

PART 2

TAX TREATMENT OF
COOPERATIVES

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APRIL 1951



UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1951

TAX TREATMENT OF COOPERATIVES

I. INTRODUCTION

A cooperative is an organization established and operated for the mutual benefit of its members or other patrons by selling goods to them, or purchasing products from them for sale to others, and returning to them any excess of profits over costs.

Cooperatives may be incorporated under State laws for the incorporation of ordinary business enterprises, but many States now have special statutes for the incorporation of cooperative corporations. The cooperative association, like any other corporation is an artificial entity created by law with a life independent of the people who own, manage, and do business with it. Moreover, like other incorporated enterprises organized to carry on some form of business activity, the cooperative has a business purpose. For example, farm cooperatives exist to serve their farmer members and to increase the profits they derive from farming; and consumer cooperatives exist to reduce the expenses of their members. In this respect, the cooperatives differ from charitable and educational corporations whose primary functions are not directed to the economic advantage of their owners and organizers.

Although cooperatives are in many ways similar to ordinary business corporations, there is one significant difference. The owners of the cooperatives are also their principal patrons. While most cooperatives issue capital stock, as do ordinary corporations, the dividends paid on such shares (and on preferred shares, if these are issued) are strictly limited. Unlike ordinary corporations, each member usually has only one vote, regardless of the number of shares he may own. There are many nonstock associations which issue membership certificates as evidences of "residual equities" in their assets. Whether the association is organized with or without stock, however, all amounts remaining after provision for limited dividends on equity capital and for necessary reserves are returnable to the patrons of the association in proportion to the use made of the association by each patron. Amounts so returned to patrons are usually called patronage refund or patronage dividends.

The way in which cooperatives carry on their business operations varies a great deal as between the different types and sizes of associations. Some associations make it a practice to buy from or sell to their patrons at current local market prices. This is commonly known as the Rochdale pricing plan. In these cases the net margins of the cooperatives bear a striking resemblance to the net profits of an ordinary business corporation. Other associations, however, make no attempt to follow a market-price policy. For example, some marketing associations make a nominal down payment at the time of delivery, and do not pay the balance until after the close of the

marketing season. On the other hand, there are some purchasing associations which sell to their patrons at cost plus estimated expenses. In this case the patrons' savings on their dealings with the cooperative are received in the form of lower prices rather than in the form of a patronage refund.

There is also considerable diversity in the manner in which different cooperative associations handle their net margins. Those associations which depend on their net margins as a source of working capital may use various methods of satisfying their obligations to their patrons. Additional capital stock, certificates of indebtedness, or certificates of equity may be issued. These instruments may be convertible into cash on demand, but as a rule they can only be redeemed at some future time. Sometimes the future time for redemption is specified while in other cases such time is left to the option of the cooperative. A technique which has proved popular with many associations is that of the so-called revolving fund. Associations which employ this method of securing their capital funds enter into an agreement with their patrons whereby net margins will be retained by the association to finance expansion and provide working capital. The amounts so retained may be evidenced by stock certificates or certificates of indebtedness. When these certificates are redeemed, either after a fixed period of time or after the cooperative decides it has acquired sufficient capital, the certificates first issued are the first to be redeemed. Thus patrons of the current year receive their patronage refunds in the form of certificates to be redeemed at a later date and patrons of prior years receive cash in redemption of their certificates.

The principal type of cooperative which has developed in this country has been the farm cooperative. These have taken the form of marketing cooperatives, which market the products of the farmer, and purchasing cooperatives, which purchase supplies and resell them to the farmer. Some farm cooperatives carry out both of these functions. The agricultural cooperative movement in the United States is more than a century old. Cooperative marketing and purchasing organizations grew out of the economic necessity of individual farmers' finding an efficient method of marketing their crops and of purchasing their supplies. Handicapped by their isolation, by their lack of knowledge of the markets in which they had to deal, by their weak bargaining position in those markets, and by their lack of capital, farmers sought to improve their economic situation through group action. Over the years, farmers' cooperative associations have grown in strength and numbers and have expanded the scope of their activities. They have received a variety of financial and other assistance from the Federal Government.

