specified period of time in order to be deductible from gross income for tax purposes. One year after the close of a fiscal year should be adequate as a time limit for such payments to be made and still be deductible.

A comment was received regarding the exemption of dividends paid by all corporations to the effect that the income tax is misused when it attempts to regulate the dividend policies of corporate taxpayers.¹ This comment does not seem applicable in the case of patronage refunds. The patronage refunds supposedly have no connection with the net worth of a cooperative but are debts payable to the patrons.

The present methods of making allocations are considered the equiv-

¹A. W. Adcock, correspondence with the author, *op. cit.*

alent of reinvestment of net margins or savings. However, such a procedure of reinvestment should not be compulsory. A common practice of cooperative associations is to have decided at an annual meeting the disposition to be made of net margins or savings for the year just ended. The members may vote to divide the amounts to be refunded into part cash payments and part allocations, or they may decide to allocate the entire amount of the patronage refund. The majority vote (usually) rules, and those who might wish to receive their patronage refunds in cash are forced to leave them in the cooperative—as an investment, true enough, but involuntarily so. It would be a simple matter to distribute the patronage refund cheques to all patrons and to seek the reinvestment of funds from the members on the basis of the needs of the cooperative.

No objection is raised to a current common practice of allowing accumulated patronage refunds to pay for the first share of stock, or the membership fee, required for membership in a cooperative association. Such retention of funds should not be subject to taxation in the cases of cooperatives that have been following such a practice through the years. Beyond the first share of stock, however, retaining cash from refunds supposedly distributed would seem contrary to public policy.

It is recommended that the courts' definitions of cash distributions be altered to allow recipients of cash patronage refunds to use such distributions for other than reinvestment if they so desire. The burden of the need for reinvestment of patronage refunds should rest upon the actual financial condition of a cooperative rather than the

whims of the Board of Directors, whose recommendations are normally accepted without much opposition in presentation to the membership.

There could be some clarification made as to the definition of "any necessary reserve" appearing in the present exemption. If the exemption should be repealed, cooperative organizations would be subject to the same regulations as profit corporations. If the exemption is retained, it would be well to place limits upon the amounts that might be placed in allowable reserves. This would not include depreciation and other usual valuation reserves, since tax regulations already require reasonable judgment regarding such reserves.

The distribution of patronage refunds provides funds that are taxable to the recipients. It should not work undue hardship upon the office forces of cooperative associations to provide the government with reports similar to those now required of profit corporations for dividend distributions. These could be similar to Form 1099 and the accompanying summary Form 1096 (Appendix B). The information included might not be as extensive as shown on the Oregon Form 99-CA (Appendix D), but similar information probably should be shown. Form 1099 requires the reporting of dividend distributions to individuals of amounts over \$100 within a calendar year. A similar form for cooperative associations should be consistent with the reporting for profit corporations and should not require information for distributions less than \$100 per patron. Nonexempt cooperative associations are at present required to file Forms 1099 and 1096 for any distributions of dividends on capital stock that amount to more than \$100 for any one individual. The addi-

tional form herein recommended would be intended for patronage refunds but would be necessary in the case of any individual whose combined dividends on stock and on patronage amount to \$100.

In summary, it appears that the recommendations would not satisfy either of the extreme views relative to the controversy.

Those groups that favor the cooperatives and the present tax status would not approve the recommendations, since they eliminate the tax exemption and may tend to deprive the cooperatives of the funds so easily obtained in the past. Such funds seem often to be derived by involuntary contributions on the part of the patrons.

Those groups proposing the fullest taxation of cooperatives would not accept the recommendations, since some distributions would be allowed that are not taxable. However, a comparable procedure of patronage refunds could be used by any business that would help its patrons rather than its owners through the reduction of profits.

The recommendations would eliminate the criticism of favoritism through tax exemption. Cooperatives and their investments would be made to stand on their own merits. Efficiency of management and better accounting procedures for those cooperatives with inadequate systems of books should result. Cooperatives should operate, under the recommendations, with better service to patrons, in order to insure patronage and attract adequate investment.

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APPENDIX A

EXEMPTION FOR COOPERATIVE ASSOCIATIONS

INTERNAL REVENUE CODE

Section 101

.....the following organizations shall be exempt from taxation.....

(12) Farmers', fruit growers's or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; nor shall exemption 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. Such an

association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 per centum of the value of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph;

(13) Corporations organized by an association exempt under the provisions of paragraph (12), or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, upon dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose;

Form 1028
U. S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
(Revised Oct. 1949)

EXEMPTION APPLICATION

FOR USE OF FARMERS', FRUIT GROWERS', OR LIKE ASSOCIATIONS CLAIMING
EXEMPTION FROM FEDERAL INCOME TAX UNDER SECTION 101 (12) OF THE
INTERNAL REVENUE CODE AND THE CORRESPONDING PROVISIONS
OF PRIOR REVENUE ACTS

(To be made only by a principal officer of the organization claiming exemption)

(Date)

I, _____, declare under the penalties of perjury that
(Name of declarant)
I am the _____ of the _____,
(Title of declarant) (Full name of association)
located at _____, and that
(Full address, including street and number)
the following answers and statements relative to the year ended _____, 19____
(Fiscal or calendar year on basis of which your books are kept)
are true to the best of my knowledge and belief:

1. Date association was organized _____

2. Purpose for which organized _____

3. Is the association incorporated? _____ If so, state:
(Yes or no)

(a) Date incorporated _____

(b) Under the laws of what State? _____

4. State the amount of each class of capital stock outstanding and the value of the consideration for which it
was issued _____

(a) State the rate of dividend paid on each class of such capital stock _____

*5. State the amount of each class of capital stock owned by:

(a) Producers _____

(b) Nonproducers _____

(c) Persons who were nonproducers at the time stock was acquired _____

*6. State the circumstances surrounding the acquisition of your capital stock by nonproducers _____

(a) What provision is made for retiring the capital stock held by nonproducers? _____

* The information called for in 5 and 6 above need not be supplied with respect to nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends.

7. If the association issues any nonvoting preferred stock, explain whether the owners thereof may participate in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends

8. What is the legal rate of interest in the State in which the association is incorporated?

9. Does the State law require the maintenance of a reserve? If so, state the amount of such reserve, \$

10. Does the association maintain any reserve or reserves other than required by the State law?

If so, state:

(a) Amount of each reserve

(b) Purpose for which each reserve is maintained

11. What are the requirements for membership in the association?

12. Does the association deal with both members and nonmembers?

13. Value of agricultural products marketed (or handled) for:

(a) Members (1) actually produced by such members, (2) purchased or otherwise acquired by such members

(b) Nonmembers (1) actually produced by such nonmembers, (2) purchased or otherwise acquired by such nonmembers

14. Value of supplies and equipment purchased for or sold to:

(a) Members who were producers

(b) Nonmembers who were producers

(c) Persons who were neither members nor producers

(Do not include this amount in Item 14(b))

15. Amount of business done for the United States Government or agencies thereof

* If it is necessary to own one or more shares of stock in order to become a member, only the amount of business transacted with persons actually owning the required number of shares should be included in 13(a) and 14(a).

16. State fully the manner in which distribution is made of the proceeds of products marketed for:

(a) Members

(b) Nonmembers

17. State fully the plan followed in charging for supplies and equipment purchased for:

(a) Members

(b) Nonmembers

18. Does the association pay patronage dividends? If so, explain how such payments are made and whether in cash or otherwise:

(a) Members

(b) Nonmembers

(c) Were all of the net earnings for the year, after payment of dividends, if any, on capital stock, distributed as patronage dividends?

If not, state the purpose for which the balance of the net earnings was used or held

(d) If any portion of the net earnings was set aside in a reserve or surplus, or was used to acquire capital assets, or to reduce indebtedness thereon, was such portion allocated on the records to all patrons on a patronage basis?

19. Is the information contained herein representative of the purposes and activities of the association since January 1, 1925, or date of organization, if organized subsequent to that date? If not, state the changes that have occurred and dates of such changes

20. Has the association filed income tax returns? If so, for what year or years?
 (Yes or no)

21. Attach to this declaration a classified statement of the receipts and expenditures of the organization during the year herein covered and a complete statement of the assets and liabilities as of the end of that year; a copy of the articles of incorporation, if incorporated, or, if not incorporated, a copy of the constitution, articles of association, or other document setting forth the aims and purposes of the organization; and a copy of the bylaws, or other similar code of regulations. (N. B.—When specifically requested by the Commissioner, a separate declaration and financial statements must be submitted for each year for which exemption is being claimed.)

.....
 (Signature of officer making declaration)

IMPORTANT

A mere claim or contention by an organization that it is exempt from income tax under section 101 of the Internal Revenue Code and the corresponding provisions of prior revenue acts will not relieve the organization from filing income tax returns and paying the tax. Unless the Commissioner has determined that an organization is exempt, it must prepare and file a complete income tax return for each taxable year of its existence. Accordingly, every organization that claims to be exempt should furnish the information and data specified herein, together with any other facts deemed material to the question, with the least possible delay, in order that the Commissioner can determine whether or not it is exempt. As soon as practicable after the information and data are received, the organization will be advised of the Commissioner's determination, and, if it is held to be exempt, no further returns of income, other than an annual return of information on Internal Revenue Form 990, will be required.

(If the space provided for the insertion of information or data under any of the questions herein is inadequate, additional sheets may be used which should be properly identified and securely attached hereto.)

APPENDIX B

Form 990
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
(Revised Oct. 1948)

UNITED STATES
ANNUAL RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX UNDER SECTION 101 OF THE
INTERNAL REVENUE CODE, OR UNDER CORRESPONDING PROVISIONS OF PRIOR REVENUE ACTS
(Statement of gross income, receipts, disbursements, etc., as required under Section 54 (f) of the Internal Revenue Code, as added by Section 117 of the Revenue Act of 1943) (See Instruction 1)

For Calendar Year _____

or Fiscal Year Begun _____, and Ended _____

PRINT PLAINLY LEGAL NAME AND ADDRESS OF THE ORGANIZATION

This return must be filed on or before the 15th day of the 5th month following the close of the annual accounting period. Return must be filed with the Collector of Internal Revenue for the district in which is located the principal place of business or principal office of the organization.

