

SOME LEGAL REQUIREMENTS
for
COOPERATIVE ASSOCIATIONS

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"Let's Study - Think it Through - Talk it Over!"

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CONTENTS

	Page
Introduction	3
I MINNESOTA COOPERATIVE LAW—Requirements for Cooperative Associations	5
II FEDERAL INCOME TAX—Requirements for Exemption of Farmers' Cooperative Marketing and Purchasing As- sociations—Section 101 (12) of the Internal Reve- nue Code	11
III STATE INCOME TAX—Requirements for Exemption of Farmers' Cooperative Marketing and Purchasing Asso- ciations	21
IV FEDERAL INSURANCE CONTRIBUTIONS ACT—Ef- fect on Farmers' Cooperative Associations (Social Se- curity—Old Age Insurance)	23
V FEDERAL UNEMPLOYMENT TAX ACT—Effect on Farmers' Cooperative Associations (Social Security— Unemployment)	26
VI MINNESOTA EMPLOYMENT AND SECURITY ACT— Effect on Farmers' Cooperative Associations	30

SOME LEGAL REQUIREMENTS OF COOPERATIVE ASSOCIATIONS

W. H. DANKERS¹

COOPERATIVES are distinguished from other corporations in that the patrons participate more fully in the control and benefits of the association. In line with this distinction, they must comply with certain requirements of federal and state laws.

It is not the purpose of this bulletin to deal with all of the laws that apply to cooperatives and the requirements set forth, but with only a few that have been confusing to the members and patrons. The particular laws that will receive brief analysis as they apply to cooperatives are:

State Laws

1. The Minnesota Cooperative Law under which most cooperatives are organized—Chapter 326 Laws of 1923 with *all* amendments (Section I).
2. The Minnesota Income and Franchise Tax Act with amendments—relating to state income tax (Section III).
3. The Minnesota Employment and Security Act with amendments—relating to compensation for temporary unemployment (Section VI).

Federal Laws

1. The Internal Revenue Code—Section 101 (12)—relating to federal income tax (Section II).
2. The Federal Insurance Contributions Act—relating to retirement or old age taxes and benefits (Section IV).
3. The Federal Unemployment Tax Act—relating to a federal employment tax (Section V).

The author is not a legal authority, nor a tax expert, nor can he speak officially for the various departments and divisions of the federal and state governments that have responsibility in applying these laws. Rather, this analysis is based upon: (1) close contact and numerous conferences with cooperative leaders and the cooperatives subject to these laws; (2) close contact and numerous conferences with the representatives of the govern-

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Introduction

mental departments and divisions concerned; (3) a study of the provisions and interpretations of the laws as made by federal and state officials, and in the courts. Therefore, the aim has been to bring together these considerations of importance to cooperatives, to coordinate them, to express the requirements in more simple language, and in a general way to provide a *guide* for cooperatives. It will not be possible to cover the many technical details. Cooperatives should turn to the federal or state department or division that is responsible and receive such assistance there.

Benefits to cooperatives under federal and state laws should be based on principle and method of operation and not on special privilege. Cooperative associations should more fully adopt such basic principles, if income tax exemption and other benefits are expected. *The burden of proof* in all cases rests with the organization. The Articles of Incorporation and By-laws should be brought and kept up to date, and made readily available for reference. To know the exact status of the association most cooperatives need an improved system of records. Such records should be audited by a competent auditor at least once a year.

How a Cooperative Association Operates

A cooperative business association is a voluntary association largely owned and operated by patrons who desire its services. It is subject to the same economic forces that affect other business enterprises.

The aim of a cooperative marketing association is to obtain the largest return for the commodities produced by patrons. It takes its gross proceeds, makes a cash advance to the patrons, deducts all necessary operating expenses (cash and noncash, including depreciation), and credits the balance to the account of the *patrons*. The funds represented by patrons' credits are used as operating capital. In some cases patrons' credits are held as "patrons' equity reserves," and in others stock is issued for such amounts. The patron funds so held are returned upon dissolution, or earlier if deemed advisable, to the patrons who have contributed them on the basis of volume of business done (patronage) with the association.

The aim of a cooperative purchasing association is to effect savings and to obtain the largest amount of goods and services for the dollars expended. It collects from its patrons money for goods furnished them, pays the cost of the goods and all operating expenses, and credits the balance to the patrons on the basis of volume of purchases made through the association.

Capital and operating funds in a cooperative association are built up through the sale of capital stock to members and also, in a marketing association, by retaining a percentage of the proceeds from the sale of products marketed or, in a purchasing association, by retaining part or all of the overpayments made by patrons for goods received.

I. MINNESOTA COOPERATIVE LAW²— Requirements for Cooperative Associations

Requirements in Organizing or Changing a Cooperative Association

- A. A cooperative association may be organized by five or more incorporators either with or without capital stock. Persons forming a cooperative association shall sign and acknowledge written articles of incorporation specifying:
1. The name of the association, its purpose, general nature of business, and the principal place where such business will be transacted.
 2. The period of its duration, which shall not exceed 50 years without renewal.
 3. If organized on a capital-stock basis, the amount of its capital stock, different classes of stock, the number of shares into which it shall be divided, and the par value of each share.
 4. That an individual stockholder shall be restricted to only one vote, regardless of the amount of stock held (voting shall be in person or by mail if a complete text of the item to be voted on is given in the notice, but not by proxy).
 5. That shares of stock shall not be transferable except with consent of the board of directors of the association.
 6. That dividends (called "interest" in the Minnesota Cooperative Law) shall not be paid on capital stock in excess of 6 per cent per annum.
 7. That the net income (balances) shall be distributed or allocated only on the basis of patronage, except such amounts as are required to be set aside as reserves and surplus.
 8. The highest amount of indebtedness to which the association shall at any time be subject.
 9. In what governing board its management shall be vested, the date of the annual meeting of stockholders at which such board shall be elected, and the names and places of residence of those who shall compose the governing board until the first annual meeting.
 10. Any other lawful provisions defining and regulating the powers or business of the association, and the duties and responsibilities of its directors, officers, and stockholders or members.

² Cooperative Laws, Chapter 326 (Laws of 1923), and all amendments thereto. Reference in revised statutes of 1941 is Chapter 308, Sections 5 to 18.

Minnesota Cooperative Law

B. Articles of Incorporation for a cooperative association shall be submitted for examination and approval and be filed.³

1. If found to be in proper and legal form and within the provisions of the cooperative law, the Attorney General will approve proposed Articles of Incorporation.
2. When approved by the Attorney General the original Articles of Incorporation or a certified copy thereof, verified by two of the incorporators, shall be filed with the Secretary of State, and a similar copy shall be filed and recorded in the office of the Register of Deeds of the county in which the principal place of business of the association is located. For filing Articles of Incorporation or amendments thereto with the Secretary of State there shall be paid to the State Treasurer a fee of five dollars. An additional fee of one dollar is required for recording the document.
3. The *By-laws* of an association may include any lawful provisions not in conflict with the Articles of Incorporation.