The Department of Agriculture's 1947-48 survey of farmers' cooperatives listed 10,135 associations of which 7,159 were engaged primarily in marketing farm products, and 2,976 were primarily engaged in purchasing farm supplies. For all of these associations, purchasing represented 21.1 percent, and marketing 79.9 percent of the total cooperative business in that year. For the period 1947-48, farmers' marketing and purchasing associations had a total aggregate volume of business of \$8.6 billion of which \$7.2 billion represented farm products marketed and \$1.4 billion, farm supplies purchased. The great majority of the cooperatives are small local associations

which confine their operations to relatively small areas, but a large percentage of the volume of business done is accounted for by some 656 large-scale associations which operate on a regional or even a nation-wide basis. Of the 9,479 local associations listed in 1947-48, 24 percent reported less than \$100,000 of dollar volume, and 53 percent less than \$300,000 of dollar volume. Less than 13 percent reported a dollar volume of over \$1 million.

The principal products marketed by farm cooperatives in the United States are grains, dairy products, livestock, fruits and vegetables, cotton and tobacco. The principal products purchased by farm cooperatives are feed, fertilizer, and automotive fuel and lubricants.

Although the vast bulk of the associations are small and local in character, many of them are either members of, or affiliated with, large-scale centralized and federated cooperative associations. The centralized associations are regional associations operating over a larger area than can be served by a local association. As in the case of the latter, however, the members of the centralized associations are individual producers who directly select the board of directors of the association. The federated associations are also regional or large-scale organizations, but their members are wholly or predominantly cooperative associations and in some cases are cooperative associations that are themselves federations. Federations are controlled by boards of directors chosen by duly elected representatives of the members in the local organizations.

In 1942-43 (the latest year for which data of this sort are available) about 43 percent of the total volume of marketing done by farm cooperatives was accounted for by 48 federated or centralized regional cooperatives, each with a business volume of more than \$10 million. In addition, there were 10 federated or centralized regional purchasing cooperatives with an annual volume of more than \$10 million each, which accounted for about 35 percent of the total purchasing volume of all farm cooperatives. These large-scale regional cooperatives, and the interregional associations formed in turn by them, frequently carry cooperation further along the chain of distribution, sometimes to the ultimate consumer (in the case of marketing associations) or to the basic manufacturing stages (in the case of purchasing associations). Among the purchasing cooperatives these operations are associated mainly with the production of feed and fertilizer, although a number of paint factories, sawmills, and oil refineries are operated by cooperative associations. Among the marketing cooperatives, advanced processing is carried on mainly in creameries and cheese factories, cotton gins, canneries, and dehydrating plants, although a few associations operate flour and cereal mills, wineries, sugar mills, and nut processing and packaging plants. Despite the wide variety of activities in which farm cooperatives are currently engaged, it appears that the number of true manufacturing plants owned and operated by them is still very small, and that cooperative manufacturing is economically significant only in a very few lines.

Closest to the farmers' marketing and purchasing associations in terms of economic functions are the urban purchasing associations. These organizations differ from farm purchasing cooperatives only in the character of their membership and to some extent in the type of commodities handled. Many of these local urban associations are affiliated with the farmers' cooperatives in the regional and interregional federations (particularly, the petroleum associations).

As of 1945 the Bureau of Labor Statistics estimates that about 2,650 nonfarm local purchasing associations were in existence with about 812,000 members. Retail grocery and other retail stores accounted for the bulk of the associations (1,850) and members (600,000), followed by petroleum associations (775 associations with 200,000 members). Total volume of business was estimated at nearly \$330 million, or about 6 percent of the total farm marketing and purchasing volume and about 33 percent of farm purchasing volume alone. Retail-store sales were \$171 million and petroleum sales nearly \$140 million.

These urban consumer cooperatives differ from farm purchasing cooperatives in that their patrons are purchasing items for their personal consumption rather than for use in their businesses. Cooperative associations for business purposes have, however, developed in a number of other fields. These include organizations such as the Railway Express Agency and various wholesale grocery associations formed by individually owned grocery stores, which provide business services for their members.

For purposes of clarity the discussion of the tax treatment of cooperatives in this study has been divided into two sections. The first section deals with the tax treatment of the exempt farm cooperatives, and the second section deals with the tax treatment of the taxable cooperatives (both farm and nonfarm) and the patrons of all cooperatives.