(Give name in full) _____
(Street and number) _____
(Post office) _____ (County) _____ (State) _____
Have you been advised by Bureau letter of your exemption? _____ If so, state
date of letter and subsection of section 101 under which you are exempt _____
State nature of your activities _____

File Code _____
Serial No. _____
District _____

1. What is the legal form of your organization (corporation, trust, unincorporated association, etc.)? _____
2. In what year was your organization formed? _____
In what State or country? _____
3. If this is your first return under your present name, indicate whether (a) completely new organization or (b) successor to previously existing organization(s) If successor to previously existing organization(s), give name(s) and address(es) of the predecessor organization(s) _____
4. Enter the approximate number of members (if a cooperative) or stockholders at the close of the year. Members _____
Stockholders: Preferred _____; Common _____
5. If you have capital stock issued and outstanding, state with respect to each class of stock (a) the number of shares outstanding, (b) the number of shares held by individuals, (c) the number of shares held by organizations, and (d) whether any dividends may be paid _____
6. Are you affiliated with any other organization whether or not tax exempt? _____ If so, give name of organization and nature of affiliation _____
7. State the names and addresses of the officers or other persons having care of the books of account, minutes, correspondence, and other documents and records of the organization:
(Name and title) _____ (Address) _____
(Name and title) _____ (Address) _____
8. Have any changes not previously reported to the Bureau been made in your articles of incorporation or bylaws or other instruments of similar import? _____ If so, attach a copy of the amendments. (Yes or no)
9. Have you had any sources of income or engaged in any activities which have not previously been reported to the Bureau? _____ If so, attach detailed statement. (Yes or no)
10. Do you derive any rents or royalties from property which you have purchased from the lessee? _____ Is any property of the organization leased or rented to, or does the organization lease or rent any property from, any person or groups of persons directly associated with the organization filing this return? _____ If either answer is "yes," give a detailed statement. (Yes or no)
11. Check whether this return was prepared on the cash or accrual basis.
12. If you were held exempt under section 101 (4), state the total amount of mortgage loans made during the year to (a) members, \$ _____; (b) nonmembers, \$ _____
13. If you were held exempt under section 101 (6), state whether any of your activities consisted of carrying on propaganda or otherwise attempting to influence legislation _____ If so, attach detailed statement. (Yes or no)
14. Farmers' cooperative marketing and purchasing organizations shall also state—
(a) Number of shares of voting stock owned by (1) producers _____; (2) nonproducers _____
(b) Were nonmembers charged the same as members for marketing and merchandise? _____ (Yes or no)
(c) State—
Sales for _____ \$ _____ Members Nonmembers
Purchases for _____ \$ _____
Patronage dividends to _____ \$ _____
(d) Value of agricultural products marketed (or handled) for members (1) actually produced by such members, \$ _____; (2) purchased or otherwise acquired by such members, \$ _____; for nonmembers (1) actually produced by such nonmembers, \$ _____; (2) purchased or otherwise acquired by such nonmembers, \$ _____
(e) Value of supplies and equipment purchased for or sold to (1) members, \$ _____; (2) nonmembers who were producers, \$ _____; (3) nonmembers who were not producers, \$ _____
(f) Amount of business done for United States Government or agencies thereof, \$ _____

1. Dues, assessments, etc., from members, excluding service and other charges properly included under item 7 (see Instruction 5)..... \$.....
2. Dues, assessments, etc., from affiliated organizations (see Instruction 5).....
3. Contributions, gifts, grants, etc., received (see Instruction 5).....
4. Interest.....
5. Dividends.....
6. Rents.....
7. Gross receipts from business activities (state nature):

| | |
|----------|---------|
| (a)..... | \$..... |
| (b)..... | ..... |
| (c)..... | ..... |
| (d)..... | ..... |
8. Patronage dividends (or patronage refunds) received.....
9. Gain (or loss) from sale of assets, excluding inventory items (from Schedule B).....
10. Other income (if more than 10 percent of item 11, attach itemized schedule. Also see Instruction 5).....
11. Total of items 1 to 10, inclusive..... \$.....

DISPOSITION OF INCOME, DUES, CONTRIBUTIONS, ETC.

- A. Expenses attributable to income items 6 and 7 (See Instruction 6):**
12. Cost of goods sold (or, in the case of farmers' cooperatives, purchases for or advances to patrons)..... \$.....
 13. Compensation of officers, directors, trustees, etc.....
 14. Wages, salaries, and commissions (other than compensation of officers, directors, trustees, etc.).....
 15. Interest.....
 16. Taxes (such as property, income, social security, unemployment taxes, etc.).....
 17. Rent.....
 18. Depreciation.....
 19. Miscellaneous expenses (state nature):

| | |
|----------|---------|
| (a)..... | \$..... |
| (b)..... | ..... |
| (c)..... | ..... |
| (d)..... | ..... |
- B. Other expenses:**
20. Dues, assessments, etc., to affiliated organizations.....
 21. Compensation of officers, directors, trustees, etc. (not included under item 13).....
 22. Wages, salaries, and commissions (not included under item 14).....
 23. Interest (not included under item 15).....
 24. Taxes (not included under item 16).....
 25. Rent (not included under item 17).....
 26. Miscellaneous expenses not elsewhere classified (state nature):

| | |
|----------|---------|
| (a)..... | \$..... |
| (b)..... | ..... |
| (c)..... | ..... |
| (d)..... | ..... |
- C. Contributions:**
27. Contributions, gifts, grants, etc., paid (state to whom paid):

| | |
|----------|---------|
| (a)..... | \$..... |
| (b)..... | ..... |
| (c)..... | ..... |
| (d)..... | ..... |
- D. Other dispositions:**
28. Benefit payments to or for members or their dependents:
 - (a) Death, sickness, hospitalization, disability, or pension benefits.....
 - (b) Other benefits.....
 29. Dividends (other than patronage dividends) and other distributions to members, shareholders, or depositors.....
 30. Cash patronage dividends (or patronage refunds) (for farmers' cooperatives only).....
 31. Patronage dividends (or patronage refunds) in stock, notes, credits, or other evidence of equity or indebtedness (for farmers' cooperatives only).....
 32. Additions (if any) to reserves (attach itemized schedule).....
 33. Additions (if any) to surplus.....
 34. Total of items 12 to 33, inclusive (see Instruction 7)..... \$.....

Schedule A.—BALANCE SHEETS (See Instruction 8)
(To be completed if gross value of assets is \$25,000 or more)

| ASSETS | BEGINNING OF YEAR | | END OF YEAR | |
|---|-------------------|---------|-------------|---------|
| | Amount | Total | Amount | Total |
| 1. Cash..... | | \$..... | | \$..... |
| 2. Notes and accounts receivable..... | \$..... | | \$..... | |
| Less: Reserve for bad debts..... | | | | |
| 3. Inventories..... | | | | |
| 4. Investments in governmental obligations..... | | | | |
| 5. Investments in nongovernmental bonds, etc..... | | | | |
| 6. Investments in corporate stocks (see Instruction 9)..... | | | | |
| 7. Other investments (itemize)..... | \$..... | | \$..... | |
| 8. Capital assets: | | | | |
| (a) Depreciable (and depletable) assets (attach itemized schedule)..... | \$..... | | \$..... | |
| Less: Reserve for depreciation (and depletion)..... | | | | |
| (b) Land..... | | | | |
| 9. Other assets (itemize)..... | \$..... | | \$..... | |
| 10. TOTAL ASSETS..... | | \$..... | | \$..... |
| LIABILITIES | | | | |
| 11. Accounts payable..... | | \$..... | | \$..... |
| 12. Bonds, notes, and mortgages payable: | | | | |
| (a) With original maturity of less than 1 year..... | \$..... | | \$..... | |
| (b) With original maturity of 1 year or more..... | | | | |
| 13. Other liabilities (itemize)..... | \$..... | | \$..... | |
| 14. Surplus reserves (itemize)..... | \$..... | | \$..... | |
| 15. Capital stock: | | | | |
| (a) Preferred stock..... | \$..... | | \$..... | |
| (b) Common stock..... | | | | |
| 16. Membership certificates..... | | | | |
| 17. Paid-in or capital surplus (or donated capital if a trust)..... | | | | |
| 18. Earned surplus and undivided profits..... | | | | |
| 19. TOTAL LIABILITIES..... | | \$..... | | \$..... |

Schedule B.—GAINS AND LOSSES FROM SALE OF ASSETS, EXCLUDING INVENTORY ITEMS

| 1. Description of property | 2. Date acquired | 3. Book value at time of sale | 4. Gross sales price (contract price) | 5. Cost (or value at time of acquisition if donated) | 6. Expense of sale and cost of improvements subsequent to acquisition | 7. Depreciation since acquisition | 8. Gain or loss (col. 4 plus col. 7 minus the sum of cols. 5 and 6) |
|---|------------------|-------------------------------|---------------------------------------|--|---|-----------------------------------|---|
| (a)..... | | \$..... | \$..... | \$..... | \$..... | \$..... | \$..... |
| (b)..... | | | | | | | |
| (c)..... | | | | | | | |
| (d)..... | | | | | | | |
| (e)..... | | | | | | | |
| (f)..... | | | | | | | |
| Total net gain (or loss) (enter as item 9, page 2)..... | | | | | | | \$..... |

Supplemental information required for Schedule B

State with respect to each item of property reported in Schedule B:

- (1) How property was acquired.....
- (2) Relationship of purchaser to vendor organization, or founder, officers, directors, or trustees of vendor organization.....
- (3) If property was not sold for cash, state terms of sale.....

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the organization for or by which this return is made, each for himself declares under the penalties of perjury that this return has been examined by him and is to the best of his knowledge and belief a true, correct, and complete return

[CORPORATE SEAL] _____ (President or other principal officer) (State title) _____ (Date) _____ (Treasurer, Assistant Treasurer, or Chief Accounting Officer) (State title) _____ (Date)

The following additional declaration shall be executed by the person other than an officer or employee of the organization actually preparing this return:

I declare under the penalties of perjury that I prepared this return for the organization(s) named herein and that this return is to the best of my knowledge and belief a true, correct, and complete return.

(Name of firm or employer, if any)

(Signature of person preparing this return)

(Date)

GENERAL INSTRUCTIONS

1. An annual statement of gross income, receipts, disbursements, etc., on this form, is required by law of every organization which is exempt from tax under the provisions of section 101 of the Internal Revenue Code, excepting only a (1) religious organization exempt under section 101 (6); (2) educational organization exempt under section 101 (6), if it normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; (3) charitable organization, or an organization for the prevention of cruelty to children or animals, exempt under section 101 (6), if supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or primarily supported by contributions of the general public; (4) organization exempt under section 101 (6), if operated, supervised, or controlled by or in connection with a religious organization exempt under section 101 (6); (5) fraternal beneficiary society, order, or association solely exempt under section 101 (3); or (6) corporation exempt under section 101 (15), if wholly owned by the United States or any agency or instrumentality thereof, or a wholly owned subsidiary of such corporation.

2. This form shall be prepared in accordance with the method of accounting regularly employed in keeping the books of your organization.

3. Fill in the items on pages 2 and 3 of this form to the extent that they apply to your organization.

4. A group return on this form may be filed by a central, parent, or like organization for two or more of its chartered, affiliated, or associated local organizations which (a) are subject to its general supervision and examination, (b) are exempt from tax under the same provision of revenue law as the central organization, (c) have authorized it in writing to include them in such return, and (d) have filed with it statements, verified under oath or affirmation, of the information required to be included in this return. Such group return shall be in addition to the separate return of the central organization, but in lieu of separate returns by the local organizations included in the group return. There shall be attached to such group return a schedule showing separately (a) the total number, names, and addresses of the local organizations included, and (b) the same information for those not included therein. In addition, if the parent or any one affiliated organization included in a group return has income of more than \$5,000 from rents and business activities includible

under items 6 and 7 of this form, there shall be submitted for such parent and each such affiliate (1) a separate statement showing the information called for in items 6 and 7 and items 12 through 19, and (2) a separate balance sheet as provided in Schedule A of the return but only if the gross value of the assets of such parent or such affiliate is \$25,000 or more.