C. The Articles of Incorporation may be amended as follows :

1. The board of directors, by majority vote of its members, may pass a resolution setting forth the full text of the proposed amendment.
2. Following the initial action of the directors, notice shall be mailed to each and every stockholder containing a complete copy of the resolution adopted by the board of directors for amending the Articles of Incorporation. This notice shall also designate the time and place of the stockholders' or members' meeting at which the proposed amendment shall be considered and voted upon. Requirements for the notice of meeting shall be the same as for regular meetings.
3. If a quorum of the stockholders is registered as being present, or represented by mail vote, at the meeting called for amending the Articles of Incorporation, a majority of the members present or represented by mail vote may adopt or reject the proposed amendments.
4. Amendments to the Articles of Incorporation must be approved and filed in the same manner as the original Articles of Incorporation before they are binding upon the members of the association. If an amendment is adopted it shall be approved by the Attorney General. The approved amendments shall be filed and recorded with the office of the Secretary of State and recorded in the office of the Register of Deeds in the county of its principal place of business together with a copy of the notice of meeting sent to stockholders, and a certificate of the president and secretary verifying the action of the meeting at which such amendment was adopted (known as the Certificate of Amended Articles of Incorporation).

³ Assistance in filing Articles of Incorporation and making amendments may be obtained from the Division of Cooperatives, which is under the supervision of the Deputy Commissioner of Agriculture, Department of Agriculture, Dairy, and Food, State Office Building, St. Paul.

*Minnesota Cooperative Law***Additional Requirements****A. Capital Stock**

1. The amount of the authorized capital stock of an association shall be fixed by the Articles of Incorporation.
2. An association may commence business whenever 20 per cent of the authorized capital stock has been subscribed and paid in. The amount of capital stock outstanding shall at no time be diminished below 20 per cent of the amount of the authorized capital.
3. Cooperative associations may issue common and preferred stock having different par values, but only the common stock shall carry voting power.
4. No share of stock shall be issued for less than its par value nor until the same has been paid in cash or its equivalent.

B. Stockholders' Meetings

1. *Regular meetings* shall be held annually at the principal place of business of the association at such times as shall be designated in the By-laws. The secretary of the association shall give notice of such meeting by mailing a copy thereof to every stockholder personally not less than 15 days previous to the date of the meeting or by publishing it in a legal newspaper, published in the county of the principal place of business of the cooperative, at least two weeks previous to the date of the meeting.
2. *Special meetings* of stockholders may be called by a majority vote of the directors, or upon the written petition of at least 10 per cent of the stockholders; in which case it shall be the duty of the president to have notice of such meeting given, the same as for regular meetings. The notice shall be issued within 10 days from presentation of the petition and such special meeting shall be held within 30 days from presentation of the petition.
3. A *quorum* at any regular or special meeting shall be at least 20 per cent of the total number of stockholders if the total number does not exceed 200. In larger associations, 50 stockholders present in person shall constitute a quorum. An association *may* provide for a higher quorum in its Articles of Incorporation and By-laws. If an association has for two successive years been unable to secure a quorum at its annual meeting, thereafter a quorum shall be at least 10 per cent of the total number of stockholders, if the total number does not exceed 200. The presence of a quorum shall be established by the registration of the members present. No action by any association shall be valid or legal in the absence of a quorum.

Minnesota Cooperative Law

C. Directors and Officers

1. Every cooperative shall be governed by a board of not less than five directors who shall be elected at the annual meeting by the stockholders for such terms and in such manner as the By-laws of the association shall prescribe.
2. The officers of the association shall be a president, one or more vice-presidents, a secretary, and a treasurer, who shall be elected annually by and from the directors. The offices of secretary and treasurer may be combined.
3. The stockholders shall have the power at any regular or special meeting to remove any director or officer for cause, and to fill the vacancy caused by such removal.

D. Earnings, Reserves, and Patronage Dividends

1. It shall be the duty of the board of directors to deduct from the total income of any association the costs of operation, a reasonable and adequate reserve for depreciation of physical properties, and a reserve against other possible losses. A further reserve may be set aside for erection of new or additional buildings or for additional machinery or equipment. An amount may be deducted sufficient to pay dividends (interest) on the issued capital stock of the association, not to exceed 6 per cent per annum on the par value of such stock.

SPECIAL COMMENT. Depreciation of buildings and equipment and reserves for losses on bad accounts, although not necessarily a cash cost, are just as much a part of the cost of operating a business as labor, supplies, and other expenses. Therefore, they should be included as a regular expense item before determining the amount of earnings (balances). A reserve set aside for the acquisition of new or additional buildings, or for additional machinery or equipment, may have the effect of earmarking part of the accumulated earnings (surplus). Even though it is so earmarked, it appears to have the same legal status as that of an undivided surplus. Unless an equivalent amount of money is earmarked on the assets side of the balance sheet, there is no assurance that the money will be available at the time such facilities are to be constructed or installed. If a reserve is set aside for the payment of indebtedness or for the erection or acquisition of additional facilities, such a reserve should be allocated to the patrons on the books of the association and in reality becomes another patrons' equity reserve. The question may then be asked, "Why have more than one type of patrons' equity reserve?"

2. All or part of the net income (balances) for the first and second fiscal year may be set aside as a reserve to be determined by the board of directors, but at least 10 per cent of the net income (balances) shall be set aside annually for such purpose until such reserve for perma-

Minnesota Cooperative Law

net surplus shall equal 50 per cent of the paid-up capital. Thereafter the reserve for permanent surplus may be increased by the board of directors of the association to such an amount as it deems advisable.

SPECIAL COMMENT—It is apparently intended through this provision to strengthen the financial position of a cooperative, beyond the amount paid in as capital stock. To set aside 10 per cent of the net income (balances) is a definite requirement up to 50 per cent of the paid-up capital. However, as indicated in part 1 of this section D, there is confusion as to how net income shall be calculated. After the 50 per cent level has been reached, the matter is entirely up to the board of directors, and there appears to be no limit to the amount of surplus that *may* be built up. Because it is provided that shares of stock *called in by the association* shall be liquidated at book value, the 50 per cent surplus requirement and the privilege of practically unlimited surpluses have caused a practical problem to cooperatives, because the payment of a high book value seems to be suggested when there may be only a limited amount of money, or no money to use for this purpose.

