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DEFINING THE COOPERATIVE

Sources from U.S. Law and Elsewhere

USDA

“A cooperative is defined as a user owned and controlled business from which benefits are derived and distributed equitably on the basis of use or as a business owned and controlled by the people who use its services.”

USDA Rural Development Circular, Cooperative Information Report 45, Section 2 (1994).

“USDA 3” – THE USE PRINCIPLES

- o User-Owner Principle: Those who own and finance the cooperative are those who use the cooperative.
- o User-Control Principle: Those who control the cooperative are those who use the cooperative.
- o User-Benefits Principle: The cooperative’s sole purpose is to provide and distribute benefits to its users on the basis of their use.

Positioning Farmer Cooperatives for the Future: A Report to Congress. 1987 (Washington, DC: USDA/ACS).

USDA GUIDANCE

“Cooperatives follow three principles that define or identify their distinctive characteristics:

- user-owned,
- user-controlled, and
- user-benefited.

“The user-owned principle means the people who own and finance the cooperative are those who use it. ‘Use’ usually means buying supplies, marketing products, or using services of the cooperative business.

....

“The user-controlled principle (also called democratic control) means that those who use the cooperative also control it by electing a board of directors and voting on major organizational issues. This is generally done on a one-member, one-vote basis, although some cooperatives use

proportional voting based on use of the cooperative (hence, a member who markets 10,000 bushels of a crop through the cooperative would have a greater vote than one who markets 1,000 bushels). “The user-benefited principle says that the cooperative’s sole purpose is to provide and distribute benefits to members on the basis of their use. Members unite in a cooperative to receive services otherwise not available, to purchase quality supplies, to increase market access, or for other mutually beneficial reasons. Members also benefit from distribution of net earnings or profit based on their use of the cooperative.”

How To Start a Cooperative, Cooperative Information Report 7, USDA Rural Development (rev. 2015).

INTERNAL REVENUE CODE

26 U.S. Code § 1381 - Organizations to which part applies

This part [IRC Subchapter T Part I] shall apply to—

- (1) any organization exempt from tax under section 521 (relating to exemption of farmers’ cooperatives from tax), and
- (2) **any corporation operating on a cooperative basis** other than an organization—
 - (A) which is exempt from tax under this chapter,
 - (B) which is subject to the provisions of—
 - (i) part II of subchapter H (relating to mutual savings banks, etc.), or
 - (ii) subchapter L (relating to insurance companies), or
 - (C) which is engaged in furnishing electric energy, or providing telephone service, to persons in rural areas.

(emphasis added).

U.S. TAX COURT

Puget Sound Plywood, Inc. v. Commissioner, 44 T.C. 305 (1965), acq. 1966-2 C.B. 6 (1966).

“A cooperative is an organization established by individuals to provide themselves with goods and services or to produce and dispose of the products of their labor. *The means of production and distribution are those owned in common and the earnings revert to the members, not on the basis of their investment in the enterprise but in proportion to their patronage or personal participation in it.*” *(emphasis original)* (*Id.* at 306)

.....

“The founders of the above-mentioned Rochdale Cooperative formulated three guiding principles, which still persist as the core of economic cooperative theory:

“(1) Subordination of capital, both as regards control over the cooperative undertaking, and as regards the ownership of the pecuniary benefits arising therefrom; (2) democratic control by the worker-members themselves; and (3) the vesting in and the allocation among the worker-members of all fruits and increases arising from their cooperative endeavor (i.e., the excess of the operating revenues over the costs incurred in generating those revenues), in proportion to the worker-members' active participation in the cooperative endeavor.” (*Id.* at 308)

....

“Thus, the basic and distinguishing feature of a workers cooperative association, as compared with a corporation-for-profit, is that in the case of a workers cooperative association the fruits and increases which the worker-members produce through their joint efforts are vested in and retained by the workers themselves, rather than in and by the association, as such, which functions only as an instrumentality for the benefit of the workers; and that these fruits and increases of the cooperative effort are then allocated among the active workers as patronage dividends, in proportion to their participation in producing the same. In the case of the corporation-for-profit, on the other hand, the fruits and increases of such organization belong to the corporate entity itself; and these increases (called net profits) are then either distributed or retained for the benefit of the equity owners, not in proportion to their personal efforts but rather in proportion to the amounts of capital which they supply. And also these same equity owners, acting either directly or indirectly, also select the management and control the functions and policies of their entity — not on a one-person one-vote basis without use of proxies, but rather through multiple voting in proportion to the number of shares of capital stock which they hold.” (*Id. at 309*)

....

“To avail itself of the exclusion, a cooperative must satisfy three requirements, (1) The allocation must be made pursuant to a legal obligation existing when the patron transacted business with the cooperative. (2) The allocation must be made out of profits or income realized from transactions with its patrons. (3) The allocations must have been equitably made. *United States v. Mississippi Chemical Co.*, 326 F.2d 569, 573-574 (5th Cir. 1964); *Pomeroy Cooperative Grain Co. v. Commissioner*, 288 F.2d 326, 328 (8th Cir. 1961). Plaintiff has met all these requirements.” (*Id. at 322*)

USDA REGULATIONS

“Farmer or Rancher Cooperative—A farmer or rancher-owned and controlled business from which benefits are derived and distributed equitably on the basis of use by each of the farmer or rancher owners.”

7 CFR § 4284.3 (Definitions) (Under 7 CFR Ch. XLII, Subpart A - “General Requirements for Cooperative Services Grant Programs”)

INTERNATIONAL COOPERATIVE ALLIANCE

Co-operative identity, values & principles

Definition

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

[The foregoing definition is best understood in light of the accompanying statement of values and principles.]

Values

Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity

and solidarity. In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

Principles

The co-operative principles are guidelines by which co-operatives put their values into practice.

1. *Voluntary and Open Membership.* Co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.
2. *Democratic Member Control.* Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner.
3. *Member Economic Participation.* Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.
4. *Autonomy and Independence.* Co-operatives are autonomous, self-help organisations controlled by their members. If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.
5. *Education, Training and Information.* Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of co-operation.
6. *Co-operation among Co-operatives.* Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures.
7. *Concern for Community.* Co-operatives work for the sustainable development of their communities through policies approved by their members.