5. In all cases where item 1, 2, 3, or 10 includes money or property amounting to \$3,000 or more, which was received directly or indirectly from one person, in one or more transactions during the year, itemized schedules showing the total amount received from and the name and address of each such person shall be attached to this return. (The term "person" includes individuals, fiduciaries, partnerships, corporations, associations, and other organizations.) Receipts by a "central" organization from organizations included in a group return need not be itemized in the "central" organization's separate return.

6. If the total of income items 6 and 7 is not more than \$5,000, amounts includible in item 12 through item 19 may be entered under item 21 through item 26 under the appropriate headings. Where sections "A" and "B" must both be completed, items of expense may be divided between these sections on the basis of accounting records, or, if such records do not provide for this division, any items of expense which do not fall wholly under either of these sections may be divided on any reasonable basis, such as an approximation of the use of a facility or the time spent by an individual.

7. If item 34 does not equal item 11, attach a schedule accounting for the difference.

8. The balance sheets, Schedule A, should agree with the books of account or any differences should be reconciled. All organizations reporting to any national, State, municipal, or other public officer may submit, in lieu of Schedule A, copies of their balance sheets prescribed by any such authority as at the beginning and end of the taxable year.

9. In all cases where line 6, Schedule A, includes 10 percent or more of any class of stock of any corporation, attach a list showing the name of the corporation, the number of shares of each type of stock owned (including information indicating whether the stock is voting or nonvoting), and the book value of the stock included in line 6.

10. For further information see regulations under sections 54 (f) and 101 of the Internal Revenue Code.

Form 1099
 U. S. TREASURY DEPARTMENT
 INTERNAL REVENUE SERVICE
 UNITED STATES
**INFORMATION RETURN FOR
 CALENDAR YEAR 1950**

INSTRUCTIONS TO PAYORS

Prepare one of these forms for each payee in accordance with the instructions on return Form 1096. **THIS FORM IS NOT REQUIRED WITH RESPECT TO WAGE PAYMENTS REPORTED ON FORM W-2a.**

Forward with return Form 1096 so as to reach the Commissioner of Internal Revenue, in care of Processing Division, C. C. Station, Kansas City 2, Missouri, on or before February 15, 1951.

Copy of this form as filed with the Government should be furnished to the employee whose income is reported in first column to assist him in preparing his income tax return.

To
 WHOM
 PAID

1950

(Print full name and home address) (Show employee's social security number, if any. If employee is a married woman, name of husband should also be furnished)

KIND AND AMOUNT OF INCOME PAID

| Salaries, Fees, Commissions, or Other Compensation. Do not include amount reported on Form W-2a | Interest on Notes, Mortgages, Etc. | Rents and Royalties | Annuities, Pensions, Alimony, and Other Fixed or Determinable Income | Foreign Items (\$600 or more) | Dividends (\$100 or more) (Total paid, including amounts claimed nontaxable) |
|---|------------------------------------|---------------------|--|-------------------------------|--|
| (\$600 or more aggregate amount of above items) | | | | | |
| \$ | \$ | \$ | \$ | \$ | \$ |

By
 WHOM
 PAID
 (Name and address)

16-62580-1

(OVER)

FORM 1096
U. S. Treasury Department
Internal Revenue Service

UNITED STATES
ANNUAL INFORMATION RETURN

1950

**SUMMARY OF REPORTS OF SALARIES OF \$600 OR MORE, OTHER INCOME PAYMENTS OF \$600 OR MORE,
DIVIDEND PAYMENTS OF \$100 OR MORE, AND DISTRIBUTIONS IN LIQUIDATION OF \$600 OR MORE**

| | | |
|---|------------------|-----------------|
| | | (Date received) |
| ----- (Name of payor of income) | | |
| ----- (Street and number or rural route) | | |
| ----- (City or town, postal zone number) | ----- (State) | |

INSTRUCTIONS

1. When and Where to File.—This return (Form 1096) must be used to summarize and transmit copies of Forms 1099 and 1099L, in accordance with the instructions hereon, and delivered together with such forms on or before February 15, 1951, to the Commissioner of Internal Revenue, in care of Processing Division, C. C. Station, Kansas City 2, Missouri.

2. General Rules for Form 1099.—Except as specified in Instruction 3, a separate information return on Form 1099 must be made by every individual, partnership, and corporation with respect to each individual to whom payments were made during the calendar year 1950 in the following amounts:

a. Salaries, wages, fees, commissions, and other compensation for personal services totaling \$600 or more, to the extent not reported on Form W-2a or Form 1042. (See definition of compensation in paragraph 4, below.)

b. Interest, rent, premiums, annuities, royalties, or other fixed or determinable income totaling \$600 or more.

c. Dividends (other than distributions in liquidation) totaling \$100 or more.

3. Exclusions from Form 1099.—No report on Form 1099 is required in the following cases: (a) Wages reported on Form W-2a; (b) payments of any type to a corporation; (c) payments to a nonresident alien reported on Form 1042; (d) distributions or salaries to members of a partnership reported on Form 1065; (e) distributions to beneficiaries of trusts or estates reported on Form 1041; (f) rent paid by a tenant to a real estate agent; (g) payments made by a broker to his customers; and (h) interest on tax-free covenant bonds reported on Form 1012.

4. Compensation Defined.—Compensation for personal services to be reported on Form 1099 includes not only wages and salaries in the ordinary meaning of the terms but also other items such as (a) the value of living quarters or meals furnished in lieu of cash compensation for personal services, (b) traveling or other expense allowances for which the employee is not required to submit an itemized account showing that such allowances were ordinary and necessary expenses in the employer's business, and (c) insurance premiums which under section 29.165-6 of Regulations 111 are income to the employee for the year in which the insurance is purchased. Such items should be separately identified on Form 1099.

5. Effect of Form W-2a.—Where the aggregate compensation of an employee is \$600 or more and a portion thereof is reported on Form W-2a, the remainder of the compensation must be reported on Form 1099, regardless of amount. For example, if the total compensation paid to an employee is \$600

of which \$400 is reported on Form W-2a, the remaining \$200 must be reported on Form 1099.

6. Annuity Payments to be Reported.—Annuity payments shall be reported in an amount equal to 3 percent of the aggregate premiums or consideration paid for the annuity (whether or not paid during the taxable year) until the aggregate amount paid to, and not required to be included in the gross income of, the annuitant equals the aggregate premiums or consideration paid for such annuity; thereafter, the entire amount of the annuity payments shall be reported.

7. Foreign Items.—In the case of foreign items, i. e., interest upon the bonds of a foreign country or of a nonresident foreign corporation not having a fiscal or paying agent in the United States, or dividends upon the stock of such corporation, a report on Form 1099 shall be filed by the bank or collecting agent accepting the items for collection, if the amount paid to an individual (citizen or resident of the United States), a resident fiduciary, or a resident partnership any member of which is a citizen or resident, during the calendar year 1950 is \$600 or more.

8. Nontaxable Distributions.—The reverse of this form should be used to explain dividend distributions made in the ordinary course of business (but not distributions in liquidation) which are considered by a corporation to be nontaxable or partly nontaxable to the shareholders. Such report should be filed not later than February 1, 1951.

9. Form 1099L—Distributions in Liquidation.—Every corporation making any distribution in liquidation of the whole or any part of its capital stock shall make a report on Form 1099L with respect to each shareholder to whom such distribution amounting to \$600 or more was made during the calendar year 1950, unless such distribution is one with respect to which information is required to be filed pursuant to section 112(b) (6), 112(g), or 371 of the Internal Revenue Code and the regulations issued thereunder. A copy of the resolution of the board of directors authorizing payments in liquidation should be attached hereto.

10. Calendar Year Basis.—Reports on Forms 1099 and 1099L are required to be rendered on the basis of the calendar year even though the income tax return of the payor is filed on the basis of a fiscal year.

11. Verification.—Returns of individuals must be signed by the individual or his duly authorized agent. Returns of corporations, partnerships, etc., must be signed by an officer of the corporation or member of the partnership.

I hereby declare under the penalties of perjury that to the best of my knowledge and belief the accompanying reports on Form 1099 and Form 1099L, and/or the statements on the reverse of this form, including any accompanying schedules, constitute a true and complete return of payments of the above-described classes of income made by the person or organization named above during the calendar year 1950.

Number of reports on Form 1099 attached _____
Number of reports on Form 1099L attached _____

(Signature)

(Title)

This side of form should NOT be filled in when distributions are considered to be taxable in their entirety as dividends

STATEMENT RELATING TO DIVIDEND DISTRIBUTIONS MADE IN ORDINARY COURSE OF BUSINESS CLAIMED TO BE NONTAXABLE OR PARTLY NONTAXABLE

In the event the corporation is of the opinion that the dividend distributions made during 1950 are, for any reason, nontaxable or partly nontaxable, the corporation should furnish the information called for below and file this form, together with Forms 1099, with the Commissioner of Internal Revenue, in care of Processing Division, C. C. Station, Kansas City 2, Missouri, not later than February 1, 1951. The corporation will be promptly advised by letter as to any apparent errors in order that the corporation may, if time permits, furnish such advice to its stockholders before the stockholders file their income tax returns for the calendar year 1950.

A schedule should accompany this form showing the manner in which the taxable and nontaxable portions were determined, including an explanation of any change in the outstanding capital stock during the year.

The following general principles should be observed in the determination of the taxable status of dividend distributions made during the year 1950:

- (a) Distributions are considered taxable if the total earnings and profits of the current year are equal to the total distributions made within the year, regardless of any deficit existing at the beginning of the year and regardless of the amount of the earnings or profits of the taxable year on hand at the time of the distribution.
- (b) In the event the earnings and profits of the current year are not sufficient to cover the distributions, then that proportion of each distribution which the total of the earnings or profits of the year bears to the total distributions made during the year shall be regarded as out of the earnings or profits of that year.
- (c) As a further source of taxable distributions in connection with that proportion of the distribution not regarded as out of the earnings or profits of the taxable year, the earnings and profits accumulated since February 28, 1913, and on hand at the beginning of the year must be considered.
- (d) In arriving at the amount of earnings accumulated since February 28, 1913, the earnings of each year or accounting period beginning prior to January 1, 1936 (and in the case of an operating loss for any year or accounting period), should be prorated up to the date each dividend was paid, if the actual earnings to the date of a distribution within any taxable year cannot be shown.
- (e) For years beginning on or after January 1, 1936, the earnings available for dividends are not prorated, but the distributions are made out of the earnings of the taxable year, to the extent that there are sufficient earnings, computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year.
- (f) Payment of nontaxable stock dividends does not reduce earnings available for ordinary dividends.
- (g) If dividends are paid in a medium other than cash, the cost to the corporation and fair market value of such property at date of distribution should be furnished.
- (h) In determining the taxable status of dividends paid to several classes of shareholders in the same taxable year, dividends paid on shares entitled to priority in payment out of earnings are considered as being paid first regardless of the date of payment.