This section has caused further concern to cooperatives and accountants who desire a federal tax-exempt status under the Internal Revenue Code. Income tax exemption requirements definitely limit the undivided surplus. This has raised the question as to whether a reserve prorated on patronage will satisfy the 50 per cent provision of this section for "a reserve for permanent surplus." There is no special ruling on this, but because additional capital funds are built up in this manner beyond the paid-in capital stock, the general opinion is that it should satisfy the requirements.

3. In addition to the reserve for permanent surplus, the directors of an association may set aside a sum not to exceed 5 per cent of the annual net income (balances) which shall be used for the purpose of promoting and encouraging cooperative organization.

SPECIAL COMMENT—Apparently this allows for lump sum expenditures for educational purposes and for the purpose of promoting and encouraging cooperative organizations. The assumption is that such expenditures cannot be accurately determined from year to year, or during the operating year. The general understanding appears to be that such an educational or special reserve fund would have to be disbursed shortly after it has been set up; otherwise its legal status would be the same as an undivided surplus. An educational or special reserve account cannot be used to accumulate *unallocated amounts* in the business as a means of income tax exemption.

4. Net income in excess of dividends on capital stock and additions to reserve and surplus shall be distributed or credited on the basis of the quantity or value of the commodities handled for each patron.

Minnesota Cooperative Law

SPECIAL COMMENT—Income tax-exemption of a farmers' cooperative appears to be more certain if *all* net income (balances) in excess of a *limited* dividend on capital stock is distributed or credited to patrons on the basis of the quantity or value of the commodities handled for each patron, including such amounts as are allowed in this section of the Minnesota Cooperative Law to remain in special reserve and surplus accounts. When cooperative associations have a *nonexempt* income tax status, *any* dividends paid on capital stock are subject to income tax.

5. If a nonmember patron is qualified and eligible for membership, the amount of patronage refund due him shall be credited to his individual account. When such credits equal the value of a share of common stock or membership, it shall be issued to him.

E. Dissolution

1. Voluntary proceedings for dissolution may be instituted whenever a resolution therefor is adopted by a two-thirds' vote at a meeting of the stockholders duly called for that purpose. The resolution shall designate a trustee or trustees to conduct the winding up. The resolution and the manner of adoption thereof, signed and acknowledged by the president and secretary, shall be filed for record by the Secretary of State.

If a cooperative is dissolved out of court, the trustee or a majority of the trustees may by petition apply to the court for a receiver. Thereafter the proceedings shall continue as if originally under the supervision of the court.

2. Court supervision—The resolution to dissolve may provide that the affairs of the cooperative shall be wound up under the supervision of the court, in which case the resolution shall authorize certain directors or stockholders to sign and present a petition to the court for such dissolution.

F. The Name "Cooperative"

1. No corporation or association shall be entitled or *permitted* to use the term "cooperative" as part of its corporate or business name or title, or to represent itself as a cooperative association, unless it has complied with the provisions of the cooperative law.

II. FEDERAL INCOME TAX—

Requirements for Exemption of Farmers' Cooperative Marketing and Purchasing Associations— Section 101 (12) of the Internal Revenue Code

Why Cooperatives Do Not Pay Income Taxes

As its name implies, an income tax applies only where there is income. Cooperative associations which carry on their operations at cost have no income of their own to which an income tax logically can be applied. Cooperative marketing associations which distribute any financial balances remaining at the end of the year to the patrons, in cash or credits, in proportion to the amount of business handled for each, are in effect allocating final payments for goods delivered. Such amounts are income to the patrons, not to the association. Similarly, cooperative purchasing associations which distribute balances at the end of the year to their patrons, in proportion to the amount of business handled for each, are refunding overpayments. Such refunds represent savings to the patrons, not income to the association.

This principle applies to all cooperatives. It is not an exemption in the sense of being a special privilege. It is a recognition of the basic fact that returns handled in the manner indicated do not constitute income to the cooperative. However, present federal laws do not place all types of cooperatives in the same category. As a result there is much confusion over the matter of "exemption" provided by laws and regulations for certain classes of cooperatives.

Certain nonprofit organizations are ruled "exempt" under Section 101 of the Internal Revenue Code, if they meet the requirements set forth therein. Subsections (1), (12), and (13) apply to agricultural organizations. Subsection (1) includes, along with labor organizations, "agricultural or horticultural organizations such as county fairs and like associations of a semipublic character, which are designed to encourage the *general* development of better agricultural and horticultural products." Subsection (12) includes "farmers' cooperative marketing and purchasing associations," frequently referred to as farmers' business cooperatives. Subsection (13) relates directly to Subsection (12) and pertains to corporations organized by farmers' cooperative marketing or purchasing associations for the purpose of financing crop operations, in conjunction with a farmers' marketing or purchasing association. Cooperative marketing associations purchasing from *independent* dealers, instead of from farmers or other farmers' cooperatives, and cooperative purchasing associations operating for nonfarmer patrons are excluded under subsection (12). This analysis will be limited to the application of the federal income tax laws to *farmers' business cooperatives*.

The following outline summarizes the major distinctions between so-called "exempt" and "nonexempt" cooperatives.

Federal Income Tax**Tax-exempt
Cooperative Association**

1. Final payments or refunds on patronage are not subject to a corporation income tax.
2. Dividends paid on capital stock are not subject to income tax if the rate is within the requirements of the state law, or 8 per cent, whichever is the higher.
3. Not subject to a capital stock tax.
4. Not subject to a stamp tax.
5. Has advantages under the State Employment and Security Act.
6. Not required to file an annual income tax return.
 - (a) However, must file a "statement of information" (Form 990).

**Nonexempt
Cooperative Association**

1. Final payments or refunds on patronage are not subject to a corporation income tax:
 - (a) If provision for such payments or refunds has been made a liability of the association through action of the board of directors prior to the end of the fiscal year, or
 - (b) If the Articles of Incorporation or By-laws make the provision for such payments or refunds a liability of the Association;
 - (c) If such payments or refunds are made within a "reasonable" time.
2. Dividends paid on capital stock are subject to income tax.
3. Must pay a capital stock tax.
4. Must pay a stamp tax on the issuance or transfer of capital stock, or bonds of indebtedness, and on conveyances of real estate.
5. Subject to the State Employment and Security Act like other business corporations.
6. Must file an annual income tax return (Form 1120), and maybe an excess profits tax return (Form 1121).

