

REPORT  
ON  
COOPERATIVES

*By the*

JOINT STATE GOVERNMENT COMMISSION



*To the*

GENERAL ASSEMBLY OF THE  
COMMONWEALTH OF PENNSYLVANIA

JOINT STATE GOVERNMENT  
COMMISSION

450 CAPITOL BUILDING  
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JOINT STATE GOVERNMENT COMMISSION  
OF  
THE GENERAL ASSEMBLY

(Created in 1937, P. L. 2640, as last amended 1943, P. L. 13)

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## LETTER OF TRANSMITTAL

*To the General Assembly of Pennsylvania:*

Under authority of the Act of July 1, 1937, P. L. 2460, as last amended by the Act of March 8, 1943, P. L. 13, and pursuant to Senate Resolution Serial No. 61 (1945), I have the honor to present herewith a report on co-operatives.

IRA T. FISS, *Chairman,*  
*Joint State Government Commission.*

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## FOREWORD

The purpose of this report is to present an analysis of the taxation and economic importance of co-operative and mutual enterprises in Pennsylvania. This report, submitted by the Committee on Co-operatives, was prepared pursuant to Senate Resolution Serial No. 61, (May 4, 1945), which directed "that the Joint State Government Commission shall cause a study and investigation to be made of the matter of taxation of co-operatives, co-operative agricultural associations, and other similar associations by a committee to be appointed by its chairman which shall submit to the General Assembly at its next regular session recommendations for proposed legislation."

The committee proceeded with its study of co-operatives and mutuals by analyzing the statistics of specific types of co-operatives and mutuals which were available in the various departments of the Commonwealth of Pennsylvania and in certain Federal agencies. The committee did not make a field survey or an analysis of the individual reports of these enterprises. However, reference was made to the business activities of specific farmers' marketing and purchasing co-operatives which were analyzed by the School of Agriculture of the Pennsylvania State College in 1945. Since there has been considerable controversy in recent years concerning the taxation and business activities of co-operatives, the committee held a conference with representatives of co-operatives and other business enterprises who presented their arguments. At another conference the committee conferred with the representatives of 42 consumer co-operatives doing business in the State; at this meeting the provisions of the Co-operative Act of 1887 were discussed. In addition, the committee sent questionnaires to state tax officials in ten selected states<sup>1</sup> in order to ascertain the types of state taxes which were imposed upon these enterprises in other states. Some materials are presented on co-operative activities in United States and taxation by the Federal government since these materials are closely related to the operations of these enterprises in Pennsylvania.

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<sup>1</sup> California, Connecticut, Delaware, Massachusetts, Minnesota, New Jersey, New York, Ohio, West Virginia, and Wisconsin.

## SUMMARY

### United States

- (1) The most recent statistics issued by the Co-operative Research and Service Division of the United States Department of Agriculture indicate that farmers' marketing co-operatives transacted approximately \$4,430,000,000 of business in the 1943-1944 marketing season; in this same period farmers' purchasing co-operatives transacted approximately \$730,000,000 of business. In 1932 farmer co-operatives handled 36.8 percent of the total farm product sales in the entire country; in 1944 they handled 21.6 percent. The trend of the percentage of farm product sales handled by co-operatives was upward until 1932, and since that year has been downward.<sup>1</sup>
- (2) The percent of total consumer expenditures represented by the dollar volume of farmers' co-operative business has never exceeded 5 percent; in fact, since 1925 this percentage has fluctuated between a low of 2.53 percent and a high of 4.64 percent.<sup>2</sup>
- (3) In 1943, 104,000 co-operative and mutual enterprises filed income tax returns with the U. S. Bureau of Internal Revenue. These enterprises reported a gross income of over 5 billion dollars for this year. This income was exempt from Federal taxation, primarily because of the tax exemptions existing in Section 101 (1) to (19) of the Internal Revenue Code.<sup>3</sup> There is reason to believe that the actual gross income of these enterprises was much larger than that reported to the Bureau of Internal Revenue because of the fact that many co-operatives which were required to file reports failed to do so.
- (4) Although co-operatives still transact a relatively insignificant percentage of the total volume of business in United States, they are growing rapidly in certain fields of business, such as in retailing, the production and sale of electric power, the lending of credit, and in the actual production and manufacture of goods.

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<sup>1</sup> U. S. Congress, Committee on Small Business, First Interim Report, pursuant to H. Res. 64, April 9, 1946, p. 24.

<sup>2</sup> Ibid.

<sup>3</sup> Actually it is the net income which is tax exempt.



The dollar volume of co-operative production more than doubled between 1943 and 1944. The most important fields of co-operative production at present are: farm seeds, feeds, fertilizers, petroleum products, food products, farm machinery, and lumber.<sup>1</sup>

### **Pennsylvania**

- (1) Co-operatives in Pennsylvania, including mutual insurance companies, are incorporated under seven major state laws: the Acts of 1874, 1887, 1919, 1921, 1929, 1933, and 1937. Since 1887, co-operatives have been incorporated under special state laws, rather than under the regular business corporation acts.
- (2) Co-operatives operate in a manner unlike that of regular business corporations, especially in relation to their members and customers. Most of the special acts providing for the incorporation of co-operatives impose certain restrictions upon their business operations. For example, these restrictions may take the following forms:
  - (a) restrictions upon the issue of capital stock;
  - (b) restrictions on the amount of dividends or interest paid;
  - (c) statements concerning the co-operative's relations with its customers; these involve the use of contracts and agreements;
  - (d) restrictions on the type of business carried on, including the area of operations;
  - (e) restrictions on the voting power of stockholders;
  - (f) restrictions on the use of reserve accounts;
  - (g) restrictions concerning the methods of distribution of net income.

In addition, the special acts providing for the incorporation of co-operatives may contain certain tax exemptions; thus, the Acts of 1929, 1933, and 1937 provide for certain exemptions from state taxation for farmer co-operatives with capital stock, credit unions, and rural electric co-operatives.

- (3) The most comprehensive, although incomplete, statistics of the number and gross income of co-operatives and mutuals operating

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<sup>1</sup> Lumbering is not permitted under the Pennsylvania Co-operative Acts of 1919 and 1929.

in Pennsylvania in 1943 are those provided by the U. S. Bureau of Internal Revenue. The bureau reported that 5,890 co-operatives and mutuals filed returns of income in that year. Of this total, 1,348 co-operatives and mutuals were engaged in actual business or "commercial" functions; these enterprises reported a gross income of \$83,000,000 which was exempt from Federal taxation.<sup>1</sup> The remaining 4,542 co-operatives which were engaged in "non-business" functions reported a gross income of \$118,098,000 in 1943. The most important co-operatives and mutuals in the group engaged in business functions were the mutual savings banks and farmers' marketing and purchasing co-operatives. The most important co-operatives and mutuals in the group engaged in non-business functions were the labor organizations, educational and charitable organizations, local associations of employees and welfare organizations, social clubs, and business leagues.

- (4) The most important farmers' marketing and purchasing co-operatives in Pennsylvania are those engaged in the handling of the following products and services: dairy products, fruits and vegetables, purchasing of supplies, poultry and poultry products, wool and mohair, grain, dry beans and livestock. They also handle feeds, fertilizers, and petroleum products. In 1925 the Pennsylvania Department of Agriculture reported that the farmer co-operatives in the State transacted a volume of business of 31 million dollars; in the 1934-1935 marketing season there were 153 farmer co-operatives in the State which transacted a volume of business of \$36,260,000. In 1945 Professor J. K. Stern of the School of Agriculture, The Pennsylvania State College, reported that there were 177 farmer-owned and farmer-operated co-operatives doing business in the State. From their annual reports filed with the Secretary of Agriculture, he ascertained that they transacted a 102 million dollar business in the year 1943. These statistics are believed to be the most comprehensive available on the subject of farmer co-operatives in the State.
- (5) In recent years since 1930 there has been a rapid growth in the number and volume of business of credit unions and rural electric co-operatives. Although there were only 10 credit unions with

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<sup>1</sup> Actually it is the net income which is exempt from taxation.

state charters operating in the State in 1933, the number increased to 92 in 1941; in that year these credit unions had loans outstanding of \$3,501,261.64. By 1944, however, the number had decreased to 80 and the volume of loans outstanding had decreased to \$1,752,339.70. In 1937 there were 11 rural electric co-operatives in operation in the state; these co-operatives had borrowed \$1,435,000 from the Federal Rural Electrification Administration, and were serving 8,010 consumers. By 1944 there were 13 such co-operatives in operation, with borrowings of \$12,166,200 from the Federal Rural Electrification Administration. These co-operatives were serving 30,569 rural consumers in this year.

- (6) The U. S. Census Bureau reported that co-operative wholesalers and retailers in Pennsylvania transacted approximately one percent of the total dollar volume of such business in the State in 1939. The 21 co-operative manufacturing enterprises in the State produced 0.03 percent of the total dollar volume of manufactured goods in the State in that year. These enterprises were primarily engaged in the manufacture of agricultural commodities or commodities for farm use.
- (7) In 1939 the U. S. Bureau of the Census reported that there were 136 consumer co-operatives (retailers) doing business in the State; they reported a dollar volume of business of \$5,511,000 for that year. The most recent reports of the U. S. Bureau of Labor Statistics indicate that there are at present 109 consumer co-operatives doing business in Pennsylvania. An examination of the records in the office of the Secretary of the Commonwealth reveals that 39 of these consumer co-operatives are operating in the State without a charter. Moreover, there are at present no available statistics of the volume of business done by these enterprises.
- (8) The co-operative incorporation acts of 1929 (agricultural co-operatives with stock), 1933 (credit unions), 1933 (agricultural credit co-operatives), and 1937 (rural electric co-operatives) contain certain tax exemption provisions with respect to State taxes. The various tax statutes themselves, in some cases, provide certain tax exemptions for co-operative enterprises. An examination of the incorporation acts affecting co-operatives, together with an examination of the tax statutes themselves, indicates that co-operatives

and mutuals operating in Pennsylvania are subject to the following State taxes:

<i>Type of Co-operatives</i>	<i>Subject to</i>
Co-operatives, productive and distributive (1887)	Bonus Capital stock tax Corporate loans tax Stock transfer tax Corporate net income tax Unemployment compensation tax (agricultural labor exempt)
Agricultural Co-operatives, without stock (1919) <sup>3</sup>	Unemployment compensation tax <sup>1</sup>
Agricultural Co-operatives, with stock (1929) <sup>3</sup>	Bonus Stock transfer tax Co-operative agricultural net income tax Unemployment compensation tax <sup>2</sup>
Agricultural Credit co-operatives (1933)	Bonus Stock transfer tax Co-operative agricultural net income tax Unemployment compensation tax
Credit Unions (1933)	No taxes
Rural Electric Co-operatives (1937)	Bonus (if stock) \$10 annual license fee per 100 members Stock transfer tax
Domestic mutual insurance companies (1921)	Unemployment compensation tax <sup>1</sup>
Mutual savings institutions, non-stock (1889)	Net earnings tax of 1889 Unemployment compensation tax

All of the above enterprises are subject to local real property taxes and are exempt from county personal property taxes. It is impossible at the present time to ascertain the yield of taxes paid

<sup>1</sup> Subject to Unemployment Compensation Tax on that portion of its employment which is not within the definition of "agricultural labor."

<sup>2</sup> Ibid.

<sup>3</sup> Foreign agricultural co-operatives, with and without capital stock, are subject to the bonus (tax) as imposed by the Act of May 8, 1901, P.L. 150.

by co-operative and mutual enterprises in Pennsylvania because of the fact that the records of the various State departments concerned with the collection of State taxes have not been set up to record separately the taxes collected from these enterprises. However, Acts 357, 358 and 360, passed by the General Assembly in 1945, provide for more complete reporting of business activities on the part of farmer co-operatives.

- (9) An examination of the taxation of co-operatives in other selected states reveals that there is no uniformity in the treatment of co-operatives. An examination of questionnaires received from state tax officials in ten selected states indicates that these states make some use of gross receipts taxes, franchise taxes, real property taxes, unemployment compensation taxes, retail sales taxes, and business licenses. There has been a marked trend toward the use of property tax exemptions for rural electric co-operatives. The most recent statistics available indicate that 21 states have granted real or personal property tax exemptions to these enterprises. There is a tendency to impose gross receipts taxes in lieu of property taxes on these enterprises in some states. There is also little uniformity in the application of retail sales taxes to co-operatives. Some states exempt the sales of agricultural commodities from retail sales taxes.





## Part I

### INTRODUCTION

Co-operatives have been the subject of some public discussion in recent years primarily because of two reasons: first, they are alleged to be in active competition with other types of business enterprises; second, they have been granted certain tax exemptions by the Federal Government and some of the states, and these tax exemptions have been the center of most of the public discussions involving them. In addition to Congressional hearings held in the spring of 1945, the legislatures of Iowa and Kansas have directed special committees to inquire into the business affairs and taxation of such enterprises. The tax status of these enterprises has also been given brief consideration by special tax committees in Utah and Kentucky.

A review of the literature on the subject of co-operatives and mutuals indicates that there is considerable misunderstanding as to the business structure and legal relationships of these enterprises. For example, many people believe co-operatives operate in the same manner as other business corporations; they thus consider that such enterprises should pay the same taxes and be subject to the same set of regulatory laws as other business enterprises. In practice, this is not the case, because most co-operatives and mutuals operate in a manner unlike that of regular business corporations. This is because of the fact that co-operatives and mutuals possess special business characteristics which distinguish them from regular business corporations. These special business characteristics, applicable to co-operatives and some mutuals in Pennsylvania, are as follows:

- (1) Co-operatives and mutuals are incorporated under special state laws, rather than under the regular business corporation acts. In Pennsylvania there are seven major state laws, together with several minor acts, which deal specifically with these enterprises.<sup>1</sup>

<sup>1</sup> Act of April 29, 1874, P. L. 73.

Act of June 7, 1887, P. L. 365.

Act of June 12, 1919, P. L. 466.

Act of May 17, 1921, P. L. 682.

Act of June 30, 1923, P. L. 984.

Act of April 30, 1929, P. L. 885.

Act of May 5, 1933, P. L. 289.

Act of May 15, 1933, P. L. 624.

Act of May 25, 1933, P. L. 1027.

Act of May 26, 1933, P. L. 1076.

Act of June 21, 1937, P. L. 1969.

- (2) These special state laws affecting these co-operatives, in many cases, restrict the co-operatives to certain fields of business operations. For example, the Pennsylvania Acts of 1919 and 1929 apply only to agricultural co-operatives; the Credit Union Act of 1933 restricts these enterprises to transactions with their members only, and the Rural Electric Co-operative Act of 1937 restricts these co-operatives to the business of producing and selling of electric power to members only in rural areas. In contrast, the Cooperative Act of 1887 is extremely broad in its scope concerning the fields of business which co-operatives may enter. This act is so broad that almost any type of agricultural, mining, manufacturing, commercial, or trading activity may be engaged in. Co-operatives incorporated under this act may deal with other persons and enterprises, in addition to their own members. It should be noted, however, that a co-operative organization gains no tax advantage in Pennsylvania by incorporating under the Act of 1887, because all such co-operatives must pay the same taxes as are paid by regular corporations, with the single exception of the unemployment compensation tax, in the event that the co-operative can qualify for such exemption because it is engaged in strictly agricultural pursuits, specifically exempted by law.
- (3) The co-operative or mutual capital structure is usually carefully prescribed by the statutes affecting these enterprises. Every major Pennsylvania act relating to the incorporation of co-operatives or mutuals contains some restrictions concerning either the type or the amount or the value of the capital structure.
- (4) Stockholders usually are given only one vote per person, irrespective of the number of shares owned. The Pennsylvania Acts of 1887, 1919, 1929, 1933 (Credit Unions), 1933 (Agricultural Credit Co-operatives), and 1937 specifically limit the voting powers of stockholders.
- (5) In some cases the method of distribution of net income is specifically prescribed by law. Thus, the Pennsylvania Acts of 1887, 1919, 1929, 1933 (Agricultural Credit Co-operatives), 1933 (Credit Unions) and 1937 specifically mention certain methods of distributing the net income of these enterprises.
- (6) In some cases, the co-operatives are required by law to set aside annually a certain portion of their net income in order to create and maintain specific reserve accounts. The Penn-



sylvania Acts of 1887, 1921, 1929, 1933 (Credit Unions), and 1937 specifically mention the use of reserve accounts.

- (7) The state laws in some cases require co-operatives to file annual financial reports with certain state departments; in Pennsylvania, every type of co-operative and mutual enterprise, with the exception of rural electric co-operatives and co-operatives incorporated under Act of 1887 must file annual financial reports with designated state departments. Co-operatives incorporated under the Act of 1887 must publish quarterly reports.
- (8) In some cases the dividends paid on capital stock and the interest paid on bonds are limited by law. For example, the Pennsylvania Acts of 1887, 1929 and 1933 (Agricultural Credit Association), specifically limit the rate of dividends. The Credit Union Act (1933) and the Rural Electric Co-operative Act (1937) do not specifically limit the amount of dividends paid by these enterprises, but there are statements in these two acts which indicate the procedures to be followed in the payment of such dividends.
- (9) Some of the incorporation acts affecting co-operative enterprises provide for certain tax exemptions for these enterprises. For example, the Pennsylvania Acts of 1929, 1933 (Agricultural Credit Associations), 1933 (Credit Unions), and 1937 specifically provide certain State tax exemptions for these enterprises. No tax exemptions are provided in the co-operative incorporation Acts of 1887 and 1919.<sup>1</sup>
- (10) The state laws, in some cases, prescribe the nature of the co-operative's relationship with its customers. For example, the Pennsylvania Acts of 1919, 1929, 1933 (Agricultural Credit Associations), 1933 (Credit Unions), and 1937 specifically mention certain business relations between the co-operatives and their customers.

Much of the confusion existing in the literature concerning co-operatives is due to the improper use of certain terms. The most important terms concerned with co-operative operations are as follows:

#### (1) FARMERS' MARKETING AND PURCHASING CO-OPERATIVES

These co-operatives market farm commodities and purchase farm supplies for their members; some of them take title to

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<sup>1</sup> Co-operative agricultural associations not having capital stock and not conducted for profit are exempt from the corporate loans tax as provided in the Act of June 30, 1885, P. L. 193, as last amended by the Act of April 25, 1929, P. L. 669.

the goods, while others do not. Some of these co-operatives act purely as bargaining agents, such as in the field of marketing milk and eggs. These co-operatives are incorporated under the Acts of 1887, 1919 and 1929.

(2) PRODUCTION AND MANUFACTURING CO-OPERATIVES

These enterprises engage in the actual production of goods. A co-operative may be said to be engaged in production or manufacturing if the basic nature of the product is changed as it passes through the hands of the co-operative. Examples of co-operatives engaged in actual production and manufacturing are those engaged in the production of: petroleum products, fertilizers, some food products, paint products, farm machinery, dairy products such as ice cream, butter and cheese. Over one-half<sup>1</sup> of the manufacturing co-operatives in Pennsylvania are engaged in the production of agricultural commodities.

(3) CONSUMER CO-OPERATIVES

These enterprises usually operate as retail stores in urban areas. They sell a wide variety of consumer goods, and in some cases, semi-durable goods, such as household appliances, including refrigerators, washers, and automobile supplies. Most of these co-operatives are incorporated under the Acts of 1887, 1919<sup>2</sup> and 1929.<sup>2</sup>

(4) CREDIT UNIONS

These enterprises, incorporated under a special act in Pennsylvania in 1935, loan money to individual members in small sums usually for the purchase of consumer goods. They may accept the savings of their members as part payments on the purchase of shares of stock. They may do business only with their members.

(5) RURAL ELECTRIC CO-OPERATIVES

These enterprises, commonly referred to as REA Co-ops, may be incorporated under a special act of the General Assembly enacted in 1937. They may produce and sell electric power

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<sup>1</sup> By number.

<sup>2</sup> Some of these agricultural co-operatives were classified as consumer co-operatives by the U. S. Bureau of Labor Statistics because of the fact that they sell consumer goods such as groceries and household supplies. See U. S. Bureau of Labor Statistics Bulletin No. 750, 1943.

to their members only, who must reside in rural areas which are not adequately served by other power producers. These co-operatives are authorized to borrow capital funds from the Federal Rural Electrification Administration.

(6) MEMBER

A member is a person who has paid a membership fee in a co-operative, or who has purchased capital stock of the enterprise. In some cases, superco-operatives may be formed, whose members consist of other types of incorporated co-operatives. In the case of a non-stock co-operative, a person may become a member by executing a contract with the co-operative and transacting business with it.

(7) NON-MEMBER PATRONS

Persons who have not paid a membership fee in a co-operative and who have not purchased capital stock in the enterprise, but who transact business with the co-operative.

(8) RESERVES

There are reserve accounts which may be required by certain state laws or which may be permitted by the Internal Revenue Code. There are three types of reserve accounts ordinarily maintained by co-operatives:

(A) *Liability reserves*

These are created out of income for purposes of meeting actual or contingent liabilities such as taxes, fire losses, expenses of lawsuits.

(B) *Valuation reserves*

These are created out of income for the purposes of maintaining asset accounts at their correct values at all times. Typical examples of such reserve accounts are: reserves for depreciation of equipment and reserves for bad debts.

(C) *Capital reserves or surplus accounts*

These are set aside out of net income for purposes of increasing the equity of the enterprise or for providing for expansion of the enterprise.

(9) PATRONAGE REFUNDS OR PATRONAGE DIVIDENDS

These refer to net income of the co-operative which is paid to members or patrons on the basis of the amount of business

transacted with each. They may be paid in the forms of cash, shares of stock, certificates of equity, merchandise, or property.

(10) DIVIDENDS

These refer to the amount of the co-operative's net income which is paid to stockholders on the basis of their stock ownership in the co-operative. They are paid in cash, but may also be paid in other forms such as the issue of additional stock or certificates of equity.

Since co-operatives and mutuals are incorporated under a number of special acts of the General Assembly and not under the regular Business Corporation Act, the committee began its study of these enterprises by examining the provisions of these special incorporation acts. With the exception of mutual insurance companies which were incorporated under the Act of May 17, 1921, P. L. 789, it was found that co-operatives in Pennsylvania were incorporated under six separate incorporation acts. The following tabulation indicates the number of co-operatives incorporated under each of these acts since the enactment of the law.

**NUMBER OF CO-OPERATIVES INCORPORATED IN PENNSYLVANIA UNDER SPECIFIC INCORPORATION LAWS AS OF MARCH 1, 1946<sup>1</sup>**

Acts of	1874	1887	1919	1929	(Credit Unions) 1933	(Rural Electric Co-operatives) 1937
Number of Co-operatives	100	344	429	70	80	11 <sup>2</sup>

The above tabulation was derived from lists of co-operatives which were taken from the records of the Department of State by the Pennsylvania Department of Agriculture. The above tabulation does not include unincorporated associations, savings banks and savings institutions without capital stock, and cemetery and burial associations. The following tabulation indicates the number of consumer co-operatives incorporated under specific acts in Pennsylvania since 1874.

<sup>1</sup> There are no agricultural credit co-operatives in existence at the present time; these co-operatives were authorized by the Act of May 25, 1933, P. L. 1027.

<sup>2</sup> The Federal Rural Electrification Administration has reported 13 rural electric co-operatives in operation in Pennsylvania; see Table XII and XVII, Appendix.



## CONSUMER CO-OPERATIVES DOING BUSINESS IN PENNSYLVANIA, 1946

(Number of co-operatives incorporated under specific acts)

Acts of Number of Co-operatives	1874	1887	1919	1929	<i>No records existing in Secretary of Commonwealth Office</i>	<i>Totals</i>
.....	2	38	7	23	39	109

Source: U. S. Bureau of Labor Statistics, Directory of Consumer Co-operatives in U. S., 1943, and Revised List. Records, Secretary of the Commonwealth, Commonwealth of Pennsylvania.

The various acts permitting the incorporation of co-operative enterprises in Pennsylvania briefly contain the following provisions:

The Act of April 29, 1874, P. L. 73, Section 2, provided for the incorporation of non-profit corporations for the purposes of the encouragement of agriculture and horticulture. These corporations were permitted to issue both common and preferred stocks. This act was repealed in so far as it related to non-profit corporations by the Non-profit Corporation Act of May 5, 1933, P. L. 289, Section 2851.

The first important act of the General Assembly relating to co-operatives was the Act of June 7, 1887, P. L. 365. Section 1 of this act provided for the incorporation of co-operatives for the following purposes: "Co-operative associations, productive and distributive, may be incorporated under this act, . . . by any five or more farmers, mechanics, laborers or other persons, who shall have associated themselves together by written articles of association, . . . for the purpose of carrying on any agricultural, horticultural, mining, quarrying, building, mechanical, manufacturing, cultivating, raising, trading or dealing in all kinds of goods, wares, merchandise, chattels, grains, vegetables, roots, fruits and other produce, or animals for sale, food or other purposes, or for the purpose of buying, selling, holding, leasing or improving lands, tenements or buildings. . . ." It may be observed from the language of this act that co-operatives could be formed under its provisions for a great variety of purposes ranging from the operation of retail stores to the regular manufacturing and production of goods. From the standpoint of State taxation, however, there was little advantage to be gained by co-operatives in incorporating under this act, since such co-operatives were treated like regular business corporations; hence, they were subject to the corporation bonus charge, the capital

stock and corporate loans taxes, stock transfer tax, and corporate net income tax. Such enterprises are also subject to the unemployment compensation tax unless they are engaged in strictly agricultural pursuits with certain limitations or some other activity specifically exempt by the Unemployment Compensation Tax Act. These co-operatives were permitted a corporate existence of only thirty years. They were permitted to issue two types of stock, "permanent stock," which was not withdrawable, but which could be transferred, and "ordinary stock," which could be transferred or withdrawn. The amounts of shares of either type of stock were limited to not less than five dollars per share nor more than twenty-five dollars per share. The act prescribed that certain reserve funds should be set up; it also prescribed the method of distributing net profits.