Date of incorporation Kind of business
 Check (✓) whether on the cash or accrual basis. The corporation's income tax return is filed for the year ending
 (Month) (Day)

STATEMENT OF CAPITAL STOCK, SURPLUS, AND EARNINGS

| | |
|--|---------|
| Earnings as shown on books for the calendar year 1950, or fiscal year ending | \$..... |
| Actual undistributed earnings accumulated since February 28, 1913, or date of incorporation if subsequent thereto, and on hand January 1, 1950, or beginning of fiscal year..... | \$..... |

| DATE | UNDISTRIBUTED SURPLUS | CAPITAL STOCK OUTSTANDING | |
|-------------------------|-----------------------|---------------------------|-----------|
| | | COMMON | PREFERRED |
| March 1, 1913..... | \$..... | \$..... | \$..... |
| *January 1, 1950..... | \$..... | \$..... | \$..... |
| *December 31, 1950..... | \$..... | \$..... | \$..... |

*Or beginning and end of fiscal year.

TOTAL DISTRIBUTIONS MADE TO SHAREHOLDERS DURING THE CALENDAR YEAR 1950

| DATE PAID | TOTAL AMOUNT PAID (Common (C), Preferred (P)) | RATE PER SHARE | AMOUNT PAID IN 1950 FROM EARNINGS AND PROFITS OF THE CURRENT YEAR OR ACCUMULATED SINCE FEBRUARY 28, 1913, OR DATE OF INCORPORATION IF SUBSEQUENT THERETO | |
|-------------|--|----------------|--|-----------|
| | | | COMMON | PREFERRED |
| | \$..... | \$..... | \$..... | \$..... |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| TOTALS..... | \$..... | XXXXX | \$..... | \$..... |

APPENDIX C

CORPORATION EXCISE TAX REGULATIONS

STATE OF OREGON

Art. 511-i-1. Farmers' Cooperative Marketing and Purchasing Associations.

(a) Cooperative associations engaged in the marketing of farm products for farmers, fruitgrowers, livestock growers, and dairymen, and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the products furnished by them, are exempt from the excise tax. For instance, cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butterfat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the tax law and is not exempt. In other words, nonmember patrons must be treated the same as members insofar as the distribution of patronage dividends is concerned, that is, if products are marketed for nonmember producers, the proceeds of the sale, less necessary operating expenses, must be returned to the patrons from the sale of whose goods such proceeds result, whether or not such patrons are members of the association. In order to show its cooperative nature and to establish compliance with the requirement of the tax law that the proceeds of sales, less necessary expenses, be turned back to all producers on the basis of the products

furnished by them, it is necessary for such an association to keep permanent records of the business done both with members and nonmembers. The law does not require, however, that the association keep ledger accounts with each producer selling through the association. Any permanent records which show that the association was operating during the taxable year on a cooperative basis in the distribution of patronage dividends to all producers will suffice. While under the tax law patronage dividends must be paid to all producers on the same basis, this requirement is complied with if an association, instead of paying patronage dividends to nonmember producers in cash, keeps permanent records from which the proportionate shares of the patronage dividends due to nonmember producers can be determined, and such shares are made applicable toward the purchase price of a share of stock or of a membership in the association.

An association which has capital stock will not for such reason be denied exemption, (1) if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the state of incorporation or 8 per cent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and (2) if substantially all of such stock (with the exception noted below) is owned by producers who market their products or purchase their supplies and equipment through the association. Any ownership of stock by others than such actual producers must be satisfactorily explained in the association's application for exemption. The association will be required to show that the ownership of its capital stock has been restricted as far as possible to such actual producers. If

by statutory requirement all officers of an association must be stockholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption. Likewise, if a stockholder for any reason ceases to be a producer and the association is unable, because of a constitutional restriction or prohibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that under such circumstances a small amount of the outstanding stock is owned by stockholders who are no longer producers will not destroy the exemption. The restriction placed on the ownership of capital stock of an exempt cooperative association shall not apply to nonvoting preferred stock, provided the owners of such stock are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends. The accumulation and maintenance of a reserve required by state statute, or the accumulation and maintenance of a reasonable reserve or surplus for any necessary purpose, such as to provide for the erection of buildings and facilities required in business or for the purchase and installation of machinery and equipment or to retire indebtedness incurred for such purposes, will not destroy the exemption. An association will not be denied exemption because it markets the products of nonmembers, provided the value of the products marketed for nonmembers does not exceed the value of the products marketed for members. Anyone who shares in the profits of a farmers' cooperative marketing association and is entitled to participate in the management of the association, must be regarded as a member of such

association within the meaning of this subsection.

(b) Cooperative associations engaged in the purchasing of supplies and equipment for farmers, fruitgrowers, livestock growers, and dairymen, and turning over such supplies and equipment to them at actual cost, plus the necessary operating expenses, are exempt. Supplies and equipment include groceries and all other goods and merchandise used by farmers in the operation and maintenance of a farm or farmer's household. The provisions of (a) relating to a reserve or surplus and to capital stock shall apply to associations coming under this paragraph. An association which purchases supplies and equipment for nonmembers will not for such reason be denied exemption, provided the value of the purchases for nonmembers does not exceed the value of the supplies and equipment purchased for members, and provided the value of the purchases made for nonmembers who are not producers does not exceed 15 per cent of the value of all its purchases.

(c) In order to be exempt under either (a) or (b) an association must establish that it has no net income for its own account other than that reflected in a reserve or surplus authorized in (a). An association engaged both in marketing farm products and in purchasing supplies and equipment is exempt if as to each of its functions it meets the requirements of the tax law. An association to be entitled to exemption must not only be organized but actually operated in the manner and for the purposes specified in section 110-1511(i).

(d) Cooperative organizations engaged in occupations dissimilar from those of farmers, fruitgrowers, and the like, such as merchants' associations and associations marketing building materials, are not exempt.

APPENDIX D

STATE OF OREGON

INFORMATION RETURN FOR
CALENDAR YEAR 1950

TO WHOM PAID (Print full name and address)

 Single
 Married

Payee—File an income tax return, reporting all income received during the tax year, with the State Tax Commission, Salem, Oregon, unless income is below minimum for which a return is required by law. Oregon income tax returns for the calendar year 1950 are due on or before April 15, 1951.

FORMS OF INCOME PAID

| Fees, commissions, salaries, or other compensation not subject to Oregon withholding tax and reported on Form 99W | Annuities and interest (\$250 or more) | Rents and royalties (\$750 single, \$1,500 married) | Dividends (\$100 or more) | Other income (Specify) |
|---|--|---|---------------------------|------------------------|
| | | | | |

BY WHOM PAID (Name and address)

Payor—Prepare one of these forms for each payee according to the instructions on Form 96. Report payments for the calendar year 1950. Forward the completed Forms 99 and Form 96 to reach the State Tax Commission, Salem, Oregon, on or before February 15, 1951.

It is suggested that the payor furnish the payee a copy of the completed Form 99.

STATE OF OREGON

COOPERATIVE ASSOCIATION
INFORMATION RETURN FOR
CALENDAR YEAR 1950**TO WHOM PAID** (Print full name and address)

Payee—File an income tax return, reporting all income received during the tax year, with the State Tax Commission, Salem, Oregon, unless income is below minimum for which a return is required by law. Oregon income tax returns for the calendar year 1950 are due on or before April 15, 1951.

FORMS OF INCOME

| Patronage dividends paid in cash | Certificates issued in 1950 | Certificates (issued prior to Jan. 1, 1950) redeemed | Interest | Other income (Specify) |
|-------------------------------------|--------------------------------|---|----------|---------------------------|
| \$ | \$ | \$ | \$ | \$ |

BY WHOM PAID (Name and address)

Payor—Prepare one of these forms for each payee according to the instructions on Form 96-CA. Report payments for the calendar year 1950. Forward the completed Form 99-CA and Form 96-CA to reach the State Tax Commission, Salem, Oregon, on or before February 15, 1951.

It is suggested that the payor furnish the payee a copy of the completed Form 99-CA.

Form 96

STATE OF OREGON
State Tax Commission
Income Tax Division
Salem, Oregon

INSTRUCTIONS AND
AFFIDAVIT

OREGON INFORMATION RETURNS for Calendar Year 1950

Use this form and Form 99 for reporting interest, dividends, rents, and other payments not subject to state withholding tax.

Use Forms 96W and 99W for reporting wages, salaries, commissions and other remuneration for personal services, which are subject to state withholding tax.

Name and

Address of

Payor

This return (Form 96) accompanied by the separate returns of information (Forms 99) must be filed with the State Tax Commission, Salem, Oregon, on or before February 15, 1951.

Before preparing the forms read carefully the instructions on both sides of this sheet.

A separate return of information (Form 99) must be filed for each payee to whom a payment required to be reported was made during 1950. All required information concerning each payee should be reported on the same Form 99.

Even though no Forms 99 are required to be filed, this Form 96 should be completed and returned to the Commission.

It is suggested that the payor furnish duplicate copies of the Forms 99 to the respective payees for their convenience in filing income tax returns. Additional blank Forms 99 will be provided upon request.

AFFIDAVIT

(If the payor is an individual, the affidavit must be signed and sworn to (or affirmed) by the individual or his authorized agent. If the payor is a partnership, the affidavit must be signed and sworn to (or affirmed) by a member of the partnership. If the payor is a corporation, the affidavit must be signed and sworn to (or affirmed) by an authorized officer of the corporation.)

I swear (or affirm) that to the best of my knowledge and belief the attached reports on Forms 99 constitute true and complete returns of the payments required to be reported made during the calendar year 1950 by the person, firm, corporation, or governmental agency named above.

Number of Forms 99 filed herewith

(Signature)

Sworn to (or affirmed) and subscribed before me

this day of, 1951.

(Title)

(Signature of officer administering oath)

(Title)

My commission expires

(OVER)

Instructions for Preparing Oregon Information Returns for Calendar Year 1950

Every person, firm, and corporation, resident or operating in Oregon, in whatever capacity acting, and every governmental agency must file annual returns of information reporting the kinds of income described below. Those required to file returns of information include individuals, partnerships, fiduciaries, trustees, receivers, banks, insurance companies, joint-stock companies, associations, churches, hospitals, clubs, syndicates, and organizations of every kind.

The payor should report all amounts paid to a resident individual, fiduciary, or partnership of salaries, fees, wages, commissions, bonuses, and other compensation for services, not subject to the Oregon withholding tax (and therefore not reported on Form 99W), rents, royalties, dividends, annuities, interest (other than on coupons payable to bearer), and other gains, profits, and income.