**Organizations that Shall Be Exempt from Income Taxation
Under Section 101 (12)**

- A. Farmers', fruit growers', or like associations organized and operated on a cooperative basis—
 1. for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or

Federal Income Tax

2. for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary operating expenses ;
- B. Exemption shall not be denied an association because it has capital stock—
1. *if* the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the state of incorporation, or 8 per cent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and
 2. *if* substantially all such stock (other than nonvoting preferred stock) is owned by producers, who market their products or purchase their supplies and equipment through the association.
- C. Exemption shall not be denied any association because there is accumulated and maintained by it a reserve required by state law, or a reasonable reserve for any necessary purpose.
- D. An association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members (provided the value of the purchases made for persons *who are neither members nor producers* does not exceed 15 per cent 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.

Explanation of Tax-Exempt Provisions

- A. "Like association" refers to an association engaged in the marketing of farm products for farmers, livestock growers, dairymen, etc., or in the purchasing of supplies and equipment for such groups. An organization purchasing merchandise for a group of retail grocers or for dealers in building materials is not considered a "like association" and does not have exemption.
- B. Exemption is not denied an association because it has capital stock if "substantially all" of such stock is owned by producers who market their products, or purchase their supplies and equipment through the association. What constitutes "substantially all" of the capital stock of a cooperative association depends upon the *circumstances* surrounding each particular case—it cannot be assumed that *a certain percentage* of producer-owned stock is satisfactory.
1. An association will be required to show that ownership of its capital stock *has been restricted as far as possible* to actual producers who market their products or purchase their supplies and equipment through the association.

Federal Income Tax

2. If an association is unable to purchase or retire the stock of nonproducers, owing to reasons beyond the control of the association, and if under such circumstances a small amount of the outstanding capital stock is held by nonproducers, it will not destroy the association's exemption.
 3. If by statutory requirement the officers of an association must be shareholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption.
 4. If a substantial part of the stock was voluntarily sold to nonproducers, or is allowed to accumulate with them, exemption from federal income tax is denied the association.
- C. Exemption is not denied an association because it has issued preferred stock or bonds or other evidence of indebtedness, for the purpose of providing necessary working capital, or acquiring property, which is necessary for the conduct of the association's business—
1. *if* the holders of such securities are not permitted to participate, directly or indirectly, in the earnings (balances) of the association upon dissolution or otherwise beyond the regular fixed dividend or interest payments.
 2. *if* the voting control of the association is retained by shareholders who are actual producers, marketing or purchasing through the association.
- D. Exemption is not denied an association because there is accumulated and maintained by it a reserve *required* by state law or a reasonable reserve for any necessary purpose. However, reserves required by state law must be distinguished from those merely *allowed*.
1. The necessity for the existence of reserves other than those required by state law must be shown.
 2. A "reasonable reserve" has been construed to include a depreciation reserve where an association has investments in buildings, machinery, and other property. Such depreciation in a given year is properly chargeable as part of the operating expenses.
 3. A "reasonable reserve" has been construed to include reserves accumulated or maintained to meet capital expenditures of such an association.
- E. Exemption is not denied an association because it engages both in marketing farm products and in purchasing farm supplies and equipment—
1. *if* the exemption requirements are met as to each of its functions; and
 2. *if* records are separately kept for each function.
- F. Exemption is not denied an association because it does business for nonmembers—
1. *if* the business done for nonmembers does not exceed the business done for members.

Federal Income Tax

2. *if* the business done by a cooperative purchasing association for non-member-nonproducers does not exceed 15 per cent of the total business.
- G. When business is done with nonmember patrons, such patrons must be treated the same as member (stockholder) patrons.
1. Nonmember patrons must be treated the same as member patrons with respect to services rendered, and prices paid in a marketing association and charges made in a purchasing association.
 2. Nonmember patrons must be treated the same as member patrons in making refunds on patronage (from balances at the end of the year or from reserves).
 - a. This requirement is complied with if a cooperative association, instead of making patronage refunds to nonmember producers in cash, keeps permanent records from which the proportionate shares of the patronage refunds due to nonmember producers can be determined, and such refunds are made applicable toward the purchase price of a share of stock or membership in the association.
 - b. This requirement is complied with if a cooperative association *defers* the payment of patronage refunds—
 - (1) *if* the Articles of Incorporation or By-laws of the association provide that patronage refunds, by whatever name known, are payable to member and nonmember patrons alike on the basis of patronage, and a reserve is set up for that purpose; or
 - (2) *if* the Articles of Incorporation or By-laws of the association provide that patronage refunds to nonmember patrons are not payable until the nonmember becomes a member of the association either through the payment of the required amount in cash or the accumulation of credits in an amount equal to the purchase price of a share of stock or membership; or
 - (3) *if* the Articles of Incorporation or By-laws of the association make no reference to the payment of patronage refunds but evidence shows that it has been the *consistent* practice of the association to pay patronage refunds in cash or its equivalent to member and nonmember patrons alike; or
 - (4) *if* the Articles of Incorporation or By-laws of the association make no reference to the payment of patronage refunds, but the association has taken action at stockholders' or members' meetings or through their directors to allocate such balances on the basis of patronage to member and nonmember patrons alike.
- H. The income tax exemption status of each association is determined by its form of organization and its actual operations *for a given year*.
1. If the Articles of Incorporation or By-laws provide for payment of patronage refunds *to members (stockholders) only*, the association

Federal Income Tax

is not suitably organized to come within the exemption provisions. To make payment to member and nonmember patrons alike would not remedy the situation because such action would be in opposition to the provisions of the Articles of Incorporation and By-laws.

2. An association cannot qualify for tax exemption in earlier years by amending its Articles of Incorporation or By-laws to provide for the payment of patronage refunds to nonmember patrons on the same basis as member patrons, and allocating to them or paying nonmember patrons the amount of patronage refunds due them for such earlier years.

Procedure in Filing Information and Obtaining Exemption from Federal Income Tax

- A. Exemption from federal income tax is not automatic under the federal law—the burden of proof rests with the association.
 1. A formal application for exemption must be made to the Collector of Internal Revenue. Exemption may or may not be granted, depending upon the organization and operation of the association.
 2. Even though exemption has been granted, an association is subject to examination by the Internal Revenue Bureau at any time. If it is found that the original application for exemption did not correctly state the facts, or that since the exemption was granted, the manner of operation of the association has changed, the exemption status may be cancelled, and *tax assessments made from the date of the changed conditions*.
 3. It is provided in the Internal Revenue Code that when an organization changes its manner of operation it must notify the Internal Revenue Bureau so that a ruling may be obtained regarding tax exemption under the new conditions.
- B. Steps necessary for a farmers' cooperative association to secure exemption from federal income tax:
 1. Obtain necessary application form (Form 1028) from the Collector of Internal Revenue, Main Post Office, St. Paul, Minnesota.
 2. Fill in the information requested on said form.
 3. Submit the affidavit together with a copy of the Articles of Incorporation, the By-laws, the latest balance sheet, and operating statement to the Collector of Internal Revenue, St. Paul, for exemption approval.