Most of the farmer marketing and purchasing co-operatives in Pennsylvania are incorporated under the Acts of 1919 or 1929, rather than under the Act of 1887.<sup>1</sup> This is because of the fact that the Acts of 1919 and 1929 were specifically designed for the incorporation of farmer co-operatives, and also because of the fact that these two acts enable agricultural co-operatives to operate as special types of business enterprises. By operating under the provisions of these two acts, farmer co-operatives may obtain exemptions from certain regular State taxes and become subject to other forms of taxation specifically applicable to them only. Co-operatives incorporated under the Act of June 12, 1919, P. L. 466, may engage in the following activities: agriculture, dairying, livestock raising, poultry raising, floriculture, mushroom growing, beekeeping, horticulture, and other allied occupations. The Act defines agricultural products to include: all agricultural, horticultural, vegetable, fruit, and floricultural products of the soil, live stock and meats, wool, hides, poultry, eggs, dairy products, nuts and honey, but shall not include timber products. These co-operatives may exist perpetually or for a term stated in the charter; they may also carry on business activities similar to those of other business enter-

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<sup>1</sup> Professor J. K. Stern of the School of Agriculture. The Pennsylvania State College, found that of the farmer co-operatives doing business in Pennsylvania in 1943, 2 were incorporated under the Act of 1887, 78 were incorporated under the Act of 1919, and 63 were incorporated under the Act of 1929, while 34 co-operatives were incorporated under the acts of other States.

See J. K. Stern, Inventory of Farmers' Co-operatives, Pennsylvania, 1943. Bulletin 474, June, 1945, p. 4, The Pennsylvania State College, School of Agriculture, Experiment Station.

prises, such as the buying and selling of properties, the making of contracts, the borrowing of money by means of notes, bonds, and other evidences of debt. They may also own the stocks of other corporations engaged in the buying or selling of agricultural products. Each member of the association shall have only one vote, and voting by proxy is not permitted.

Agricultural co-operatives having capital stock may be incorporated under the Act of April 30, 1929, P. L. 885. The act provides that "co-operative agricultural associations, instituted for the purposes of mutual help, having capital stock, may be formed . . . by any number of persons, not less than five, engaged in agriculture. For the purposes of this act, all persons engaged in agriculture, dairying, live stock raising, poultry raising, floriculture, mushroom growing, beekeeping, horticulture, and other allied occupations shall be deemed to be engaged in "agriculture."<sup>1</sup> These associations may engage in the buying and selling of agriculture products, and take title to such products, and may, as agent for its stockholders or any of them perform for them services connected with the production, preservation, drying, grading, canning, storing, handling, utilization, marketing, or sale of agriculture products produced by them; and for the agricultural purposes of such stockholders, may perform for them services connected with the purchase or hiring for or use by them of supplies, including livestock, machinery, and equipment, and the hiring of labor, or any one or more of the kinds of service specified in this section." These co-operatives have corporate powers similar to those of regular business corporations. For example, they may buy and sell properties, make contracts, and may own stock in other corporations which are engaged in the buying and selling of agricultural products. The General Assembly in Act No. 358, May 23, 1945, broadened the powers of these associations by permitting them to own stock in corporations engaged in the freezing, refrigerating, warehousing, packing, and processing of agricultural products. These associations may issue both common and preferred stocks, but common stocks may be sold to patrons only. Dividends on both common and preferred stocks are limited to six percent per year. In the distribution of patronage dividends, patron stockholders and non-stockholder-patrons shall be en-

<sup>1</sup> The Act does not permit these co-operatives to engage in lumbering.

titled to patronage refunds at the same rate. This latter provision was added by the General Assembly in Act No. 358, 1945, mentioned above. Common shareholders may have only one vote, and voting by proxy is not permitted unless the association has more than 500 common shareholders. The act also provides that the association must set aside ten percent of the total net earnings annually for a reserve fund until the reserve fund shall equal at least thirty percent of the paid up capital stock. These associations are subject to the corporation bonus charge, the stock transfer tax, and the co-operative agricultural association corporate net income tax. This latter tax was enacted by the General Assembly under the provisions of Act No. 360, May 13, 1945.

Agricultural co-operatives incorporated under the Acts of 1919 and 1929 are required to file annual financial reports with the Secretary of the Pennsylvania Department of Agriculture, as well as with the Dean of the School of Agriculture, the Pennsylvania State College. The General Assembly in Acts 357 and 358, May 23, 1945, supplemented the requirements concerning the filing of annual reports by these co-operatives. The Secretary of Agriculture is given power of enforcement concerning these reports, and if such co-operatives do not file reports for three successive years, and if such co-operatives are determined to have ceased operations, the Secretary of the Commonwealth may proceed with involuntary dissolution of such associations.

Co-operative agricultural credit associations having capital stock were permitted to incorporate under the provisions of Act of May 25, 1933, P. L. 1027. These associations were authorized to assist regular agricultural co-operatives in their borrowing activities with the Federal Intermediate Credit Banks and the Reconstruction Finance Corporation. Little use was made of these special co-operatives, and there are none in existence at the present time.

The newest type of co-operatives in operation in Pennsylvania<sup>1</sup> and in the country at large are the credit unions and the rural electric co-operatives. These co-operatives have experienced a very rapid growth both in Pennsylvania and in the entire country. Like some of the other co-operatives, these associations are also incorporated under special acts of the General Assembly. The credit unions are author-

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<sup>1</sup> With the exception of artificial livestock breeding co-operatives.



ized to incorporate under the provisions of the Act of May 26, 1933, P. L. 1076. The incorporation act states that "a credit union shall be a co-operative society, in the nature of a corporate entity, incorporated for the purpose of promoting thrift among members and creating a source of credit for them, at legitimate rates of interest." These co-operatives may receive savings of members as payments of shares of stock; they may also make loans only to members and other co-operative associations. They are under the supervision of the State Department of Banking, and must file annual reports with this department. The capital of credit unions consists of the payments that have been paid in on shares of stock. The par value of shares shall not exceed \$10 per share and membership fees shall not exceed \$1.00 per member. A member shall have only one vote, and voting by proxy is not permitted. Interest rates on loans to members shall not exceed the rate of six percent per year when discounted on loans which are repayable in equal installments, or the rate of twelve per cent per year, when calculated on the unpaid principal balances. The act requires that all entrance fees and 20 percent of the annual net earnings shall be set aside as a reserve fund which may not be loaned out to members. The act further provides that the sum annually set aside as a reserve fund may be reduced under certain prescribed conditions when approved by the Secretary of Banking. Credit unions are not subject to any State taxes in Pennsylvania at the present time.

Rural electric co-operatives may be incorporated under the provisions of Act of June 21, 1937, P. L. 1969. They may produce and sell electric power to members only in rural areas who are not receiving central station service. They may assist in the wiring of the premises of persons in rural areas or assist in the acquisition, supply or installation of electrical or plumbing equipment. They may also furnish members with electrical and plumbing equipment. Members have only one vote and voting by proxy is permitted. These co-operatives are required to operate as non-profit corporations, and the act prescribes that any income in excess of that required for the operations of the enterprises shall be returned to the members on a pro rata basis, according to the amount of business done with each during the period, either in cash, abatement of current charges, or in general rate reductions. These enterprises are subject to no State regulations so long as

they serve members only. They are not required to file reports with any State department. They are subject to a single State tax which amounts to \$10 per 100 members per year.

In summary, the co-operative enterprises now in operation in Pennsylvania, exclusive of mutual insurance companies, have been incorporated under six special incorporation acts; the Act of 1874, under which some of the earlier co-operatives were incorporated, has been repealed. Many of the consumer co-operatives and very few farmer co-operatives are incorporated under the Act of 1887. Although the provisions of this act are very broad, enabling a co-operative to engage in almost any type of agricultural, mining, manufacturing, commercial, or trading activity, there is no advantage which will accrue to a co-operative in the matter of State taxation by incorporating under this act. This is because of the fact that co-operatives incorporated under this act are subject to the same State taxes as are paid by regular corporations. Agricultural co-operatives incorporated under the Acts of 1919 and 1929 are restricted in their operations to those connected with agriculture; furthermore, the acts affecting these co-operatives place certain restrictions upon their business operations, such as restrictions on the use of capital stock, the payment of interest and dividends, and the establishment of required reserves. These co-operatives, however, benefit from certain State tax exemptions and become subject to others specifically applicable to them and these will be discussed in a later section of this report. Credit unions are restricted in their operations to transactions with members only; furthermore, they are subject to supervision by the State Department of Banking. Most of these organizations are very small in the matter of their annual gross receipts. The U. S. Treasury Department has reported that on the average the State-chartered credit unions received gross income of \$2,900 each in 1943; nearly two-thirds of all credit unions received gross income less than \$1,000 each in the same year. Credit unions, however, at present are subject to no State taxes in Pennsylvania. The rural electric co-operatives, like the credit unions, are restricted to transactions with their members only, who must reside in rural areas which are not adequately served with electric power. These co-operatives are required by law to operate as non-profit organizations, and they therefore, cannot operate as profit ventures. These co-operatives are not subject

to any supervision by any State department; they also are not subject to any State taxes, with the single exception of a very nominal annual license fee which amounts to \$10 per 100 members. Although certain types of co-operatives receive Federal tax exemptions, they must conduct their business operations according to a prescribed set of regulations which are provided by the Federal Internal Revenue Code and by the Treasury Regulations.

## Part II

# THE GROWTH OF CO-OPERATIVE BUSINESS ENTERPRISES IN UNITED STATES

The first co-operative business enterprises in United States were mutual fire insurance companies organized by groups of farmers well over one hundred years ago. There is also evidence that co-operative cheese plants were in operation as early as 1810. The co-operative movement grew rapidly, especially during periods of agricultural economic distress, when groups of farmers organized in order to obtain additional markets, better prices for their produce sold, and also to obtain lower prices on goods purchased. The growth of co-operatives was especially rapid during the period of the depression in 1872-1877, in 1920, and after 1929. There has been a very marked growth in the number and volume of business of certain special types of co-operatives since 1929. These types of co-operatives include those engaged in the actual production and manufacture of goods,<sup>1</sup> consumers co-operatives, credit unions, and rural electric co-operatives.

The growth of farmers' marketing and purchasing co-operatives has been rapid since the first World War. The statistics presented in Tables I, II, III *Appendix* indicate the growth of these co-operatives since 1913. Their growth may be measured by the number of associations, the number of members, and the dollar volume of business transacted. In 1913 there were 2,988 farmers' marketing co-operatives. In 1929-1930 marketing season these co-operatives reached their peak of growth with respect to the number of such associations; in this marketing season 10,546 such associations were in business; by 1944 there were 7,522 such units. In 1913 there were 111 farmers' purchasing co-operatives, but by 1944 there were 2,778 such units. There

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<sup>1</sup> A production or manufacturing co-operative has previously been defined as one engaged in any business activity in which the basic nature of the product is changed in the production or manufacturing process. The U. S. Bureau of Labor Statistics includes the following in co-operative production activities: food products, chemical products, coal, crude oil, pipeline operations, refined petroleum products, grease, printing, paint, lumber and shingles, shelving, poultry and poultry products, insecticides, feed, seed, fertilizer, and farm machinery. (Bul. No. 843, Sept. 14, 1945).

has been a steady growth in the number of farmers' purchasing associations since 1913. In 1915 the farmers' marketing co-operatives had a membership of 591,683 members; by 1944 this number had increased to 2,730,000. The purchasing co-operatives had a membership of 59,503 in 1915, but by 1944 there were 1,520,000 members in these units. In 1913 the marketing co-operatives transacted a volume of business valued at \$304,385,000; by 1944 this business had increased to \$4,430,000,000. In 1913 the purchasing co-operatives transacted a volume of business valued at \$5,928,000; by 1944 this business had increased to \$730,000,000. The higher price level during the war years was responsible for some increase in this dollar volume of business.

The House Committee on Small Business, which held hearings during the past year on the subject of the competition between co-operatives and regular business corporations, commented upon the growth of farmer co-operatives as follows:

" . . . the committee has prepared a chart which indicates the relationship between farm co-operative marketing volume and the total farm product sales and the gross consumer expenditures. It is interesting to note with respect to farm marketing in 1932 when the percentage reached 36.8 percent that the trend had been upward until that year and since 1932 has been downward, reaching 21.6 percent in 1944. The percent of total consumer expenditures represented by the dollar volume of farmers' co-operative business has never exceeded 5 percent, in fact since 1925 this percentage has fluctuated between a low of 2.53 percent and a high of 4.64 percent.

In view of these astonishing statistics the committee does not see anything alarming, or particularly noticeable, from a Nationwide viewpoint in the dollar volume of business done by co-operatives during 1944."<sup>1</sup>

In 1914 there were 1,947 farmers' mutual fire insurance companies in the country with \$5,264,119,000 of insurance in force; in 1941 there were 1,885 such mutual companies with \$12,518,913,000 of insurance in force (Table IV, Appendix); although there was a slight decrease in the number of such mutual companies at various times

<sup>1</sup> House Committee on Small Business, *The Competition of Co-operatives with Other Forms of Business Enterprise*, First Interim Report, Pursuant to H. Res. 64, p. 24, April 9, 1946.

during this period, the amount of insurance in force continued to increase during the period.

In 1943 the Farm Credit Administration reported 40,812 farmers' co-operative organizations of all types which were serving 11,296,121 members and participants.<sup>1</sup> These farmer cooperatives were classified according to the following functions: production, marketing and purchasing, financing, mutual fire insurance companies, mutual telephone and mutual electric power companies, and burial associations. These statistics are presented in Table V, *Appendix*.

The importance of specific agricultural commodities in the business of farmer co-operatives is indicated by the statistics presented in Table VI, *Appendix*, which indicates the trends in selected years from 1913 to 1943. It is apparent from this table that four commodity groups were of primary importance to these farmer co-operatives. These commodity groups and their relative importance in the 1942-1943 marketing season were as follows:

<i>Commodity Group</i>	<i>Percentage of Farmer Co-operative Market- ing and Purchasing Business in 1942-1943</i>
Dairy products .....	25.1%
Grain, dry beans, rice .....	18.5
Livestock .....	15.8
Fruits and Vegetables .....	11.9

In the 1942-1943 marketing season 4.4 percent of the farmer co-operative business was transacted in the cotton and cotton products industry and 3.8 percent in the poultry and poultry products industry.

Since 1929 the growth of business transacted by co-operative enterprises has been especially rapid in the fields of actual production of goods, retailing (consumer co-operatives), the lending of funds by credit unions, and the production and sale of electric power by rural electric co-operatives. The U. S. Bureau of Labor Statistics reported

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<sup>1</sup> Statistics of farmer co-operatives for the 1944-45 marketing seasons have not been compiled as yet by the U. S. Department of Agriculture. This figure of 40,812 co-operatives is large in comparison with the number of farmers' marketing and purchasing co-operatives previously quoted because of the fact that this latter figure includes *all types* of co-operatives serving farmers.



that there were 26,673 consumer co-operatives engaged in business at the end of the year 1944. These consumer co-operatives, operating locally, transacted a volume of business valued at \$1,604,860,479. The statistics presented in Tables VII and VIII, *Appendix*, indicate the growth of consumer co-operatives in the United States in the period from 1929 to 1944. These statistics indicate the growth of these enterprises as measured by the number of associations and their dollar volume of business. A summary of the trend of development of specific types of consumer co-operatives during the period 1929 to 1944 is provided in Table IX, *Appendix*. The development of these enterprises is measured by the number of associations, the number of members, and the dollar value of business transacted. The statistics presented in Table X, *Appendix*, show the business transacted by wholesale co-operative associations, by commodities, in 1944. In order of their economic importance, these commodities were as follows: petroleum products, farm supplies (including feed, seed, and fertilizer), food products, building materials, paint, tires, tubes and accessories, coal and farm machinery.

The growth of credit unions in the period from 1929 to 1944 has been especially rapid. In 1929 there were 974 credit unions with a membership of 264,908 members, and a volume of business (loans) of \$54,048,000. In 1944 there were 9,099 credit unions (5,051 with state charters and 4,048 with federal charters) with a membership of 3,027,694 and a volume of loans of \$212,305,479. The statistics presented in Table XI, *Appendix*, indicates the growth of credit unions in the period from 1929 to 1944.

The newest type of co-operatives, the rural electric co-operatives, have made phenomenal progress and growth since 1936. The following table illustrates the growth of rural electric co-operatives in United States since 1936:

Year	Number of Co-operatives	Federal Funds Advanced (Cumulative)	Number of Consumers (Cumulative)
1936 .....	275	\$823,262	693
1939 .....	575	122,337,824	268,242
1940 .....	700	221,287,287	567,998
1942 .....	810	354,616,010	981,193
1944 .....	887	387,630,670	1,152,031

Source: *Annual Reports, Rural Electrification Administration; Operations of Consumers' Co-operatives in 1944*, Bul. No. 843, U. S. Bureau of Labor Statistics, (September 14, 1945).

The statistics presented in *Table XII, Appendix*, show the status of rural electric co-operatives in all states as of June 30, 1944, as measured by the number of borrower associations, the funds advanced by the Rural Electrification Administration, and the number of consumers served by these associations.

The growth of co-operatives in the field of actual production and manufacturing is of considerable interest; this growth was very rapid during the years 1943 and 1944. The statistics presented in *Table XIII, Appendix*, show the dollar value of production by commodity groups of all co-operatives for the years 1943 and 1944. The dollar value of co-operative production increased from \$31,104,255 in 1943 to \$65,255,203 in 1944. This rapid growth in production was primarily in the fields of refined petroleum products, lumber and shingles, feeds, seeds, and fertilizers.

Undoubtedly the most comprehensive statistics available on the number of co-operatives and mutual organizations and their volume of business transacted in United States are those published by the U. S. Bureau of Internal Revenue. These statistics indicate the number of co-operatives and mutuals doing business in United States in 1943, as determined by those enterprises filing income tax returns with the Bureau in 1944. These statistics are presented in Tables 1 and 2 of the text. For purposes of classification the bureau divided the co-operatives and mutuals into two groups; the first group consisted of those enterprises which engaged only in regular business or "commercial" activities (Table 1); the second group consisted of those enterprises which engaged primarily in non-business functions such as many non-profit institutions such as business leagues, labor unions, educational and employee benefit institutions and associations, (Table 2). The bureau reported 24,045 co-operatives engaged in business functions in 1943; these enterprises reported a gross income of \$3,206,572,000 which was exempt from Federal taxes.<sup>1</sup> The most important group of co-operatives in this first classification was the farmers', fruit growers', livestock, and dairy co-operatives which numbered 4,397 enterprises with a gross income of \$2,233,904,000 in 1943.

<sup>1</sup> Actually it is the net income which is exempt from taxation because of the fact that cost of goods sold items and other regular business expenses may be deducted from gross income in arriving at net income. In this case, cost of goods sold items and business expenses represent 84 per cent of the gross income, leaving \$502,363,00 net income exempt from taxation.



Table 1

## TAX-EXEMPT BUSINESS ORGANIZATIONS IN UNITED STATES—1943

<i>Type of Organization</i>	<i>Number<sup>1</sup> of returns</i>	<i>Total gross income and receipts</i>
Mutual savings banks—Savings department .....	322	\$445,220,000
Mutual savings banks—Life insurance department .....	28	877,000
Building and loan associations, savings and loan associations (not Federal), co-operative banks organized in Massachusetts	3,461	170,344,000
Co-operative banks except those organized in Massachusetts, credit unions including those in Massachusetts but not Federal Cemetery companies and associations .....	3,458	8,484,000
Local benevolent life insurance associations .....	1,188	19,288,000
Mutual ditch or irrigation companies .....	176	4,273,000
Mutual or co-operative telephone companies .....	765	6,087,000
Mutual rural electrification organizations, and other mutual organizations exempt under subsection (10) .....	406	571,000
Mutual insurance companies or associations other than life or marine; farmer's mutual hail, cyclone, fire or casualty insur- ance companies .....	1,017	54,144,000
Farmers', fruit-growers', livestock and dairy co-operatives, and like associations .....	1,459	28,364,000
Crop financing associations .....	4,397	2,233,904,000
Financing and holding companies .....	27	1,447,000
Federal credit unions .....	934	15,221,000
Federal Savings and loan associations .....	3,092	5,031,000
National farm loan associations .....	1,301	110,357,000
Production credit associations .....	1,498	8,909,000
Federal intermediate credit banks, Federal land banks, banks of co-operatives, production credit corporations, and other cor- porations organized under the Act of Congress, which are instrumentalities of the United States but are not wholly owned by the United States .....	498	14,092,000
	18	79,959,000
<b>Total</b> .....	<b>24,045</b>	<b>\$3,206,572,000</b>

<sup>1</sup> Returns filed with Bureau of Internal Revenue through Dec. 31, 1944. Source: U. S. Treasury Dept., "Supplement to Statistics of Income for 1943, Part 2," pp. 9-10, (November, 1945).

Table 2

## TAX-EXEMPT ORGANIZATIONS IN UNITED STATES WHOSE PRIMARY FUNCTIONS ARE NON- BUSINESS ACTIVITIES, 1943

<i>Type of Organization</i>	<i>Number<sup>1</sup> of returns</i>	<i>Total gross income and receipts</i>
<b>Labor organizations:</b>		
1. Total .....	28,638	\$389,686,000
2. Not engaged in business activities .....	27,297	310,893,000
3. Engaged in business activities .....	1,341	78,793,000
<b>Agricultural and horticultural organizations, county fairs, State fairs, farm bureaus:</b>		
1. Total .....	955	12,718,000
2. Not engaged in business activities .....	505	3,904,000
3. Engaged in business activities .....	450	8,814,000

<sup>1</sup> Returns filed with Bureau of Internal Revenue through Dec. 31, 1944. Source: U. S. Treasury Dept., "Supplement to Statistics of Income for 1943, Part 2," pp. 7 and 8, (November, 1945).

**Table 2—Continued**

<i>Type of Organization</i>	<i>Number<sup>1</sup> of returns</i>	<i>Total gross income and receipts</i>
Literary organizations, library associations, scientific or research organizations, educational organizations, schools, colleges, charitable organizations, hospitals, community funds or foundations, Boy Scouts, Girl Scouts, Y. M. C. A., Y. W. C. A.:		
1. Total .....	8,901	\$828,427,000
2. Not engaged in business activities .....	5,411	404,107,000
3. Engaged in business activities .....	3,490	424,320,000
Business leagues, chambers of commerce, real estate boards, boards of trade, manufacturer's associations, trade associations, advertising clubs, audit bureaus, inspection bureaus, bar associations:		
1. Total .....	5,695	185,024,000
2. Not engaged in business activities .....	4,453	124,543,000
3. Engaged in business activities .....	1,242	60,481,000
Local association of employees devoted to charitable, educational or recreational purposes; civic leagues or organizations for the promotion of social welfare; American Legion:		
1. Total .....	8,549	189,823,000
2. Not engaged in business activities .....	4,523	57,247,000
3. Engaged in business activities .....	4,026	132,576,000
Clubs organized for pleasure or recreation social clubs, country clubs, Greek letter fraternities and sororities, AAA motor clubs, sport and athletic clubs, service clubs, rotary clubs:		
1. Total .....	7,297	144,038,000
2. Not engaged in business activities .....	4,303	16,164,000
3. Engaged in business activities .....	2,994	127,874,000
Employee's beneficiary associations paying life, sick, accident, or other benefits to the members or their dependents:		
1. Total .....	423	48,077,000
2. Not engaged in business activities .....	363	35,421,000
3. Engaged in business activities .....	60	12,656,000
Teacher's retirement fund associations of a purely local character:		
1. Total .....	6	1,502,000
2. Not engaged in business activities .....	6	1,502,000
3. Engaged in business activities .....	.....	.....
United States Employee's beneficiary associations paying life, sick, accident, or other benefits to the members, their dependents, or beneficiaries:		
1. Total .....	138	3,752,000
2. Not engaged in business activities .....	132	2,548,000
3. Engaged in business activities .....	6	1,204,000
<b>TOTAL TAX-EXEMPT ORGANIZATIONS WHOSE PRIMARY FUNCTIONS ARE NON-BUSINESS ACTIVITIES:</b>		
1. Total .....	60,602	\$1,803,047,000
2. Not engaged in business activities .....	46,993	956,329,000
3. Engaged in business activities .....	13,609	846,718,000

<sup>1</sup> Returns filed with Bureau of Internal Revenue through Dec. 31, 1944. Source: U. S. Treasury Dept., "Supplement to Statistics of Income for 1943, Part 2," pp. 7 and 8, (November, 1945).

In the second group of co-operatives engaged in non-business functions, 60,602 such enterprises filed returns in 1943 and reported a gross income of \$1,803,047,000 which was exempt from Federal taxation.<sup>1</sup> In this group the labor organizations were the largest numerically, with 28,638 associations reporting a gross income of \$389,686,000; the next most important group numerically consisted of the non-profit educational and charitable organizations which reported the largest amount of gross income of any such group; this amount of income in 1943 was \$828,427,000.

It should be carefully observed that even these statistics reported by the Bureau of Internal Revenue are incomplete for several reasons. First, many co-operatives are legally excused from filing income tax returns with the Bureau of Internal Revenue; second, many co-operatives which should have filed returns failed to do so. The fact that many co-operatives are legally excused from filing returns makes the total returns appear much smaller than is actually the case. An example in point is the fact that although there are approximately 177 farmer co-operatives doing business in Pennsylvania under the Acts of 1919 and 1929, only 55 such co-operatives filed income tax returns in 1943. These 55 farmer co-operatives doing business in Pennsylvania reported a gross income of \$25,059,000 in 1943, whereas the gross income of all the 177 farmer co-operatives in the same year was \$102,000,000 as reported by Professor Stern in his recent survey of farmer co-operatives in the State.<sup>2</sup>

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<sup>1</sup> In this case cost of goods sold items and regular business expenses represent about 83 percent of the gross income, leaving \$269,642,000 net income exempt from taxation.

<sup>2</sup> J. K. Stern, *op. cit.*, p. 4.

## Part III

# THE GROWTH OF CO-OPERATIVES IN PENNSYLVANIA

The history of organized co-operatives in Pennsylvania began in 1866 with the operation of cheese plants in Springville, Bridgewater, and New Milford in Susquehanna County and in Spring Hill in Bradford county.<sup>1</sup> The earliest purchasing co-operative in Pennsylvania was one established in 1875 by the State Grange. The co-operative movement in the state experienced a rapid growth following the first World War. In 1929 there were 74 co-operative retail (consumer) organizations in Pennsylvania with an annual sales volume of \$4,150,749; by 1939 there were 136 such retailers with an annual sales volume of \$5,511,000. The sales made by these co-operatives, however, constituted only about one-tenth of one percent of the total retail sales in the state. The most recent information indicates that there were 109 consumer co-operatives doing business in Pennsylvania in 1944.<sup>2</sup> In 1929 there were 28 co-operative wholesale organizations with an annual sales volume of \$24,500,524; by 1939 there were 37 co-operative wholesale organizations with an annual sales volume of \$39,613,000. The co-operative wholesalers did approximately one percent of the total wholesale business in the state. In 1939 there were 21 co-operative manufacturing establishments which produced goods valued at \$1,647,354, or 0.3 per cent of the total value of goods produced by all types of business in the state. Most of these co-operative manufacturers were engaged in the production of agricultural commodities, or commodities for farm use. The statistics of co-operative retailing, wholesaling, and manufacturing in Pennsylvania as reported by the Bureau of the Census for 1939 are presented in Tables XIV, XV, and XVI, Appendix.