II. EXEMPT FARM COOPERATIVES

A. PRESENT TAX TREATMENT

Of the approximately 10,000 farm cooperatives, in 1946 there were 6,009 which qualified for exemption under section 101 (12) of the Internal Revenue Code. These exempt cooperatives had total gross receipts of \$5.6 billion. Receipts of \$1 million or more were reported for 1946 by 802 of the exempt farm cooperatives, and receipts of \$25 million or more were reported by 33 of these cooperatives. Information available with respect to the exempt cooperatives with gross receipts of \$50,000 or more in 1946 shows that these organizations had aggregate net margins (before payment of patronage dividends, ordinary dividends, or other distributions to members) of \$140 million. Of this amount \$6 million was paid as ordinary dividends or similar distributions to members, and \$106 million was paid or credited as patronage dividends. Of the \$106 million in patronage dividends, approximately \$16.5 million was actually paid out in cash. These cooperatives retained, presumably as reserves, \$28 million of their net margins in excess of the amounts distributed as ordinary dividends or paid or credited as patronage dividends.

The act of 1913, which imposed the first income tax under the sixteenth amendment, made no specific reference to farmers' cooperative associations, but it did expressly exempt from tax "agricultural and horticultural organizations." The Treasury Department construed this exemption to include all farmer and fruit grower associations without capital stock represented by shares, if their purpose was to promote the mutual benefit of their members in growing, harvesting, and marketing their products and if their income was derived wholly from membership fees, dues, and assessments to meet necessary expenses.

In 1916 Congress specifically extended the exemption to "farmers, fruit growers, or like associations, organized and operated as the sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales less necessary selling expenses, on the basis of the quantity of produce furnished by them." Express statutory exemption was granted on the same terms to agricultural purchasing cooperatives in 1921. In order to qualify for the exemption under the 1916 act, a cooperative had to show that its business was that of marketing products for its members and that the entire proceeds of such marketing had to be turned back or paid to such members on the basis of the quantity of produce turned in by them. The regulations under the 1916 act, like those under the 1913 act, provided that any cooperative association which could not qualify for the exemption, because it did not act strictly as agent but purchased produce from members with a view toward selling it for gain, might nevertheless exclude from gross income all amounts paid to members on the basis of quantity of goods handled for them. Thus one kind of tax treatment was prescribed for the so-called agency-type cooperative which was deemed not to have income, and a different treatment for the association taking title to the commodities handled but under contract to return to its patrons on the basis of patronage the bulk of its net proceeds.

In the decade between 1916 and 1926, there were substantial changes in the tax statutes and Treasury Regulations with respect to farm cooperatives. In the belief that Congress desired the exemption to be construed broadly, the Treasury ruled that an otherwise exempt cooperative would not be denied exemption because it had outstanding capital stock on which it paid a fixed dividend amounting to the legal rate of interest, provided that all such capital stock was owned by farmers. Somewhat later it was held that an otherwise exempt cooperative could accumulate and maintain a reserve required by State laws as well as a fixed fund or surplus for the erection of buildings and facilities required in its business without losing its exempt status. Still later the Treasury ruled in effect that an exempt marketing cooperative need not be operated strictly as an agent of its members but could take title to commodities without losing its exempt status, provided that it turned back to producers the proceeds of the sales of their products, less necessary operating expenses, on the basis of produce furnished by them.

In the Revenue Act of 1926, Congress incorporated these administrative rulings into statutory law and at the same time established tests of eligibility for the exemption. These statutory provisions have remained virtually intact to the present day.

At present, the exemption under section 101 (12) for farm cooperatives is applicable to both marketing and purchasing cooperatives. Such cooperatives, to qualify for exemption—

(a) Must be farmers, fruit growers, or like associations organized and operated on a cooperative basis for the purpose of marketing produce or purchasing supplies for their members; and

(b) Substantially all their stock (other than preferred non-voting) must be owned by producers marketing products or purchasing supplies through the cooperatives; and

(c) Their marketing of products of nonmembers cannot exceed 50 percent of their total marketing in value; and

(d) Their purchasing for nonmembers cannot exceed 50 percent of their total purchasing; and

(e) Their purchasing for persons who are neither members nor producers cannot exceed 15 percent of total purchasing; and

(f) Nonmembers must be equally entitled, with members, to net savings; i. e., members cannot make profit from the business done with nonmembers.