NOTE: For specific details regarding the Internal Revenue Act and exemption requirements of cooperative organizations write to the Collector of Internal Revenue, Main Post Office, St. Paul.

Federal Income Tax

- C. Cooperative associations that have an exemption must file "a return of information."
1. Obtain necessary form (Form 990) from the Collector of Internal Revenue, Main Post Office, St. Paul, Minnesota.
 2. Fill in the information requested on said form, and attach a balance sheet for the end of the taxable year covered.
 3. File with the Collector of Internal Revenue, St. Paul, on or before the 15th day of the fifth month following the close of the taxable year.

The Practical Application of Exemption Requirements

- A. **The principle of mutuality is the basis for income tax exemption.** Income tax exemption requirements compel cooperative associations to adopt a form of organization, and methods of operation toward like treatment of all patrons, whether members or nonmembers, that should be in effect in a cooperative association even though income tax exemption was not involved.
- B. **Capital stock or memberships must be kept in the hands of producers using the association.** A cooperative association should be owned and controlled by those who are using it. To qualify for income tax exemption, and to remain exempt, a cooperative should purchase the shares of stock or memberships of those who move away, or who retire and become nonproducers even though they remain in the territory. This process should be continuous, and action should be taken soon after the status of a member changes from producer to nonproducer. Some borderline cases will arise as to what constitutes a producer, but in the main the test is whether he is actively carrying on producer business with the association. It appears that when a farm owner rents his farm for cash (even though it might be to his son) and no longer receives a check for cream from the creamery, he is considered a nonproducer. If a farm is rented on a share basis and the farm owner is selling his share of the cream he is considered a producer, even though he is not actively operating the farm. A landlord selling his crop share to a cooperative elevator would classify as a producer. Similarly a landlord purchasing seed and commercial fertilizer for a farm he owned would classify as a producer in a cooperative purchasing association even though he is not actively operating a farm.

Nonproducer stockholders or members are frequently reluctant to turn in their stock because the dividends received on such shares far exceed the normal rate of interest on investments. To make liquidation of nonproducer shares easier, many cooperative associations are cutting down the rate of dividends paid on stock below the maximum of 6 per cent allowed by state law, to the "going rate" of interest, or lower. If

Federal Income Tax

the Articles of Incorporation provide that shares of stock may be "called in" at the discretion of the board of directors, and they have been called in the proper manner, in accordance with the Articles of Incorporation and the state law, the owner thereafter does not receive dividends, nor does he have voting rights even though he chooses not to turn in such shares. When they have been "called in," such shares are not included in the amount of outstanding "nonproducer" stock. In some cooperative associations the amount of common stock is limited to one share per eligible member. This constitutes the voting stock, which has a low par value of 1, or 5, or 10 dollars. All other credits of patrons and members are represented by preferred stock, certificates of interest, or patron's equity reserve (book credit). When *common* stock is limited to one share it is easy for an association to retire such stock when the holders thereof cease to be eligible for membership.

- C. Business done with members must exceed the amount done with nonmembers.** In many associations and especially in the older ones, when new patrons are acquired little or no effort is made to sell them a share of stock or a membership. The result is that the proportion of nonmember (nonstockholder) business increases to a point where the association is not exempt from income tax. Along with direct sale of shares of stock, for cash or its equivalent, many cooperatives prorate balances at the end of the year, on the basis of patronage to members and nonmember patrons alike, and have a provision in their Articles of Incorporation that nonmember patron credits shall be applied on a share of stock. The par value of stock is usually low. Under this plan, membership (stock ownership) becomes practically automatic when there are balances at the end of the year; except for those patrons who may not be eligible for membership. In a cooperative association that has completely adopted a revolving plan of financing, the money obtained from new patrons, who purchase and acquire a share of stock, is used to retire nonproducer stock.
- D. Member and nonmember patrons must be treated alike.** This provision goes further than the price paid for products delivered by patrons to a cooperative association and the price charged for goods furnished them. If a cooperative association is to be a nonprofit association the balances at the end of the year must be equitably distributed. In a cooperative marketing association a balance at the end of the year indicates that less was paid for the product as an advance to patrons than the association could pay. Similar balances in a cooperative purchasing association indicate that patrons were overcharged in the original purchase price. Such balances then were withheld or obtained from *patrons* (members and nonmembers alike) and even though held as capital in the associa-

Federal Income Tax

tion, should be credited to patrons on the basis of volume of business done with the association. Confusion frequently prevails when balances at the end of the year are used to pay debts or expand facilities. Because they were so used and cash did not accumulate, the assumption is erroneously made that the association actually did *not* have earnings (balances) and that, therefore, even though *nothing was prorated on patronage*, the association is not subject to tax. The question might be asked as to how these obligations could have been met unless there were earnings (balances) at the end of year. Regardless of how balances at the end of the year are applied, and even though such balances do not improve the *cash* position of the association, they must be properly credited on the books of the association to patrons from whom they were withheld or obtained, if the association wants to operate cooperatively and remain tax-exempt.

The Minnesota Cooperative law provides for the building up of a "surplus." This has been interpreted by some to mean an *undivided* surplus (not prorated on the basis of patronage). The earlier interpretation was that reserves and surplus required by state law, even though undivided, came within the provisions for exemption from federal income tax (Section D—Federal Income Tax). In the court decision of the Fertile Cooperative Dairy Association case (Iowa, 1941), the interpretation read "If part of the proceeds from nonmembers' products is to be used to create or maintain a surplus—without allowing them (the nonmembers) a proportionate distributive interest in the permanent value of such surplus accumulations—it must be held that the association to that extent is being operated for profit to its members, as against nonmember patrons, and that it is not exempt from income taxation." This interpretation appears to prevail. Many cooperatives are now prorating *all* balances at the end of the year on the basis of volume of business, to member and nonmember patrons. The assumption is that even though such reserves are prorated on the basis of patronage (divided—on the books of the association), it should satisfy the surplus requirements of the law. This appears to be a desirable procedure as a means of remaining exempt from income tax. When this accounting procedure is followed from the beginning of a cooperative association, it has the effect of keeping the book value of shares of stock at par. This avoids the problem that frequently exists in older cooperative associations, where a large undivided surplus has accrued to the *stockholders*, and the book value of shares is considerably higher than par. In such cases when non-producer shares are to be "called in" the association finds it impossible to pay the high book value because little or no cash is available for that purpose.