In the 1934-1935 marketing season there were 155 farmer buying

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<sup>1</sup> See Manning, F. E. A. History of Agricultural Co-operation in Pa. (Unpublished.) The Pennsylvania State College, School of Agriculture Library.

<sup>2</sup> U. S. Bureau of Labor Statistics, Directory of Consumer Co-operatives in U. S., 1943, and Revised List, 1945.

and selling co-operatives which did \$36,310,000 worth of business<sup>1</sup>; in 1943 there were 177 such farmer organizations which did over 102 million dollars worth of business. The statistics of farmer co-operatives operating in Pennsylvania in 1943 are presented in Table 3 of the text. These statistics, compiled by Professor J. K. Stern of the Pennsylvania State College, School of Agriculture, are believed to be the most comprehensive statistics available on the subject of farmer co-operatives in Pennsylvania. The data were obtained by analysis of the annual reports of farmer co-operatives filed with the Pennsylvania Department of Agriculture.

**TABLE 3**  
**INVENTORY OF FARMER CO-OPERATIVES DOING**  
**BUSINESS IN PENNSYLVANIA IN 1943**

<i>Type of Co-operative</i>	<i>Number of Units</i>	<i>Number of Members</i>	<i>Number of Patrons</i>	<i>Volume of Busi- ness in Millions of Dollars</i>
<b>Marketing:</b>				
Milk .....	36	21,324	20,596	43
Eggs and Poultry .....	8	8,054	8,335	11
Fruit and Vegetable .....	14	2,342	1,856	4
Livestock .....	9	3,149	7,908	3
Wool .....	22	4,859	3,864	1/3
Purchasing .....	83	52,903	129,745	40
Others .....	5	435	416	1/3
<b>Totals .....</b>	<u>177</u>	<u>93,066</u>	<u>172,720</u>	<u>102</u>

(Includes only farmer-owned and farmer-controlled co-operatives incorporated under Pennsylvania Acts of 1887, 1919, and 1929 and 34 co-operatives incorporated under laws of other states).

Source: J. K. Stern, *Inventory of Farmers' Co-operatives in Pennsylvania, 1943*, Bulletin No. 474, Pennsylvania State College, School of Agriculture, Experiment Station, June, 1945.

The statistics presented in Table 4 of the text indicate the growth of farmer co-operative business in Pennsylvania during the periods of 1934-1935 and 1942-1943 marketing seasons.<sup>2</sup> This growth in farmer co-operative business is measured by the number of associations, the number of members, and the dollar value of products sold. These statistics show that in the period between these two marketing seasons there was a considerable growth in the business of farmer co-oper-

<sup>1</sup> U. S. Farm Credit Administration, *Statistics of Farmers' Co-operative Business Organizations, 1920-1935*, p. 122, (May 1936).

<sup>2</sup> Statistics for the 1944-1945 marketing season are not available.



atives in the sale of dairy products, purchasing of farm supplies, the sale of poultry products, livestock, and fruits and vegetables. There was some slight growth in the sale of wool and mohair, and an actual decrease in the sale of grain and dry beans.

The business activities of farmer co-operatives in Pennsylvania in 1943 were analyzed by Professor J. K. Stern of the School of Agriculture, the Pennsylvania State College.<sup>1</sup> He has described the business activities of the most important farmers' marketing and purchasing co-operatives as follows:

### **Dairy Co-operatives**

"In 1943 there were 36 dairy co-operatives in Pennsylvania with 21,324 members. These co-operatives sold 43 million dollars of milk in 1943. This accounted for more than one-third of the milk sold at wholesale by Pennsylvania farmers. Of the 36 dairy co-operatives, 24 were of the bargaining type, and of these, 19 owned no facilities."

### **Eggs and Poultry Co-operatives**

"In 1943 there were 8 independent egg co-operatives in Pennsylvania, 5 of them operating auctions. Three of the latter group also marketed poultry. Some of the egg co-operatives transport the products from the farm to the co-operative headquarters. Some of them also negotiate between buyers and sellers on the matter of price and quality."

### **Fruits and Vegetables**

"Co-operative marketing of fruits and vegetables has become of importance in Pennsylvania since 1921. In 1943 there were 14 fruit and vegetable co-operatives with 2,300 members, doing 4 $\frac{1}{4}$  million dollars of business. The commodities marketed in order of importance were potatoes, grape juice, apples, mushrooms and tomatoes."

### **Livestock**

"The livestock co-operatives in Pennsylvania include two regional co-operatives and two local auction co-operatives, all of which operate on a commission basis. In addition, there are three artificial breeding co-operatives and two incorporated bull associations. The livestock co-operatives have proved of great value to Pennsylvania farmers in the grading and marketing of livestock. The two large co-operatives

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<sup>1</sup> J. K. Stern, op. cit., p. 5.



TABLE 4

STATISTICS OF FARMERS' MARKETING AND PURCHASING ASSOCIATIONS IN PENNSYLVANIA FOR THE 1934-1935 AND 1942-1943 MARKETING SEASONS

	<i>Dairy Products</i>		<i>Fruits and Vegetables</i>		<i>Miscellaneous</i> <sup>1</sup>		<i>Purchasing</i>	
	1934-1935	1942-1943	1934-1935	1942-1943	1934-1935	1942-1943	1934-1935	1942-1943
Associations Listed .....	29	37	10	13	5	3	75	87
Estimated Members .....	43,000	21,600	1,200	3,000	1,300	160	14,000	30,000
Estimated Value of Business ...	\$28,760,000	\$37,650,000	\$2,000,000	\$3,000,000	\$340,000	\$300,000	\$3,200,000	\$19,000,000

  

	<i>Poultry &amp; Poultry Products</i>		<i>Wool &amp; Mohair</i>		<i>Grain, Dry Beans and Rice</i>		<i>Livestock</i>	
	1934-1935	1942-1943	1934-1935	1942-1943	1934-1935	1942-1943	1934-1935	1942-1943
Associations Listed .....	5	7	26	31	2	2	1	1
Estimated Members .....	1,800	6,700	3,600	5,400	1,500	230	800	6,000
Estimated Value of Business ...	\$960,000	\$7,000,000	\$180,000	\$320,000	\$500,000	\$150,000	\$320,000	\$8,750,000

<sup>1</sup> Includes associations handling commodities not specified above, those handling several types of commodities, and those furnishing special marketing or other services.

Source: U. S. Farm Credit Administration, *Statistics of Farmers' Marketing and Purchasing Co-operatives, 1942-1943 Marketing Season*, Misc. Report No. 70, January, 1944, pp. 17-20; *Statistics of Farmers' Co-operative Business Organizations, 1920-1935*, Bul. No. 6, May, 1936, pp. 118-120.

sold more than one million dollars of livestock and purchased more than one million dollars of feeder cattle for them in 1943. The two auction co-operatives handled another million dollars' of livestock in 1943."

### Wool

"In 1943 there were 22 active wool marketing co-operatives in Pennsylvania, all incorporated under the 1919 Act. They have 5,000 patrons and a sales volume of \$300,000. About 90 per cent of all the wool marketed through wool pools was handled by these co-operatives and about 90 per cent of all the wool produced in Pennsylvania, except in Greene and Washington counties, was marketed through these pools."

### Purchasing Co-operatives

"In 1943 there were 83 purchasing co-operatives in Pennsylvania with a membership of 52,903 farmers. These co-operatives purchased supplies for their members valued at 40 million dollars. The 83 co-operatives may be divided into the following types of organizations:—

Regional co-operatives and their affiliated branches	52
Local independent co-operatives . . . . .	14
Potato Growers' co-operatives . . . . .	17

"More than one-half of the business of purchasing co-operatives was car-door business or did not go through a warehouse. This proportion, however, is decreasing as farmers are demanding more services from the co-operatives and are willing to pay the cost of that service. More than one-half of the total business of purchasing co-operatives was for cash, and at least 80 percent of it was paid within 30 days. The most important commodities handled by the purchasing co-operatives were feeds, seeds, fertilizers, gas and oil, hardware and farm equipment, and seed potatoes."

### Other Co-operatives

"In addition to the other farm co-operatives operating in Pennsylvania there are 4 special types of co-operatives:—<sup>1</sup>

*Smicksburg Co-operative Lime Association.* (1919 Co-operative Act.) This co-operative operates a lime manufacturing plant and provides members with lime at cost.

<sup>1</sup> These co-operatives, incorporated under the Co-operative Acts of 1919 and 1929, benefit by certain State tax exemptions which will be discussed in detail in a later section of this report.

*Lake Erie Honey Producers' Co-operative.* (1929 Co-operative Act.) This co-operative buys bees and bee supplies and sells honey and wax.

*Atlantic Seed Stocks Co-operative.* (1929 Co-operative Act.) This co-operative was incorporated under the 1929 Act and was first located at Hanover, Pennsylvania; later it moved to Ellicott City, Maryland. This co-operative produces various types of seeds.

*The G. L. F. Coudersport Produce Co-operative,* incorporated under New York laws in 1940, operates a flour mill.

"In 1944, the Potter Seed Potato Growers' Co-operative Association was organized at Ulysses to provide potato storage facilities." (1919 Co-operative Act.)

"In the same year the Pennsylvania Tobacco Growers' Co-operative was organized at Lancaster."<sup>1</sup> (1919 Co-operative Act.)

"The Pennsylvania Soybean Co-operative Association was operated at Jersey Shore. (1929 Co-operative Act.) It owned and operated a soybean processing plant. The latest information indicates that this plant has been sold to a private enterprise."

Professor Stern has summarized his findings as follows:<sup>2</sup>

"The 177 farmer-owned co-operatives operating in Pennsylvania in 1943, which were incorporated under the Pennsylvania Co-operative Acts or similar laws, transacted a 102 million dollar business for 172,000 patrons, of which 93,000 were members. After estimating and eliminating the duplication resulting where farmers were members of several co-operatives, it appears certain that a majority of the farmers in the state were patronizing one or more of these co-operatives in 1943."

"Milk was the number one commodity marketed, with co-operatives reporting a volume of 43 million dollars' worth; eggs and poultry ranked next, with a 11 million dollar volume; fruit and vegetable co-operatives were third with 4 million dollars; and livestock co-operatives fourth with 3 million dollars."

"Artificial breeding co-operatives are the newest type of farmer co-operatives in Pennsylvania and they are attracting state-wide attention. Several central units are organized, and local groups throughout the dairy sections of the state are organizing associations to work with the central units."

<sup>1</sup> J. K. Stern, *op. cit.*, pp. 5-58.

<sup>2</sup> *Ibid.*, Digest Section.

"Interest in marketing co-operatives is increasing, with more attention being focused on processing and on keeping control of commodities until near to the point of consumption. Consumer preference is being given more consideration in the planning of co-operative marketing programs."

"Many marketing co-operatives are now buying some supplies for members, and many purchasing co-operatives are now marketing some products for members. The purchasing co-operatives bought more than 40 million dollars' worth of farm supplies for their patrons. Most of these supplies were processed in plants which the farmers owned. The number of services provided is steadily increasing."

"The trend in local co-operatives is strongly toward buying through a wholesale co-operative rather than through commercial channels. The trend in all of the purchasing co-operatives is away from car-door transactions and toward warehouse business. There is also a trend toward cash business and away from credit on farm supplies."

"Many co-operatives reduced or eliminated their membership meetings during the war emergency. As quickly as possible these membership contacts need to be re-established."

"Farmer co-operatives are increasing in size and importance in Pennsylvania. The services of at least one co-operative are now available in almost every community. In many areas the services of five or more co-operatives, such as purchasing, bargaining, marketing, auctions, telephone, electric, and insurance organizations, are now available."

The co-operatives in Pennsylvania have achieved a significant growth in fields other than agriculture, as is evidenced by the following statistics:

In 1937 there were 11 rural electric co-operatives in the State; these co-operatives had borrowed \$1,435,000 from the Federal Rural Electrification Administration, and were serving 8,010 consumers. By 1944 there were 13 rural electric co-operatives in the State with borrowings of \$12,166,200 from the Rural Electrification Administration; these co-operatives in 1944 served 30,569 rural consumers. The growth of rural electric co-operatives in Pennsylvania from 1937 to 1944, as measured by the number of co-operatives, Federal funds allotted, and consumers served, is presented in Table XVII, Appendix.

There has also been a very significant growth in the business done by credit unions in the State since 1933. In 1933 there were only 10 credit unions operating with State charters; by 1934 there were 43

credit unions with \$188,866 in loans outstanding; however, by 1944 there were 80 credit unions operating with State charters with \$1,752,339 in outstanding loans. The growth of credit unions in Pennsylvania from 1933 to 1944 is presented by the data in Table XVIII, Appendix. The statistics presented in this table show the growth of credit unions as measured by the number and membership of credit unions, the amount of loans made annually, the shareholders' equity balances at the end of each year, and the dividends paid annually.

In 1929 there were 371 mutual insurance companies of all types operating in the state, but by 1943 this number had decreased to but 297 mutual companies. Besides the types of co-operatives previously mentioned, there are approximately 700 mutual telephone companies<sup>1</sup> operating in the state, serving 12,500 customers. It is believed that these companies have little economic importance in the co-operative field of business in Pennsylvania at present because of their small volume of business, and also because of the fact that they are rapidly being absorbed by larger companies.

There are also such quasi-governmental co-operatives as the National Farm Loan Associations, Production Credit Associations, and Farm Security Co-operatives.

Some idea of the status of co-operative and mutual business activity in Pennsylvania in 1943 may be obtained from the recent report of the U. S. Treasury Department, mentioned earlier in this report. The Treasury Department reported that 1,348 co-operatives engaged in business activities in Pennsylvania had reported gross income of \$83,313,000 for the year 1943.<sup>2</sup> The term "gross income" or "gross receipts" as used by the Treasury Department here includes the fol-

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<sup>1</sup> Estimated for the Pennsylvania Public Utility Commission by the Bell Telephone Company and the Independent Telephone Association of Pennsylvania.

<sup>2</sup> Every organization exempt from Federal taxation under Section 101, Internal Revenue Code (except religious and charitable organizations, educational organizations, fraternal beneficiary societies, etc.) must file an annual information return (Form 990); even though a co-operative operates without profit, every such co-operative must file an affidavit concerning its operation with the Bureau of Internal Revenue, in order that the Bureau may confirm the co-operative's tax status: it is not necessary for the co-operative to file such an affidavit annually, unless there has been a change in its legal status or operations which would affect its tax status.

For all co-operatives reporting to the Bureau of Internal Revenue, cost of goods sold items and regular business expenses represent about 80 percent of the gross income; therefore, it may be estimated that for Pennsylvania co-operatives, only about 20 percent of the gross income represents net income which is exempt from Federal taxes.



lowing items: dues received from members, fees, fines, assessments; dues, assessments, and per capita taxes received from affiliated organizations; grants, gifts, contributions received, dividends and interest, rents gross receipts from business activities, and other gross income. This income was exempt from taxation by the Federal government. The Treasury Department also reported that there were 4,542 co-operatives in Pennsylvania in 1943 which were engaging in non-business activities; such co-operatives included labor unions, some agricultural organizations, educational institutions, and employee benefit associations. These 4,542 non-business co-operatives reported gross income of \$118,098,000 in 1943; such income was not taxed by the Federal government.<sup>1</sup> While the above number of co-operatives in Pennsylvania is authoritative from the standpoint of those enterprises filing income tax returns, such a list of co-operatives doing business in Pennsylvania is incomplete for the same reasons previously cited for the list of co-operatives doing business in United States in 1943. In reality, there are probably several thousand co-operatives doing business in Pennsylvania, even though only 5,890 such enterprises filed income tax returns with the Bureau of Internal Revenue in 1944.

A list of those co-operative enterprises engaging in strictly business functions in Pennsylvania which filed income tax returns in 1944 is presented in Table 5 of the text. A list of these co-operatives which engaged in non-business functions in 1943 is presented in Table 6 of the text.

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<sup>1</sup> Ibid.



**TABLE 5**  
**TAX-EXEMPT BUSINESS ORGANIZATIONS**  
**IN PENNSYLVANIA, 1943 <sup>1</sup>**  
**(Number of returns filed with U. S. Bureau Internal Revenue,**  
**and amount of gross income and receipts)**

<i>Type of Business Organization</i>	<i>Number of Tax Returns Filed</i>	<i>Total Gross Income and Receipts, 1943</i>
Mutual savings banks (savings dept.) . . . . .	7	\$30,169,000
Mutual savings banks (life insurance dept.) . . . . .	1	31,000
Building and loan or savings and loan assns. (not Federal) and co-op. banks organized in Mass. . .	410	13,791,000
Co-op. banks (except in Mass.) and credit unions (not Federal) . . . . .	45	77,000
Cemetery companies . . . . .	104	1,866,000
Local benevolent life insurance assns. . . . .	5	67,000
Mutual ditch or irrigation companies . . . . .	1	38,000
Mutual telephone companies . . . . .	8	2,000
Mutual organizations not elsewhere classified . . . .	10	894,000
Mutual insurance organizations (not life or marine)	123	3,035,000
Farmer's co-op. marketing and purchasing assns. . .	55	25,059,000
Crop financing assns. . . . .	. . .	. . . . .
Holding companies for other tax exempt units . . .	45	587,000
Federal credit unions . . . . .	381	669,000
Federal savings and loan assns. . . . .	100	6,683,000
National farm loan assns. . . . .	43	87,000
Production credit assns. . . . .	10	258,000
Federal intermediate credit banks, Federal land banks, banks of co-operatives, production credit corporations, etc. . . . .	. . .	. . . . .
Totals . . . . .	1,348	\$83,313,000

<sup>1</sup> Returns from business organizations whose activities are primarily business in character; returns received through December 31, 1944.

Source: U. S. Treasury Dept., "Supplement to Statistics of Income, for 1943, part 2," pp. 24-25, (November, 1945).

Note: This is not a complete list of tax exempt organizations because some of these units are not required to file tax returns and also because some units have failed to file the required reports with the Bureau of Internal Revenue.

**TABLE 6**  
**TAX-EXEMPT BUSINESS ORGANIZATIONS IN**  
**PENNSYLVANIA WHOSE PRIMARY**  
**FUNCTIONS ARE NON-BUSINESS**  
**ACTIVITIES, 1943**

<i>Type of Organization</i>	<i>Number<sup>1</sup> of Returns</i>	<i>Total Gross Income and Receipts</i>
Labor organizations .....	2,401	\$28,948,000
Agricultural, and horticultural organizations .....	13	308,000
Literary, scientific, educational or charitable organiza- tions, hospitals, foundations, funds, etc. ....	479	37,465,000
Business leagues, chambers of commerce, boards of trade, etc. ....	294	6,269,000
Local associations of employees, civic leagues, social welfare, etc. ....	635	21,369,000
Social clubs for pleasure or recreation .....	681	14,956,000
Employees' beneficiary associations .....	35	8,598,000
Teachers' retirement fund associations .....	...	.....
United States employees' beneficiary associations ....	4	184,000
<b>Total .....</b>	<b><u>4,542</u></b>	<b><u>\$118,098,000</u></b>

<sup>1</sup> Returns filed with Bureau of Internal Revenue through Dec. 31, 1944.

Source: U. S. Treasury Dept., "Supplement to Statistics of Income for 1943, Part 2," page 14, (November, 1945).

## Part IV

### HISTORY AND METHODS OF FEDERAL TAXATION OF CO-OPERATIVES

Since 1898 Congress has provided certain tax exemptions for farmers' co-operative enterprises. In later years Congress extended the tax exemption privilege to certain other types of co-operative and mutual organizations. By 1943 the Internal Revenue Code contained a list of 19 different types of co-operatives and mutuals which were exempt from Federal taxation. These exemption provisions are in force at the present time.

It is believed that the first Federal statute to refer to farmers' co-operatives was the War Revenue Act of 1898,<sup>1</sup> which had a section providing for stamp taxes, but which provided for the exemption of farmers' purely local co-operative companies and associations organized for mutual benefit and not for profit.

The next Federal tax act to mention farmer and other co-operatives was the Corporation Tax Statute of 1909.<sup>2</sup> This act placed a tax on the net income of corporations and joint stock associations, but provided for the exemption of labor, agricultural, horticultural, and domestic building and loan associations operating on a mutual basis. Furthermore, the United States Supreme Court upheld the right of Congress to select the objects for excise taxation, which it considered had the right to exempt certain types of business from the tax. The Supreme Court, in discussing the constitutionality of the Corporation Tax Statute said:

"As to the objections that certain organizations, labor, agricultural and horticultural, fraternal and benevolent societies, loan and building associations, and those for religious, charitable or educational purposes, are excepted from the operation of the law, we find nothing in them to invalidate the tax. As we have had frequent occasion to say, the decisions of this court from an early date to the present time have emphasized the right of Congress to select the objects of excise taxation, and

<sup>1</sup> 30 Stat. 448,461.

<sup>2</sup> 36 Stat. 11, 113.

within this power to tax some and leave others untaxed, must be included the right to make exemptions such as are found in this act.”<sup>1</sup>

The third Federal income tax act to affect agricultural and other types of co-operatives was the Income Tax Statute of 1913.<sup>2</sup> This act provided for the exemption of labor, agricultural or horticultural organizations, and mutual savings banks not having a capital stock represented by shares.

The next Federal revenue act affecting co-operatives was the Revenue Act of 1916.<sup>3</sup> This act considerably broadened the scope of the tax exemptions for co-operatives and listed exemptions for fourteen types of co-operatives, including some Federal agencies. Every important Federal revenue act since 1916 has contained some provisions for the tax exemption of co-operative enterprises. These important acts were the Revenue Acts of 1918,<sup>4</sup> 1921,<sup>5</sup> 1924,<sup>6</sup> 1926,<sup>7</sup> 1928,<sup>8</sup> 1932,<sup>9</sup> 1934,<sup>10</sup> 1936,<sup>11</sup> 1938,<sup>12</sup> Second Revenue Act of 1940,<sup>13</sup> 1941,<sup>14</sup> 1943,<sup>15</sup> Social Security Act of 1935 and its amendments.<sup>16</sup> The tax exemption provisions of the Internal Revenue Code, applicable to co-operatives, which are in force at the present time are presented in Appendix XIX.

In any analysis of the state taxation of co-operatives, a review of the methods of taxation used by the Federal government is essential because of the fact that many of the states have patterned their taxation of co-operatives after the provisions of the Internal Revenue Code. Thus, it is our purpose to present the present methods used by the Federal government in the taxation of co-operatives.

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<sup>1</sup> Flint v. Stone Tracy Company, 220 U. S. 107, 173, 31 S. Ct., 342, 55 L. ed. 389.

<sup>2</sup> 38 Stat. 114, 172.

<sup>3</sup> 39 Stat. 756, 767.

<sup>4</sup> 40 Stat. 1057, 1076.

<sup>5</sup> 42 Stat. 253.

<sup>6</sup> 43 Stat. 283.

<sup>7</sup> 44 Stat. 39, 40.

<sup>8</sup> 45 Stat. 812.

<sup>9</sup> 47 Stat. 169-289.

<sup>10</sup> 48 Stat. 680-772.

<sup>11</sup> 49 Stat. 1648-1756.

<sup>12</sup> 52 Stat. 447-584.

<sup>13</sup> 54 Stat. 974.

<sup>14</sup> 55 Stat. 687.

<sup>15</sup> 58 Stat. 21.

<sup>16</sup> 49 Stat. 625, 42 USCA 409.

In recent months the research of several agencies has revealed that there is considerable misunderstanding of the subject of Federal and State taxation of co-operatives. Some of this misunderstanding is because of the confused use of certain terms. Furthermore, it is almost impossible to consider all co-operatives in the same group or class for tax purposes; this is because of the fact that the Federal government itself has established a list of 19 different types of co-operatives, all having the tax exempt privilege, but being required to conform to different standards of business conduct. In addition, all co-operatives are not incorporated under a common incorporation law; there is in many states a separate incorporation law for each type of co-operative business. This means that the various types of co-operatives have different powers, different capital structures, and are subject to different types of state regulation. Thus, there are several difficulties which arise whenever any study of the taxation of co-operatives is attempted.

There are few positive statements in the Internal Revenue Code with respect to the taxation of co-operatives. Present Federal tax practices with respect to such enterprises are provided in Section 101 (1) to (19) of the Internal Revenue Code, by the exemptions provided in the Social Security Act of 1935, with the amendments of 1939, by the Regulations of the Treasury Department, 103 (1940), and by the various decisions of the United States Tax Court.

Co-operatives<sup>1</sup> are now subject to three important Federal taxes: the corporate net income tax, including the income arising from capital gains, the Federal Unemployment Tax, and the Federal Insurance Contribution for old-age benefits. Prior to the Revenue Act of 1945, co-operatives were also subject to the excess-profits tax, the capital stock tax, and the declared-value-excess-profits tax. The Revenue Act of 1945, however, repealed these three taxes. For purposes of Federal taxation, co-operatives are divided into two classes:

- (A) Co-operatives which are not exempt from taxation and which pay the same Federal taxes as other business corporations;
- (B) Co-operatives which are exempt from taxation under Section 101 (1) to (19) of the Internal Revenue Code, or under some other specific act such as the agricultural labor provisions of the Social Security Act and its amendments.

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<sup>1</sup> That is, those co-operatives which cannot qualify for a tax exemption.



All co-operatives, with a few exceptions,<sup>1</sup> must file annual returns of income and expenditures with the U. S. Treasury Department on Form 990.

In order for co-operatives to acquire a tax exempt status, they must carry on their business activities according to a prescribed list of requirements which are set forth both in the Internal Revenue Code and in the Regulations of the Treasury Department. Although the Treasury Department has established different requirements for various types of co-operatives, we shall here examine those requirements for farmers' co-operatives, since these co-operatives are the most numerous and transact the largest dollar volume of business as compared with all types of co-operatives.

According to the Internal Revenue Code and the Regulations of the Treasury Department, farmers' co-operatives must meet the following requirements in order to be exempt from Federal taxes:

### **OPERATING REQUIREMENTS**

1. The operating purposes must be restricted.
2. Operations must be of a mutual nature, with equal treatment of all patrons.
3. Business with non-members must not exceed that done with members.
4. Financial reserves must have a necessary purpose and must be reasonable in amount.
5. Patronage and equity records must be maintained and must be permanently preserved.
6. Supplies and equipment purchased for non-members who are not producers must be limited.