The payor should report all amounts paid to a nonresident individual, fiduciary, or partnership of salaries, fees, wages, commissions, bonuses, and other compensation for services rendered in or allocable to Oregon not subject to the Oregon withholding tax (and therefore not reported on Form 99W), rents and royalties from real or personal property located in Oregon, and gains, profits, and other income from the payee's property, business, or enterprise situated or operated in Oregon.

Returns of information (Form 99) must report payments made during the *calendar* year 1950 even though the books of the payor, or of the payee, are kept on the basis of a fiscal year other than a calendar year, if the amounts paid during the calendar year equal or exceed:

(1) In the case of salaries, wages, fees, commissions, bonuses and other compensation for services not subject to the Oregon withholding tax (and therefore not reported on Form 99W), (a) \$750, if the payee was single, or married and not living with husband or wife, or (b) \$1,500, if the payee was married and living with husband or wife.

(2) In the case of annuities, and of interest on notes, mortgages, etc., \$250. Report only annuities paid after the sum of all payments made (at any time in this or prior years) exceeds the annuitant's cost. All payments must be reported after cost has been recovered.

(3) In the case of dividends, \$100. (Dividends must be reported even though deemed nontaxable in whole or part.)

(4) In the case of rents and royalties, and other fixed or determinable income, (a) \$750, if the payee was single, or married and not living with husband or wife, (b) \$750, if the payee was a fiduciary or partnership, or (c) \$1,500, if the payee was married and living with husband or wife.

If the payor does not know what the marital status of the payee was during 1950, the report should be made on the assumption that the payee was single. If the payor believes that the payee, or the payee's spouse, has sufficient income from all sources to require the filing of an income tax return, it is suggested that the payor file an information return even though the amount paid does not equal the amount indicated above.

For the purposes of a return of information an amount is deemed to be paid when it is actually paid, or when it is payable in the sense that it is credited or set apart and made available to the payee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made. In the case of salaries, wages, etc., report the amount actually paid during the year. December, 1949, salaries paid in 1950 should be reported.

Reports on Forms 99 are not required for the following types of payments:

(1) Partnership distributions paid to the partners, but such payments should be reported on the partnership return of income (Form 65).

(2) Distributions to the beneficiaries of an estate or trust, but such distributions should be reported on the fiduciary return of income (Form 41).

(3) Salaries, fees, wages, bonuses and other compensation for services reported on Forms 96W, 99W and 96R under the Oregon withholding tax law.

Form 96-CA

State of Oregon--State Tax Commission--Income Tax Division--Salem, Oregon
 OREGON INFORMATION RETURNS FOR CALENDAR YEAR 1950 FOR COOPERATIVE ASSOCIA-
 TIONS

Instructions and Affidavit

Name and Address
 of Cooperative
 Association

INSTRUCTIONS

This return (Form 96-CA) accompanied by the separate returns of information (Forms 99-CA) must be filed with the State Tax Commission, Salem, Oregon, on or before February 15, 1951, in compliance with section 110-1615, O.C.L.A. Under this section the commission requires every cooperative association operating in Oregon to file an annual return of information, reporting as to each patron, whether an association member or not, (1) all sums paid in cash as patronage dividends, (2) the face amount of all certificates distributed in the current year, evidencing earnings, savings or rebates based upon the amount or value of goods furnished to the cooperative association by such patron or purchased by him from a cooperative during the calendar year 1950, (3) the actual amount of all certificates or credits distributed prior to January 1, 1950 which have been redeemed in the year 1950, (4) miscellaneous payments including rent, interest, or other (except any sums reported on the withholding form, 99-W, or salaries, wages, fees, and items which have been reported on the general information return, Form 99). No report is required where the items total less than \$100.

Certificates or evidences of credits include those distributed in the form of capital stock, revolving fund certificate, retail certificate, certificate of indebtedness, letter of advice as to net amount retained, or any other form or statement evidencing earnings, savings or rebates based upon the amount or value of goods furnished to the cooperative by the patron or purchased by him from a cooperative.

Returns of information (Form 99-CA) must show payments made during the calendar year 1950 even though the books of the association or of the patron are kept on the basis of a fiscal year other than a calendar year.

A separate return of information (Form 99-CA) must be filed for each patron to whom a payment required to be reported was made during 1950. Even though no Forms 99-CA are required to be filed, this Form 96-CA should be completed and returned to the commission. It is suggested that the association furnish duplicate copies of the Form 99-CA to the respective patrons for their convenience in filing income tax returns.

AFFIDAVIT

I swear (or affirm) that to the best of my knowledge and belief the attached reports on Forms 99-CA constitute true and complete returns of the payments required to be reported made during the calendar year 1950 by the cooperative association named above.

Number of Forms 99-CA filed herewith _____.

(Signature)

(Title)

Sworn to (or affirmed) and subscribed to before me this _____ day of _____, 1951.

(Signature of Officer)

(Title of Officer Administering Oath)

My commission expires _____

AFFIDAVIT - PROOF OF EXEMPTION

There is no form provided for preparing the affidavit and proof of exemption required of cooperative associations. It is required that exempt organizations establish the exemptions in accordance with Article 511 of the Corporation Excise Tax Law and Regulations.

Art. 511. Proof of Exemption. A corporation is not exempt from the excise tax merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns and paying taxes, each organization claiming exemption must file an affidavit with the commission showing the character of the organization, the purpose for which it was organized, its actual activities, the sources and the disposition of its income, whether or not any of its income is credited to surplus or may inure to the benefit of any private stockholder or individual, and in general all other facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the articles of association or incorporation, the by-laws of the organization, and the latest financial statement showing the assets, liabilities, receipts and disbursements of the organization. When an organization has established its right to exemption, it need not thereafter make a return or any further showing with respect to its status unless it changes the character of its organization or operations or the purpose for which it is organized, or unless the commission requests the filing of returns or the furnishing of other information.

APPENDIX E

H. R. 5064

81st CONGRESS, 1st SESSION

IN THE HOUSE OF REPRESENTATIVES

June 8, 1949

Mr. Mason introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To impose income taxes on the business income of certain exempt corporations, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. TAX ON BUSINESS INCOME OF SECTION 101 CORPORATIONS.

(a) Chapter 1 of the Internal Revenue Code is amended by inserting after section 421 the following:

"Supplement V--Taxation of Business Income of Section 101 Corporations
"SEC. 431. IMPOSITION OF TAX.

"(a) IN GENERAL.--Every corporation specified in section 101 shall be subject to the tax imposed by this chapter (except the tax under section 102) with respect to its business income.

"(b) DEFINITION.--As Used in this section, the term 'business income' means (1) the gross income derived from any activity of a kind which is recognized as an ordinary trade or business activity commonly engaged in by other persons for profit, minus (2) the deductions allowed by section 23 which, under regulations prescribed by the Commissioner with the

approval of the Secretary, are determined to be properly allocable thereto; but such terms shall not include dividends or interest."

(b) TECHNICAL AMENDMENT.--Section 101 of the Internal Revenue Code is amended by striking out "The" at the beginning of such section and inserting in lieu thereof "Except as provided in Supplement V, the".

(c) EFFECTIVE DATE.--The amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1948.

SEC. 2. TAXATION OF COOPERATIVE CORPORATIONS.

(a) REPEAL OF EXEMPTION OF FARM COOPERATIVES.--Section 101 (12) and (13) of the Internal Revenue Code are repealed.

(b) IMPOSITION OF TAX AND COMPUTATION OF INCOME.--

(1) TECHNICAL AMENDMENT.--Section 4 of the Internal Revenue Code is amended by inserting at the end thereof a new subsection reading as follows:

"(m) COOPERATIVE CORPORATIONS--SUPPLEMENT W."

(2) TAXATION OF COOPERATIVES.--Chapter 1 of the Internal Revenue Code is amended by inserting before subchapter D a new supplement reading as follows:

"Supplement W--Cooperative Corporations

"SEC. 441. TAX OF COOPERATIVE CORPORATIONS.

"(a) IN GENERAL.--

"(1) COOPERATIVE CORPORATION.--For the purposes of this chapter the term 'cooperative corporation' means a corporation (A) that calls

itself a 'cooperative' or 'co-op', or (B) that represents to any persons or classes of persons which deal with it that their patronage will or may entitle them (i) to the payment, either actually or constructively, of patronage dividends, or (ii) to an equity interest in any of the corporation's assets, or (C) that is otherwise operated for the mutual benefit of persons or classes of persons that deal with it; but such term does not include a mutual insurance company or any corporation exempt under section 101.

"(2) GROSS RECEIPTS.--The gross receipts from the sales of goods or services used in computing the gross income of a cooperative corporation shall be determined without the exclusion or subtraction of any patronage dividends, paid or payable to patrons.

"(3) COST OF PRODUCTS BOUGHT FROM PRODUCERS.--In determining the cost to a cooperative corporation of products sold to it by a producer for resale (whether or not in their original form), only amounts, other than patronage dividends, paid or payable to such producer on account of such sales shall be used in computing such cost unless under regulations prescribed by the Commissioner with the approval of the Secretary, the corporation establishes that the application of this paragraph would more clearly reflect income, in which case the prevailing market price on sales of such products by producers, or the amounts, including patronage dividends, paid or payable in money on account of such sales, whichever is the lesser, shall be used in determining the cost to the corporation of such products so sold to it for resale.

"(4) PATRONAGE DIVIDEND.--For the purposes of this chapter the term 'patronage dividend' means an allocation or a distribution paid or payable (whether or not in money and whether described as a refund, rebate, price adjustment, or payment of a balance due under a marketing agreement) to member patrons or to member and nonmember patrons on some basis related to their sales to or purchases from the corporation during the taxable year, if (A) the allocation or distribution is conditional (i) upon profits or margins being earned by the corporation from all its operations or a class of its operations during its fiscal year, or (ii) upon income attributable to the resale of the producer's product along with products or a class or classes of products of some other producers less any deductions, determination of which is within the discretion of the corporations, or (B) the amount of the allocation or distribution can be determined only with reference to the amount of the profits, margins, or income earned, or (C) the amount of the allocation or distribution can be determined only after declaration or payment of dividends on any class of stock of the corporation or only after the fixing of sums to be transferred to capital, reserves, or surplus."

(c) INFORMATION RETURNS REQUIRED OF COOPERATIVES.--The Internal Revenue Code is amended by inserting between sections 148 and 149 a new section as follows:

"SEC. 149A. INFORMATION BY COOPERATIVES.

(a) PAYMENTS OF PATRONAGE DIVIDENDS, REFUNDS, OR REBATES.--Every association organized and operated as a cooperative shall, when required by the Commissioner, render a correct return, duly verified under oath,

of its payments of patronage dividends, rebates, or refunds, stating the name and address of each member in the association, and the amount of payments paid to each member and patron.

"(b) ACCUMULATED EARNINGS AND PROFITS.--When requested by the Commissioner, every association organized and operated as a cooperative shall forward to him a correct statement of accumulated earnings and profits, including patronage dividends, rebates, or refunds allocated to, but not paid in cash to, members and patrons, and the names and addresses of members and patrons who would be entitled to the same if divided or distributed, and the amounts that would be payable to each."

