

CO-OPERATIVE  
PURCHASING OF  
FARM SUPPLIES .

By

Joseph G. Knapp & John H. Lister

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*Cooperative*  
**PURCHASING**  
*OF*  
**FARM SUPPLIES**

21748

by  
**Joseph G. Knapp**  
and  
**John H. Lister**

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**FARM CREDIT ADMINISTRATION**  
COOPERATIVE DIVISION  
WASHINGTON, D.C.

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The research, service, and educational staff conducts research studies and service activities relating to problems of management, organization, policies, merchandising, sales, costs, competition, and membership, arising in connection with the cooperative marketing of agricultural products and the cooperative purchase of farm supplies and services; publishes the results of such studies; confers and advises with officials of farmers' cooperative associations; and cooperates with educational agencies, cooperative associations and others in the dissemination of information relating to cooperative principles and practices.

Copies of this publication may be obtained upon request from the

Director of Information,  
Farm Credit Administration,  
Washington, D. C.

# COOPERATIVE PURCHASING OF FARM SUPPLIES

By

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FARM CREDIT ADMINISTRATION  
Cooperative Division  
WASHINGTON, D. C.

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## APPENDIX A

### FARM SUPPLY BUSINESS REPORTED BY REGIONAL PURCHASING AND MARKETING ASSOCIATIONS<sup>1</sup>

Association and Farm Credit Administration district <sup>2</sup>	Address	Value of farm supplies sold <sup>3</sup>		Value of farm products marketed	Period covered <sup>4</sup>	Comments
		Wholesale	Retail			
District No. 1:						
Aroostook Federation of Farmers.	Caribou, Maine.....		\$343, 438		1934-35	
Burlington County Supply and Produce Company.	Mount Holly, N. J.....		377, 184	\$63, 308	1934	
Central Jersey Farmers Cooperative Association, Inc.	Hightstown, N. J.....		102, 474		1934	
Cooperative Grange League Federation Exchange, Inc.	Ithaca, N. Y.....	\$24, 258, 347	16, 011, 107	2, 500, 000	1934-35	Operates in New York, New Jersey and northern Pennsylvania. "Sales at retail" represent sales of 139 G. L. F. service stores. The wholesale sales include wholesale value of retail sales. For further information see pp. 8, 16, 17, 35-38.
Eastern States Farmers Exchange.	Springfield, Mass.....		12, 386, 498		1934	Operates in New England, Delaware, parts of Pennsylvania and Maryland. For further information see pp. 8, 16, 17, 35, 46.
Gloucester County Agricultural Cooperative Association, Inc.	Woodbury, N. J.....		144, 219	241, 357	1934	
Merrimack Farmers Exchange, Inc.	Concord, N. H.....	100, 000	1, 308, 607		1934-35	Data for period June 1, 1934 to May 31, 1935.

<sup>1</sup> The term "regional" is here used to define an area larger than a county.

<sup>2</sup> Several associations which were organized to serve 1 county have extended their operations to adjoining counties. Not all associations of this type could be included in this table.

<sup>3</sup> The principal farm supplies handled are feed, seed, fertilizer, petroleum products, and package supplies. Sales at wholesale represent purchases from associations by associations or cooperating dealers. Sales at retail represent amounts paid directly by farmers for supplies purchased through these associations.

<sup>4</sup> The operating years usually ended on or near June 30 or Dec. 31.