### **OWNERSHIP AND CONTROL REQUIREMENTS**

7. Substantially all voting rights must be held by actual producers who currently patronize the association.

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<sup>1</sup> These co-operatives are: religious organizations exempt under Section 101 (6), educational organizations exempt under Section 101 (6), charitable organizations or an organization for the prevention of cruelty to children or animals, exempt under Section 101 (6), organizations exempt under Section 101 (6), if operated, supervised, or controlled by or in connection with a religious organization exempt under Section 101 (6); fraternal beneficiary societies, orders, or associations solely exempt under Section 101 (3), or (6) or corporations 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.

The above exemptions are provided in Section 54 (f), in Section 117, Revenue Act of 1943.



8. Substantially all capital shares, of participating type, must be owned by actual producers.
9. The rate of dividends (or interest) on capital shares must be limited.

### GENERAL REQUIREMENT

10. The legal structure of the association must be co-operative in principle and must not contain provisions inconsistent with the foregoing requirements.

The methods used by the Federal governments in the taxation of co-operatives may be illustrated by an examination of some of the practices of the Treasury Department with respect to the treatment of the following items:

- (1) Income
- (2) Dividends on Capital Stock
- (3) Patronage Dividends or Patronage Refunds
- (4) Reserves
- (5) Principles and Practices Followed by the Treasury Department with Respect to the Requirements Established for the Tax Exemption of Co-operatives

In our treatment of the above items, attention will be centered on the taxation practices affecting farmers' co-operatives. It is important to note that there is at present no provision in the Internal Revenue Code for the tax exemption of urban "consumer co-operatives."

### INCOME

One of the most confusing questions involving the taxation of co-operatives is: to whom does the net income of the co-operative business unit belong? Does it belong to the co-operative as a business entity, or does it belong to the members and patrons as individuals? The Treasury Department for many years has considered the net income of farmer co-operatives, in excess of all reserves and necessary expenses, as the property of the members and patrons as individuals;<sup>1</sup> the Treasury has thus followed a practice of taxing the net income of farmers' co-operatives in the hands of the members and patrons as individuals and has not taxed such income in the hands of the co-operative itself

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<sup>1</sup> Cost of goods sold items and other regular business expenses may be deducted from gross income in arriving at net income; thus, it is the net income which is exempt from taxation.

as a business organization, provided all the requirements of the tax laws with respect to exemptions and operating methods have been met by the organization. The practice of taxing the net income of farmer co-operatives only in the hands of the individual recipients is based upon the special nature of the net income of the co-operatives. It is a fundamental principle of co-operative operation that these enterprises intend to distribute *all* of their net income (with the exception of certain statutory reserves and other permitted reserves) to their members and patrons on a predetermined basis of the amount of business done with each member and patron. The net income of a farmer co-operative, thus, will accrue to the benefit of all the members and patrons on an equal basis, the amount of business done with each member or patron, rather than to the stockholders on the basis of the stock investment of each.

In determining the net income of *all types* of co-operatives the Treasury Department has allowed them to deduct patronage refunds or patronage dividends from gross income in arriving at net income.<sup>1</sup> It should be further noted that the Treasury Department has granted this same privilege of deducting patronage dividends from gross income in ascertaining net income to non-exempt co-operatives and regular business corporations; however, the same regulations apply equally to all types of co-operatives and regular business corporations; specifically, this means that the business unit of whatever type must establish by prior agreement with its customers that the profits will be distributed on the basis of the business done with each.<sup>2</sup> It is thus possible for a non-exempt co-operative enterprise or other corporation to have no statutory net income for tax purposes under Federal laws, merely by following a process of distributing all of its net income in excess of all operating costs and required and permitted reserves to members and patrons on a patronage basis.

## DIVIDENDS ON CAPITAL STOCK

Farmers' marketing and purchasing co-operatives and crop financing co-operatives which qualify for Federal tax exemptions are not subject to Federal income taxes on that part of their net income which

<sup>1</sup> Fruit Growers' Supply Co., 21 B. T. A., 315, 326; *affd.* 56 Fed. (2d) 90.

United Co-operatives, Inc., v. Commissioner, 4 T. C. No. 12, September 29, 1944.

<sup>2</sup> Uniform Printing and Supply Co. v. Commissioner, 88 F. (2d) 75 (Feb. 4, 1937).

is paid out in dividends on capital stock. However, these co-operatives are limited in their rate of dividends on stock to the "legal rate of interest in the state of incorporation or 8 percent per annum, whichever is greater."<sup>1</sup> This is in contrast to non-exempt co-operatives and regular corporations which are taxed on the income represented by such dividends; furthermore, this same income distributed in dividends by these latter co-operatives and corporations is taxed a second time in the hands of the individual recipients.

A non-exempt co-operative may not refrain from the payment of dividends on capital stock and at the same time pay out the greater portion of its net income in patronage dividends in order to escape Federal income taxes on that part of the net income paid out in dividends on stock. The net income of these co-operatives is fully taxable up to 8 percent on the value of the stock. This was held by the United States Tax Court in the case of *United Co-operatives, Inc. v. Commissioner*.<sup>2</sup> In this case the Court held that the net income of the co-operative used to pay dividends on the value of the stock was taxable as the income of the co-operative enterprise itself because of the fact that the directors of the co-operative had it in their power to decide as to the distribution of that portion of the income of the co-operative which was not in excess of 8 percent on the value of the stock; such power thus rested with the directors, rather than with the members and patrons. The significant statements of the Tax Court of the United States in this matter are as follows:

"However, the right of petitioner's board of directors to declare dividends upon its common stock is radically different. These dividends, if paid, would be paid out of net income. If dividends were not paid, then the net income of petitioner available for distribution to its patrons would be accordingly greater. The choice of whether so much of its net income as equalled eight per centum of the par value of its common stock should be distributed to its stockholders as a dividend or to its patrons as rebates was in the corporation. Therefore, it cannot be said that all of the money eventually distributed to its patrons as so-called patronage dividends was received by petitioner with a legal obligation existing at the time of its receipt to later so distribute it. We conclude that petitioner's patrons were entitled by reason of its by-laws of that

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<sup>1</sup> Internal Revenue Code, Section 101, (12, 13).

<sup>2</sup> 4 T. C. 12, September 29, 1944.

part of the so-called patronage dividends distributed to them which was in excess of eight per centum of the par value of petitioner's common stock outstanding and to that extent these patronage dividends were properly excluded from the taxable income of petitioner. However, that part of these patronage dividends which could have been distributed upon petitioner's common stock must be considered as the property of petitioner and taxable to it as its income."

While it is obvious that cash dividends paid to shareholders of co-operatives are taxable as earned income in their hands, it is also a fact that dividends paid to shareholders in the forms of capital stock, certificates of indebtedness or equity, or merchandise or property are taxable in the hands of such shareholders, and not in the hands of the co-operative as a separate entity. The rulings on the taxable status of the above forms of dividends were provided by the Bureau of Internal Revenue<sup>1</sup> and are presented in Appendix XX.

### **PATRONAGE REFUNDS OR PATRONAGE DIVIDENDS**

It was previously stated that the Treasury Department for many years permitted co-operative organizations and other types of business units to deduct patronage refunds or patronage dividends from gross income in ascertaining net income for tax purposes. It is important to note that there is no specific statutory provision for the deduction of patronage refunds from gross income; such provision has been allowed by the administrative rulings of the Treasury Department and has been upheld by the Federal courts.

The exemption of patronage refunds of agricultural co-operatives from Federal income taxation is not a new practice, but dates from the Revenue Act of 1918. The Commissioner of Internal Revenue ruled that such patronage refunds were exempt from Federal taxation, and could, therefore, be excluded from gross income in calculating the taxable income of a non-exempt purchasing co-operative.<sup>2</sup> The following excerpts are quoted from this ruling:

"Article 522 of Regulation 45 provides in part:

\*"(b) Co-operative associations acting as purchasing agents are not expressly exempt from tax and must make returns of income,

<sup>1</sup> Letter from T. C. Mooney, Deputy Commissioner, Bureau of Internal Revenue, To National Council of Farmer Co-operatives, November 23, 1943, as quoted in Congressional Hearings on *Financial Problems of Small Business*, H. Res. 64, Part 1, pp. 744-745, March 20-May 17, 1945.

<sup>2</sup> S. M. 2595, C. B. III-2, p. 238.



but rebates made to purchasers, whether or not members of the association, in proportion to their purchases may be excluded from gross income in computing the net income subject to tax. Any profits made from non-members and distributed to members in the guise of rebates are, of course, subject to tax.”<sup>1</sup>

The ruling quoted was reiterated by the United States Tax Court in its decision in *United Cooperatives, Inc. v. Commissioner*, previously cited. In this decision the Court emphasized the following practices with regard to the treatment of patronage refunds:

“The ultimate question here is whether certain ‘patronage refunds’ constitute a part of the gross income of the petitioner, or are, in reality, not the property of the petitioner but of its several ‘patrons.’ There is no question involved of ‘deductions’ in the technical sense of the statute, for the petitioner’s claim is the broad one that it is an agricultural co-operative, doing business not for its own profit but for the cheaper buying of agricultural and other goods by its members and, as such, is a mere conduit of their moneys.

“However, this practice of excluding patronage dividends from gross income has been limited to those cases in which the right of patrons to such dividends arises by reason of the corporation’s charter, or by-laws, or some other contract, and does not depend upon some corporate action taken subsequent to its receipt of the money later so distributed, such as the action of the corporation’s officers or directors. This limitation recognizes that if the money later distributed to patrons is received by the corporation without a legal obligation existing at the time of its receipt to later distribute it, it must be considered as the gross income of the corporation and, since there is no deduction permitted by statute of the amounts later distributed to patrons, it is taxable as such.”

It is important to note that the co-operative must establish a prior agreement with its customers providing for the distribution of patronage dividends on the basis of patronage in order to obtain a Federal tax exemption. The U. S. Board of Tax Appeals denied a tax exemption to the Midland Co-operative Wholesale Association of Minnesota because of the fact that this co-operative did not have such a legal obligation to distribute its earnings to patrons because such obligation rested upon subsequent action of the co-operative as a business unit.<sup>2</sup>

<sup>1</sup> Treasury Decision 2727.

<sup>2</sup> *Midland Co-operative Wholesale Assn. v. Commissioner*, 44 BTA, 824-830, June 26, 1941. Also, *Fruit Growers’ Supply Co. of Cal.*, 21 BTA, 315, Nov. 13, 1930.

In another ruling the Bureau of Internal Revenue held that a co-operative was not subject to the surtax on undistributed profits under Section 14 of the Revenue Act of 1936, even though the profits were not distributed until after the close of the taxable year.<sup>1</sup> The patronage dividends were allowed to be excluded from gross income, provided the liability to patrons and members was set up on the books of the co-operative pursuant to corporate action taken with respect thereto prior to the close of the particular accounting period.

In addition to other requirements, a co-operative must treat non-member patrons in the same manner as members in the distribution of patronage dividends. The Treasury Department has ruled that a co-operative marketing association may not, without losing its tax exempt status, make a profit on the business transacted with non-member patrons and divert the proceeds of such business from the patrons entitled thereto. The regulations of the Treasury Department with respect to the distribution of patronage dividends, however, do not require that the dividends must be paid in cash immediately after the close of a specific fiscal period. Where a co-operative marketing association has otherwise complied with provisions of the statute with respect to exemptions, but defers the payment of patronage dividends to non-members, exemption will not be denied:<sup>2</sup>

- (1) Where the by-laws of the association provide that patronage dividends are payable to members and non-members alike, and a general reserve is set up for payment of patronage dividends to non-members;
- (2) Where the by-laws provide for payment of patronage dividends to members, but are silent as to the payment of patronage dividends to non-members, but a specific credit to the individual account of each non-member is set up on the books of the association.

For co-operatives claiming Federal tax exemptions the equal treatment of members and non-members in the distribution of profits and in the sharing of reserves established from such profits was recently reaffirmed by the Court in the case of *Fertile Co-operative Dairy Association v. Huston*.<sup>3</sup>

<sup>1</sup> GCM, 17895, C. B. 1937-1, p. 56.

<sup>2</sup> U. S. Treasury Department, Mim. 3886, C. B. Dec. 1931, p. 64.

<sup>3</sup> 33 F. Supp. 712 (April 26, 1941).



## RESERVES

One of the most confusing terms in the literature concerning co-operative enterprises is that of "reserves." Since there are several types of reserves, we shall first define those in use by both corporations and co-operatives. Reserves may be grouped into three important classes, as follows:

- (A) Liability reserves
- (B) Valuation reserves
- (C) Capital reserves

Liability reserves are those which are established upon the books of the corporation or the co-operative for the purpose of meeting some liability or expense which will occur in the future. Typical examples are: reserves for payment of taxes, reserves for fire losses and for various possible expenses, labeled "contingencies."

Valuation reserves are technically known as "minus assets," that is, they are established upon the books of the corporation or the co-operative as a deduction from asset items in order to show the correct value of particular assets at all times. Typical examples of valuation reserves are: reserves for depreciation of fixed plant and other types of equipment, and reserves for bad debts. Co-operatives and regular corporations may deduct from their gross income for tax purposes the additions to their liability and valuation reserve accounts.

The practice with respect to capital reserves, however, is somewhat different. This is because of the fact that the capital reserves of co-operatives are of a different legal nature than the capital reserves of regular corporations. As a matter of definition, capital reserves consist of the amounts of a corporation's net income which are set aside and transferred to a capital reserve or "surplus" account. For a regular corporation, the addition to a capital or surplus reserve is never allowed as a deduction from gross income for Federal tax purposes. In a regular corporation the capital reserve or surplus belongs to the stockholders, and in the event of dissolution would be distributed to the stockholders on the basis of their stock ownership. Thus, that portion of a regular corporation's net income which is set aside and transferred to a capital or surplus reserve is fully taxable by the Federal government.

Although a co-operative enterprise may also set aside a portion of

its net income and transfer the same to its capital reserve or surplus account, the courts have ruled that such capital reserves belong at all times to the members and patrons of the co-operative, and are not, therefore, the property of the co-operative as a business unit.<sup>1</sup> Since these reserves are not the property of the co-operative as a business unit, they are not taxable in its hands, but are subject to taxation in the hands of the individual recipients when distributed (in whatever form) by the co-operative. It must be emphasized that it is the *income* which is set aside as capital reserves which is not taxable in the hands of the co-operative. The fact that the capital reserves of a co-operative enterprise belong to the individual members and patrons, and not to the co-operative as a unit, is perhaps the most important and significant economic difference between the co-operative and the regular business corporation.

Although the capital reserves of farmer co-operatives are not subject to Federal taxation in the hands of the co-operative unit itself, the Internal Revenue Bureau has imposed certain regulations on these co-operatives concerning their use of reserve accounts. Briefly, these regulations may be summarized as follows:

- (A) The capital reserves must be reasonable and for a necessary purpose;
- (B) Members and non-members must be treated alike in the allocation of capital reserves;
- (C) The capital reserves must be allocated by the co-operative unit among both members and non-members; otherwise, the co-operative will be liable for taxation on such reserves, since reserves not allocated might be used by the co-operative for the sole benefit of the shareholders, to the detriment of non-members who are patrons. Such allocation of reserves must be set up on the books of the co-operative, and these records must be preserved permanently.

The requirement that capital reserves must be reasonable and for a necessary purpose is stated in the Internal Revenue Code itself. Reserves for necessary purposes have been construed to include reserves for new buildings, plants, and fixed types of equipment. The Bureau,

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<sup>1</sup> See *Fertile Dairy Co-operative Assn. v. Huston*, 33 F. Supp. 712. Also, *United Co-operatives, Inc. v. Commissioner*, 4 T. C. No. 12.

however, has denied tax exemptions to co-operatives where such reserves have been considered as excessive.

The second and third requirements that capital reserves must be allocated on an equal basis as between members and non-members, and that these reserves must be allocated and set forth in permanent records are set forth in the case of *Fertile Dairy Co-operative Association v. Huston*,<sup>1</sup> quoted previously. The important statements of the Court on the subject of equal treatment in allocation of reserves in this case were as follows:

"Where part of proceeds from non-members' products is used by farmers co-operative marketing association to create or maintain a surplus and to make additions to capital assets of the association, without allowing non-members a proportionate distributive interest in permanent value contributed thereby, the association is not exempt from income, excess profits and capital stock taxes, since to that extent the association is being operated for profit to its members, as against non-member patrons.

"The business of non-member patrons of a farmers' co-operative marketing association may be made to carry its just share of operating expenses, actual depreciation of plant and equipment, and dividends on existing capital stock, but if such business is made to contribute to permanent surplus and capital asset additions, the association cannot remain exempt from income, excess profits and capital stock taxes unless provision has been made by appropriate enabling action on part of the association and by adequate protective entries on books and records for non-members to share rateably with members in an ultimate liquidation of association's assets on basis of their comparative contributions thereto."

#### **PRINCIPLES AND PRACTICES FOLLOWED BY THE TREASURY DEPARTMENT WITH RESPECT TO THE REQUIREMENTS ESTABLISHED FOR THE TAX EXEMPTION OF CO-OPERATIVES**

While some of the requirements for a Federal tax exemption for farmer co-operatives have been discussed in the preceding pages concerned with a discussion of the subjects of co-operative income, dividends on stock, patronage dividends, and reserves, there are a few other requirements which have not been discussed. Two of these requirements are concerned with the nature of the operations of the farmer

<sup>1</sup> 33 F. Supp. 712.

co-operatives. These enterprises must restrict their business functions to those permitted by their charters, and in transacting business, they must observe co-operative principles. This means specifically that a farmer co-operative cannot carry on "commercial functions" and receive a Federal tax exemption at the same time.<sup>1</sup> Furthermore, it means that a substantial share of the capital must be owned by producer-members, in order that the voting rights may be continued on co-operative principles.

In order to maintain a tax exempt status, farmers' marketing and purchasing co-operatives, life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or co-operative telephone companies, and employee beneficiary associations must limit the value of business which is transacted with non-members. These limitations are set forth in Section 101, (10, 12, 16), of the Internal Revenue Code. In practice, co-operatives which pay dividends on capital stock in excess of the statutory limits are denied Federal tax exemptions.<sup>2</sup>

In summary, the comparative Federal tax status of exempt-co-operatives and regular business corporations is presented in Table 7 of the text. This table indicates the chief differences between co-operatives and regular corporations with respect to the liability for Federal taxes. The materials presented in Table 8 of the text indicate the comparative Federal tax status of regular corporations, non-exempt farmers' co-operatives, and exempt farmers' co-operatives. This table, in addition, lists some of the legal requirements prescribed for the tax exemption of the exempt co-operatives. The Federal taxation of co-operatives may be summarized briefly as follows:<sup>3</sup>

- (1) All net income of a co-operative which is distributed in the form of patronage dividends or patronage refunds is permitted as a deduction from gross income, and is not taxable in

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<sup>1</sup> See Eugene Fruit Growers' Association, 37 BTA, 993, Dec. 10,053. That is, a co-operative cannot obtain a Federal tax exemption on that portion of its business which is "commercial" in character, but may receive an exemption on that portion of its business which is co-operative in character, provided all other requirements for such exemptions have been met.

<sup>2</sup> See Farmers' Mutual Co-operative Creamery of Sioux Center, Iowa, 33 BTA, 117, Dec. 9085.

<sup>3</sup> This refers to farmer co-operatives, but the principles also are applicable to most other types of cooperatives.

the hands of the co-operative, but is taxable in the hands of the individual recipients.

- (2) That part of a co-operative's net income which is paid in dividends on capital stock is not taxable in the hands of the co-operative as a business unit. The rate of dividends, however, must be limited as stipulated by law.
- (3) That part of a co-operative's net income which is an addition to its liability and valuation reserves is permitted as a deduction from gross income for tax purposes.
- (4) That part of a co-operative's net income which is set aside and transferred to a capital reserve or surplus account is not taxable in the hands of the co-operative as a business unit because the courts have ruled that the net income set aside in such reserves is the property of the members and patrons as individuals, and is thus taxable in their hands as individuals.
- (5) Patronage dividends or patronage refunds, when paid by the co-operative in the forms of cash, shares of stock, certificates of equity, merchandise, or property, are fully taxable in the hands of the recipients as individuals.

**TABLE 7**

**COMPARATIVE TAX STATUS OF REGULAR BUSINESS CORPORATIONS AND EXEMPT CO-OPERATIVE BUSINESS ENTERPRISES UNDER FEDERAL LAWS, 1946**

<i>Co-operative Enterprises</i>		<i>Taxable Status</i>	<i>Regular Business Corporation</i>		<i>Taxable Status</i>
TOTAL NET INCOME	Balance of net income carried to surplus account.	Not taxed in hands of co-operative. <sup>1</sup>	TOTAL NET INCOME	Balance of net income retained and carried to surplus accounts.	Taxable to corporation.
	Net income paid out in dividends on the basis of capital stock ownership.	Not taxable in hand of co-operative. <sup>2</sup>		Net income paid to stockholders as dividends.	Taxable to corporation.
	Net income distributed to members and non-members on a patronage basis.	Not taxable in hand of co-operative.		Net income set aside as Capital reserves.	Taxable if set aside out of net income.
	Net income set aside as reserves required by State Law or permitted by Federal Government.	Not taxable.			
	Net income set aside as Capital reserves.	Not taxed in hands of co-operative. <sup>1</sup>			

<sup>1</sup> If allocated to members and non-members alike and if such liability is established on the books of the co-operative.

<sup>2</sup> Must limit rate of dividends, as stipulated by statute.



**TABLE 8**

**A COMPARISON OF THE TAX STATUS OF REGULAR BUSINESS CORPORATIONS, NON-EXEMPT, AND EXEMPT FARMERS' CO-OPERATIVES UNDER FEDERAL LAWS, 1946<sup>1</sup>**

*Regular Corporations*

*Non-exempt Farmers' Co-operatives*

*Exempt Farmers' Co-operatives*

- |   |  |   |
|---|--|---|
| <p>1. Must file annual returns of income</p> <p>2. Must pay income taxes on any taxable income such as:</p> <p style="padding-left: 20px;">(A) Non-operating or extraneous income &amp; capital gains</p> <p style="padding-left: 20px;">(B) Reserved operating earnings</p> <p style="padding-left: 20px;">(C) All earnings distributed as dividends on capital shares</p> <p>3. (A) Earnings distributed to patron on basis of amount of business done with each are not taxable if prior agreement with customers has been established</p> <p>4. Must pay documentary stamp taxes</p> <p>5. Must pay social security taxes</p> <p>6. May pay any rate of dividends or interest on capital shares but is taxed on amounts so paid or accrued</p> <p>7. May have unlimited capital reserves, but is taxed thereon</p> <p>8. Must maintain corporate records of business transactions</p> <p>9. May be owned and controlled by any type of persons</p> <p>10. May operate in part commercially and in part co-operatively</p> <p>11. May engage in any type of business</p> <p>12. May do any portion of its business with non-members or non-producers</p> | <p>1. Must file annual returns of income</p> <p>2. Must pay income taxes on any taxable income such as:</p> <p style="padding-left: 20px;">(A) Non-operating or extraneous income &amp; capital gains</p> <p style="padding-left: 20px;">(B) Reserved operating earnings</p> <p style="padding-left: 20px;">(C) All earnings distributed as dividends on capital shares</p> <p>3. (A) Earnings distributed to patrons on basis of amount of business done with each are not taxable if prior agreement with customers has been established</p> <p>4. Must pay documentary stamp taxes</p> <p>5. Must pay social security taxes</p> <p>6. May pay any rate of dividends or interest on capital shares, but is taxed on amounts so paid or accrued</p> <p>7. May have unlimited capital reserves, but is taxed thereon</p> <p>8. Must maintain records of patronage refunds</p> <p>9. May be owned by any type of persons</p> <p>10. May operate in part commercially and in part co-operatively</p> <p>11. May engage in any type of business</p> <p>12. May do any portion of its business with non-members or non-producers</p> | <p>1. Must file annual returns of income on Treasury Form 990.</p> <p>2.</p> <p style="padding-left: 20px;">(A) Not taxable</p> <p style="padding-left: 20px;">(B) Not taxable if allocated to members &amp; patrons alike and if such liability is established on the books of the co-operative</p> <p style="padding-left: 20px;">(C) Not taxable<sup>2</sup></p> <p>3. (A) Patronage dividends are deductible from gross income when computing the taxable income of the co-operative</p> <p>4. Exempt from stamp taxes</p> <p>5. Have a limited exemption from this tax depending primarily upon the nature of the actual occupation of the employees</p> <p>6. Must limit rate of dividends as provided by Federal and State Laws</p> <p>7. Such reserves are not taxable to the co-operative if they are "reasonable" in amount, and if they are allocated to members and patrons on a patronage basis, and if such liability is established on the books of the co-operative</p> <p>8. Must maintain records of patronage refunds and allocations of same</p> <p>9. Must be substantially controlled by producer patrons</p> <p>10. Must operate on co-operative principles</p> <p>11. Must restrict business to types provided in charter in order to preserve its tax exempt status</p> <p>12. Must restrict volume of business with non-members to limits provided by law if tax exemption is to be preserved</p> |
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<sup>1</sup> Derived from George J. Waas and Daniel G. White, *Application of the Federal Income Statutes to Farmers' Co-operatives*, Farm Credit Administration, Bulletin No. 53, p. 165, (1942).

<sup>2</sup> Must limit the rate of dividends, as stipulated in statute.

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## Part V

# TAXATION OF CO-OPERATIVES BY THE COMMONWEALTH OF PENNSYLVANIA

Co-operative enterprises in Pennsylvania are incorporated under separate incorporation acts, and not under the regular business incorporation laws. The tax status of co-operatives, therefore, depends not only upon the construction of the tax statutes involved but also upon the provisions of the various incorporation acts affecting such co-operatives. In reviewing the taxation of co-operatives in Pennsylvania we must examine not only the various tax laws and the incorporation laws affecting the co-operatives, but we must also consult the formal opinions of the Attorney General and the decisions of the courts and acts passed by the General Assembly in 1945.

A careful analysis of the taxation of co-operatives in Pennsylvania indicates that the General Assembly has granted no broad tax exemptions to these enterprises. The tax exemptions which have been provided for certain co-operatives are quite specific and are set up either in the tax laws or the special incorporation acts affecting co-operatives.

In general, the practices of the Department of Revenue with respect to the taxation of co-operatives are governed by the Formal Opinion of the Attorney General, Number 461, June 28, 1943. Certain rulings in this Formal Opinion, however, have been altered recently by a decision of the Supreme Court of Pennsylvania affecting Rural Electric Co-operatives<sup>1</sup> and by Acts 357, 358, 360 and 365 enacted by the General Assembly in 1945.