(d) TAXABLE YEARS TO WHICH APPLICABLE.--The amendments and repeals made by this section shall be applicable with respect to taxable years beginning after December 31, 1948.

H. R. 7343

81st CONGRESS, 2d SESSION

IN THE HOUSE OF REPRESENTATIVES

February 20, 1950

Mr. Davis of Tennessee introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To equalize taxation by imposing income taxes on cooperative corporations and on the business income of certain other taxexempt corporations and organizations.

Author's Note: H. R. 7343 repeats H. R. 5064; hence that portion of H. R. 7343 will not here be included. The counterpart of last paragraph of H. R. 5064 will be repeated, with a change in date therein as appears in H. R. 7343. The remainder of H. R. 7343 is here presented.

(d) TAXABLE YEARS TO WHICH APPLICABLE.--The amendments and repeals made by this section shall be applicable with respect to taxable years beginning after December 31, 1949.

SEC. 3. TAX CREDIT FOR FARMERS RECEIVING PATRONAGE DIVIDENDS FROM FARM COOPERATIVES.

(a) CREDIT AGAINST FARMER'S TAX.--Chapter 1 of the Internal Revenue Code is amended by inserting after section 35 a new section reading as follows:

"SEC. 36. CREDIT TO RECIPIENTS OF PATRONAGE DIVIDENDS FOR TAX PAID BY FARMER COOPERATIVES.

"(a) In the case of the recipient of a patronage dividend from a farmer cooperative, which is includible in his gross income, there shall be allowed as a credit against the tax of such recipient (if an individual) an amount equal to the tax imposed on the cooperative in respect of the portion of the income of the cooperative that is represented by such dividend, if such recipient includes in his gross income, in addition to the patronage dividend so received, an amount equal to the tax so imposed on the cooperative.

"(b) As used in this chapter, the term 'farmer cooperative' means--

"(1) a farmer's, fruit grower's, or like association organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Such an association shall be considered a farmer cooperative under this paragraph even though it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or

permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; and such an association shall not cease to be a farmer cooperative because it accumulates and maintains a reserve required by State law or a reasonable reserve for any necessary purpose. Such an association shall be considered a farmer cooperative even though it markets the products of nonmembers, if the value of the products so marketed does not exceed the value of the products marketed for members, and shall be considered a farmer cooperative even though it purchases supplies and equipment for nonmembers if the value of the supplies and equipment so purchased does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 per centum of the value of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the status of such an association as a farmer cooperative; and

"(2) a corporation organized by an association which is a farmer cooperative under paragraph (1), or by members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. A corporation shall be considered a farmer cooperative under

this paragraph even though it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, upon dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; and such a corporation shall not cease to be a farmer cooperative under this paragraph because it accumulates and maintains a reserve required by State law or a reasonable reserve for any necessary purpose."

(b) The amendments made by this section shall be effective with respect to taxable years beginning after December 31, 1949.

H. R. 4431

81st CONGRESS, 1st SESSION

IN THE HOUSE OF REPRESENTATIVES

April 28, 1949

Mr. Philbin (by request) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To allow to corporations an exemption of \$25,000 for income-tax purposes, and to provide that the combined normal tax and surtax rate of 33 per centum shall be applicable to corporations having taxable incomes of less than \$50,000.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,
That section 13 (b) of the Internal Revenue Code (relating to normal tax on corporations) is hereby amended to read as follows:

"(b) IMPOSITION OF TAX.--There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation (except a corporation subject to the tax imposed by section 14, section 231 (a), supplement G, or supplement Q) a tax of 24 per centum of the amount of the normal-tax net income in excess of \$25,000."

SEC. 2. Section 14 (b) of the Internal Revenue Code (relating to tax on corporations with normal-tax net incomes of not more than \$25,000) is hereby repealed.

SEC. 3. Section 14 (c) (1) of the Internal Revenue Code (relating to tax of foreign corporations engaged in trade or business with the United States) is hereby amended to read as follows:

"(1) In the case of a foreign corporation engaged in trade or business within the United States, the tax shall be an amount equal to 24 per centum of the normal-tax net income."

SEC. 4. Section 15 (b) of the Internal Revenue Code (relating to surtax on corporations) is hereby amended to read as follows:

"(b) IMPOSITION OF TAX.--There shall be levied, collected, and paid for each taxable year upon the corporation surtax net income of every corporation (except a Western Hemisphere trade corporation as defined in section 109, and except a corporation subject to a tax imposed by section 231 (a), supplement G or supplement Q) a surtax of 14 per centum of the amount of the corporation surtax net income in excess of \$25,000."

SEC. 5. The amendments made by this Act shall be applicable with respect to taxable years beginning after December 31, 1949.

SUGGESTIONS WITH RESPECT TO THE TAXATION OF FARMER COOPERATIVES (8-8-50)

H.R. 8920

Author's Note: The amendments here were prepared by a special committee of cooperative leaders at the request of Senator George of the Senate Finance Committee.

Amend Section 101(12) of the Internal Revenue Code as follows:*

Sec. 101(12) Farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend paid on rate of such stock is fixed at ~~does not~~ exceed the legal rate of interest in the State of incorporation or 6 per centum per annum, ~~whichever is greater~~ on the value of the consideration for which the stock was issued, and if substantially all such stock (other than non-voting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by

*Deleted language is crossed out and new language underlined.

producers who market their products or purchase their supplies and equipment through the association; nor shall exemption 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. However, any such association which may be exempt hereunder, shall pay a tax at the corporate tax rate prescribed in Sections 13 and 14, on the amounts of any additions made, in any taxable year beginning after December 31, 1950, to reserves (a) (other than those reserves additions to which are recognized as deductions from income under section 23) to the extent that the amounts so added are not distributed (b) on a patronage basis, within nine months following the end of the taxable year, in the form of capital stock, other certificates (such as revolving fund certificates, retain certificates, certificates of equity or certificates of indebtedness), letters of advice or in some manner which discloses to each recipient the amount of his interest in such addition to such reserve. Provided that such associations making such additions to undistributed reserves shall have the benefit of a carry-back and carry-over with respect to any annual reduction in such undistributed reserves similar to the carry-back and carry-over of net operating losses provided for in Section 122. Such an association may market the products of non-members in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for non-members in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of

the products marketed or the purchases made for persons who are neither members nor producers does not exceed 15 percentum of the value of all its marketings or purchases respectively. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph.

EXPLANATION

1. This amendment changes dividend rate allowed tax exempt cooperatives from a maximum of 8 percent to a maximum of 6 percent. This recognizes the generally lower interest rates now in effect and will meet the criticism that the present exemption applies to cooperatives paying dividends in excess of normal interest rates.

2. This amendment imposes a tax at regular corporate tax rates on any additions to reserves that are not allocated and distributed as patronage refunds in such manner as to give the patron notice of his interest therein which he can then report either on an accrual or cash basis. This meets the only substantial criticism of the farmer cooperative tax exemption. A cooperative making unallocated and undistributed additions to reserves would not lose its exemption but would be taxed on the amount of any such unallocated and undistributed additions. In order to make this tax on unallocated and undistributed reserves fair, lines 16-19 (page 175) permit the carry-back and carry-over of any reductions in such unallocated and undistributed reserves. The conditions for such treatment would be the same as those specified in section 122 with respect to the carry-back and

carry-over of net operating losses of other corporations. By this means the cooperative would pay the required tax on its net additions over a period of years, just as other corporations pay the tax on their net incomes over a period of years.

3. This amendment places on marketing cooperatives the same limitations as now exist with respect to non-member, non-producer business of purchasing cooperatives. Under existing law both purchasing and marketing cooperatives are permitted to engage in limited non-member and non-producer business. In the case of purchasing cooperatives this is specifically limited by the statute to 15 percent of the total business. In the case of marketing cooperatives the statute is silent as to any specific limitation. This amendment imposes the 15 percent limitation on both.

APPENDIX F

House Bill No. 151

Forty-Sixth Legislative Assembly--Regular Session

Introduced by Representative FRENCH and Senators BELTON and MARSH and
read first time January 22, 1951

A BILL

For an Act relating to corporation excise taxes; amending section 110-1502, O. C. L. A., as amended by section 1, chapter 172, Oregon Laws 1947 and section 110-1511, O. C. L. A., as amended by section 1, chapter 406, Oregon Laws 1949.

Be It Enacted by the People of the State of Oregon:

Author's Note: Section 110-1502, O. C. L. A., is not under consideration here; hence that portion of the bill relating to Section 110-1502 will be omitted.

Section 2. Section 110-1511, O. C. L. A., as amended by section 1, chapter 406, Oregon Laws 1949, is amended to read as follows:

Sec. 10-1511. (1) For taxable years beginning prior to January 1, 1951, ~~The~~ the following corporations shall be exempt from the taxes imposed by this Act:

(a) Labor, agricultural or horticultural organizations no part of the net earnings of which inures to the benefit of any private stockholders or individual.

(b) Fraternal beneficiary societies, orders or associations (1) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (2) providing

for the payment of life, sick, accident or other benefits to the members of such society, order or association or their dependents.

(c) Cemetery companies which are owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(d) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(e) Business leagues, chambers of commerce, real estate boards or boards of trade, not organized for profit, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(f) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes, and no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(g) Clubs organized and operated exclusively for pleasure, recreation and other non-profitable purposes, no part of the net earnings of

which inures to the benefit of any private stockholder or individual.

(h) Farmers' or other mutual hail, cyclone, fire or life insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies or like organizations of a purely local character, but only if 85 percent or more of the income of which companies consists of assessments, dues and fees collected from the members for the sole purpose of meeting expenses.

(1) ~~(A)~~ (A) Farmers and fruit growers' associations, organized and operated on a cooperative basis ~~(A)~~ (1) for the purpose of marketing the products of members or other producers and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or ~~(B)~~ (2) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the state of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association;

nor shall exemption 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 purpose. Such an association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 percent of the value of all its purchases.

~~§(2)~~ (B) Corporations organized by an association exempt under the provisions of paragraph (i) ~~§(1)~~ (A), or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the state of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, upon dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by state law or a reasonable reserve for any necessary purpose.

~~(i)~~ Insurance companies and interinsurance and reciprocal exchanges, upon which a tax on premiums is levied.

~~(k)~~ (j) Every corporation whose gross receipts to the extent of at least 95 percent thereof is derived from rentals of real property owned by it; provided, however, that this exemption shall not apply to any corporation which receives directly or indirectly 50 percent or more of the total amount of its gross rentals from a person or corporation controlling, or from a corporation controlled by, the corporation which receives the rent, or from any group or combination of such persons and/or corporations. For the purposes of this subsection a corporation shall be deemed to be controlled by the ownership of 80 percent of its outstanding voting stock.

~~(l)~~ (k) State and federal credit unions so long as the interest or dividends paid on shares do not exceed 8 percent per annum.

~~(m)~~ (L) Corporations whose properties are assessed by the State Tax Commission under the provisions of subsection 14, section 110-505, O.C.L.A.