## FARM SUPPLY BUSINESS REPORTED BY REGIONAL PURCHASING AND MARKETING ASSOCIATIONS—Continued

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Association and Farm Credit Administration district	Address	Value of farm supplies sold		Value of farm products marketed	Period covered	Comments
		Wholesale	Retail			
District No. 1—Continued.						
Middlesex County Farm Bureau.	Waltham, Mass.....		\$885, 880		1934	Data for period Nov. 1, 1933 to Oct. 31, 1934.
Windsor County Farmers Exchange, Inc.	White River Junction, Vt.	\$5, 600	274, 400	\$38, 000	1934	
District No. 2: 5						
The Agricultural Corporation of Maryland.	Baltimore, Md.....	325, 000			1934	
Cooperative Farm Services, Inc.	Clarksburg, W. Va...	449, 693	525, 028	60, 000	1934	In addition, sales of household supplies amounted to \$18,000.
Cumberland Valley Cooperative Association.	Shippensburg, Pa....	23, 311	442, 899	202, 025	1934	
Eastern Shore Farmers Supply Co., Inc.	Onley, Va.....	796, 134			1934	Operates as subsidiary of Eastern Shore of Virginia Produce Exchange, Inc., on Eastern Shore of Virginia and Maryland. Data for period Dec. 1, 1933 to Nov. 30, 1934.
Producers Cooperative Exchange, Inc.	Richmond, Va.....	* 346, 643			1934-35	Data for period Aug. 1, 1934 to July 31, 1935.
Rockingham Cooperative Farm Bureau, Inc.	Harrisonburg, Va....		455, 395	50, 769	1934-35	In addition, sales of household supplies amounted to \$227,698. Data for period Aug. 1, 1934 to July 31, 1935.
Southern States Cooperative, Inc.	Richmond, Va.....	4, 000, 000	1, 000, 000	180, 000	1934-35	Operates in Virginia, parts of Delaware and Maryland, and in North Carolina in cooperation with the Farmers' Cooperative Exchange. Retail sales represent sales through S. S. C. service stores. For further information see pp. 16, 18 and 38.

FARM CREDIT ADMINISTRATION



Virginia Truck Growers Manufacturing Corporation.	Norfolk, Va.		100,400		1934	
District No. 3: Carolina Cooperatives Consolidated.	Florence, S. C.		* 67,000	490,000	1934	
Exchange Supply Co.	Tampa, Fla.	329,044			1934	Operates as purchasing agency for member associations of Florida Citrus Exchange.
Farmers Cooperative Exchange, Inc.	Raleigh, N. C.	990,669		112,490	1934-35	First year of operation. For further information see pp. 18 and 38.
Farmers Federation, Inc.	Asheville, N. C.		387,495	273,004	1934	Operates in 6 counties in western North Carolina.
Hastings Potato Growers Association.	Hastings, Fla.		230,497	306,993	1934-35	
Producers Cooperative Exchange, Inc.	Atlanta, Ga.		287,703		1934	Operates in Georgia and part of South Carolina and Florida.
Sowega Fertilizer Corporation.	Adel, Ga.		98,000		1934-35	Operates in southern Georgia and northern Florida. Started manufacturing operations in 1934.
District No. 4: <sup>†</sup> Farm Bureau Cooperative Association, Inc.	Columbus, Ohio	1,488,332	1,997,026	1,169,914	1934	Includes business of Ohio Farm Bureau Service Company which is being merged into the Farm Bureau Cooperative Association, Inc.
Indiana Farm Bureau Cooperative Association, Inc.	Indianapolis, Ind.	3,130,900	94,928		1934	Does not include retail value of sales of 87 member county associations, which amounted to approximately \$7,000,000. For further information see pp. 15, 19, and 34.
National Cooperatives, Inc.	do	19,202,390			1934	Serves as bargaining agency for 7 regional associations operating in 20 midwestern and western States. For further information see pp. 15 and 20.

Data are not available for the Pennsylvania Farm Bureau Cooperative Association, Inc., Harrisburg, Pa., which has not yet operated for a full year.

\* Unclassified.

<sup>†</sup> There are also in this district the Farm Bureau Milling Co., Inc., of Columbus, Ohio, and the Farm Bureau Oil Co., Inc., of Indianapolis, Ind., which serve State Farm Bureau purchasing associations as described on p. 15.