The Attorney General, in ruling upon the taxable status of the various types of co-operatives operating in the Commonwealth, has made the following significant statement:<sup>2</sup>

"The taxability of all incorporated co-operative associations of whatever kind is thus determined with a view to accomplishing

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<sup>1</sup> The Department of Labor and Industry, Commonwealth of Pennsylvania, v. New Enterprise Rural Electric Co-operative, Inc., June 29, 1945.

<sup>2</sup> Attorney General, Commonwealth of Pennsylvania, *Formal Opinion Number 461*, p. 12, June 28, 1943.

a two-fold objective—first, to foster the lawful endeavors of true co-operative associations, and secondly, to protect competitive business corporations from the consequences of granting unqualified immunities from taxation to incorporated associations operating beyond the scope of true co-operative activities.”

As a general rule it may be said that all incorporated co-operative associations, other than those specially incorporated and subject to or free from taxation under special provisions of law, come within the provisions of the Corporate Net Income Tax Act and the Capital Stock Tax Act.<sup>1</sup>

Four of the eight special incorporation acts creating co-operatives in Pennsylvania specifically provide for certain exemptions from State taxation. Of the early acts, the Act of 1887, June 7, P. L. 365, contains no specific provisions on the subject of tax exemptions. Consequently, these co-operatives are treated like regular business corporations for purposes of State taxation. The Attorney General has ruled as follows concerning these co-operatives:<sup>2</sup>

“Co-operative associations, productive and distributive, incorporated under the Act of June 7, 1887, P. L. 365, Section 1, 14 P. S. Section 1, et. seq., or availing themselves of the provisions of the said act, have capital stock and clearly fall within the meaning of the word, ‘corporation’ as defined by the Corporate Net Income Tax Act, *supra*. Hence, these associations are liable for the payment of the said tax. Those associations, unlike co-operative agricultural associations incorporated under the Act of April 30, 1929, are not expressly exempted by their incorporation act from capital stock taxes; hence, they come within the Capital Stock Tax Act, *supra*, but correspondingly are not subject to the complementary Net Earnings Tax Act, *supra*.”

There are specific provisions in the co-operative incorporation acts of Pennsylvania which establish certain tax exemptions for the following types of co-operatives: Agricultural Co-operatives incorporated under the Act of April 30, 1929, P. L. 885; Agricultural Credit Co-operatives, incorporated under the Act of May 25, 1933, P. L. 1027; Credit Unions incorporated under the Act of May 26, 1933, P. L. 1076,

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<sup>1</sup> *Ibid.*

<sup>2</sup> Attorney General, Commonwealth of Pennsylvania, *op. cit.*, p. 11, June 28, 1943.



and Rural Electric Co-operatives incorporated under the Act of June 21, 1937, P. L. 1969.

The tax exemption provisions of the incorporation laws mentioned above are as follows:

### **AGRICULTURAL CO-OPERATIVES (Act of 1929)**

#### **Section 20**

"No association organized under the provisions of this act shall be liable for the payment of any State tax upon its capital stock, or upon any scrip, bonds, certificates, or other evidences of indebtedness issued by such corporation, and all stock, bonds, et cetera, issued by such associations shall be exempt from all State taxation; and such associations shall not be required to file with the Auditor General of this Commonwealth the reports relative to such taxes as are or may be required of corporations not exempt from the payment of such taxes."

### **AGRICULTURAL CREDIT CO-OPERATIVES (Act of 1933)**

#### **Section 15**

"No association organized under the provisions of this act shall be liable for the payment of any State tax upon its capital stock, or upon any scrip, bonds, certificates or other evidences of indebtedness issued by such corporation, and all stocks, bonds, et cetera, issued by such associations shall be exempt from all State taxations; and such associations shall not be required to file with the Department of Revenue of this Commonwealth the reports relative to such taxes as are or may be by law required of corporations not exempt from the payment of such taxes."

### **CREDIT UNIONS (Act of 1933)**

#### **Section 23**

"A credit union, organized under this act, shall be deemed an institution for savings and its assets, together with all the accumulations therein, shall not be subject to taxation except as to real estate owned by it. The shares of a credit union shall not be subject to a capital stock bonus tax or a stock transfer tax when issued by the corporation."

### **RURAL ELECTRIC CO-OPERATIVES (Act of 1937)**

#### **Section 31**

"Corporations formed hereunder shall pay annually, on or before July first, to the Department of Revenue a fee of ten dol-

lars (\$10) for each one hundred members, or fraction thereof, but shall be exempt from all other State taxes of whatsoever kind or nature."

In addition to the specific State tax exemptions granted to certain types of co-operatives in the incorporation acts cited previously, the General Assembly in 1945 provided for certain other tax exemptions for these enterprises in four Acts: number 357, 358, 360 and 365. The tax exemption provisions of these four acts are as follows:

**Act Number 357, May 23, 1945**

This act amends the Act of June 12, 1919, P. L. 466, with respect to certain business practices and reports required of agricultural co-operatives, without capital stock. The tax exemption provision is as follows:

"All associations organized and doing business under the provisions of this act shall be exempt from the payment of any State tax upon net income or measured by net income, and shall not be required to file with the Department of Revenue of this Commonwealth reports relative to such taxes."

**Act Number 358, May 23, 1945**

This act amended the Act of April 30, 1929, P. L. 885, with respect to certain business practices, stock issues, and reports required of agricultural co-operatives with capital stock. The tax exemption provisions are as follows:

"No association organized under the provisions of this act shall be liable for the payment of any State tax upon its capital stock, or upon any scrip, bonds, certificates, or other evidences of indebtedness issued by such corporation, and all stocks, bonds, et cetera, issued by such associations shall be exempt from all State taxation; and such associations shall not be required to file with the Secretary of Revenue of this Commonwealth the reports relative to such taxes as are or may be by law required of corporations not exempt from the payment of such taxes."

**Act Number 360, May 23, 1945**

**Section 3**

This act imposes an excise tax at the rate of four percent per year upon the net income of both domestic and foreign agricultural co-op-



eratives, having capital stock. The provisions of this section relating to the imposition of this tax and the exemption from other State taxes are as follows:

"Every association shall be subject to, and shall pay for, the privilege of doing business in this Commonwealth, or having capital or property employed or used in the Commonwealth, by, or in the name of itself, or any other person, partnership or association, a State excise tax at the rate of four per centum (4%) per annum upon each dollar of the net income, which tax shall be collected in lieu of any other excise tax including corporate net income tax or property tax. The property shall be free from any county tax excepting tax on real estate. . . . net income for the calendar year or fiscal year shall be only an amount equal to the sum of the dividends declared, or declared and paid on the shares of common and preferred stock during the year.'" (Section 2.)

#### **Act Number 365, May 23, 1945**

This act amends the Net Earnings Tax Act of June 1, 1889, P. L. 420, as follows:

". . . Provided that this section shall not apply to corporations and limited partnerships chartered or organized for manufacturing purposes, nor to co-operative agricultural associations organized under the laws of this or any other state. There shall be no liability for tax under the provisions of this act from any co-operative agricultural association doing business in the Commonwealth of Pennsylvania prior to the passage of this amendment."

The Unemployment Compensation Law, 1936, Second Ex. Sess., Dec. 5, P. L. (1937) 2897, and its amendments exempted certain types of agricultural labor from the unemployment compensation tax. Thus, Section 4, defines agricultural labor to include the following activities which are exempt from the tax:

"(1) Agricultural labor which shall include all services performed—

"(a) On a farm in the employ of any person in connection with cultivating the soil or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training and management of livestock, bees, poultry and fur-bearing animals and wildlife.

- “(b) In the employ of the owner or tenant or other operator of a farm in connection with the operation, management, conservation, improvement, or maintenance of such farm and its tools and equipment or in salvaging timber or clearing land of brush and other debris left by a hurricane, if the major part of such service is performed on a farm.
- “(c) In connection with the production or harvesting of maple sirup or maple sugar or any agricultural commodity, or in connection with the raising or harvesting of mushrooms, or in connection with the hatching of poultry, or in connection with the ginning of cotton, or in connection with the operation or maintenance of ditches, canals, reservoirs or waterways used exclusively for supplying and storing water for farming purposes.
- “(d) In handling, planting, drying, packing, packaging, processing, freezing, grading, storing or delivering to storage or to market or to a carrier for transportation to market any agricultural or horticultural commodity, but only if such service is performed as an incident to ordinary farming operations, or, in the case of fruits and vegetables, an incident to the preparation of such fruits and vegetables for market. The provisions of this paragraph shall not be deemed to be applicable with respect to service performed in connection with commercial canning, or commercial freezing or in connection with any agricultural or horticultural commodity after its delivery to a terminal market for distribution for consumption.

As used in this subsection the term “farm” includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities and orchards.

- “(10) Service performed in the employ of an agricultural or horticultural organization exempt from income tax under Section 101 (1) of the Federal Internal Revenue Code as amended.
- “(11) Service performed in the employ of a voluntary employees’ beneficiary association providing for the payment of life,

sick, accident or other benefits to the members of such associations or their dependents, if (i) no part of its net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and (ii) eighty-five per centum or more of the income consists of amounts collected from members for the sole purpose of making such payments and meeting expenses.”

The Pennsylvania Unemployment Compensation Bureau holds strictly to the rule that only co-operative organizations engaged strictly in agricultural pursuits are exempt from the unemployment compensation tax. Thus, such organizations as crop financing and agricultural credit organizations are liable for the tax.

The unemployment compensation tax, however, is not applicable to rural electric co-operatives and credit unions in Pennsylvania. The Supreme Court of Pennsylvania in a recent decision<sup>1</sup> ruled that rural electric co-operatives were not subject to this tax because the incorporation act creating such co-operatives specifically exempts these organizations from all State taxes. The Court in its decision said:

“ . . . The legislature may have concluded that to impose the payment of this excise tax upon corporations created under the Electric Co-operative Corporation Act would result in increased charges for rural electric current and might seriously impede the accomplishment of the very purpose of the legislation.”

In the opinion of counsel, since the incorporation act creating credit unions also exempts these co-operatives from all types of State taxes, it is thought that these units are also exempt from the unemployment compensation tax, as based upon the above decision of the Court affecting rural electric co-operatives. In the matter of the bonus charge, all types of co-operatives with capital stock in Pennsylvania, with the single exception of credit unions, are subject to such a charge. Credit unions are relieved of the bonus charge because of the provision in their incorporation act which states: “the shares of a credit union shall not be subject to a capital stock bonus tax or a stock transfer tax when issued by the corporation.”<sup>2</sup> This provision also relieves the

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<sup>1</sup> Department of Labor and Industry, Commonwealth of Pennsylvania v. New Enterprise Rural Electric Co-operative, Inc., Commonwealth Docket No. 88, (June 29, 1945).

<sup>2</sup> Act of May 26, 1933; P. L. 1076, Section 23.

credit unions of liability for payment of the stock transfer tax. However, all other types of co-operatives are subject to the stock transfer tax.

The statistics presented in Table 9 indicate the types of State taxes imposed upon all types of co-operative enterprises in Pennsylvania in comparison with those imposed upon regular industrial corporations, utilities, and banks. These data are for the year 1945, and reflect all changes in State taxation as provided by the acts of the General Assembly in 1945.

In summary, the co-operatives operating in Pennsylvania are subject to the following types of taxes:

<i>Types of Co-operatives</i>	<i>Subject to:</i>
Co-operatives, productive and distributive, (1887)	Bonus Capital stock tax Corporate loans tax Stock transfer tax Corporate net income tax Unemployment compensation tax <sup>1</sup>
Agricultural co-operatives, without stock, (1919) <sup>3</sup>	Unemployment compensation tax <sup>2</sup>
Agricultural co-operatives, with capital stock, (1929) <sup>3</sup>	Bonus Stock transfer tax Co-operative agricultural net income tax Unemployment compensation tax <sup>1</sup>
Agricultural credit co-operatives, (1933)	Bonus Stock transfer tax Co-operative agricultural net income tax Unemployment compensation tax
Credit unions, (1933)	No taxes

<sup>1</sup> Subject to Unemployment Compensation Tax on that portion of its employment which is not within the definition of "agricultural labor."

<sup>2</sup> *Ibid.*

<sup>3</sup> Foreign agricultural co-operatives, with and without capital stock, are subject to the bonus (tax) as imposed by the Act of May 8, 1901, P. L. 150.

<i>Types of Co-operatives</i>	<i>Subject to:</i>
Rural electric co-operatives, (1937)	Bonus (if stock) \$10 annual license fee per 100 members Stock transfer tax
Domestic mutual insurance companies	Unemployment compensation tax
Savings Institutions, non- stock, (1889)	Net earnings tax of 1889 Unemployment compensation tax

The data presented in Table 10 indicate the types of local taxes imposed upon co-operative enterprises in Pennsylvania as of 1946. It will be noted that all types of co-operatives are subject to the real property tax and are exempt from the county personal property tax. Pennsylvania, unlike some states, has not granted real property tax exemptions to special classes of co-operatives.



TABLE 9

TYPES OF STATE TAXES IMPOSED ON DOMESTIC BUSINESS UNITS IN PENNSYLVANIA—1945

Type of Business Units	Bonus on Charters	Capital <sup>2</sup> Stock	Corporate Loans	Utility Gross Receipts	Bank Shares 1897	Tax on Title Ins. & Trust Co. Stock 1907	Gross Receipts Private Bankers	Gross Premiums of Domestic Ins. Co.	Stock Transfer	Corporate Net Income	Co-op. Agr. <sup>1</sup> Assn. Net Income Tax	Net Earnings Tax of 1889	Unemployment Compensator Tax
1. Regular Industrial Corporations ..	Yes	Yes	Yes	No	No	No	No	No	Yes	Yes	No	No	Yes
2. Co-ops., Productive & Distributive, with stock 1887 .....	Yes	Yes	Yes	No	No	No	No	No	Yes	Yes	No	No	No <sup>4</sup>
3. Co-ops., Agr., without stock 1919 <sup>7</sup>	No	No	No	No	No	No	No	No	No	No	No	No	No <sup>4</sup>
4. Co-ops., Agr., with stock 1929 <sup>7</sup> ..	Yes	No	No	No	No	No	No	No	Yes	No	Yes	No	No <sup>4</sup>
5. Co-ops., Agr. Credit with stock 1933	Yes	No	No	No	No	No	No	No	Yes	No	Yes <sup>6</sup>	No	Yes
6. Credit Unions 1933 .....	No	No	No	No	No	No	No	No	No	No	No	No	No
7. Electric Co-op. Corporations 1937 .	Yes <sup>5</sup>	No	No	No	No	No	No	No	Yes	No	No	No	No <sup>3</sup>
8. Domestic Mutual Ins. Companies (without stock) 1921 .....	No	No	No	No	No	No	No	No	No	No	No	No	Yes
9. Banks (with State charters) .....	Yes	No	Yes	No	Yes	No	No	No	Yes	No	No	No	Yes
10. Domestic Insurance Companies ...	Yes	Yes	Yes	No	No	No	No	Yes	Yes	Yes	No	No	Yes
11. Utilities, Incorporated .....	Yes	Yes	Yes	Yes	No	No	No	No	Yes	Yes	No	No	Yes
12. Title Ins. & Trust Companies ....	Yes	No	Yes	No	No	Yes	No	No	Yes	No	No	No	Yes
13. Savings Institutions without Capital Stock 1889 .....	No	No	No	No	No	No	No	No	No	No	No	Yes	Yes
14. Private Banks (Individuals) .....	No	No	No	No	No	No	Yes	No	No	No	No	No	Yes

<sup>1</sup> Act No. 360, 1945.

<sup>2</sup> The capital stock tax exemption was restored for manufacturing corporations by Act No. 323, May 27, 1943, P. L. 762, effective January 1 of the year following Presidential or Congressional Proclamation of end of the war.

<sup>3</sup> Exempt by Act of June 21, 1937, P. L. 1969 and upheld by the Pennsylvania Supreme Court. (Dept. of Labor and Industry v. New Enterprise Rural Electric Co-operative, Inc., June 29, 1945).

<sup>4</sup> It would appear that co-operatives of this type are exempt as to such employees performing services incident to farming operations, and under certain conditions. (See Unemployment Compensation Law and cases.)

Note: The tax status of co-operatives is based upon Formal Opinion No. 461, June 28, 1943, Pennsylvania Department of Justice and Acts 357 and 360, (1945).

Note: Cigarette and Liquor License Taxes have not been included, since these taxes are paid by all types of units.

Note: Chart excludes unincorporated associations authorized by Act of June 30, 1923, P. L. 984, since these associations are not taxable as corporations.

Note: All co-operative agricultural associations were exempted from the Net Earnings Tax of 1889 under the provisions of Act No. 365, May 23, 1945.

<sup>5</sup> Subject to bonus charge if the co-operative has capital stock.

<sup>6</sup> Department of Revenue Statement.

<sup>7</sup> Foreign agricultural co-operatives, with and without capital stock, are subject to the bonus (tax) as imposed by the Act of May 8, 1901, P. L. 150.

STATE TAX RATES

Tax	Rates
Bonus on Charters .....	1/5 of 1 percent
Capital Stock .....	5 mills
Corporate Loans .....	4 mills
Utility Gross Receipts .....	8 mills (plus 6 mills extra for calendar years 1945 and 1946)
Bank Shares .....	4 mills
Tax on Stock of Title Insurance and Trust Companies .....	4 mills
Gross Receipts of Private Bankers .....	1 percent
Gross Premiums of Domestic Insurance Companies .....	8 mills
Stock Transfer .....	2c per \$100 value
Corporate Net Income .....	4 percent
Co-operative Agricultural Association Net Income Tax .....	4 percent
Net Earnings Tax (1889) .....	3 percent
Unemployment Compensation Tax .....	1 percent to 2.7 percent

TABLE 10

LOCAL TAXES IMPOSED UPON CO-OPERATIVE  
BUSINESS ENTERPRISES IN PENNSYLVANIA,  
1946

<i>Type of Co-operative</i>	<i>Real Property Taxes</i>	<i>County Personal Property Taxes</i>
1. Co-operatives, productive & distributive, with stock, (1887) . . . . .	Taxable	Exempt
2. Co-operatives, Agr. without stock, (1919) . .	Taxable	Exempt
3. Co-operatives, Agr., with stock, (1929) . . . .	Taxable	Exempt
4. Co-operatives, Agr. credit, with stock, (1933)	Taxable	Exempt
5. Credit unions, (1933) . . . . .	Taxable	Exempt
6. Electric co-operative corporations, (1937) . .	Taxable	Exempt
7. Domestic mutual insurance companies, without stock, (1921) . . . . .	Taxable	Exempt

## Part VI

# TAXATION OF CO-OPERATIVES IN OTHER STATES

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### A. TAXATION IN PENNSYLVANIA AND TEN OTHER SELECTED STATES

In order to ascertain the types of state taxes imposed upon co-operative enterprises in some other states, the Commission addressed questionnaires to state tax officials in ten selected industrial and mining states.<sup>1</sup> These states were chosen because they had previously been selected by the Commission for purposes of comparative tax studies because their products and services compete with those of enterprises operating in Pennsylvania. The results of this survey are tabulated in Tables 11 to 18 of the text. A summary of all the data appearing in these tables is presented in Table 19 of the text, which indicates the number of states imposing specific taxes upon all types of co-operatives included in this study. The reader must be cautioned, however, in the interpretation of the data appearing in Tables 11 to 18. The mere fact that a co-operative may be liable for a specific state tax does not mean that a sizable tax burden is actually imposed upon the enterprise. For example, in California, co-operatives, with the exception of banks and mutual insurance companies, are subject either to the Bank and Corporation Franchise Tax or the Corporation Net Income Tax. However, in actual practice in California such co-operatives pay only a minimum annual tax of \$25 under the Franchise Tax, and they may pay no net income taxes since they are allowed to deduct from gross income all of their income arising from business carried on with members. However, co-operative earnings distributed to members or patrons in California are subject to taxation in the hands of the individual taxpayers under the personal income tax laws.

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<sup>1</sup> California, Connecticut, Delaware, Massachusetts, Minnesota, New Jersey, New York, Ohio, West Virginia, and Wisconsin.

In most of the states examined, co-operatives are exempt from capital stock taxes. Only two states, Massachusetts and Pennsylvania, levy such capital stock taxes on co-operatives. Massachusetts levies capital stock taxes only upon agricultural co-operatives with stock, and Pennsylvania levies such a tax upon co-operative telephone companies in the event such enterprises are incorporated and also on co-operatives incorporated under the Act of 1887. However, most of the co-operative telephone companies in Pennsylvania are unincorporated units and are very small in terms of capital and volume of business; hence, this tax is very insignificant as a revenue producer from co-operatives, especially in Pennsylvania.

The facts reveal that there is little use of the net income tax in these states. California and Pennsylvania are the only two states in this group imposing a net income tax upon co-operatives. Under the California laws, it was pointed out, co-operatives are allowed a deduction from gross income of all business carried on with members; consequently the co-operatives in most cases have no taxable income to report.

The General Assembly of Pennsylvania at the 1945 Session imposed a Co-operative Agricultural Net Income Tax.<sup>1</sup> This tax applies to two types of co-operatives in Pennsylvania, agricultural co-operatives with capital stock and agricultural credit associations with capital stock. This act does not apply to co-operatives not having capital stock.

There is a greater use of gross receipts taxes than net income taxes with respect to co-operatives in the states in this group. For example, four states impose gross receipts taxes upon rural electric co-operatives, and six states make use of gross receipts (or premiums) taxes on mutual insurance companies. However, only one or two states impose gross receipts taxes on the other types of co-operatives.

Franchise taxes are imposed on agricultural co-operatives with stock in four states: California, Massachusetts, New Jersey, and New York. Only two states impose such taxes upon agricultural co-operatives without stock; rural electric co-operatives, and mutual insurance companies. Three states impose such taxes upon agricultural credit co-operatives and credit unions (with state charters), and co-operative

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<sup>1</sup> Act Number 360, May 23, 1945.

water co-operatives. Four states levy franchise taxes upon co-operative telephone companies: California, New Jersey, New York, and West Virginia. It should be remembered, however, that in some states the franchise taxes result in a very nominal annual tax burden, such as \$25 per year in California.

In the matter of real property taxation five states, Massachusetts, Minnesota, Ohio, West Virginia, and Wisconsin impose such a tax on the properties of agricultural co-operatives of all types. Four states impose such taxes on co-operative agricultural credit associations, credit unions, mutual insurance companies, and co-operative water companies. Three of the states in this group, Minnesota, Ohio, and West Virginia impose property taxes on rural electric co-operatives. Two states tax the real properties of co-operative telephone companies.

Although the taxation of specific co-operatives in certain states is still somewhat unsettled with respect to the application of unemployment compensation taxes, it appears that there is greater uniformity in the use of this tax than any other tax in this group of states. For example, Pennsylvania is the only state in the group which has exempted credit unions and rural electric co-operatives from this tax. The exemption of these two types of co-operatives is the result of a decision of the Pennsylvania Supreme Court June 29, 1945, in the case of *The Department of Labor and Industry, Commonwealth of Pennsylvania v. New Enterprise Rural Electric Co-operative, Inc.* The Court held that the unemployment compensation tax was a tax within the meaning of the incorporation act affecting these co-operatives, and since the incorporation act creating rural electric co-operatives (Act of June 21, 1937, P. L. 1969) specifically exempted such co-operatives from all State taxes, it ruled that they were thus exempt from the unemployment compensation tax. The opinion of the Court in this case can be construed, in the opinion of counsel, to include credit unions, since their incorporation act also exempts them from all types of State taxation.

In the matter of sales taxation, three states in this group, California, Ohio, and West Virginia, impose such a tax. All three states impose a sales tax on commodities sold by co-operative agricultural associations of the buying and selling type. Sales taxes are imposed to a lesser extent by these states on the other types of co-operatives.



The situation with respect to the application of sales taxes to co-operatives is still an unsettled matter in a number of states, as will be explained later in this discussion.

The practice with respect to the state taxation of dividends and patronage refunds paid to stockholders and patrons is generally to tax these earnings so distributed in the hands of the individual taxpayers under a personal income tax. This method is in use in four states in this group: California, Massachusetts, Minnesota and Wisconsin. The method of state taxation of such co-operative earnings in the hands of the individual taxpayers follows the practice of the U. S. Bureau of Internal Revenue which has been in effect for several decades.

In the matter of "other taxes," these generally take the forms of various types of business licenses and fees for the privilege of engaging in business. Some of these taxes are exactly the same as those paid by ordinary business corporations, such as dealers' licenses for the sale of commodities such as cigarettes and liquor; some of these licenses apply specifically to certain co-operative enterprises, such as those levied by a number of states on rural electric co-operatives at the rate of \$10 per 100 members per year, as is the case in Pennsylvania. Approximately one-half of the states studied in this group make use of business license taxes on co-operatives, but in most cases such taxes are very nominal in amount, and therefore, do not place a great burden on co-operatives subject to these taxes.

## **B. TAXATION OF CO-OPERATIVES IN OTHER STATES**

There are at present no comprehensive statistics on the subject of the state taxation of co-operative enterprises. However, a few studies have been made in recent years with respect to the application of some specific taxes to certain types of co-operatives. For example, a few studies have considered the application of state income taxes to all types of co-operatives, and others have considered the application of real property taxes and state sales taxes to rural electric co-operatives.

The most comprehensive study of the application of state income taxes to all types of co-operatives was one published by the United States Bureau of the Census in 1939. In regard to income tax liability

TABLE 11

TYPES OF STATE TAXES IMPOSED UPON CO-OPERATIVE AGRICULTURAL ASSOCIATIONS  
WITH STOCK IN SELECTED STATES, 1945

## Types of State Taxes

States	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>8</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes
California .....	No	Yes <sup>6</sup>	No	Yes <sup>5</sup>	... <sup>1</sup>	Yes	Yes	No	No	Yes
Connecticut .....	... <sup>1</sup>	... <sup>4</sup>	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	No	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	None
Delaware <sup>2</sup> .....	...	...	...	...	...	No	... <sup>1</sup>	...	...	...
Massachusetts .....	Yes	No	Yes	Yes	Yes	Yes	... <sup>1</sup>	Yes	No	Yes
Minnesota .....	... <sup>1</sup>	No	No	No	Yes	... <sup>7</sup>	... <sup>1</sup>	No	No	None
New Jersey .....	... <sup>1</sup>	... <sup>1</sup>	No	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None
New York .....	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	Yes
Ohio .....	... <sup>1</sup>	... <sup>1</sup>	No	No	Yes	Yes	Yes	No	No	Yes
West Virginia .....	No	No	Yes <sup>3</sup>	No	Yes	Yes	Yes	No	No	No
Wisconsin .....	... <sup>1</sup>	No	No	... <sup>1</sup>	Yes	Yes	... <sup>1</sup>	No	No	Business Licenses paid by all units
Pennsylvania .....	No	Yes	No	No	No	No <sup>9</sup>	... <sup>1</sup>	No	No	No

<sup>1</sup> Not used in the State.