(2) For taxable years beginning after December 31, 1950, those corporations specified in subsection (1) of this section shall be subject to the taxes imposed by this Act. The provisions of sections 110-1508, 110-1512 and 110-1513, O.C.L.A., as amended, shall apply to all such corporations to the same extent as would have been the case had they been subject to the tax imposed by this Act from its inception.

(3) The following corporations shall be exempt from the taxes imposed by this Act.

(a) Insurance companies and interinsurance and reciprocal exchanges, upon which a tax on premiums is levied.

APPENDIX G

Committee Substitute for House Bill 30

Session 1949

A BILL TO BE ENTITLED AN ACT TO AMEND AND SUPPLEMENT "THE REVENUE ACT,"
BEING SUBCHAPTER I OF CHAPTER 105 OF THE GENERAL STATUTES.

The General Assembly of North Carolina do enact:

Author's Note: Only the portion of the bill relating to cooperative associations will be entered here.

SEC. 3. Amendments to the Income Tax Article.

Article 4, Schedule D.

Subsection (a). Amend subsection 9 of Section 105-138 of the General Statutes by adding at the end thereof the following:

"Nothing in this subsection shall be construed to exempt any cooperative, mutual association or other organization from an income tax on net income (gross income minus operating expenses, including interest paid on capital stock) which has not been allocated to patrons on a patronage basis and distributed either in cash, stock, certificates, or in some other manner that discloses to each patron the amount of his patronage refund; provided, that no stabilization or marketing organization, which handles agricultural products for sale for producers on a pool basis, shall be deemed to have realized any net income or profit in the disposition of a pool or any part of a pool until all of the products in that pool shall have been sold and the pool shall have been closed; provided, further, that a pool shall not be deemed closed until the expiration of at least 90 days after

the sale of the last remaining products in that pool. Such cooperatives and other organizations shall file an annual information return with the State Department of Revenue on forms to be furnished by the Commissioner and shall include therein the names and addresses of all persons, patrons and/or shareholders, whose patronage refunds or interest on stock amount to \$50.00 or more."

Subsection (b). Add a new subsection to section 105-142 to read as follows:

"An individual, who patronizes or owns stock or has membership in a farmers' marketing or purchasing cooperative or mutual, organized under Sub-chapter 4 or Subchapter 5 of Chapter 54 of the General Statutes of North Carolina, shall include in his gross income for the year in which the allocation is made his distributive share of any savings or interest on stock, whether distributed in cash or credit, allocated by the cooperative or mutual association for each income year."

APPENDIX H

Excerpts From
THE COMPETITION OF COOPERATIVES WITH OTHER FORMS OF BUSINESS ENTERPRISE
FIRST INTERIM REPORT
from the
COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

Tax-exempt farmer cooperatives apparently do have an advantage over competitive businesses operating in the same fields to the extent that amounts of income available for the payment of dividends on capital stock and accumulated in reserve for the use of the cooperative for its corporate operation escape Federal income taxation. Nonfarmers may invest in the preferred stock or other nonvoting stock of tax-exempt farmer cooperatives, but this stock is not rated as attractive to investors since the dividends are limited and the stock does not constitute controlling stock. The cooperative reserves apparently constitute a substitute for the capital markets normally available to other business enterprises, since the capital for an exempt cooperative comes principally from farmers, and they have a very limited capacity for supplying capital at any one time.

Apparently about only 54 percent of the farm cooperatives have elected to and have taken the requisite affirmative action necessary for qualification as an exempt cooperative. As a result of the limited number of cooperatives which have qualified as exempt the aggregate amount of income available for the payment of dividends on capital stock and/or retained in

one allocated reserve is relatively small. No appreciable revenue would accrue to the government if income tax were levied on these amounts.

It does not appear that the tax exemption available to exempt farmer cooperatives has any true bearing upon any competitive advantage which the cooperative might have in its normal operations.

Agricultural cooperatives which are nonexempt from Federal income tax and all consumer cooperatives apparently enjoy no privileges or advantages under the tax laws which are not available to all other types of competitive businesses operating in the same lines of endeavor. It seems readily apparent that noncooperative business agencies, if they are willing to render services at cost, would not be subject to any income tax.

There is undoubtedly some relaxation or nonobservance of the restrictions of section 101 (12) and (13) in some cases, the exact extent of which, however, was not developed or determinable. Enforcement of the restrictions of section 101 (12) and (13) is a matter of administrative and not legislative responsibility. More strict administrative supervision is indicated. If rigidly enforced, no competitive advantage can be afforded agricultural cooperatives over other types of business with which they are in competition.

It is obvious to the committee that no benefit would derive to private business if section 101 (12) and (13) of the Revenue Act were repealed. It appears possible that farmer cooperatives having to qualify for tax exemption under the act do have income which escapes taxation, but it appears that no substantial advantage is afforded them by virtue thereof.

The operation within restrictions of the statute seems to constitute a disadvantage of comparability at any time to the advantage, and, further, since the amount of income involved seems so significant, any advantage may be hypothetical only.

The enactment and reenactment of section 101 (12) and (13) of the Internal Revenue Act appears to represent a continuing attitude on the part of the Congress that the maintenance of a sound agricultural economy is necessary for the preservation of the national well-being. . . .

Existing income-tax laws clearly spell out a nonprofit operation by farmer cooperatives. A strict application by the Bureau of Internal Revenue would provide a marked deterrent to any group which attempts to abuse the exemption granted to true cooperatives, and which has tried evasion of corporate taxes behind a cooperative mask. . . .

Since nonexempt cooperatives are subject to all of the taxes normally assessed against comparable noncooperative organizations it appears that to tax the income of a cooperative would require a drastic change in the basic principle of our revenue laws. The Bureau of Internal Revenue has ruled, and the courts have upheld, the principle that the cooperative entity serves only as an agent for and on behalf of its members, and that at no time does its income belong to other than its members. Since the apparent intent of the Congress in levying taxes has been to levy on ability to pay, it does not appear to be reasonable or equitable to attempt to levy a tax on a cooperative for income which does not belong to it nor to levy a tax for which it has no funds to pay. The levy of a receipts tax

on such a cooperative would probably raise constitutional objections. Such a tax would have to be levied against all types of organizations which have income, which, by virtue of their charter, does not belong to them as an entity, but which belongs in a nonprofit sense to their members. Such a tax would seriously affect schools, churches, charitable and scientific organizations, and many social clubs which have a comparable advantage of tax exemption. . . .

There is no evidence to show that cooperatives have been granted a type of preferential financial treatment by the Federal Government that has not likewise been made available to and accepted by other forms of business enterprise, including banks, savings and loan societies, manufacturers, distributors and other types of private enterprise operating for the principal purpose of making profits. . . .

There is substantial evidence to indicate that many of the most vocal opponents of cooperatives are themselves members of cooperatives and their firms engage as members in cooperative enterprises. One particular industry group has organized and operates one of the largest cooperative insurance agencies. Other wholesale and retail groups have organized and operate cooperative purchasing and distributive organizations. . . .

The theory that the cooperative movement is seriously endangering other economic forms of business operation can be utterly disregarded inasmuch as the volume of business enjoyed by cooperatives and their degree of participation in the national income is very nominal.

RECOMMENDATIONS

It is recommended, after due examination of all of the facts disclosed herein, that the following procedure be followed by the Congress with respect to cooperatives:

1. That a single agency of government be authorized and directed to compile and maintain complete and accurate records and make periodic reports to the Congress on the operation of all types of cooperative enterprises; and that this single agency shall be held responsible for supplying all other interested agencies of the Federal Government with information pertaining to cooperatives and the cooperative movement.

2. That the Bureau of Internal Revenue be requested to amend and restate its regulations pertaining to section 101 (12) and (13) of the Internal Revenue Act with respect to cooperatives as follows:

(a) Specifically designate what shall constitute "reasonable reserves" and what shall constitute a "necessary purpose" in an example farm cooperative which qualifies under the act.

(b) Require that the allocation of all capital and other reserves to each patron be made in accordance with the decision of the Circuit Court of Appeals in Fertile Cooperative Dairy Association vs. The Commissioner of Internal Revenue, (119 Fed. (2d) 274).

(c) Require that, as to all amounts retained in capital reserves, a certificate or other evidence be issued to each patron indicating the amount of his equity or investment, and further require the cooperative to file information returns with the collector of Internal

revenue showing the amount of patronage refund of each patron, whether paid in cash, stock, certificate of participation, or otherwise.

(d) Require that farm purchasing cooperatives limit their transactions to the handling of farm production supplies, and place upon cooperatives the burden of establishing the fact that it meets this restriction.

(e) Require that all refunds due to the patrons but retained as reserves by the cooperative be subject to mandatory payment at stated intervals not to exceed five years, thereby limiting the furnishing of capital for the cooperative to those patrons currently using its facilities.

3. That the Bureau of Internal Revenue be requested to revise Form 990, which it is required 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 nonmember 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. That there be established by legislative action a basis upon which nonexempt cooperatives may be established, operated, expanded and be or become federated in their various types of combination operations. Section 101 (12) and (13) establishes certain criteria for the establishment of corporations under State control. No such law exists controlling nonexempt cooperatives with the exception of minor State regulations.

Legislation seems necessary which will provide the manner in which patronage refunds will be handled, interest rates on capital stock will be computed, reserves will be limited, and which will describe the scope of operations of nonexempt cooperatives.

Excerpts From

STATEMENT OF WALTER C. FLOESER, CHAIRMAN, SELECT COMMITTEE ON SMALL BUSINESS, HOUSE OF REPRESENTATIVES, BEFORE COMMITTEE ON WAYS AND MEANS OF THE HOUSE OF REPRESENTATIVES, NOVEMBER 24, 1947.

It has been argued by cooperative leadership. . . .that the cash refunds can in no sense be considered corporate money or a part of corporate profits. . . .it is most difficult to determine in the case of the marketing cooperative corporation where personal profit of the patron ends and corporate profit begins so far as the cash refunds are concerned, but my observation leads me to the belief that both elements exist. . . . , might be resolved to the benefit of the farmers by the application of corporate income taxes on the net income which is retained in the cooperative corporation.

In the marketing cooperative corporation, I can see a degree of merit in both arguments relative to personal or corporate profit. I have not gained any such impression in relation to purchasing or urban consumer cooperatives.

. . . .from the beginning of our cooperative investigation, the operators of farm cooperatives have impressed on me in private that they are not blood brothers of the urban consumer cooperatives--and curiously enough, the operators of urban consumer cooperatives have been claiming that they are identical twins with farm cooperatives. We are trying to learn by exhaustive study just where each fits into the pattern of our competitive economy. As of this date, it appears to me, personally, that

there is room in our economy for all types of cooperatives which seek through fair competitive enterprise to improve the standard of living of their members.

But I must admit that in the course of our cooperative investigation, I have gotten the impression that farm cooperatives apparently stem from one ideology, while urban consumer cooperatives apparently stem from another.