Equal treatment of all patrons and equitable distribution of balances at the end of the year involves keeping careful records of the business

Federal Income Tax

done in different departments of a cooperative association. Many associations, such as farmers' elevators, have both a marketing and purchasing department. Balances at the end of the year from each department must be prorated to the patrons of that department. If a cooperative creamery maintains a cold storage locker department which is a significant part of the association's business, it cannot prorate the cold storage locker department balances at the end of the year on the basis of butterfat patronage and expect to remain exempt from income tax. In such a case, funds obtained or withheld from one group of patrons are passed on to another group of patrons and the principle of "equal treatment" is violated.

III. STATE INCOME TAX—Requirements for Exemption of Farmers' Cooperative Marketing and Purchasing Associations

- A. The requirements of cooperative associations for exemption from state income tax as provided in the Minnesota Income and Franchise Tax Act, Article II, Section 5g are practically the same as those for exemption from federal income tax. Specific requirements are set forth as follows:
1. Only cooperative associations whose ownership rests with farmers, fruit growers, or livestock growers may claim exemption. Cooperative associations marketing agricultural products or purchasing supplies, but not substantially owned by farmers, are not entitled to exemption.
 2. Proceeds from sales of products marketed, or processed and marketed, less actual operating expenses, must be distributed to patrons.
 3. Sales of supplies and equipment to farmers must be made at cost, plus the actual operating expenses.
 4. Records must be kept of each patron's interest in any earnings (balances) not paid in cash. The total of the individual patron's accounts shall be called a reserve for patronage dividends, or a patron's equity reserve, in lieu of what is usually termed a surplus account.
 5. The dividend rate paid upon capital stock must not exceed the legal rate, or 8 per cent, whichever is greater.
 6. Substantially all of the common or voting capital stock must be held by producers.
 7. A cooperative may not market the products of nonmembers in excess of the products of members.
 - a. Business done for the United States or any of its agencies shall be disregarded.
 - b. Business done for the State of Minnesota or its political subdivisions shall *not* be disregarded.
 8. A cooperative may not purchase supplies and equipment for nonmembers in excess of supplies and equipment purchased for members.
 9. A cooperative may not purchase supplies and equipment for persons who are neither members nor producers in excess of 15 per cent of the total value of all its purchases of supplies and equipment.
 10. An association engaged both in marketing farm products and in purchasing supplies and equipment is exempt if as to each of its functions it meets the requirements.
 11. An association to be entitled to state income tax exemption must not only be organized but actually operate in the manner and for the purposes specified. Under circumstances where the Minnesota statutory

State Income Tax

provisions are identical with provisions of the Internal Revenue Code and the State Commissioner of Taxation has not made specific interpretations, those provided by the Federal Internal Revenue Bureau and the courts shall be controlling.

- B. Exemption from state income tax is not automatic under the state law or because the association is exempt from federal income tax—the burden of proof rests with the association.**
1. A formal application for exemption must be made to the Minnesota Income Tax Division. Exemption may or may not be granted depending upon the organization and operation of the association.
 2. Even though exemption has been granted, an association is subject to examination by the Minnesota Income Tax Division. If it is found that the original application did not correctly state the facts, or that since the exemption was granted, the manner of operation of the association has changed, the exemption status may be cancelled, and *tax assessments made from the date of the changed conditions*.
 3. When an association changes its manner of operation, it should notify the Minnesota Income Tax Division so that a ruling may be obtained regarding the tax exemption under the new conditions.
 4. So long as its method of operation does not change from the manner and conditions set forth in the application, which was approved for income tax exemption, a cooperative association need not file additional returns.
- C. Steps necessary for a farmers' cooperative association to secure exemption from state income tax.**
1. Obtain necessary application form (Form 120) from the Minnesota Income Tax Division, State Office Building, St. Paul, Minnesota.
 2. Fill in the information requested on said form.
 3. Submit the affidavit with a copy of the Articles of Incorporation, the By-laws, the latest balance sheet, and operating statement to the Minnesota Income Tax Division, State Office Building, St. Paul, for exemption approval.

NOTE: For specific details regarding the State Income Tax Act write to the Minnesota Income Tax Division, State Office Building, St. Paul.

IV. FEDERAL INSURANCE CONTRIBUTIONS ACT

Effect on Farmers' Cooperative Associations (Social Security—Old Age Insurance)

A. Statements from sections of the Act

1. Chapter 9—Subchapter A, Part I of the Internal Revenue Code provides, in part: "There shall be levied, collected, and paid on the income of every individual employee a tax equal to a certain percentage of the wages" (2 per cent in 1945, 2½ per cent in 1946, 1947, and 1948, and 3 per cent after that⁴).
 - a. The tax shall be collected by the employer, by deducting the amount of the tax from the wages paid.
 - b. Every employer shall furnish a written statement to the employee covering a calendar year, or one, two, three, or four calendar quarters, showing the name of the employer, the name of the employee, the period covered by the statement, the total amount of wages paid within such period, and the tax imposed.
2. Chapter 9—Subchapter A, Part II of the Internal Revenue Code provides, in part: "Every employer shall pay an excise tax, with respect to having individuals in his employ, equal to a certain percentage of the wages" (2 per cent in 1945, 2½ per cent in 1946, 1947, and 1948, and 3 per cent after that⁴).

B. The following types of service *do not constitute "employment"* under the Act:

1. Agricultural labor

- a. Services performed *on a farm*, in connection with the cultivation of the soil, the harvesting of crops, or the raising, feeding, or management of livestock, bees, and poultry.
- b. Services performed in connection with the operation, management, conservation, improvement, or maintenance of a farm and its tools and equipment, if the major part of such service is performed on the farm.
- c. Services performed in connection with the hatching of poultry without regard to the place where such services are performed.
- d. Services performed in the employ of a farmer or a farmers' cooperative organization or group in the handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage, to market, or to a carrier for transportation to market, of any agricultural or horticultural commodity, other than fruits and vegetables, produced by such farmer members. However, only if such services are performed as an incident to ordinary farming operations, and as a prerequisite to the marketing, in its unmanufactured state, of any agricultural or horticultural commodity. Services per-

⁴The actual rate paid by employers and employees to date has not exceeded 1 per cent. Although the law provided for a rate of 2 per cent in 1943 and 1944, special Congressional action lowered it to 1 per cent. This has been done on an annual basis. Unless special Congressional action is again taken, the rate provided for in the Act will apply beginning in 1945.

Federal Employment Taxes

formed in connection with "*commercial*" operations, or in connection with any commodity after its delivery to a terminal market for distribution for consumption are not excluded.