<sup>2</sup> Exempt from all State taxes by statute.

<sup>3</sup> Actually on occupations.

<sup>4</sup> Exempt by statute.

<sup>6</sup> Engaging in intrastate business only.

<sup>6</sup> Engaging in interstate business within California and if an unincorporated association. Liberal deductions allowed.

<sup>7</sup> Follows Federal exemptions.

<sup>8</sup> In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor, as construed by the proper agency, would likely be exempt.

<sup>9</sup> It would appear that co-operatives of this type are exempt as to such employees performing services incident to farming operations, and under certain conditions. (See Unemployment Compensation Law and cases.)

TABLE 12

TYPES OF STATE TAXES IMPOSED UPON CO-OPERATIVE AGRICULTURAL ASSOCIATIONS  
WITHOUT STOCK IN SELECTED STATES, 1945

Types of State Taxes

States	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>7</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes
California	No	Yes <sup>5</sup>	No	Yes <sup>4</sup>	... <sup>1</sup>	Yes	Yes	No	No	Yes
Connecticut	... <sup>1</sup>	... <sup>3</sup>	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	No	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	None
Delaware	No	No	No	No	No	Yes	No	No	No	No
Massachusetts	No	No	No	No	Yes	Yes	... <sup>1</sup>	Yes	No	Yes
Minnesota	... <sup>1</sup>	No	No	No	Yes	... <sup>6</sup>	... <sup>1</sup>	No	No	None
New Jersey	... <sup>1</sup>	... <sup>1</sup>	No	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None
New York	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	No	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	Yes
Ohio	... <sup>1</sup>	... <sup>1</sup>	No	No	Yes	Yes	Yes	No	No	Yes
West Virginia	No	No	Yes <sup>2</sup>	No	Yes	Yes	Yes	No	No	No
Wisconsin	... <sup>1</sup>	No	No	... <sup>1</sup>	Yes	Yes	... <sup>1</sup>	No	No	Business Licenses paid by all units No
Pennsylvania	No	No	No	No	No	No <sup>8</sup>	... <sup>1</sup>	No	No	No

<sup>1</sup> Not used in the States.

<sup>2</sup> Actually on occupations.

<sup>3</sup> Exempt by statute.

<sup>4</sup> Engaging in intrastate business only.

<sup>5</sup> Engaging in interstate business within California, or if an unincorporated association. Liberal deductions allowed.

<sup>6</sup> Follows Federal exemptions.

<sup>7</sup> In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor, as construed by the proper agency, would likely be exempt.

<sup>8</sup> It would appear that co-operatives of this type are exempt as to such employees performing services incident to farming operations, and under certain conditions. (See Unemployment Compensation Law and cases.)

TABLE 13

TYPES OF STATE TAXES IMPOSED UPON CO-OPERATIVE AGRICULTURAL CREDIT ASSOCIATIONS IN SELECTED STATES, 1945

Types of State Taxes

States	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>8</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes
California	No	Yes <sup>5</sup>	No	Yes <sup>4</sup>	... <sup>1</sup>	Yes	Yes	No	No	Yes
Connecticut	... <sup>1</sup>	... <sup>3</sup>	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	No	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	None
Delaware	No	No	No	No	No	Yes	No	No	No	No
Massachusetts <sup>2</sup>	...	...	...	...	...	...	...	...	...	...
Minnesota	... <sup>1</sup>	No	No	No	Yes	... <sup>6</sup>	... <sup>1</sup>	No	No	None
New Jersey	... <sup>1</sup>	... <sup>1</sup>	No	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None
New York	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	Yes
Ohio	... <sup>1</sup>	... <sup>1</sup>	No	No	Yes	Yes	Yes	No	No	Yes
West Virginia	No	No	No	No	Yes	Yes	Yes	No	No	No
Wisconsin	... <sup>1</sup>	No	No	... <sup>1</sup>	Yes	Yes	... <sup>1</sup>	No	No	Business Licenses paid by all units
Pennsylvania	No	Yes	No <sup>7</sup>	No	No	Yes	... <sup>1</sup>	No	No	No

<sup>1</sup> Not used in the State.

<sup>2</sup> Not chartered in the State.

<sup>3</sup> Exempt by statute.

<sup>4</sup> Engaging in intrastate business only.

<sup>5</sup> Engaging in interstate business within California, or if an unincorporated association. Liberal deductions allowed.

<sup>6</sup> Follows Federal exemptions.

<sup>7</sup> Net earnings tax of 1889 is not applicable to any co-operative agricultural association under the provisions of Act No. 365, May 23, 1945.

<sup>8</sup> In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor, as construed by the proper agency, would likely be exempt.

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TABLE 14

TYPES OF STATE TAXES IMPOSED UPON CREDIT UNIONS (STATE CHARTERS)  
IN SELECTED STATES, 1945

Types of State Taxes

States	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>9</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes
California .....	No	Yes <sup>6</sup>	No	Yes <sup>5</sup>	... <sup>1</sup>	Yes	Yes	No	No	Yes
Connecticut <sup>4</sup> .....	...	...	...	...	...	...	...	...	...	...
Delaware .....	No	No	No	Yes	No	Yes	No	No	No	No
Massachusetts <sup>8</sup> .....	...	...	...	...	...	...	...	...	...	...
Minnesota .....	... <sup>1</sup>	No	No	No	Yes	... <sup>7</sup>	... <sup>1</sup>	No	No	None
New Jersey .....	... <sup>1</sup>	... <sup>1</sup>	No	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None
New York .....	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	No	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	Yes
Ohio .....	... <sup>1</sup>	... <sup>1</sup>	No	... <sup>3</sup>	Yes	Yes	Yes	No	No	No
West Virginia .....	No	No	Yes <sup>2</sup>	No	Yes	Yes	No	No	No	No
Wisconsin .....	... <sup>1</sup>	No	No	... <sup>1</sup>	Yes	Yes	... <sup>1</sup>	No	No	Business Licenses paid by all units
Pennsylvania .....	No	No	No	No	No	No	... <sup>1</sup>	No	No	No

<sup>1</sup> Not used in the State.

<sup>2</sup> Actually on occupations.

<sup>3</sup> A tax is levied with "invested capital" as the base.

<sup>4</sup> At present not chartered in State.

<sup>5</sup> Engaged in intrastate business only.

<sup>6</sup> Engaged in interstate business within California, or if unincorporated association. Liberal deductions allowed.

<sup>7</sup> Follows Federal exemptions.

<sup>8</sup> Taxable only locally on personal property.

<sup>9</sup> In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor, as construed by the proper agency, would likely be exempt.



TABLE 15

**TYPES OF STATE TAXES IMPOSED UPON RURAL ELECTRIC CO-OPERATIVES  
IN SELECTED STATES**

**Types of State Taxes**

States	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>5</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes
California .....	No	Yes <sup>5</sup>	No	Yes <sup>4</sup>	... <sup>1</sup>	Yes	Yes	No	No	Yes
Connecticut <sup>2</sup> .....	...	...	...	...	...	...	...	...	...	...
Delaware .....	No	No	Yes	No	No	Yes	No	No	No	No
Massachusetts <sup>2</sup> .....	...	...	...	...	...	...	...	...	...	...
Minnesota .....	... <sup>1</sup>	No	No	No	Yes	... <sup>6</sup>	... <sup>1</sup>	No	No	Privilege Tax \$10 per 100 members
New Jersey .....	... <sup>1</sup>	... <sup>1</sup>	Yes	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None
New York .....	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	No	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	Yes
Ohio .....	... <sup>1</sup>	... <sup>1</sup>	No	No	Yes	Yes	Yes	No	No	No
West Virginia .....	No	No	Yes <sup>3</sup>	No	Yes	Yes	No	No	No	No
Wisconsin .....	... <sup>1</sup>	No	Yes	... <sup>1</sup>	No	Yes	... <sup>1</sup>	No	No	Business Licenses paid by all units
Pennsylvania .....	No	No	No	No	No	No	... <sup>1</sup>	No	No	Yes <sup>7</sup>

<sup>1</sup> Not used in State.

<sup>2</sup> Not chartered in State.

<sup>3</sup> Actually on occupations.

<sup>4</sup> Engaged in intrastate business only.

<sup>5</sup> Engaged in interstate business within California or, if unincorporated association. Liberal deductions allowed.

<sup>6</sup> Follows Federal exemptions.

<sup>7</sup> Annual license fee of \$10 per 100 members.

<sup>8</sup> In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor, as construed by the proper agency, would likely be exempt.

TABLE 16

TYPES OF STATE TAXES IMPOSED UPON MUTUAL INSURANCE COMPANIES  
IN SELECTED STATES, 1945

Types of State Taxes

States	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>5</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes
California .....	No	No	Yes <sup>2</sup>	No	... <sup>1</sup>	Yes	Yes	No	No	Yes
Connecticut .....	No	No	Yes <sup>2</sup>	No	... <sup>1</sup>	No	No	Yes <sup>4</sup>	No	None
Delaware .....	No	No	Yes <sup>2</sup>	No	No	Yes	No	No	No	No
Massachusetts .....	No	No	No	Yes	Yes	Yes	... <sup>1</sup>	Yes	No	Yes
Minnesota .....	... <sup>1</sup>	No	No	No	Yes	... <sup>3</sup>	... <sup>1</sup>	No	No	None
New Jersey .....	... <sup>1</sup>	... <sup>1</sup>	Yes <sup>2</sup>	No	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None
New York .....	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	Yes
Ohio .....	... <sup>1</sup>	... <sup>1</sup>	Yes <sup>2</sup>	No	Yes	Yes	No	No	No	No
West Virginia .....	No	No	No	No	Yes	Yes	No	No	No	Yes
Wisconsin .....	... <sup>1</sup>	No	Yes	... <sup>1</sup>	No	Yes	... <sup>1</sup>	No	No	Business Licenses paid by all units
Pennsylvania .....	No	No	No	No	No	Yes	... <sup>1</sup>	No	No	No

<sup>1</sup> Not used in State.

<sup>2</sup> Premiums used as base.

<sup>3</sup> Follows Federal exemptions.

<sup>4</sup> This tax is imposed on the company.

<sup>5</sup> In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor, as construed by the proper agency, would likely be exempt.

TABLE 17

TYPES OF STATE TAXES IMPOSED UPON CO-OPERATIVE TELEPHONE COMPANIES  
IN SELECTED STATES, 1945

Types of State Taxes

States	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>9</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes
California .....	No	Yes <sup>5</sup>	No	Yes <sup>4</sup>	... <sup>1</sup>	Yes	Yes	No	No	Yes
Connecticut <sup>2</sup> .....	...	...	...	...	...	...	...	...	...	...
Delaware <sup>3</sup> .....	No	No	No	No	No	Yes	No	No	No	No
Massachusetts <sup>2</sup> .....	...	...	...	...	...	...	...	...	...	...
Minnesota .....	... <sup>1</sup>	No	Yes	No	No	... <sup>6</sup>	... <sup>1</sup>	No	No	None
New Jersey .....	... <sup>1</sup>	... <sup>1</sup>	No	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None
New York .....	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	Yes
Ohio .....	... <sup>1</sup>	... <sup>1</sup>	No	No	Yes	Yes	Yes	No	No	No
West Virginia .....	No	No	No	Yes	Yes	Yes	No	No	No	No
Wisconsin .....	... <sup>1</sup>	No	Yes	... <sup>1</sup>	No	Yes	... <sup>1</sup>	No	No	Business Licenses paid by all units
Pennsylvania .....	Yes <sup>7</sup>	No	Yes <sup>7,8</sup>	No	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None

<sup>1</sup> Not used in the State.

<sup>2</sup> Not chartered in the State.

<sup>3</sup> Taxes imposed on lines of wire and transmitters.

<sup>4</sup> Engaged in intrastate business only.

<sup>5</sup> Engaged in interstate business within California, or if unincorporated association. Liberal deductions allowed.

<sup>6</sup> Follows Federal exemptions.

<sup>7</sup> If incorporated.

<sup>8</sup> If unincorporated, subject to net earnings tax of 1889.

<sup>9</sup> In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor, as construed by the proper agency, would likely be exempt.

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TABLE 18

TYPES OF STATE TAXES IMPOSED UPON CO-OPERATIVE WATER COMPANIES  
IN SELECTED STATES, 1945

Types of State Taxes

States	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>8</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes
California	No	Yes <sup>5</sup>	No	Yes <sup>4</sup>	... <sup>1</sup>	Yes	Yes	No	No	Yes
Connecticut <sup>2</sup>	...	...	...	...	...	...	...	...	...	...
Delaware	No	No	No	No	No	Yes	No	No	No	No
Massachusetts <sup>2</sup>	...	...	...	...	...	...	...	...	...	...
Minnesota	... <sup>1</sup>	Yes	No	No	Yes	... <sup>6</sup>	... <sup>1</sup>	No	No	None
New Jersey	... <sup>1</sup>	... <sup>1</sup>	No	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	None
New York	... <sup>1</sup>	... <sup>1</sup>	... <sup>1</sup>	Yes	... <sup>1</sup>	Yes	... <sup>1</sup>	No	No	Yes
Ohio	... <sup>1</sup>	... <sup>1</sup>	No	No	Yes	Yes	Yes	No	No	No
West Virginia	No	No	Yes <sup>3</sup>	No	Yes	Yes	No	No	No	No
Wisconsin	... <sup>1</sup>	No	No	... <sup>1</sup>	Yes	Yes	... <sup>1</sup>	No	No	Business Licenses paid by all units
Pennsylvania <sup>7</sup>	...	...	...	...	...	...	...	...	...	...

<sup>1</sup> Not used in the State.

<sup>2</sup> Not chartered in the State.

<sup>3</sup> Actually on occupations.

<sup>4</sup> Engaged in intrastate business only.

<sup>5</sup> Engaged in interstate business within California, or if unincorporated association. Liberal deductions allowed.

<sup>6</sup> Follows Federal exemptions.

<sup>7</sup> Records indicate there is only one such company in operation in the State.

<sup>8</sup> In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor, as construed by the proper agency, would likely be exempt.

TABLE 19

A SUMMARY OF STATE TAXES IMPOSED ON CO-OPERATIVE BUSINESS ENTERPRISES  
IN PENNSYLVANIA AND TEN SELECTED STATES,<sup>1</sup> 1945

(Number of States Imposing Specific State Taxes)

Types of State Taxes

Types of Co-operative Enterprises	Capital Stock Taxes	Net Income Taxes	Gross Receipts Taxes	Annual Franchise Taxes	Real Property Taxes	Unemployment Compensation Taxes <sup>2</sup>	Retail Sales Taxes	Taxes on Dividends Paid to Shareholders	Taxes on Patronage Refunds Paid to Patrons	Other Taxes Primarily Business Licenses
Co-operative Agricultural Associations with Stock	1	2	2	4	5	7	3	1	0	5
Co-operative Agricultural Associations without Stock	0	1	1	2	5	8	3	1	0	5
Co-operative Agricultural Credit Associations	0	2	0	3	4	8	3	0	0	4
Credit Unions (with state charters)	0	1	1	3	4	8	2	0	0	3
Rural Electric Co-operatives	0	1	4	2	3	7	2	0	0	5
Mutual Insurance Companies	0	0	6	2	4	9	1	2	0	5
Co-operative Telephone Companies	1	1	3	4	2	8	2	0	0	3
Co-operative Water Companies	0	2	1	3	4	7	2	0	0	3

<sup>1</sup>These States are: California, Connecticut, Delaware, Massachusetts, Minnesota, New Jersey, New York, Ohio, West Virginia, and Wisconsin.

NOTE: This Table is an analysis of comparative State tax tables 11 through 18.

<sup>2</sup>In states where services performed for co-operatives are not exempt from unemployment compensation taxes, it is possible that services performed in agricultural labor as construed by the proper agency, would likely be exempt.



of co-operatives in the various states, the bureau reported the following:<sup>1</sup>

In 1939, 34 states and the District of Columbia had either straight corporation income-tax laws or laws providing for business-privilege taxes measured by net income. Of these, 27 provided for a flat rate on all net income; these rates ranged in the various states from 11½ percent in Maryland to 8 percent in Oregon. No rate was set in New Hampshire, where the law set the "same rate as on other property." In the other 7 states a progressive rate schedule was used. The laws of New Hampshire and Ohio provide for no exceptions which would affect co-operatives. In only Wisconsin are consumers' co-operatives exempt from the income tax, and New Mexico and Wisconsin are the only states whose consumers' co-operative laws contain any provisions regarding taxation. The Wisconsin laws exempt all domestic co-operative associations. The new consumers' co-operative act in New Mexico imposes an annual license fee of \$5 in addition to the income tax. Credit unions receive exemptions in the six states of Colorado, Iowa, Massachusetts, Minnesota, Oregon, and Virginia. The most common tax exemption is that of building and loan associations, found in the laws of 25 states. . . . Co-operative banks are exempt in Iowa; and co-operative banks without capital stock in 7 states. Mutual ditch or irrigation companies are excused from payment of income taxes in 14 states. Farmers' or other mutual insurance companies or associations writing specified types of insurance receive income tax exemptions in 15 states; generally these include hail, cyclone, and fire insurance, but a few states also include life (Oregon), casualty (Colorado, Idaho, Kansas, Louisiana, Maryland, Utah), crop (Kansas), or wind-storm (Kentucky). All kinds of mutual insurance is exempted in Arkansas, Pennsylvania, South Dakota and Vermont, and all farmers' mutual insurance in Minnesota. Mutual telephone companies are exempt from income taxes in Idaho, co-operative or mutual rural telephone companies in Minnesota, and both mutual and co-operative organizations in 12 states. "Like organizations" are also exempted in Louisiana. In addition to the farmers' mutual associations, various other types of farmers' associations are exempt from income taxes. The laws of 18 states excuse "farmers, fruit growers, or like organizations," but Missouri specifies that they cannot be operated for profit. Arkansas, Georgia,

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<sup>1</sup> U. S. Bureau of the Census, Digest of State Laws Relating to Net Income Taxes, 1938, and 1939 Supplement, quoted in Bulletin of U. S. Bureau of Labor Statistics, Serial No. R.1062, p. 1.

Iowa, North Dakota, Oregon, South Carolina, and Utah exempt only those acting as sales agents for the marketing of members' products, but Georgia and Oregon further require that the proceeds must be returned to the producers on the basis of quantity supplied (Utah on the basis of either quantity or value). These associations must be on a co-operative basis in California ("in whole or in part"), Colorado, Idaho, Kansas, Louisiana, and New York. Arizona and Wisconsin exempt all co-operative associations marketing farm products for producers. Wisconsin exempts, in addition to the associations marketing farm products for producers, those processing farm products for a co-operative association and charging therefor not more than enough to pay expenses plus not to exceed 8 percent on capital stock and 5 percent for surplus. The Minnesota law now exempts farmers' co-operatives purchasing supplies and equipment. The Montana law provides exemptions for "labor, agricultural, or horticultural associations" operating on a co-operative basis and according to certain prescribed conditions. The Utah law provides similar exemptions, but specifies a maximum rate of interest on capital stock of 8 percent. Louisiana and Oregon exempt any organization organized by an exempt association or its members to finance ordinary co-operative operations. Rural electric co-operatives are specifically exempt from income taxes in Montana and Tennessee. The Tennessee law taxes corporations and "co-operatives conducted for profit . . . other than those organized for general welfare and not for profit."

## **RURAL ELECTRIC CO-OPERATIVES AND REAL PROPERTY TAXATION**

As a general rule, all types of co-operatives pay the same real property taxes as are levied upon regular business enterprises by states and local governments. However, there is one important exception to this general rule. Rural electric co-operatives, because of their peculiar nature and operations, have been relieved from real property taxes in a significant number of states. There are several reasons for these property tax exemptions for rural electric co-operatives. First, the laws of many states regard such co-operatives as non-profit enterprises; therefore, they are excused from real property taxation on that ground. Second, some states consider rural electric co-operatives as closely related to Federal agencies because of the fact that their properties and revenues are pledged to the Rural Electrification Administration for

payment of loans advanced by this Federal agency. Therefore, some states excuse such co-operatives from property taxes on this basis. Third, some states have substituted net income or gross receipts or even privilege taxes in lieu of property taxes. Fourth, a few states consider rural electric co-operatives as a special class of "municipal units" or "power authorities," and thus excuse them from payment of property taxes on the ground that they are actually special types of government enterprises. However, there is no real uniformity in the treatment of such co-operatives with respect to payment of property taxes. It is the purpose of this section to set forth the practices at present followed in a number of states for which information is available.

Although the practices with respect to the use of property tax exemptions are not uniform in the various states, it is interesting to note that the United States Supreme Court has upheld property tax exemptions for the benefit of co-operative telephone companies, and it is probable that the Court would hold a similar view with respect to co-operative electric enterprises, since these latter units operate in the same manner as co-operative telephone companies. With respect to property tax exemptions for co-operative telephone companies, the Court said: <sup>1</sup>

"It has a reasonable basis, resting on a real distinction. It is not a distinction based on mere size only, as contended by appellant, nor upon the mere amount of business done. There is a difference in the doing of business and its results; a difference in the relation to the public . . . The use of the untaxed property, as pointed out by the District Court is predominately private, while the use of the taxed property is correspondingly public; the exempt property is used for the personal convenience of the owners, while the taxed property represents commercial investment for profit making purposes."

It should also be noted that the Legislature has the power to classify co-operatives for tax purposes; it may impose a tax upon ordinary corporations, and may exempt co-operatives; it may also tax one kind of co-operative and exempt another kind of co-operative. In Pennsylvania the Supreme Court upheld such classification and exemp-

<sup>1</sup> Citizens' Telephone Co. v. Fuller, 220 U. S. 322, 332, 33 S. Ct. 837, 57 L. ed. 1215 (1913).



tion of certain types of co-operatives (mutual insurance companies) with respect to the gross premiums tax and the personal property tax.<sup>1</sup>

Although property tax exemptions for rural electric co-operatives have been upheld in a number of states, such was not the case in Kentucky. In this state, the Court of Appeals held that the provision of the Kentucky Rural Electric Co-operative Act which purported to exempt Rural Electric Co-operatives from property taxes was invalid as in conflict with the State Constitution. In contrast, the Iowa Supreme Court held that REA co-operatives were not operated for profit and their property was not subject to assessment by the State Tax Commission. It had been contended that the co-operatives should be taxed on the same basis as private utilities operated for profit. The Court's decision had the effect of nullifying an assessment made by the Tax Commission which would have resulted in very substantial and burdensome taxes for the co-operatives.

The statistics presented in Table 20 indicate the specific tax exemptions granted rural electric co-operatives in 26 states in 1945. In 21 of these states the legislatures have granted real or personal property tax exemptions. In some states the legislatures have imposed gross receipts taxes or special business privilege taxes in lieu of real or personal property taxes.

The Rural Electrification Administration has reported that the real property tax and its administration constitute the most important tax problem facing the rural electric co-operatives. This is because the assessments of their properties vary widely among the several states, and even among sections of a single state. Where these co-operatives are subject to state taxation, they have contended that earning power, rather than construction cost should be the chief criterion for purposes of taxation. This is because of two conditions. First, extensive rural electric systems in their early years must necessarily show a low earning power as compared with similar enterprises in urban areas or in the best rural territory. Second, these co-operatives have a large investment in proportion to earning power. Therefore, any tax measured upon earnings is more acceptable than one based upon property valuations.

<sup>1</sup> See: *Commonwealth v. Girard Life Ins. Co.* 305 Pa. 558, 158 Atl. 262, (1932). *Commonwealth v. Threshermen & Farmers' Mut. Casualty Ins. Co.*, 339 Pa. 62, 14 A (2d) 295, (1940).

**TABLE 20**  
**STATUTORY AND CONSTITUTIONAL TAX EXEMPTIONS AFFECTING RURAL ELECTRIC CO-OPERATIVES, 1945**<sup>1</sup>

<i>Georgia</i>	A 1941 constitutional amendment grants exemption to REA co-operatives and their properties for a period of twenty years from January 1, 1942. (Ga. Const., Art. 7, sec. 2, par. 2.) The exemption is from "all" taxes and hence includes both property and license taxes.
<i>Louisiana</i>	A 1942 constitutional amendment grants REA co-operatives a twenty-five year exemption from ad valorem taxation on transmission and distribution lines. (La. Const., Art. X, sec. 4, par. 14.)
<i>Minnesota</i>	REA co-operatives pay a tax of \$10 per 100 members in lieu of all personal property taxes upon distribution lines. (Minn. Stats. (Mason's 1940 Supp.) secs. 2012-4, 5, 6.) An income tax exemption has also been enacted.
<i>Mississippi</i>	REA co-operatives are exempt from taxation on all physical property used or useful in the distribution of electric current. (Miss. Code Ann. (1942) sec. 9700.) They are also exempt from all privilege, sales and gross income taxes.
<i>Montana</i>	A statute provides that the property of REA co-operatives shall be assessed at 7% of its true and full value. (Mont. Laws 1941, c. 107 and Rev. Code (1935) sec. 2000.)
<i>Nebraska</i>	REA borrowers are organized under a statute which declares them to be political subdivisions of the state and in such capacity they are exempt from all taxes. (Neb. Rev. Stat. Ann. (1943) sec. 70-601 et seq.)
<i>Nevada</i>	REA borrowers are organized under a statute which gives them the status of municipal corporations and as such they are exempt from state taxes. (Nev. Comp. Laws (1931-1941 Supp.) sec. 5180.04.)
<i>New Mexico</i>	The law under which rural electric co-operatives are organized exempts them from all state taxes upon the payment of a tax of \$10 for each 100 members. N. Mex. Stat. Ann. (1941) sec. 48-428.)
<i>North Carolina</i>	REA borrowers are organized under a statute which declares them to be agencies of the state and they are thereby exempt from state taxation. N. C. Gen. Stat. Ann. (1943) sec. 117-19).
<i>North Dakota</i>	In lieu of personal property taxes rural electric co-operatives are subject to a gross receipts tax of 1% during the first five years of operation and 2% thereafter. N. D. Rev. Code (1943) sec. 57-3301 et seq.)
<i>Ohio</i>	A statute provides that property of REA co-operatives shall be assessed at 50% of its true value. (Ohio Code Ann. (Baldwin's Supp. 1940-1945) sec. 5388-5.)
<i>Oklahoma</i>	At the 1943 session of the legislature a law was enacted which imposes a 2% gross receipts tax on rural electric co-operatives in lieu of all other property taxes. (Okla. Laws 1943, c. 20a.)