The cooperatives can disregard business done for the United States Government in the application of these rules. Also, they are expressly permitted to maintain reserves required by State law or reasonable reserves for any necessary purpose. The exception of business done with the United States allows patrons to divide profits allocable not only to business done on their account but also to business done with the United States. Administrative experience with the provision of the exemption permitting reserves to be accumulated indicates that it does not provide a practical limitation on the reserves a cooperative may set aside and still retain its exemption.

The exempt farm cooperatives have certain tax advantages over the taxable cooperatives. First, in the case of the taxable cooperatives, earnings which are distributed to shareholders in the form of dividends on capital stock are first taxed in the hands of the associations, whereas such earnings are not taxed in the case of the exempt cooperatives. For 1946 the exempt cooperatives with gross receipts of \$50,000 or more reported dividends on stock and other similar distributions of \$6,000,000.

Second, since the exempt farm cooperatives may retain a part of their net margins as reserves before computing the amount of the patronage dividends, such amounts are not subject to tax in the hands of either the cooperatives or their members or other patrons. This is an advantage which the taxable cooperatives do not have. If the taxable cooperatives retain earnings as reserves without allocation to patrons, they are subject to the corporate tax on such amounts. Although the taxable cooperatives can retain such amounts without corporate tax if they are first allocated to the patrons, then in that case these amounts are taxable to the members or other patrons.

Third, in the case of taxable cooperatives, profits on business done with the United States Government are taxable to the cooperative, regardless of whether or not distributed to members or other patrons, unless the United States Government shared equally with other patrons in the allocation or distribution of patronage dividends. The exempt farm cooperatives, however, are not taxable on profits made from business done with the United States even though the United States does not share in the patronage dividends.

Fourth, as a general rule, an exempt marketing cooperative must restrict its activities to the actual marketing of agricultural products and must act only on behalf of farmers. The courts and the Bureau of Internal Revenue, however, have enunciated the principle that the exemption provisions should not be construed in such a way as to prevent the organization from carrying on its functions successfully. Consequently, the Bureau has made an exception to the general rule in cases where the amount of nonfarm products marketed is small and where the handling of such items is essential to the efficient operation of the business. Exception is also usually made where products are purchased from dealers for a limited time only in order

to fulfill delivery contracts or for other emergency purposes. Patronage dividends are not usually paid to such nonmember suppliers or suppliers of nonagricultural products. Limited amounts of ordinary commercial profits thus may escape taxation.

Fifth, nonoperating income such as interest on bank deposits or on investments, dividends, rents, and capital gains would be taxable to the cooperative in the absence of the exemption. However, the amount of income which exempt cooperatives derive from these sources is extremely small.

The exemption also involves certain disadvantages for cooperatives. This is suggested by the fact that many of the farm cooperatives do not attempt to meet the statutory requirements. One of the most important disadvantages is the requirement that exempt associations must not discriminate against nonmembers in paying patronage dividends. Another disadvantage in the case of marketing cooperatives is the prohibition against dealings with nonproducers. Similarly, the restriction of nonfarmer purchasing to 15 percent of total purchasing has been said to act as a limitation on growth and expansion.

B. PROPOSED TAX TREATMENT

It is proposed that the section 101 (12) exemption for farm cooperatives be retained in the Internal Revenue Code, with the following modifications:

- (1) Limit the exemption to cooperatives all of whose members are individuals;

- (2) Limit the exemption to cooperatives whose total assets do not exceed \$75,000; and

- (3) Provide that business done with the United States Government is to be disregarded in determining the right to exemption only if the United States receives patronage dividends on the same basis as members.

The first proposed modification of the present exemption provision (limiting the exemption to cooperatives all of whose members are individuals) would have the effect of denying exemption to a cooperative in which corporations, including incorporated farms, were members. It would also deny exemption to federated cooperatives; that is cooperatives of which other cooperatives are members.

The second proposed modification of the present exemption provision (limiting the exemption to cooperatives with assets not in excess of \$75,000) would have the effect of restricting the exemption to small, local associations of farmers. Although many returns with incomplete information were filed, so that an accurate estimate is not possible, it is estimated that over half of the 6,000 presently exempt cooperatives would retain their exemption under this limitation.