- e. Services performed in the employ of a farmer, a farmers' cooperative, *or a commercial handler* in the handling, planting, drying, packaging, processing, freezing, grading, storing, or delivering to storage, to market, or to a carrier for transportation to market of fruits and vegetables, provided such services are performed as an incident to the preparation of such fruits and vegetables for market. Services performed in connection with commercial canning or commercial freezing or in connection with fruits and vegetables, after delivery to a terminal market for distribution for consumption are not excluded.
 2. Domestic service in a private home, undergraduate college club, or fraternity.
 3. Family employment—conditioned solely upon the family relationship between the employer and employee.
 - a. Services performed by a husband for his wife or by a wife for her husband.
 - b. Services performed by a father or mother for a son or daughter.
 - c. Services performed by a son or daughter under 21 years of age for the father or mother.
 4. Service performed in the employ of the United States Government, of a state, or political subdivision thereof.
 5. Service performed in the employ of an organization operated exclusively for religious, charitable, scientific, literary, or educational purposes if no part of the net earnings go to the benefit of any private shareholder or individual.
- C. Important considerations for associations that are subject to the Act.
1. "Employment"—means any service, of whatever nature, performed within the United States by an employee for his employer.
 2. "Employer"—every person *who employs one or more individuals* in an employment that is not specifically exempted under the Act.
 - a. The number of individuals employed by the employer and the period during which any such individual is so employed are immaterial.
 - b. An employer may be an individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization, group, or entity.
 - c. An employer may be a person acting in a fiduciary capacity or on behalf of another, such as a guardian, committee, trustee, executor or administrator, trustee in bankruptcy, receiver, assignee for the benefit of creditors, or conservator.
 3. "Employee"—any individual is an employee if he performs services in an employment where the legal relationship of employer and employee exists.

Federal Employment Taxes

- a. An employer-employee relationship exists when the person for whom services are performed *has the right* to control and direct the individual who performs the services—not only as to *what* shall be done but *how* it shall be done.
 - b. Superintendents, managers, and other superior employees are “employees.”
 - c. A director is an employee of an organization only if he performs services other than those required by attendance at and participation in meetings of the board of directors.
 - d. All officers of corporations (including cooperatives) are considered to be employees (D-1).
4. “Wages”—includes all remuneration for employment, *up to a maximum of \$3,000 to any one employee* during any one calendar year.
- a. Includes the cash value of all remuneration paid in any medium other than cash.
 - b. Salaries, commissions on sales or on insurance premiums, fees, and bonuses are wages within the meaning of the Act.
 - c. The basis upon which remuneration is paid is immaterial—it may be paid hourly, daily, weekly, monthly, or annually; on the basis of piecework; or as a percentage of profits.
- D. No general provision is made in the Act for excluding services performed in farmers’ cooperative marketing and purchasing associations.** A few special provisions have been made for cooperative associations *exempt from federal income tax under Section 101 (12)* of the Internal Revenue Code.
1. Services performed in any calendar quarter for which the remuneration to an employee does not exceed \$45.00 are not considered subject to the Act. This provision excludes most of the officers that are included in the definition for employees (C-3-d).
 2. Services performed by a student who is enrolled and regularly attending classes in a school or college are not considered subject to the Act.
 3. Services performed under 1 and 2 are *not excluded* if the farmers’ cooperative marketing or purchasing association is not exempt from federal income tax.

<p>NOTE: For detailed information about the Federal Insurance Contributions Act, write to the Collector of Internal Revenue, Main Post Office, St. Paul, Minnesota.</p>

V. FEDERAL UNEMPLOYMENT TAX ACT—Effect on Farmers' Cooperative Associations (Social Security—Unemployment)

A. Statements from sections of the Act

1. Every employer (C-2) shall pay an excise tax for each calendar year for individuals in his employ.
 - a. The rate shall be 3 per cent.
 - b. Method of computation—the tax for any calendar year is computed by applying the rate of tax to the total wages paid by the employer (C-4).

B. The following types of service *do not constitute "employment"* under the Act:

1. Agricultural labor

- a. Services performed on a farm, in connection with the cultivation of the soil, the harvesting of crops, or the raising, feeding, or management of livestock, bees, and poultry.
 - b. Services performed in connection with the operation, management, conservation, improvement, or maintenance of a farm and its tools and equipment, if the major part of such service is performed on the farm.
 - c. Services performed in connection with the hatching of poultry without regard to the place where such services are performed.
 - d. Services performed in the employ of a farmer or a farmers' cooperative organization or group in the handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage, to market, or to a carrier for transportation to market, of any agricultural or horticultural commodity, other than fruits and vegetables, produced by such farmer members. However, such services are excluded only if performed as an incident to ordinary farming operations, and as a prerequisite to the marketing, in its unmanufactured state, of any agricultural or horticultural commodity. Services performed in connection with "*commercial*" operations, or in connection with any commodity after its delivery to a terminal market for distribution for consumption, are not excluded.
 - e. Services performed in the employ of a farmer, a farmers' cooperative, or a *commercial handler* in the handling, planting, drying, packaging, processing, freezing, grading, storing, or delivering to storage, to market, or to a carrier for transportation to market of fruits and vegetables, provided such services are performed as an incident to the preparation of such fruits and vegetables for market. Services performed in connection with commercial canning or commercial freezing or in connection with fruits and vegetables, after delivery to a terminal market for distribution for consumption are not excluded.
2. Domestic service in a private home, undergraduate college club, or fraternity.
 3. Family employment—conditioned solely upon the family relationship between the employer and employee.

Federal Employment Taxes

- a. Services performed by a husband for his wife, or by a wife for her husband.
 - b. Services performed by a father or mother for a son or daughter.
 - c. Services performed by a son or daughter under 21 years of age for the father or mother.
4. Service performed in the employ of the United States Government, of a state, or political subdivision thereof.
 5. Service performed in the employ of an organization operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the earnings of which goes to the benefit of any private shareholders or individuals.
- C. Important considerations for associations that are subject to the Act.
1. "Employment"—means any service, of whatever nature, performed within the United States by an employee for his employer.
 2. "Employer"—every person *who employs eight or more individuals on 20 or more days during a calendar year, each such day being in a different calendar week, in an employment that is not specifically exempted under the Act.*
 3. "Employee"—every individual is an employee if he performs services in an employment where the legal relationship of employer and employee exists.
 - a. An employer-employee relationship exists when the person for whom services are performed *has the right* to control and direct the individual who performs the services—not only as to *what* shall be done but *how* it shall be done.
 - b. Superintendents, managers, and other superior employees are "employees."
 - c. A director is an employee of an organization only if he performs services other than those required by attendance at and participation in meetings of the board of directors.
 - d. All officers of corporations (including cooperatives) are employees according to the Act (D-1).
 4. "Wages"—includes all remuneration for employment, *up to a maximum of \$3,000 to any one employee during any calendar year.*
 - a. Includes the cash value of all remuneration paid in any medium other than cash.
 - b. Salaries, commissions on sales or on insurance premiums, fees, and bonuses are wages within the meaning of the Act.
 - c. The basis upon which remuneration is paid is immaterial—it may be paid hourly, daily, weekly, monthly, or annually; on the basis of piecework; or as a percentage of profits.
- D. No general provision is made in the Act for excluding farmers' cooperative marketing and purchasing associations. A few special provisions have been made for cooperative associations *exempt from federal income tax under Section 101 (12) of the Internal Revenue Code.*