FARM SUPPLY BUSINESS REPORTED BY REGIONAL PURCHASING AND MARKETING ASSOCIATIONS—Continued

Association and Farm Credit Administration district	Address	Value of farm supplies sold		Value of farm products marketed	Period covered	Comments
		Wholesale	Retail			
<b>District No. 4—Continued.</b>						
Ohio Farmers Grain & Supply Association.	Fostoria, Ohio-----	\$1, 000, 000	-----	\$2, 250, 000	1934	
Ohio State Grange-----	Zanesville, Ohio-----	100, 000	-----		1934	
Tennessee Cooperative Supplies Association.	Columbia, Tenn-----	113, 947	-----		1934	
<b>District No. 5:</b>						
Central Strawberry Cooperative Association.	Hammond, La-----	170, 737	-----	416, 395	1934-35	
Farmers Marketing & Exchange Association.	Montgomery, Ala----	625, 402	-----	61, 571	1934-35	Retail supply business is done through local units.
Louisiana Farm Bureau Federation, Inc.	Baton Rouge, La----	295, 035	-----	104, 281	1934-35	
Mississippi Federated Cooperatives.	Jackson, Miss-----	409, 593	-----	85, 796	1934-35	
Mississippi Vegetable Exchange, Inc.	Crystal Springs, Miss.	* 45, 259	-----	115, 457	1934-35	Data for period Sept. 1, 1934 to Aug. 31, 1935.
Truck Growers Association, Inc.	do-----		* \$127, 467		1933-34	
<b>District No. 6:</b>						
Consumers Cooperative Association.	North Kansas City, Mo.	1, 776, 839	241, 872	-----	1934	Operates in Kansas and parts of Missouri, Nebraska, South Dakota, North Dakota, Colorado, and Utah. See pp. 19-20.
Equity Union Grain Co-----	Kansas City, Mo-----	27, 020	-----	882, 400	1934-35	Data for period May 1, 1934 to Apr. 30, 1935. Operates in Kansas.
Farmers Union Jobbing Association.	do-----	750, 000	-----	-----	1934	Operates in Kansas.

Illinois Farm Supply Co.	Chicago, Ill.	3, 378, 833			1934	Data for period Sept. 1, 1933 to Aug. 31, 1934. Does not include retail value of sales of 58 member companies, which amounted to \$6,729,834. For further information see pp. 20-21.
Missouri Farmers Association, Inc.	Kansas City, Mo.	2, 856, 179			1934	
M. F. A. Milling Co.	Springfield, Mo.	1, 861, 601			1934	Operates in Missouri, Arkansas, Oklahoma, Tennessee.
M. F. A. Oil Co., Inc.	Columbia, Mo.		546, 000			Data for period Nov. 1, 1933 to Dec. 1, 1934.
District No. 7: Central Cooperative Wholesale.	Superior, Wis.	301, 746			1934	Operates in parts of Michigan, Wisconsin, and Minnesota. In addition, sales of household supplies amounted to \$1,485,-810.
Cherry Growers Packing Co.	Traverse City, Mich.	158, 073		510, 023	1934-35	
Farm Bureau Services, Inc.	Lansing, Mich.	1, 670, 000	630, 000	100, 000	1934-35	
Farmers Union Central Exchange, Inc.	St. Paul, Minn.	2, 615, 519			1934	Data for period Nov. 1, 1933 to Oct. 31, 1934. Operates in North Dakota, Montana, parts of Wisconsin and Minnesota. For further information see pp. 14 and 40.
Fruit Growers Cooperative.	Sturgeon Bay, Wis.	160, 600		390, 000	1934	This association serves the sour cherry area of Wisconsin.
Great Lakes Fruit Industries.	Benton Harbor, Mich.		*185, 860		1934	
Land O'Lakes Creameries, Inc.	Minneapolis, Minn.	2, 082, 316		33, 000, 000	1934	Operates in Minnesota, North Dakota, South Dakota, Iowa, and nearby States. Includes feed sales amounting to \$652,-316. For further information see p. 21.

\* Unclassified.