The third proposed modification of the present exemption provision would mean that a farm cooperative which did business with the United States would be required, in order to retain its exemption, to allocate or pay patronage dividends to the United States on the same basis as is now required with respect to other nonmembers.

C. DISCUSSION OF PROPOSED TAX TREATMENT

In spite of the tax advantages which exempt farm cooperatives have under the present law, and in spite of the additional tax ad-

vantage which they would have over taxable cooperatives under the proposals made in this study with respect to the retained net margins of taxable cooperatives, it is believed desirable to retain the principle of exemption for farm cooperatives. The exemption is more important to most farmers as a symbol of approval of the association of farmers in cooperatives than as a means of actually gaining a tax advantage. Also, the exemption is valuable in fostering the organization and growth of new farm cooperatives.

The exemption, at the time originally granted, appears to have been contemplated only to aid local groups of farmers in marketing produce and in purchasing supplies. The proposed modifications of the exemption to limit it to small cooperatives and to ccooperatives all of whose members are individuals would have the effect of reinstating this original concept. The principal effect of these proposed limitations would be to bring within the scope of the corporation income tax the large regional and federated associations. It is primarily these large cooperatives which have entered into the business of manufacturing or have accumulated sizable amounts of capital tax-free so as to present serious competitive problems for taxable private businessmen. The \$75,000 asset figure is suggested because it appears to represent a reasonable breaking point between the small local cooperative and the larger ones and would still provide encouragement for the formation of new associations. Asset size appears to be preferable to gross receipts as a test since it will lessen extensively the problem of organizations moving involuntarily in and out of an exempt status from year to year and thus has less tendency to discourage growth.

The proposal that exemption be denied cooperatives whose members are not individuals has been made for two reasons. First, it is not believed that it is desirable to foster, by tax exemption, the growth of associations set up by corporations, even though engaged in farming, for their mutual profit. Second, it is believed that much of the abuse of the present exemption through cooperatives engaging in manufacturing, processing, refining, etc. has been through the technique of cooperatives setting up associations (the federated cooperatives) which go beyond direct marketing of farm products and purchasing of farm supplies.

The proposal relating to business done by farm cooperatives with the United States is not likely to cause cooperatives to lose their exemption. It is more likely that the cooperatives will revise their procedures so as to give patronage dividends to the United States on the same basis as to other nonmembers; this should result in savings to the Government on business done with exempt cooperatives.

III. TAXABLE COOPERATIVES

Taxable cooperatives include those farm cooperatives which are not eligible for exemption under section 101 (12), the consumer cooperatives, and the various cooperative associations of business firms.

A. PRESENT TAX TREATMENT

Cooperatives are taxable as corporations and are subject to the regular corporate income and excess-profits-tax rates. The difference

between their treatment under the corporate income tax and the treatment of ordinary business corporations arises from their practice of allocating their net margins as patronage dividends, and computing their tax only on that amount of their net margins which is not so allocated.

To be permitted this privilege, a cooperative association must have agreed, at the time of the original transaction with the patrons, to return any net proceeds to him in proportion to patronage. Moreover, if only members may receive patronage dividends, the cooperative may not exclude from its gross income the portion of any distribution to members which represents profits from dealings with nonmembers. This principle was announced by the Bureau of Internal Revenue as long ago as 1918, when Treasury Decision 2737 stated:

Where such refund payments are made in accordance with bylaws or published rules regularly adhered to, they are to be regarded as discounts or rebates, tending to reduce the taxable net income of the organization. Like discounts generally, they should appear as an added item of cost in the detailed schedule of cost items submitted with the organization's returns of income.

In determining the amount of patronage dividends which reduce the net margins of the cooperatives, no distinction has been drawn between patronage dividends paid in cash and such dividends in the form of stock, revolving fund certificates, certificates of indebtedness, or letters of advice as to net amounts retained and credited to the patrons' accounts on the books of the cooperatives. All such forms of distribution or allocation are regarded as the equivalent of cash distributions in the hands of the patrons, the theory being that they are cash payments which have been automatically reinvested in the association under provisions of the charter, bylaws, or other contracts previously agreed to by the patrons.