Federal Employment Taxes

1. Services performed in any calendar quarter for which the remuneration to an employee does not exceed \$45 are not considered subject to the Act. This provision excludes most of the officers that are included in the definition for employees (C-3-d).
 2. Services performed by a student who is enrolled and regularly attending classes in a school or college are not considered subject to the Act.
 3. Services performed under 1 and 2 are *not excluded* if the farmers' cooperative marketing or purchasing association has a nonexempt income tax status.
- E. The taxpayer may credit against the federal tax the amount of contributions paid by him into a State Unemployment Compensation Fund, certified under this Act.
1. The total credit allowed shall not exceed 90 per cent of the federal tax.
 - a. The present Minnesota base rate for payment to the state unemployment compensation fund is 2.7 per cent of total payrolls, which is 90 per cent of the 3 per cent tax imposed upon total payrolls under the federal law.
 - b. To obtain *maximum* credit, state unemployment fund contributions must have been made on or before the date on which the federal return for the calendar year is required to be filed. When state unemployment contributions are paid after the last day upon which the federal return for the taxable year is due, but before the next July 1, 90 per cent of the maximum credit is allowed (or 81 per cent of the total amount of the federal tax). Extension of time for filing returns is granted under special circumstances.
 2. Credit for state unemployment contributions can be obtained only for services performed during the calendar year covered by the federal return.

NOTE: For detailed information regarding the Federal Unemployment Tax Act, write to the Collector of Internal Revenue, Main Post Office, St. Paul, Minn.

The Practical Application of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act to Cooperative Associations

- A. Provisions of the Acts that are similar—Both of the Acts exempt cooperative associations that are exempt from federal income tax under Section 101 (1) of the Internal Revenue Code. Neither of the Acts excludes those exempt from federal income tax under Section 101 (12). Cooperative associations should carefully ascertain under what subsection of the Internal Revenue Code they qualify. An association that assumes

Federal Employment Taxes

or obtains income tax exemption under 101 (1), but is later ruled to be exempt under 101 (12), may find itself subject to the taxes provided for under these Acts, *for past years*.

Special services in cooperative associations exempt from income tax under 101 (12) are excluded under both of these Acts. These are services performed for which the remuneration does not exceed \$45.00 per calendar quarter, and services performed by a school or college student.

The provisions for employment, employees, and wages are the same under both Acts. Also alike are the types of service that do not constitute employment under the Acts.

B. Provisions of the Acts that are not similar.—A significant difference in the two Acts is that under the Federal Insurance Contributions Act (Old Age) any employer who employs *one* or more individuals is subject to that tax, whereas under the Federal Unemployment Tax Act (Unemployment) any employer who employs *eight* or more individuals is subject to that tax. Because many cooperative associations are small and have less than eight employees, such associations have not been subject to the Federal Unemployment tax. Officers must be counted as “employees” but are excluded if their remuneration is less than \$45.00 per calendar quarter, if the association is exempt from federal income tax under Section 101 (12). Under the Federal Insurance Contributions Act, tax payments must be made by both the employer and employees. Under the Federal Unemployment Tax Act, the excise tax is levied only on the employer.

The Federal Insurance Contributions Act does not provide for cooperation with a state Act. The Federal Unemployment Tax Act does provide for a cooperative arrangement with the state, in Minnesota under the State Employment and Security Act.

VI. MINNESOTA EMPLOYMENT AND SECURITY ACT—Effect on Farmers' Cooperative Associations

A. Purpose of the Act.

1. To create an unemployment compensation fund from contributions by employers for compensation for involuntary unemployment.
2. To provide for merit ratings for employers with creditable employment records ("experience rating").
3. To cooperate with the federal agency, and other state agencies, in administering unemployment compensation laws.

B. General application of the Act.

The main provisions of the Minnesota Employment and Security Act are so similar to those of the Federal Unemployment Tax Act in their application to cooperatives that a separate outline is unnecessary. Under the federal Act an "employer is any person who employs eight or more persons" whereas under the state Act an "employer is any person who employs one or more persons." *However*, cooperatives that are not subject to the federal Act (because they have less than eight employees) are not subject to the provisions of the state Act. Hence, in effect the provisions are the same.

C. Important provisions of the Act.

1. Rate of contribution—Each employer shall pay contributions at a base rate of 2.7 per cent of the wages paid during each calendar year.
 - a. A favorable "experience rating" may lower this rate. The "experience rating" refers to an employer's employment record. Benefits paid to an unemployed worker by the Division of Employment and Security are charged against the accounts of his "base-period" employers, and affect the "experience rating" of such employers, and in turn their rate of tax.
2. Seasonal employment—seasonal employment means employment in activities pertaining to the first processing of seasonally produced agricultural products in which, because of the seasonal nature thereof, it is customary to operate only during a regularly recurring period or periods of less than 26 weeks in any calendar year. *Wages paid for seasonal employment are subject to tax under the act.* However, when employment has been determined seasonal by the Director of the Division, wage credits are set up by the Division for each seasonal employee on a *percentage* basis. Wage credits are allowed in the same proportion to total seasonal wages that the period of seasonal employment bears to a full year. (Example: If the seasonal period is three months or one fourth of a year and seasonal wages are \$300.00, then wage credits are \$75.00.) In nonseasonal employment, wage credits are allowed an employee *equal to the full amount* of the wages paid.

Minnesota Unemployment Compensation

Wage credits obtained from seasonal and nonseasonal wages form the basis for benefit payments to an unemployed worker. The rate of weekly benefit payments is established by the "base period," which is the first four of the last five completed calendar quarters preceding an employee's benefit claim.

3. Failure to submit reports—Any employer who knowingly fails to make and submit a report of wages paid by or due from him at the time such report is required shall pay an amount equal to 1 per cent of contributions accrued during the period for which such report is required, for each month, until such a report is properly made. The minimum amount of the penalty shall be \$10.00.

A failure to file reports, other than wage reports, required by the director, shall carry a penalty of \$10.00. Such penalties are in addition to interest on delinquent contributions.

NOTE: For detailed information regarding the Minnesota Employment and Security Act, write to the Director of the Minnesota Division of Employment and Security, St. Paul.

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