I am convinced. . . .that farm cooperatives where not monopolistic, seem to be a logical part of a competitive capitalistic profit system. But I have not been able to determine in my own mind as yet, in what kind of an economic system the urban consumers cooperative finds its natural and logical place.

. . . .certain points seem to naturally suggest themselves and they are these:

1. For tax purposes all deductible reserves in corporations shall be clearly defined and the definition be made applicable to all corporations alike with regard to the computation of their net taxable income under the Federal tax on corporate income.

2. For tax purposes all corporate income should be treated equitably at whatever rate is determined by the Congress for all alike and all corporations should be permitted to deduct from gross income dividends paid in cash on stock and all patronage refunds paid in cash as a result of contractual obligations, provided section 101-12 of the Internal Revenue Code is repealed.

3. All stock dividends and patronage refunds paid by evidence of ownership or debt but not in cash should be treated alike for the purposes of taxation. Only when a corporation gives a clear option to the beneficiary of such stock dividend or refund either to redeem within specified reasonable time for cash or to make a capital contribution to the corporation, shall such amounts as are thus contributed to the corporation be tax exempt at corporate level.

4. All of the above presupposes a continuation of the Federal tax on corporate income.

(During the course of the committee's hearings, the suggestion was made by cooperative leaders, and even by the former chairman of the Small Business Committee, that the solution of the problem could best be accomplished if the Federal tax on corporate income was repealed. The very fact that this proposal was made indicates to my mind that such persons realize that there is inequity in the present application of the Federal tax on corporate income. Such a suggestion fails to take into consideration the present day enormous cost of Government on the one hand, and on the other hand, the heavy concentration of corporate reserves. This would be a terrible injury to small business whether it be proprietary or cooperative.)

5. I definitely recommend to the committee that you consider in your tax revision an exemption on the first \$25,000 earned net income for all corporations.

Such an exemption will, in my opinion, be a much needed incentive for the birth and growth not only of small proprietary corporations, but small

cooperative corporations as well.

Such a proposal is just because it gives equal competitive opportunity to probably 80 percent of all cooperatives and small proprietary corporations. When you have accomplished this solution, you will eliminate most of the present-day controversy.

This recommendation is directly in line with the expressed belief of most cooperative leaders that the elimination of double taxation would solve the problem. I am proposing to eliminate double taxation with respect to the first \$25,000 of net earnings which will give life and opportunity to grow to 80 percent of all corporate enterprises whether proprietary or cooperative.

APPENDIX I

UNIVERSITY OF OREGON
SCHOOL OF BUSINESS ADMINISTRATION
EUGENE, OREGON

Dear Sir:

In fulfilling the requirements for a Master's degree in the School of Business Administration at the University of Oregon, I am preparing a thesis about the current controversy regarding the status of cooperatives under the federal income tax laws.

In newspaper and magazine articles, and in recent Congressional hearings, there has been much said about the effect of changes in the laws on the cooperative organizations, and the amount of tax money to be gained (if any) by the federal government as a result of various changes proposed. Opinions vary so much that estimates are not reliable, and usually tend to support the viewpoint of the one being quoted. In order to complete my study with any degree of accuracy, I need first-hand information about the ones affected, the cooperative organizations themselves. There have been at least 19 different proposals made, and I am trying to learn what effect each of the proposals would have on the cooperatives in Oregon.

Detailed information available in newspapers about individual cooperatives is usually not complete enough to supply the data for making my analyses. Therefore, I would appreciate your cooperation in furnishing the data not otherwise available. This may be entered in the blank spaces on the enclosed sheet for any (or all) of the years indicated. Any data

I have on hand regarding your cooperative is already entered. A copy of your latest annual financial report, if available, would serve to provide most of the information needed. I will be glad to return any financial statements to you, if requested. All information will be held strictly confidential and will be used only in summary form. A self-addressed envelope is included for your convenience.

Some of the proposed changes in the federal income tax laws are enclosed. Any comments and suggestions regarding these proposals and the study I am making would be helpful.

If circumstances prevent your furnishing data for this study, I would appreciate your returning the form anyway, so that you need not receive any "follow-up" correspondence.

If you desire a summary of this study, please check in the space provided at the bottom of the enclosed form.

Thank you for your cooperation and assistance in this project.

Very truly yours,

(s) Melvin Holt

COOPERATIVE SURVEY

| | 1947 | 1948 | 1949 |
|---|------|------|------|
| 1. Gross Sales, or Receipts | | | |
| 2. Net Margins, or Savings | | | |
| 3. Net Margins, or Savings, on business with Non-members | | | |
| 4. Total Patronage Refunds | | | |
| 5. Dividends Paid on Capital Stock | | | |
| 6. Non-cash Patronage Allocations made each year (Revolving Fund, Stock Certificates, etc.) | | | |
| 7. Amount of Federal Income Taxes Paid, if any | | | |
| 8. Amount of Invested Capital | | | |
| 9. Total amount of Net Worth Reserves (Surplus Reserves) | | | |
| 10. Total Amount of Savings Allocated to Patrons but not yet paid in cash | | | |
| 11. Total Amount of Net Savings Not Allocated | | | |
| 12. Total Amount of Net Worth | | | |
| 13. Total Amount of Assets | | | |
| 14. The Approximate Membership of your Organization | | | |

Please answer the following questions by checking the appropriate blank space for each.

Is this cooperative organization a corporation? Yes _____ No _____

If it is a corporation, is it exempt _____ or not exempt _____ from federal income taxes?

Are non-member patrons, if any, awarded patronage refunds on the same basis as members? Yes _____ No _____

Check here _____ if you want the results of the study sent to you. This summary should be mailed to:

Name _____

Address _____

(List of proposals to accompany questionnaire)

Following are some proposals for changing the federal income tax laws as they relate to cooperative organizations. If you care to comment on any of these proposals, your remarks would be greatly appreciated.

1. Repeal the present exemption granted to cooperatives that qualify under present laws.
2. Tax as income to the cooperative patronage refunds distributed but not paid in cash.
3. Terminate the exclusion from net income of all patronage refunds.
4. Repeal all exemptions, and eliminate all exclusions for patronage refunds.
5. Tax non-cash dividends as income to the cooperative, but allow a \$25,000 net income tax exemption on all corporations (both cooperative and non-cooperative).
6. Exempt all corporations on earnings distributed as dividends.
7. Limit the exemption to transactions for members only.

Corp. _____ No. Members _____

Exempt _____ Want Summary _____

| | 1947 | 1948 | 1949 |
|--|------|------|------|
| <u>Gross Receipts</u> | | | |
| <u>Net Margins</u> | | | |
| <u>Net Plus Pat. Refunds Received</u> | | | |
| <u>Non-member savings</u> | | | |
| <u>Total Patronage Refunds</u> | | | |
| <u>Cash Patronage Refunds</u> | | | |
| <u>Non-cash Patronage Refunds</u> | | | |
| <u>Dividends paid on Capital Stock</u> | | | |
| <u>Invested Capital</u> | | | |
| <u>Membership Reserves (allocated)</u> | | | |
| <u>Surplus Reserves (allocated)</u> | | | |
| <u>Unallocated Reserves</u> | | | |
| <u>Total Net Worth</u> | | | |
| <u>Total Assets</u> | | | |
| <u>Federal Income Taxes Paid</u> | | | |

| EXEMPT or NONEXEMPT (if known) | / Proposal---- | NAME OF COOPERATIVE ASSOCIATION | | | | | | | | | | | |
|--|----------------|---------------------------------|-------|-------|-------|-------|-------|-------|---------|----------------|-------|-------|-----------------|
| | | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) | (12) |
| | | | | | | | | | | (a) if nonfarm | | | |
| Dividends Paid on Capital Stock | | XXXXX | | | | XXXXX | | | | | | | |
| Cash Patronage Refunds Paid | | | XXXXX | | | | | | | | | | |
| Noncash Patronage Allocations | | | XXXXX | XXXXX | | XXXXX | | | XXXXX | | | | |
| Additions to Unallocated Reserves | | XXXXX | | | | | XXXXX | | | | | | |
| Nonmember Savings (or Margins) | | | | | | | | XXXXX | | XXXXX | | | |
| Gross Receipts | | | | | | | | | | | XXXXX | | |
| Net Savings (or Margins) | | | | | XXXXX | | | | | XXXXX (a) | | | |
| Invested Capital | | | | | | | | | | | | XXXXX | |
| Not Distributed as Dividends | | | | | | | | | | | | | XXXXX |
| Less \$25,000 Exemption (No. 8 only) | | | | | | | | | 2500000 | | | | |
| Net Amount Taxable | | | | | | | | | | | | | |
| Tax Rates: (Per 1949 Federal) | | | | | | | | | | | | | |
| First \$5,000: | | | | | | | | | | | | | 21% |
| \$5,000 - \$20,000: | | | | | | | | | | | | | \$1050 plus 23% |
| \$20,000 - \$25,000: | | | | | | | | | | | | | \$4500 plus 25% |
| \$25,000 - \$50,000: | | | | | | | | | | | | | \$5750 plus 53% |
| Over \$50,000: | | | | | | | | | | | | | 38% |
| $\frac{1}{2}$ of 1% (per Indiana state rate) | | | | | | | | | | | | | |
| (for No. 10 only) | | | | | | | | | | | | | |
| 4% ($\frac{1}{2}$ of Excess-Profits Tax capital credit) (for No. 11 only) | | | | | | | | | | | | | |
| TOTAL PROJECTED TAX | | | | | | | | | | | | | |

APPENDIX J

NAME OF COOPERATIVE

Statement of Allocations

December 1, 1948

Dear Patron:

Presented below is a statement of your share of the 1947 capital accumulation of your Association.

As you know, a true cooperative does not have earnings for itself as a corporation. All margins belong to the Patrons on basis of patronage.

Under authority of the bylaws, all margins are held in the business as new capital. However, the ownership of this capital is identified to each individual patron - hence, the issuance of this statement to reflect your share of the 1947 capital.

As funds become available by the retention of yearly margins, the oldest margins are redeemed in cash. At the present time, your Association has redeemed all Association margins through 1943.

Also, your Association receives patronage refunds from Pacific Supply Cooperative, which, in turn, are identified to each individual patron, just as actual Association margins are.

Pacific Supply is also on a revolving program, and funds received from them will be utilized to revolve your share of their refunds to you.

In other words, all of the capital of every true cooperative association is identified as to ownership by the individual patron.

If there is anything you do not understand about this or any other feature of your Association, please come in and talk to Mr. _____. It is vitally important that you have a thorough understanding of not only your own Association but of cooperatives in general.

Here is your statement.

Your share of Pacific Supply Refund for 1947 -

| | | |
|------------------------|----------|----------|
| Operating Loss Reserve | \$ _____ | |
| General Reserve | _____ | |
| Certificates and Stock | _____ | \$ _____ |

Your share of Association margin for 1947

| | |
|----------------------------|----------|
| Your share of 1947 Capital | \$ _____ |
|----------------------------|----------|

BOARD OF DIRECTORS
NAME OF COOPERATIVE

Typed by

Betty Wagner Crosley