The effect of thus treating as cash distributions amounts allocated to patrons which are not in fact paid in cash allows a cooperative to retain tax-free sums which can be used by it to strengthen its position and to improve and expand its operations. This is, essentially, the tax advantage which the cooperative has over the ordinary business corporation.

Patronage dividends to patrons of a marketing cooperative, whether or not exempt, are includible in the patron's gross income, since they are additional receipts for goods sold. At the present time this is true irrespective of whether such refunds are in the form of cash, certificates, or credit allocations. Patronage dividends to patrons of a cooperative purchasing items for use in the patron's business, whether or not the cooperative is exempt, are either includible in the patron's gross income or operate to reduce his deductible expenses. This, also, is irrespective of whether such refunds are in the form of cash, certificates, or credit allocations. Patronage dividends to patrons of a consumer cooperative generally have no income-tax consequences to the patron, since they represent a return with respect to expenditures of a personal nature of the patron, for which no income-tax deduction has been taken by him. Payments to patrons of any cooperative which are not true patronage refunds, such as payments to members of profits arising out of nonmember business, are includible in the income of the patron.

B. PROPOSED TREATMENT OF TAXABLE COOPERATIVES

It is proposed that taxable cooperatives be permitted to deduct only the following patronage dividends from gross income:

(1) Patronage dividends proportionate to patronage of the current taxable year which are paid out during the year or within 75 days thereafter in cash or merchandise; and

(2) Payments during the current taxable year in cash or merchandise which are in satisfaction of patronage dividends which have been allocated to the patron on the books of the cooperative or which are evidenced by certificates with respect to patronage during prior taxable years which began after 1950.

In the case of a cooperative on the accrual basis, a patronage dividend would be considered as paid in cash or merchandise if it were so payable at the option of the patron. In the case of such amounts, however, the deduction by the cooperative would be limited to the percentage of such amounts which the experience of the cooperative indicates will be cashed by the patrons. This is the same treatment which is now provided in the case of ordinary business corporations which issue merchandise coupons or trading stamps which are redeemable by their customers where experience shows that only a percentage of the customers will actually redeem their coupons or stamps.

C. PROPOSED TREATMENT OF PATRONAGE DIVIDENDS IN THE HANDS OF PATRONS

With respect to patronage dividends received from either taxable cooperatives or exempt cooperatives, it is proposed that—

(a) Patronage dividends received with respect to marketing of the patron's products by the cooperative shall be included in the patron's gross income to the extent paid in cash or merchandise (or so payable at the option of the patron) in proportion to the patronage of the cooperative during the current taxable year of the cooperative or in satisfaction of certificates or credits on the books of the cooperative which are based on patronage of the cooperative during previous taxable years beginning after 1950.

(b) Patronage dividends received with respect to the purchase of goods from the cooperative for use by the patron in his trade or business shall reduce the deduction by the patron of the cost of such goods (or increase his gross income) to the same extent as indicated above.

(c) Patronage dividends received with respect to the purchase of goods from the cooperative for the personal consumption of the patron should, as at present, not be taxable to the patron.

D. WITHHOLDING ON PATRONAGE DIVIDENDS

If withholding on ordinary corporate dividends is adopted, it is recommended that:

(a) Patronage dividends be withheld on by cooperatives (other than consumer cooperatives) at the same rate and in the same manner as ordinary corporate dividends at the time when they are taxable to the patrons. Patronage dividends paid by one

cooperative to another cooperative would be exempt from withholding.

(b) Dividends which are not true patronage dividends be withheld on by all cooperatives at the same rate and in the same manner as ordinary corporate dividends at the time when they are taxable to the patrons.

E. DISCUSSION OF PROPOSED TAX TREATMENT

The proposed change in the treatment of patronage dividends is based on the principle that taxable cooperatives should be taxed on the basis of what they actually do with their earnings rather than on the basis of what they are presumed to do with them. It would allow as a matter of policy the deduction of net proceeds actually distributed in the form of cash but the associations will not be able to avoid taxation on earnings retained in the business. In other words, the net income of cooperatives would be taxed to those which had the use and enjoyment of those earnings; namely, the patrons in the case of cash payments, and the associations themselves in cases where they retain the income and give the patrons stock or scrip payments.