<sup>1</sup> Source: U. S. Rural Electrification Administration, Annual Reports, 1937-1944.



- Oregon* In 1943 the legislature enacted a law which imposes a 2% gross revenue tax in lieu of all other taxes on the distribution and transmission lines owned by rural electric co-operatives. (O.C.L.A. (Supp. 1943) sec. 110-515a, b & c.)
- Pennsylvania* The statute under which rural electric co-operatives are organized exempts them from all state taxes upon the payment of a fee of \$10 for each 100 members. (14 Purdon Pa. Stats. (1938) sec. 281.)
- South Carolina* At the 1941 session of the legislature a law was enacted exempting property of rural electric co-operatives from ad valorem taxation for a period of five years. (S. C. Code (1942) sec. 2578 (61.)) In 1945 the exemption was extended for five years from June 11, 1946. (Acts 1945, Gov. No. 160, eff. 3-29-45.)
- South Dakota* In 1941 the legislature enacted a law imposing a 2% gross receipts tax on rural electric co-operatives in lieu of personal property taxes. (S. D. Laws 1941, c. 363.)
- Tennessee* In 1945 the legislature passed a law providing that all facilities and plants constructed after January 1, 1945 shall be exempt from ad valorem property taxes for a period of four years after the date of their construction. (P. A. 1945, c. 157, appd. and eff. 3-2-45.)
- Utah* A statute provides that the property of rural electric co-operatives shall be assessed at no more than \$50 per mile of primary distribution lines. (Utah Code Ann. (1943) sec. 18-6-16.)
- Wisconsin* In lieu of all general property taxes rural electric co-operatives are subject to a 3% gross receipts tax. (Wis. Stat. 1943, sec. 76.48.)
- Wyoming* By statute enacted in 1943, rural electric co-operatives have been accorded exemption from the ad valorem tax for a period of six years. (Wyo. Laws 1943, c. 37 amending Wyo. Laws 1939, c. 44, sec. 1.)
- Arkansas* Act 414, 1941, amending Sec. 30 of Act 342 of 1937 exempts REA co-operatives from property taxes in improvement districts.
- Iowa* Under the laws of 1941, Chap. 248, REA co-operatives are exempted from ad valorem property taxes for the calendar years 1941 and 1942. The Supreme Court held that REA co-operatives were not operated for profit and their property was not subject to assessment by the State Tax Commission.
- West Virginia* Chapman v. Huntington Housing Authority, 3 S. E. (2d) 502 decided by the Supreme Court of Appeals of West Virginia on June 13, 1939, contains a dictum which indicates that REA co-operatives are exempt from the ad valorem property tax because the Federal Government has a lien upon their property to secure loans made through REA. The Court said "Generally, the state or its municipalities cannot assess for local improvements property belonging to the Federal Government." This rule has been held to apply to property upon which the U. S. has a lien securing a debt due to it. Copp et al v. State of West Virginia, 69 W. Va. 439, 71 S. E., 580, 35 L. R. A. (NS) 669.
- Connecticut* Substituted a fee of \$10 per 100 members for excise and income taxes.
- Virginia* Counties may grant property tax exemptions for a period of 5 years.
- New York* Exempts REA co-operatives from all franchise, excise, income and incorporation taxes.

In states where rural electric co-operatives are subject to state and local property taxes, the co-operatives have attempted to reduce their tax burdens by obtaining limitations on the assessments of their properties. For example, Ohio and Utah have enacted limitations on assessments of rural electric properties, and Montana has limited the assessed value of such properties to 7 percent of the actual value of such properties. Arkansas has a provision which exempts rural electric co-operatives from special assessments. Although the transmission and distribution lines of rural electric co-operatives in Louisiana are exempt from all taxes for 25 years under a constitutional amendment, their other property is subject to taxation. The taxable property is valued under a section of the state law that it shall be assessed at 10 percent of actual value, but the attorney general of the State has taken the position that this law is unconstitutional. In order to obtain a reduction in their assessed valuations, the rural electric co-operatives have taken their valuations to the courts for review, and in a number of states have succeeded in having them reduced considerably. In a suit against rural electric co-operatives in Illinois to collect property taxes, an Illinois county court upheld the contention of the co-operatives that assessments on their property had been excessive, and reduced such assessments, ranging from \$198 to \$1,124 per mile, to \$50 per mile. These co-operatives have succeeded in obtaining reductions in their assessed valuations in Kansas, Michigan, Oklahoma, West Virginia, and Illinois. In Alabama, Arkansas, Indiana, Maryland, Ohio, Tennessee, and Texas, the co-operatives have had their assessments reduced or have thwarted attempts at increasing such valuations.

The Rural Electrification Administration has summarized the attempts of the co-operatives to obtain a reduction or limitation of their assessed valuations as follows:<sup>1</sup>

“In Arkansas and Colorado, assessments for 1940 have been based on 10 percent of construction cost. In Georgia, REA co-operatives have been assessed on the basis of 10 percent of actual construction cost, after excluding overhead items, or by capitalizing ‘net operating income’ at 9 percent and taking the greater figure. In Illinois, recommendations have been made by the State Tax Commission to local boards of review that REA lines be given a fair cash value of not less than \$100 a mile—with some exceptions. This value must then be equalized at the same percentage

<sup>1</sup> U. S. Rural Electrification Administration, Annual Reports, 1937-1944.

as is applied to other property in the tax district, resulting normally in tax values of approximately \$50 per mile. In Indiana, the State Tax Board has been assessing the property of REA co-operatives on the basis of \$50 per mile. In Oklahoma, 1939 assessments fixed by the Tax Commission ranged from \$275 to \$300 per mile. Reductions made in 1940 bring the valuations down to an average of approximately \$200 per pole mile. In Texas, valuations show a very wide range, with most assessments below \$150 per mile. The instances enumerated, chosen from different parts of the country, are typical of the present tax situation in about half the States. Arkansas, Georgia, Iowa, Kentucky, Louisiana, Maryland, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, North Dakota, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Washington, Wisconsin, and Wyoming have statutory enactments affecting REA co-operatives granting them special treatment with regard to taxes. Most of these statutes relate to excise or income taxes but some of them evidence an increasing tendency to solve the special problems of ad valorem assessments by new legislation. In many States there has been a growing interest in the Wisconsin plan by which power and light co-operatives (as well as mutual telephone companies) are taxed at 3 percent of gross revenues in lieu of all other taxes."

In summary, the Editors of *Tax Systems of the World*<sup>1</sup> have characterized the confusion in the field of property taxation of rural electric co-operatives in the following statements:

The most serious tax problems faced by rural electric co-operatives concern property taxation. Assessments and rates vary widely among the states and often among sections of a single state. The problem involved can be shown by the varying percentages of gross revenues consumed in property taxation. These percentages have been computed for all states.<sup>2</sup> The property tax burden in relation to gross revenues appears to be higher than average in the following states:

Alabama	Kansas
New Hampshire	Michigan
Vermont	West Virginia
Oklahoma	Virginia
Washington	Oregon
Ohio	Utah

<sup>1</sup> Tax Research Foundation, Ninth Edition, 1942.

<sup>2</sup> These data on property tax burdens are not available at present as reported by the Rural Electrification Administration.



Other states are either below the average in their property tax burdens on rural electric co-operatives or have granted exemptions.

### **Rural Electric Co-operatives and State Sales Taxes**

The Rural Electrification Administration has reported information concerning the liability of rural electric co-operatives for state sales taxes in six states: Missouri, Kansas, Oklahoma, Colorado, Wyoming, and Utah. Of these six states, four exempt such co-operatives from the sales tax. A summary of the available materials on sales taxation in relation to these co-operatives in the respective states is as follows:

#### ***Missouri:***

On September 10, 1937, the Attorney General ruled that REA co-operatives were "consumers" and not "retailers." On this basis the co-operatives did not collect the sales tax but paid the tax on the wholesale bill to the company from which they purchased the electric energy. However, on April 15, 1940, the Attorney General reversed this prior ruling and held that REA co-operatives were "retailers" and not "consumers." Consequently, the co-operatives must now add the tax to each member's bill and make a return to the Auditor General.

#### ***Kansas:***

It has been held that in some states in connection with sales taxation that REA co-operatives are consumers and not retailers on the theory that the co-operative does not sell to its members but simply purchases electricity for its members. In Kansas, electricity used in farming, processing, and all other uses, not domestic or commercial, is exempt from taxation; hence, sales to many REA members may be exempt on the ground that the use is agricultural. The Kansas Tax Commission has ruled that sales to co-operative organizations of personal property to be distributed by such organizations to their members are sales for resale to which the sales tax does not apply. Under this theory it cannot be maintained that a REA co-operative is a consumer and not a retailer of electrical energy.

#### ***Colorado:***

It was recently ruled that the supply of energy by REA co-operatives to their members did not constitute "sales" within the meaning of the taxing statute, on the theory that the members

were in reality serving themselves, the co-operative being merely the distribution agent of the members.

***Utah:***

The Tax Commission held that a tax on sales by "public utilities" was not applicable to REA co-operatives pursuant to a recent decision of the State Supreme Court.

***Wyoming:***

The court held that REA co-operatives were subject to the State sales tax.

***Oklahoma:***

A district court sustained the constitutionality of a statute exempting electric co-operatives from the State sales tax. The Tax Commission, which had attacked the validity of the provision, refunded to the co-operatives about \$18,000 in taxes paid under protest.

**Rural Electric Co-operatives and Unemployment  
Compensation Taxes**

The State Supreme Courts in Pennsylvania and in Arkansas have held that rural electric co-operatives are not liable for unemployment compensation taxes under statutes which exempt them from all excise taxes. In Georgia, Louisiana, and New York, REA co-operatives have secured similar administrative rulings on the same question.



## Part VII

# REGULATION OF CO-OPERATIVE ENTERPRISES UNDER FEDERAL AND PENNSYLVANIA LAWS

### A. Regulation of Co-operatives by the Federal Government

There is no single Federal statute which provides for the regulation of co-operatives. Instead, certain specific Federal acts provide for some regulation of the business activities of these enterprises. For example, the Agricultural Marketing Act of 1922 authorized the Secretary of Agriculture to institute proceedings against any agricultural co-operative which engaged in price fixing agreements where the intent was to lessen the effects of competition. Similarly, the co-operatives may be brought before the courts for violation of the anti-trust acts and the Federal Trade Commission Act. Co-operatives are also subject to the provisions of the Robinson-Patman Act of 1936, in so far as this act prohibits the payment of rebates to customers or dealers, where the effect of such rebates results in unjustifiable price discrimination. This act, however, does not prohibit a co-operative from rebating patronage dividends to its members and patrons. Co-operative enterprises are also subject to certain regulations of the Federal Motor Carriers Act of 1935, the Fair Labor Standards Act of 1938, with respect to minimum wages and maximum hours worked in interstate commerce, and the National Labor Relations Act of 1935. Co-operatives engaged in agriculture are not subject to the Social Security Act of 1935 or the Securities Act of 1933.

### B. Regulation of Co-operatives by the State of Pennsylvania

The General Assembly of Pennsylvania has provided no single statute for the regulation of co-operative enterprises. Agricultural co-operatives organized under the Acts of 1919 and 1929 are required by law to file annual financial reports with the State Secretary of Agriculture, as well as with the Dean of the School of Agriculture, the Pennsylvania State College. These provisions were further strengthened by Acts 357 and 358, passed by the General Assembly, May 23,

1945. Co-operatives engaged in the manufacturing and processing of dairy products are required to submit annual reports concerning production statistics and costs of operations to the Department of Internal Affairs under the provisions of the Act of April 20, 1921, P. L. 193. It appears that co-operatives are subject to many of the same regulations which are imposed upon regular business corporations because of the fact that they are not specifically exempted from the provisions of these acts. For example, if co-operatives wish to engage in the retail selling of liquor or cigarettes, they must obtain the required dealers' licenses the same as regular business corporations. Co-operatives are also subject to the provisions of the Fair Sales Act of 1937 because of the fact that they are not excluded from the act. Likewise, co-operatives, except those hiring agricultural labor, are subject to the provisions of the Pennsylvania Labor Relations Act of 1937, because they are not excluded from the act. Co-operative manufacturing organizations are subject to the same factory regulations as regular business corporations because they are not excluded from the act. Also co-operatives are subject to the Act of July 25, 1913, P. L. 1024, limiting the hours of labor for women employees and prohibiting night work for females under twenty-one years of age. Co-operative bakeries are subject to certain regulations of the Department of Agriculture as provided in the Act of May 22, 1933, P. L. 912; this act requires that all bakeries must obtain a license to do business, and since co-operatives are not excluded from the act, they must secure such a license if they wish to produce bakery products, in addition to selling them. Co-operative manufacturing organizations and other co-operative enterprises (except those hiring agricultural labor) are subject to the provisions of the Workmen's Compensation Act, June 4, 1937, P. L. 1552, unless such enterprises elect to provide for the compensation of injured employees by special agreements approved by the Department of Labor and Industry. Credit unions chartered under the Act of 1933 are subject to supervision by the Department of Banking, and must file annual financial statements with this department and also must pay a proportionate share of the overhead expenses of this department. Co-operative enterprises are not considered "public utilities" as long as they furnish services to their members only on a non-profit basis. However, as soon as a co-operative utility enterprise serves customers other than its own

members, it immediately becomes subject to all the regulations imposed by the Pennsylvania Public Utility Law of 1937. This applies especially to mutual telephone companies operating in the state. Rural Electric Co-operatives incorporated under the Act of 1937 are exempt from the jurisdiction of the Public Utility Commission. Agricultural co-operatives are exempt from the provisions of the Pennsylvania Securities Act of 1941.

## APPENDIX

# APPENDIX

## Part I

### TABLE I

#### NUMBER OF FARMERS' MARKETING AND PURCHASING CO-OPERATIVE ASSOCIATIONS IN UNITED STATES, 1913-1944<sup>1</sup>

<i>Period</i>	<i>Marketing</i>		<i>Purchasing</i>		<i>Total Number</i>
	<i>Number</i>	<i>Percent</i>	<i>Number</i>	<i>Percent</i>	
1913 .....	2,998	96.4	111	3.6	3,099
1915 .....	5,149	94.9	275	5.1	5,424
1921 .....	6,476	87.8	898	12.2	7,374
1925-1926 .....	9,586	88.7	1,217	11.3	10,803
1927-1928 .....	10,195	89.4	1,205	10.6	11,400
1929-1930 .....	10,546	87.9	1,454	12.1	12,000
1930-1931 .....	10,362	86.7	1,588	13.3	11,950
1931-1932 .....	10,255	86.2	1,645	13.8	11,900
1932-1933 .....	9,352	85.0	1,648	15.0	11,000
1933-1934 .....	9,052	83.0	1,848	17.0	10,900
1934-1935 .....	8,794	82.2	1,906	17.8	10,700
1935-1936 .....	8,388	79.9	2,112	20.1	10,500
1936-1937 .....	8,142	75.8	2,601	24.2	10,743
1937-1938 .....	8,300	76.2	2,600	23.8	10,900
1938-1939 .....	8,100	75.7	2,600	24.3	10,700
1939-1940 .....	8,051	75.3	2,649	24.7	10,700
1940-1941 .....	7,943	74.9	2,657	25.1	10,600
1941-1942 .....	7,824	74.2	2,726	25.8	10,550
1942-1943 .....	7,708	73.8	2,742	26.2	10,450
1943-1944 .....	7,522	73.0	2,778	27.0	10,300

<sup>1</sup> Includes independent local associations, federations, large-scale centralized associations, sales agencies, independent service-rendering associations, and subsidiaries whose businesses are distinct from those of the parent organizations.

Source: U. S. Farm Credit Administration, *Statistics of Farmers' Marketing and Purchasing Co-operatives, 1942-1943 Marketing Season*, Misc. Report No. 70, by G. Wanstall and R. H. Elsworth, (Jan., 1944).



**TABLE II**  
**ESTIMATED MEMBERSHIP OF FARMERS' MARKETING**  
**AND PURCHASING CO-OPERATIVES IN UNITED**  
**STATES, 1915-1944**

<i>Period</i>	<i>Marketing</i>		<i>Purchasing</i>		<i>Total Number</i>
	<i>Number</i>	<i>Percent</i>	<i>Number</i>	<i>Percent</i>	
1915 .....	591,683	90.9	59,503	9.1	651,186
1925-1926 .....	2,453,000	90.9	247,000	9.1	2,700,000
1927-1928 .....	2,602,000	86.7	398,000	13.3	3,000,000
1929-1930 .....	2,630,000	84.8	470,000	15.2	3,100,000
1930-1931 .....	2,608,000	86.9	392,000	13.1	3,000,000
1931-1932 .....	2,667,000	83.3	533,000	16.7	3,200,000
1932-1933 .....	2,457,300	81.9	542,700	18.1	3,000,000
1933-1934 .....	2,464,000	78.1	692,000	21.9	3,156,000
1934-1935 .....	2,490,000	75.9	790,000	24.1	3,280,000
1935-1936 .....	2,710,000	74.0	950,000	26.0	3,660,000
1936-1937 .....	2,414,000	73.8	856,000	26.2	3,270,000
1937-1938 .....	2,500,000	73.5	900,000	26.5	3,400,000
1938-1939 .....	2,410,000	73.0	890,000	27.0	3,300,000
1939-1940 .....	2,300,000	71.9	900,000	28.1	3,200,000
1940-1941 .....	2,420,000	71.2	980,000	28.8	3,400,000
1941-1942 .....	2,430,000	67.5	1,170,000	32.5	3,600,000
1942-1943 .....	2,580,000	67.0	1,270,000	33.0	3,850,000
1943-1944 .....	2,730,000	64.2	1,520,000	35.8	4,250,000

Source: U. S. Farm Credit Administration, Statistics of Farmers' Marketing and Purchasing Co-operatives, 1942-1943 Marketing Season, Misc. Report No. 70, by G. Wanstall and R. H. Elsworth, (Jan. 1944).

**TABLE III**  
**ESTIMATED BUSINESS OF FARMERS' MARKETING AND**  
**PURCHASING CO-OPERATIVES IN UNITED**  
**STATES, 1913-1944**

(Amounts in thousands of dollars)

<i>Period</i>	<i>Marketing</i>		<i>Purchasing</i>		<i>Total</i> (\$1,000)
	<i>(\$1,000)</i>	<i>Percent</i>	<i>(\$1,000)</i>	<i>Percent</i>	
1913 .....	304,385	98.1	5,928	1.9	310,313
1915 .....	624,161	98.2	11,678	1.8	635,839
1921 .....	1,198,493	95.4	57,721	4.6	1,256,214
1925-1926 .....	2,265,000	94.4	135,000	5.6	2,400,000
1927-1928 .....	2,172,000	94.4	128,000	5.6	2,300,000
1929-1930 .....	2,310,000	92.4	190,000	7.6	2,500,000
1930-1931 .....	2,185,000	91.0	215,000	9.0	2,400,000
1931-1932 .....	1,744,000	90.6	181,000	9.4	1,925,000
1932-1933 .....	1,199,500	89.5	140,500	10.5	1,340,000
1933-1934 .....	1,213,000	88.9	152,000	11.1	1,365,000
1934-1935 .....	1,343,000	87.8	187,000	12.2	1,530,000
1935-1936 .....	1,586,000	86.2	254,000	13.8	1,840,000
1936-1937 .....	1,882,600	85.7	313,400	14.3	2,196,000
1937-1938 .....	2,050,000	85.4	350,000	14.6	2,400,000
1938-1939 .....	1,765,000	84.0	335,000	16.0	2,100,000
1939-1940 .....	1,729,000	82.8	358,000	17.2	2,087,000
1940-1941 .....	1,911,000	83.8	369,000	16.2	2,280,000
1941-1942 .....	2,360,000	83.1	480,000	16.9	2,840,000
1942-1943 .....	3,180,000	84.1	600,000	15.9	3,780,000
1943-1944 .....	4,430,000	85.8	730,000	14.2	5,160,000

Source: U. S. Farm Credit Administration, Statistics of Farmers' Marketing and Purchasing Co-operatives, 1942-1943 Marketing Season, Misc. Report No. 70, by G. Wanstall and R. H. Elsworth, (Jan. 1944).

**TABLE IV**  
**STATISTICS OF FARMERS' MUTUAL FIRE INSURANCE**  
**COMPANIES IN UNITED STATES, 1914-1941**  
(Amounts in thousands of dollars)

Year	Companies Number	Amount of Insurance in Force Dec. 31 (\$1,000)	Cost Per \$100 of Insurance		
			Losses	Expense (Cents)	Total
1914	1,947	5,264,119	20.4	6.0	26.4
1915	1,879	5,366,760	17.5	6.0	23.5
1916	1,883	5,635,968	19.6	5.9	25.5
1917	1,829	5,876,853	18.2	6.4	24.6
1918	1,866	6,391,522	18.8	6.3	25.1
1919	1,922	6,937,523	17.3	7.8	25.1
1920	1,944	7,865,988	17.4	8.4	25.8
1921	1,951	8,409,683	19.4	7.8	27.2
1922	1,918	8,769,948	20.9	5.8	26.7
1923	1,907	9,057,938	19.8	6.6	26.4
1924	1,929	9,487,029	20.4	6.5	26.9
1925	1,839	9,477,139	21.1	6.7	27.8
1926	1,911	9,988,580	19.4	6.9	26.3
1927	1,889	10,345,463	19.0	6.3	25.3
1928	1,884	10,781,212	20.5	6.6	27.1
1929	1,876	11,118,510	21.8	6.6	28.4
1930	1,886	11,382,104	24.8	6.8	31.6
1931	1,863	11,292,339	24.1	6.9	31.0
1932	1,847	10,974,082	24.9	7.1	32.0
1933	1,826	10,466,384	21.2	7.3	28.5
1934	1,852	10,571,508	19.7	7.2	26.9
1935	1,941	11,083,300	15.7	7.5	23.2
1936	1,936	11,399,510	20.7	7.4	28.0
1937	1,924	11,569,476	16.5	7.6	24.1
1938	1,914	11,868,569	18.0	8.0	26.0
1939	1,904	12,143,881	18.4	8.2	26.6
1940	1,898	12,294,287	17.1	8.1	25.2
1941	1,885	12,518,913	16.2	8.4	24.6

Source: U. S. Farm Credit Adm., Statistics of Farmers' Marketing and Purchasing Co-operatives, 1942-1943 Marketing Season, Misc. Report No. 70, by G. Wanstall and R. H. Elsworth, (Jan., 1944).

**TABLE V**  
**FARMERS' CO-OPERATIVES IN UNITED STATES**

<i>Type</i>	<i>Associations Number</i>	<i>Estimated Members or Participants Number</i>
<i>Production:</i>		
Mutual irrigation companies (1936) .....	2,442	177,392
F. S. A. machinery co-operatives (1943) .....	10,145	90,000
F. S. A. sire associations (1943) .....	3,489	50,000
F. S. A. marketing and purchasing (1943) .....	963	100,000
Dairy herd improvement associations (Feb. 1944) .....	954	20,825
Dairy bull associations (January 1943) .....	306	5,981
Co-operative dairy-cattle artificial-breeding associations (Jan- uary 1943) .....	99	23,448
Grazing associations (1943) .....	40	1,954
Indian enterprises (December 1943) .....	437	207,300
<i>Marketing and purchasing:</i>		
Marketing (1942-1943) .....	7,708	2,580,000
Purchasing (1942-1943) .....	2,742	1,270,000
<i>Financing:</i>		
National farm loan associations (Dec. 1943) .....	2,805	448,000
Production credit associations (Dec. 1943) .....	523	275,196
Banks for co-operatives (December 1943) .....	13	1,158,525
Rural credit unions (1942) .....	370	20,000
<i>Farmers' mutual fire insurances companies (1941) .....</i>	<i>1,885</i>	<i>3,300,000</i>
<i>Public Service:</i>		
Mutual telephone companies (1942) .....	5,000	330,000
Electric power and light associations (1942) .....	850	1,210,000
<i>Farmers' burial associations (1942) .....</i>	<i>41</i>	<i>27,500</i>
<b>Totals .....</b>	<b>40,812</b>	<b>11,296,121</b>

Source: U. S. Farm Credit Administration, Statistics of Farmers' Marketing and Purchasing Co-operatives, 1942-1943 Marketing Season. Misc. Report No. 70. by G. Wanstall and R. H. Elsworth, (Jan. 1944).

**TABLE VI**  
**VOLUME OF BUSINESS TRANSACTED BY FARMERS'**  
**MARKETING AND PURCHASING CO-OPERATIVES**  
**ACCORDING TO COMMODITY GROUPS,**  
**UNITED STATES**

Selected Years, 1913-1943

(Data expressed as a percentage of total commodities  
marketed co-operatively)

<i>Commodity Group</i>	1913	1921	1925- 1926	1930- 1931	1935- 1936	1942- 1943
Cotton and cotton products . . . . .	4.9	1.9	6.2	5.4	6.0	4.4
Dairy products . . . . .	19.2	18.1	22.3	25.8	28.3	25.1
Fruits and vegetables . . . . .	22.5	17.0	11.7	13.3	11.5	11.9
Grain, dry beans and rice . . . . .	42.1	38.4	31.2	25.9	19.6	18.5
Livestock . . . . .	1.6	8.5	13.3	12.5	13.6	15.8
Nuts . . . . .	. . . .	1.3	.7	.5	.7	2.0
Poultry and products . . . . .	. . . .	1.2	1.7	3.6	3.7	3.8
Tobacco . . . . .	.8	.2	3.8	.3	.6	.5
Wool and mohair . . . . .	. . . .	.8	.4	1.1	.6	.9
Miscellaneous products . . . . .	7.0	8.0	3.1	2.6	1.6	1.2
Total marketing . . . . .	98.1	15.4	94.4	91.0	86.2	84.1
Purchasing . . . . .	1.9	4.6	5.6	9.0	13.8	15.9
Total marketing and purchasing . . . . .	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Number of associations . . . . .	<u>3,099</u>	<u>7,374</u>	<u>10,803</u>	<u>11,950</u>	<u>10,500</u>	<u>10,450</u>

Source: U. S. Farm Credit Administration, Statistics of Farmers' Marketing and Purchasing Co-operatives, 1942-1943 Marketing Season, Misc. Report No. 70, by G. Wanstall and R. H. Elsworth, (Jan. 1944).



TABLE VII

ESTIMATES OF NUMBER OF CO-OPERATIVE ASSOCIATIONS, (LOCAL CONSUMER) 1929-1944, BY TYPE OF ASSOCIATION (IN UNITED STATES)

Type of association	1929	1936	1939	1940	1941	1942	1943	1944
<i>Local Associations</i>	<i>Number of Associations</i>							
Retail distributor . . . .	1,114	3,000	3,700	3,700	3,950	4,025	4,150	4,285
Stores and buying clubs . . . . .	900	2,400	2,450	2,400	2,550	2,600	2,700	2,810
Petroleum . . . . .	198	1,150	1,200	1,250	1,350	1,375	1,400	1,425
Other . . . . .	16	50	50	50	50	50	50	50
Service . . . . .	98	266	354	415	497	526	551	577
Rooms and/or meals	32	60	100	150	200	190	175	175
Housing . . . . .	45	50	53	60	59	59	59	59
Medical care:								
On contract . . . .	..	..	..	..	24	35	50	50
Own facilities . . .	6	10	20	30	11	11	18	18
Burial:								
Complete funeral } . . .	5	30	36	40	{ 35	{ 35	{ 35	{ 36
Caskets only } . . .					{ 6	{ 6	{ 4	{ 4
Other . . . . .	10	116	145	135	162	190	210	235
Electricity associations .	50	275	575	700	800	810	820	850
Telephone associations	4,500	5,000	5,000	5,000	5,000	5,000	5,000	5,000
Credit unions . . . . .	974	5,355	8,362	9,479	10,456	10,602	10,373	9,099
Insurance associations								
Federations . . . . .	..	1,800	1,900	1,900	2,000	2,000	2,000	2,000
Wholesales:								
Inter-regional . . . .	..	2	2	2	2	2	2	2
Regional . . . . .	8	21	23	24	26	25	23	25
District . . . . .	..	9	13	13	13	11	11	10
Service federation . . .	1	6	7	9	17	19	22	21
Productive federation .	..	4	5	7	7	9	11	12
Non-commercial federations . . . . .	6	8	9	11	13	15	16	18

Source: U. S. Bureau of Labor Statistics, Operations of Consumers' Co-operatives in 1944, Bulletin No. 843, p. 21 (Sept. 14, 1945). (Footnotes omitted.)

TABLE VIII

## ESTIMATES OF THE BUSINESS OF CO-OPERATIVE ASSOCIATIONS BY TYPE OF ASSOCIATION, IN UNITED STATES, 1929-1944

Type of Association	1929	1936	1939	1940	1941	1942	1943	1944
<i>Local associations</i>	<i>Amount of Business (In thousands of dollars)</i>							
Retail distributive .....	\$49,000	\$182,685	\$211,653	\$228,325	\$345,150	\$398,500	\$466,750	\$557,000
Stores and buying clubs .....	37,700	107,250	120,053	129,650	160,000	195,000	235,000	280,000
Petroleum .....	10,800	69,985	86,000	92,875	179,000	197,000	225,000	270,000
Other .....	500	5,450	5,600	5,800	6,150	6,500	6,750	7,000
Service .....	1,728	3,950	5,280	5,530	8,345	8,495	9,775	11,055
Rooms and/or meals .....	1,640	1,000	1,250	1,500	3,325	3,000	2,775	2,600
Housing .....	.....	2,525	2,750	2,530	1,575	1,575	1,575	1,575
Medical care								
On contract .....	.....	.....	500	600	925	1,000	1,150	1,300
Own facilities .....	.....	50	.....	.....	1,125	1,150	2,000	2,100
Burial:								
Complete funeral .....	53	160	190	200	255	260	270	275
Caskets only .....	.....	.....	.....	.....	10	10	5	5
Other .....	35	215	590	700	1,130	1,500	2,000	3,200
Electricity associations .....	.....	.....	.....	16,650	33,400	45,000	52,610	60,960
Telephone associations .....	5,000	5,485	5,485	5,485	5,485	5,485	5,485	5,485
Credit Unions .....	54,048	100,200	230,430	306,092	362,291	250,000	208,808	212,305
Insurance associations .....	.....	103,375	115,000	125,000	170,000	180,000	185,000	190,000
Federations								
Wholesales:								
Inter-regional:								
Wholesale business .....	.....	468	1,020	7,760	4,204	4,500	9,280	11,775
Own production .....	.....	.....	.....	159	.....	.....	2,149	3,688
Regional:								
Wholesale business .....	7,023	41,370	50,485	58,742	76,474	87,164	98,004	131,210
Service business .....	.....	.....	325	585	1,695	1,607	3,192	3,780
Retail business .....	.....	.....	1,956	1,252	1,339	11,542	16,611	5,508
Own production .....	.....	.....	.....	6,582	7,960	11,705	23,396	55,476
District:								
Wholesale business .....	.....	860	1,812	1,986	2,352	2,625	2,809	3,020
Service business .....	.....	.....	73	158	231	99	106	158
Own production .....	.....	.....	.....	259	261	798	555	786
Service federations .....	.....	.....	.....	.....	1,174	1,500	1,977	7,820
Productive federations .....	.....	.....	.....	.....	5,988	5,810	5,630	14,895

Source: U. S. Bureau of Labor Statistics, Operations of Consumer Co-operatives in 1944, Bulletin No. 843, p. 22 (Sept. 14, 1945). (Footnotes omitted.)

**TABLE IX**  
**TREND OF DEVELOPMENT OF SPECIFIED TYPES OF CO-OPERATIVES IN**  
**UNITED STATES, 1929-1944**

Year	<i>Number of Associations</i>				<i>Number of Members</i> (in tens of thousands)				<i>Amount of Business</i> (in millions of dollars)				<i>Regional Wholesale sales (distributive only)</i>
	<i>Retail Distributive</i>	<i>Local Service</i>	<i>Electricity</i>	<i>Credit Union</i>	<i>Retail Distributive</i>	<i>Local Service</i>	<i>Electricity</i>	<i>Credit Unions</i>	<i>Retail Distributive</i>	<i>Local Service</i>	<i>Electricity</i>	<i>Credit Unions</i>	
1929 .....	1,114	98	50	974	18.6	1.0	... <sup>1</sup>	26.5	\$49.0	\$1.7	... <sup>1</sup>	\$54.0	\$7.0
1936 .....	3,600	266	275	5,440	67.8	9.4	8.3	121.0	182.7	4.0	... <sup>1</sup>	112.1	41.4
1939 .....	3,700	354	575	8,315	92.3	14.0	48.5	242.1	211.7	5.3	... <sup>1</sup>	240.5	50.5
1940 .....	3,700	415	700	9,510	98.9	16.9	57.5	281.7	228.3	5.5	\$16.7	302.3	58.7
1941 .....	3,950	497	800	10,425	116.9	21.5	100.5	353.2	345.2	8.3	33.4	362.8	76.5
1942 .....	4,025	526	810	10,601	121.4	24.2	101.0	313.9	398.5	8.5	45.0	251.4	87.2
1943 .....	4,150	551	820	10,332	135.9	27.8	102.5	302.3	466.8	9.8	52.6	308.6	98.0
1944 .....	4,285	577	850	9,099	152.5	31.9	115.0	302.8	557.0	11.1	61.0	212.3	140.5

<sup>1</sup>No data.

Source: U. S. Bureau of Labor Statistics, Operations of Consumers' Co-operatives in 1944, Bulletin No. 843, p. 5, (Sept. 1945).

**TABLE X**  
**AMOUNT AND PERCENT OF BUSINESS DONE BY WHOLE-**  
**SALE CO-OPERATIVE ASSOCIATIONS IN 1944,**  
**BY COMMODITY GROUPS**  
**(In United States)**

Commodity Group	Regional Associations			District Associations		
	Number of Associations Handling	Amount	Per cent	Number of Associations Handling	Amount	Per cent
All commodities	20	\$116,188,244	100	8	\$2,451,280	100.0
Food products	9	9,568,403	8.2	2	846,360	34.5
Household supplies	3	139,420	.1	..	.....	...
Electrical appliances	8	1,529,859	1.3	..	.....	...
Clothing	2	500,707	.4	..	.....	...
Hardware	1	275,705	.2	..	.....	...
Coal	9	2,298,760	2.0	1	11,575	.5
Petroleum products (including grease)	18	52,867,819	45.5	8	1,068,160	43.6
Tires, tubes and accessories	16	3,226,377	2.8	2	3,607	.1
Building materials and point	12	3,865,072	3.3	2	29,443	1.2
Farm supplies (including feed, seed, and fertilizer)	15	38,378,174	33.0	2	125,233	5.1
Farm machinery and implements	12	2,071,625	1.8	3	31,293	1.3
Store and station equipment	6	1,015,367	.9	..	.....	...
Automobiles	..	.....	....	1	2,308	.1
Other (not classified)	5	450,956	.4	7	333,301	13.6

Source: U. S. Bureau of Labor Statistics, Operations of Consumer Co-operatives in 1944, Bulletin No. 843, p. 13, (Sept. 14, 1945).

**TABLE XI**  
**RELATIVE DEVELOPMENT OF STATE AND FEDERAL**  
**CREDIT UNIONS, 1925-1944, IN UNITED STATES**

Item and Year	Total	State	Federal
	Associations	Chartered Associations	Chartered Associations
(NUMBER OF CREDIT UNIONS)			
1925	419	419	.....
1929	974	974	.....
1931	1,500	1,500	.....
1932	1,612	1,612	.....
1933	2,016	2,016	.....
1934	2,450	2,450	.....
1935	2,600	2,600	.....
1936	5,355	3,490	1,865
1937	6,292	3,792	2,500
1938	7,314	4,299	3,015
1939	8,479	4,782	3,544
1940	9,479	5,269	4,210
1941	10,456	5,663	4,793
1942	10,602	5,622	4,980
1943	10,373	5,285	5,088
1944	9,099	5,051	4,048

(NUMBER OF MEMBERS)			
1925	108,000	108,000	.....
1929	264,908	264,908	.....
1931	286,143	286,143	.....
1932	301,119	301,119	.....
1933	359,646	359,646	.....
1934	427,097	427,097	.....
1935	597,609	523,132	74,477
1936	1,170,445	854,475	315,970
1937	1,503,826	1,055,736	448,090
1938	1,863,353	1,236,826	626,527
1939	2,305,364	1,459,377	845,987
1940	2,815,590	1,695,358	1,120,232
1941	3,529,097	2,132,401	1,396,696
1942	3,144,603	1,797,084	1,347,519
1943	3,023,603	1,721,240	1,302,363
1944	3,027,694	1,723,893	1,303,801

(AMOUNT OF LOANS MADE BY YEARS)			
Amount of loans made during year:			
1925	\$20,000,000	\$20,000,000	.....
1929	54,048,000	54,048,000	.....
1931	21,214,500	21,214,500	.....
1932	32,065,000	32,065,000	.....
1933	28,217,457	28,217,467	.....
1934	36,200,000	36,200,000	.....
1935	39,172,308	36,850,000	\$2,322,308
1936	100,199,695	84,541,635	15,658,060
1937	141,399,790	110,625,321	30,774,469
1938	175,952,433	129,058,548	46,893,885
1939	230,429,517	159,403,457	71,026,060
1940	306,092,416	201,105,625	104,986,791
1941	362,291,005	227,959,046	134,331,959
1942	250,000,284	158,463,317	91,536,967
1943	208,807,888	131,542,506	77,265,382
1944	212,305,479	133,971,582	78,333,897

Source: U. S. Bureau of Labor Statistics, Activities of Credit Unions in 1944, Bulletin No. 850, p. 5 ff (Oct. 16, 1945).



**TABLE XII**  
**REA-FINANCED ACTIVITIES IN THE STATES,**  
**JUNE 30, 1944**

<i>State</i>	<i>Borrowers</i>	<i>Funds Allotted</i>	<i>Consumers</i>
	<i>Numbers</i>	<i>Dollars</i>	<i>Number</i>
Alabama .....	24	\$14,878,649	34,977
Arizona .....	3	11,308,000	2,011
Arkansas .....	19	12,616,500	27,143
California .....	7	2,729,500	4,237
Colorado .....	19	11,267,810	17,310
Connecticut .....	..	.....	.....
Delaware .....	1	1,098,000	3,046
Florida .....	14	4,899,500	10,907
Georgia .....	45	23,568,202	69,459
Idaho .....	9	4,184,750	7,365
Illinois .....	28	22,559,803	53,491
Indiana .....	45	22,630,269	73,274
Iowa .....	53	27,562,198	59,153
Kansas .....	25	10,584,151	17,700
Kentucky .....	26	16,539,855	46,765
Louisiana .....	16	10,270,100	17,238
Maine .....	4	653,353	1,088
Maryland .....	2	1,778,500	4,717
Massachusetts .....	..	.....	.....
Michigan .....	13	13,547,500	31,778
Minnesota .....	51	32,881,807	62,999
Mississippi .....	24	14,209,953	46,437
Missouri .....	39	27,587,200	54,984
Montana .....	15	3,771,598	7,374
Nebraska .....	22	13,326,663	20,937
Nevada .....	2	259,000	442
New Hampshire .....	1	1,674,000	2,691
New Jersey .....	2	568,500	1,444
New Mexico .....	7	1,890,000	2,820
New York .....	7	4,233,618	6,618
North Carolina .....	35	19,633,302	41,061
North Dakota .....	8	4,931,472	6,215
Ohio .....	28	24,363,301	62,311
Oklahoma .....	24	13,314,506	27,929
Oregon .....	13	5,842,000	7,501
Pennsylvania .....	13	12,166,200	30,569
Rhode Island .....	..	.....	.....
South Carolina .....	25	9,573,249	31,913
South Dakota .....	11	3,427,154	4,402
Tennessee .....	29	13,950,735	71,475
Texas .....	84	41,590,174	92,176
Utah .....	4	1,345,000	2,263
Vermont .....	3	1,311,000	2,635
Virginia .....	18	10,489,356	25,496
Washington .....	19	8,030,419	12,591
West Virginia .....	2	702,000	1,543
Wisconsin .....	32	20,717,452	37,235
Wyoming .....	13	3,592,000	5,255
Alaska .....	2	478,000	682
Virgin Islands .....	1	275,000	374
<b>Total .....</b>	<b>887</b>	<b>\$498,811,446</b>	<b>1,152,031</b>

Source: Annual Report, Rural Electrification Administration, Oct. 15, 1944.

**TABLE XIII**  
**VALUE OF CO-OPERATIVE PRODUCTION AND MANUFACTURING, 1943 AND 1944, BY COMMODITIES**

(In United States)

<i>Commodity</i>	<i>1943</i>		<i>1944</i>	
	<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>
All products .....	\$31,104,255	100.0	\$65,255,203	100.0
Food products .....	\$1,958,036	6.3	\$2,073,462	3.2
Chemical products .....		...	38,000	.1
Coal .....		...	29,274	...
Crude oil .....	31,340	.1	721,050	1.1
Pipeline operations .....	1,672,756	5.4	4,947,745	7.6
Refined petroleum products ..	6,743,901	21.7	21,165,002	32.4
Lubricating oil .....	1,358,479	4.4	4,659,465	7.1
Grease .....	223,864	.7	226,374	.3
Printing .....	326,959	1.1	192,793	.3
Paint .....	1,351,782	4.3	81,689	.1
Lumber and shingles .....	360,502	1.2	1,361,866	2.1
Shelving .....	5,316	...	11,574	...
Poultry and poultry products ..	246,247	.8	369,296	.6
Insecticides .....		...	98,034	.2
Feed, seed, fertilizer .....	16,781,157	53.9	27,410,770	42.0
Farm machinery .....		...	1,868,809	2.8
Other .....	43,916	.1		...

Source: U. S. Bureau of Labor Statistics, Operations of Consumers' Co-operatives in 1944, Bulletin No. 843, P. 16, (Sept. 14, 1945).

**TABLE XIV**  
**STATISTICS OF RETAIL TRADE ACCORDING TO TYPES OF BUSINESS UNITS—PENNSYLVANIA—1939**

<i>Types of Units</i>	<i>No. of Units</i>	<i>Volume of Sales</i>	<i>Percent of Total Sales</i>
Individual Proprietorship .....	107,091	\$1,280,327,000	40.0%
Partnerships .....	13,093	388,723,000	12.0%
Co-operative Associations .....	136	5,511,000	0.1%
Corporations .....	12,997	1,372,133,000	43.0%
Other Forms .....	1,226	86,683,000	4.9%
Totals .....	134,543	\$3,133,377,000	100.0%

Source: U. S. Census, Retail Trade, Vol. 1, P. 338—1939.

**TABLE XV**  
**STATISTICS OF WHOLESALE TRADE BY CO-OPERATIVE**  
**BUSINESS UNITS IN PENNSYLVANIA—1939**

<i>Type of Co-operatives</i>	<i>No. of Units</i>	<i>Volume of Sales</i>	<i>Percent of Total Sales of all Units in Pennsylvania</i>
Retailer—Co-operative Warehouses .....	37	\$39,613,000	1.0%
Co-operative Bulk Petroleum Stations .....	3	276,000	0.009%
Assemblers Co-operative marketing associations (farm) .....	60	11,813,000	0.3%
Co-operative sales agencies (farm) .....	11	33,983,000	1.0%

Source: U. S. Census—Wholesale Trade, P. 270—1939.

**TABLE XVI**  
**MANUFACTURING UNITS IN PENNSYLVANIA ACCORD-**  
**ING TO TYPES OF OWNERSHIP—1939**

	<i>No. of Units</i>	<i>No. of Wage Earners</i>	<i>Value of Products</i>
Corporate .....	6,858	759,370	\$5,064,736,392
Individual Proprietorships .....	4,619	48,937	192,369,751
Partnership .....	2,257	49,036	215,136,101
Co-operatives .....	21	350	1,647,354
Others .....	46	603	2,035,884
Total .....	13,801	858,296	\$5,475,925,482

Source: U. S. Census of Manufacturers, Volume 3, P. 863, 1939.

**TABLE XVII**  
**GROWTH OF CO-OPERATIVE RURAL ELECTRIC ENTER-**  
**PRISES IN PENNSYLVANIA, 1937 TO 1944**

<i>Year</i>	<i>No. of Units (Borrowers)</i>	<i>Federal Funds Allotted</i>	<i>Number of Consumers</i>
1937 .....	11	\$1,435,000	8,010
1938 .....	7	2,509,500	8,010
1939 .....	9	5,351,200	16,783
1940 .....	12	7,221,200	23,198
1941 <sup>1</sup> .....	..	.....	.....
1942 <sup>1</sup> .....	..	.....	.....
1943 .....	13	11,377,200	28,520
1944 .....	13	12,166,200	30,569

<sup>1</sup> Data not available in annual reports.

Source: *Annual Reports*, Rural Electrification Administration.

**TABLE XVIII**  
**PENNSYLVANIA CREDIT UNIONS**

Period Ending	Number of Credit Unions		Members at End of Period		Share Balance at End of Period		
	Chartered	Reporting	Number	Average per Credit Union	Total	Per Credit Union	Per Member
Dec. 31, 1933	10	10	3,601	360	\$205,940.43 <sup>1</sup>	\$20,594.00	\$57.00
Dec. 31, 1934	34	43	7,187	167	196,055.79	4,559.00	27.00
Dec. 31, 1935	7	48	11,237	234	427,410.08	8,904.00	38.00
Dec. 31, 1936	11	58	16,394	282	842,982.79	14,534.00	51.00
Dec. 31, 1937	4	61	21,655	355	1,365,873.51	22,391.00	63.00
Dec. 31, 1938	8	67	26,965	402	2,109,014.60	31,477.00	78.00
Dec. 31, 1939	11	77	31,365	407	2,716,782.98	35,282.00	86.00
Dec. 31, 1940	10	86	35,703	415	3,127,097.63	36,362.00	86.00
Dec. 31, 1941	3	92	59,652	648	3,557,653.49	38,670.00	59.64
Dec. 31, 1942	5	90	42,112	468	3,523,380.50	39,148.00	85.66
Dec. 31, 1943	2	87	31,277	360	3,502,626.83	40,260.00	112.00
Dec. 31, 1944	1	80	31,881	398	3,590,103.25	44,876.00	112.00

<sup>1</sup> Paid in.

Source: Commonwealth of Pennsylvania, Department of Banking.

Period Ending	Loans Made			Loans Outstanding			Dividends Paid	
	Number	Total Amount	Average per Credit Union	Number	Total Amount	Average per Credit Union	Amount	Amount
Dec. 31, 1933	7,746	\$836,945.21	\$108.00	774	\$83,694	.....	.....	.....
Dec. 31, 1934	4,404	348,272.86	81.00	102	8,099	2,928	\$188,866.01	\$64.00
Dec. 31, 1935	8,995	868,090.32	96.00	187	18,085	5,463	403,525.18	74.00
Dec. 31, 1936	14,487	1,660,119.54	115.00	249	28,622	9,343	859,167.01	92.00
Dec. 31, 1937	18,965	2,625,697.32	138.00	311	43,044	13,588	1,480,962.17	108.00
Dec. 31, 1938	20,495	3,051,044.29	148.00	306	45,538	17,258	2,192,787.12	127.00
Dec. 31, 1939	25,115	3,578,787.15	142.00	323	46,477	17,490	2,702,705.88	154.00
Dec. 31, 1940	28,633	4,776,461.20	167.00	333	55,540	20,249	3,139,560.79	155.00
Dec. 31, 1941	28,208	5,469,196.82	193.00	306	59,447	20,466	3,501,261.64	171.00
Dec. 31, 1942	19,881	3,616,690.71	182.00	221	40,185	15,910	2,715,645.62	170.00
Dec. 31, 1943	16,614	2,903,231.31	174.00	191	33,370	12,671	2,035,529.31	160.00
Dec. 31, 1944	15,173	2,811,337.35	185.00	189	35,141	11,721	1,752,339.70	149.00

Source: Commonwealth of Pennsylvania, Department of Banking.



## APPENDIX

### Part II

#### CORPORATIONS EXEMPT FROM FEDERAL INCOME TAXES<sup>1</sup>

##### Internal Revenue Code, Section 101

The following organizations shall be exempt from taxation under this chapter—

- (1) Labor, agricultural, or horticultural organizations;
- (2) Mutual savings banks not having a capital stock represented by shares;

(3) Fraternal beneficiary societies, orders, or associations, (A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

(4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and co-operative banks without capital stock organized and operated for mutual purposes and without profit;

(5) Cemetery companies 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 shareholder or individual;

(6) 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 shareholder or individual, and no substantial part of the activities of which is carrying on propagand, or otherwise attempting, to influence legislation;

(7) Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual;

<sup>1</sup> 26 U. S. C. A. 101, (1) to (19).



(8) 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;

(9) 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 shareholder;

(10) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or co-operative telephone companies, or like organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses;

(11) Mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed \$75,000;

(12) Farmers', fruit growers', or like associations organized and operated on a co-operative 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 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 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 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 equip-

ment 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 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 non-voting 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;

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this chapter;

(15) Corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes;

(16) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, if (A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and (B) 85 per centum or more of the income consists of amounts collected from members and amounts contributed to the association by the employer of the members for the sole purpose of making such payments and meeting expenses;

(17) Teachers' retirement fund associations of a purely local character, if (A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private

shareholder or individual, and (B) the income consists solely of amounts received from public taxation, amounts received from assessments upon the teaching salaries of members, and income in respect of investments;

(18) Religious or apostolic associations or corporations if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro-rata shares, whether distributed or not, of the net income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

(19) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or their designated beneficiaries, if (A) admission to membership in such association is limited to individuals who are officers or employees of the United States Government, and (B) no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual. 53 Stat. 33, as amended June 29, 1939, 10 p. m., E.S.T., c. 247, Title II,—217, 53 Stat. 876; Oct. 21, 1942, 4:30 p. m., E.W.T., c. 619, Title I,—137 (a), 165 (a), 56 Stat. 836, 872.



## APPENDIX

### Part III

#### RULINGS OF THE U. S. BUREAU OF INTERNAL REVENUE WITH RESPECT TO THE PAYMENT OF DIVIDENDS ON THE CAPITAL STOCK OF CO-OPERATIVE ENTERPRISES

"(1) When patronage refunds are paid in cash they reflect taxable income to the recipient either as a reduction of operating costs in the case of purchases made by the patron distributee, or as an item of income in the case of goods sold for the account of the patron distributee and constitute income in the year received to a taxpayer on either a cash or accrual basis, unless the latter had previously received authentic advice upon which to accrue it in advance of its receipt.

"(2) When the patronage refunds are paid in capital stock of the association receipt of such stock constitutes, for income tax purposes, constructive receipt of income to the recipient in the case of goods sold for the account of the patron distributee, or as a reduction of operating costs in the case of purchases made by the patron distributee, to the extent of the cash value of the refunds. This is true whether or not the capital stock has a readily realizable market value and the cash value of the refunds represents the cost basis of the stock for the purpose of determining capital gain or loss upon the sale or exchange of the stock.

"(3) When patronage refunds are paid in certificates of indebtedness or equity issued by the association with or without interest but having a definite due date, receipt of such certificates constitutes, for income tax purposes, constructive receipt of income to the recipient in the case of goods sold for the account of the patron distributee, or as a reduction of operating costs in the case of purchases made by the patron distributee, or as a reduction of operating costs in the case of purchases made by the patron distributee, to the extent of the cash value of the refunds. This is true whether or not the certificates have a realizable market value and the cash value of the refunds represents the cost basis of the certificates for the purpose of determining capital gain or loss upon the sale or exchange of the certificates.

"(4) The answer to question (3) is also applicable when patronage refunds are paid in certificates of indebtedness or certificates of equity issued by the association with or without interest but having no definite due date.

"(5) When patronage refunds are paid in merchandise or other property, receipt of such payment constitutes, for income tax purposes, constructive receipt of income to the recipient in the case of goods sold for the account of the patron distributee, or as a reduction of operating costs in the case of purchases made by the patron distributee, to the extent of the cash value of the refunds which represents the value of the property received.

"(6) When patronage refunds are paid in the form of advance to the patron of his equity in retained margins such advance constitutes, for income-tax purposes, constructive receipt of income to the recipient in the case of goods sold for the account of the patron distributee, or as a reduction of operating costs in the case of purchases made by the patron distributee, to the extent of the cash value of the refunds which represents the equity of the patron in retained margins."

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Note: The above rulings were issued by the Bureau of Internal Revenue in the form of a letter, but have not been published in the Internal Revenue Bulletins. The principles have been established, however, in I. T. 3208, C. B. 1938-2, 127.