While taxable cooperatives may have competitive advantages of a nontax nature over other businesses, their principal competitive tax advantage has arisen through their ability to retain their net margins for expansion of their plant, equipment, and working capital without payment of tax on these amounts. The proposed changes in tax treatment would impose the corporate tax on these retained amounts.

To the extent that the earnings of the taxable cooperatives are used to pay dividends on stock to members, they are already subject to double taxation like the earnings of any ordinary business corporation which are used to pay dividends. The changes proposed here would not impose a double tax on that portion of the net margins which are actually paid out to patrons (these amounts would be deductible when paid out) or on that portion of the net margins which are retained these amounts would not be taxable to the patrons. Since a patronage dividend with respect to patronage of a prior year would be deductible by the cooperative when actually paid out in cash in a later year, the practical effect will be to prevent the impact of both the corporate income tax and the individual income tax on patronage dividends paid out.

With respect to the individual cooperative patron, the effect of the proposed changes is to require him to pay tax only on amounts actually received (or which can be received at his option) in cash or merchandise.

The proposed withholding on patronage dividends of the type taxable to the patron is consistent with the proposals made for withholding an ordinary corporate dividend and interest payments. This withholding plan would be simpler for the cooperatives to administer than the dividend withholding system adopted by the committee last year. It also differs from last year's plan in that it is applicable only to dividends paid in cash or merchandise, since the proposals made now do not contemplate taxing the individual patron on noncash patronage dividends.

TABLE I.—Farmers' marketing and purchasing associations: Estimated number of associations and business done for specified periods, 1913 to 1947-48

[Money figures in millions]

Period	Number of associations	Marketing	Purchasing	Total
1913.....	3,099	\$304.4	\$5.9	\$310.3
1921.....	7,374	1,198.5	57.7	1,256.2
1925-26.....	10,803	2,265.0	135.0	2,400.0
1930-31.....	11,950	2,185.0	215.0	2,400.0
1935-36.....	10,500	1,586.0	254.0	1,840.0
1940-41.....	10,600	1,911.0	369.0	2,280.0
1945-46.....	10,150	5,147.0	923.0	6,070.0
1947-48.....	10,135	7,195.0	1,440.0	8,635.0
1948-49.....	10,075	7,297.6	2,022.4	9,320.0

Source: Statistics of Farmers' Marketing and Purchasing Cooperatives, 1947-48. Farm Credit Administration, U. S. Department of Agriculture, 1950.

TABLE II.—Farmers' marketing and purchasing associations: Number of associations listed in 1947-48

Group	Locals	Large scale	Total
Cotton and products.....	489	25	514
Dairy products.....	1,849	242	2,091
Fruit and vegetables.....	802	127	929
Grain, dry beans, rice.....	2,201	32	2,233
Livestock.....	508	44	552
Nuts.....	33	7	40
Poultry and products.....	122	21	143
Tobacco.....	—	16	16
Wool and mohair.....	93	30	123
Miscellaneous.....	503	15	518
Total marketing.....	6,600	559	7,159
Purchasing.....	2,879	97	2,976
Total marketing and purchasing.....	9,479	656	10,135

Source: Statistics of Farmers' Marketing and Purchasing Cooperatives, 1947-48. Farm Credit Administration, U. S. Department of Agriculture, 1950.

TABLE III.—Selected financial data for farmers' marketing and purchasing cooperatives

[Dollar amounts in millions]

	Exempt ¹	Total (exempt and nonexempt)
Year to which data apply.....	1946	1948-49
Number of organizations.....	6,009	10,075
Gross receipts.....	\$5,620	\$9,320
Earned surplus and undivided profits.....	\$193	(²)
Net income before payment of dividends to members or shareholders.....	³ \$140	(²)
Cash dividends paid to members or stockholders.....	\$23	(²)
Noncash dividends paid to members or shareholders.....	\$90	(²)
Net income after dividends to members or shareholders.....	³ \$128	(²)

¹ Except for gross receipts and the number of organizations, the figures are for 4,703 organizations with receipts of \$50,000 or more.

² Not available.

³ May include some valuation reserve charges.

Sources: (1) Exempt farmers' marketing and purchasing cooperatives: Treasury Department, Supplement to Statistics of Income, for 1946, pt. 2, and unpublished data; (2) all farmers' marketing and purchasing cooperatives, Department of Agriculture, Farm Credit Administration, undated press release.