FARM SUPPLY BUSINESS REPORTED BY REGIONAL PURCHASING AND MARKETING ASSOCIATIONS—Continued

Association and Farm Credit Administration district	Address	Value of farm supplies sold		Value of farm products marketed	Period covered	Comments
		Wholesale	Retail			
District No. 7—Continued. Midland Cooperative Wholesale, Inc.	Minneapolis, Minn.	\$1, 751, 007	-----	-----	1934	Operates in Minnesota and Wisconsin. For further information see pp. 19, 20, and 34.
Minnesota Farm Bureau Service Co.	St. Paul, Minn.	235, 000	-----	-----	1934	
Wisconsin Farm Bureau Federation.	Madison, Wis.	177, 334	-----	-----	1934	
District No. 8: Farm Bureau Service Co.	Des Moines, Iowa	1, 500, 000	-----	-----	1934	Data for period, Nov. 1, 1933 to Oct. 31, 1934.
Farmers Elevator Service Co.	Ralston, Iowa	400, 000	-----	-----	1934	
Farmers Union Brokerage Co.	Sioux City, Iowa	351, 452	-----	-----	1934	Value of supplies handled on brokerage basis. Data for period, Jan. 1, 1934 to Nov. 30, 1934.
Farmers Union Cooperative Oil Association.	Des Moines, Iowa	219, 000	-----	-----	1934	
Farmers Union State Exchange.	Omaha, Nebr.	1, 115, 009	\$779, 926	\$150, 000	1934	In addition, sales of household supplies amounted to \$241,788. See also p. 13.
Nebraska Farm Bureau Service Co.	Lincoln, Nebr.	60, 409	-----	-----	1934	
South Dakota Farm Bureau Service Co.	Huron, S. Dak.	58, 324	144, 869	-----	1934	Data for period Nov. 1, 1933 to Sept. 30, 1934.
District No. 9: Colorado Potato Growers Exchange.	Denver, Colo.	100, 000	-----	750, 000	1934	
Oklahoma Farmers Union.	Oklahoma City, Okla.	111, 528	80, 426	82, 017	1934	In addition, sales of household supplies amounted to \$4,072.

District No. 10: Consumers Cooperatives Associated, Inc.	Amarillo, Tex.....	251, 993			1934	Operates in Texas Panhandle and parts of New Mexico and Oklahoma. Includes business done on brokerage basis of approximately \$125,000.
Rio Grande Valley Citrus Exchange.	Wealaco, Tex.....	89, 000		570, 000	1934-35	Data for period July 1, 1934, to April 30, 1935.
Texas Cooperatives, Inc....	Dallas, Tex.....	126, 373			1934-35	In addition, sales of household supplies amounted to \$750.
District No. 11: California Fruit Exchange..	Sacramento, Calif....	919, 364		15, 050, 121	1934	For further information see pp. 21 and 51.
Dairymen's Feed & Supply Co.	Los Angeles, Calif....		* 500, 416		1934-35	Data for period May 31, 1934, to May 31, 1935.
Escondido Valley Poultry Association.	Escondido, Calif.....		140, 000	1, 200	1934	
Fontana Producers Egg & Supply Co.	Fontana, Calif.....		275, 804	405, 990	1934	
Fruit Growers Supply Co..	Los Angeles, Calif....	7, 649, 491			1934	Operates in connection with California Fruit Growers Exchange. Farm supply business includes 1 percent household supplies. For further information see pp. 21, 22, and 51.
Hayward Poultry Produc- ers Association.	Hayward, Calif.....		25, 000	700, 000	1934	In addition, sales of household supplies amounted to \$25,000.
Mutual Orange Distribu- tors.	Redlands, Calif.....		711, 703	5, 680, 706	1934	Data for period Nov. 1, 1933, to Oct. 31, 1934.
Poultry Producers of Cen- tral California.	San Francisco, Calif..	697, 387	3, 549, 717	8, 618, 528	1934	For further information see p. 52.
Poultry Producers of North- ern California.	Eureka, Calif.....	86, 199		119, 413	1934	
Poultrymen's Cooperative Association of Southern California.	Los Angeles, Calif....	58, 918	1, 119, 449	998, 581	1934	

\* Unclassified

FARM SUPPLY BUSINESS REPORTED BY REGIONAL PURCHASING AND MARKETING ASSOCIATIONS—Continued

Association and Farm Credit Administration district	Address	Value of farm supplies sold		Value of farm products marketed	Period covered	Comments
		Wholesale	Retail			
District No. 11—Continued.						
San Diego Cooperative Poultry Association.	San Diego, Calif.....	\$613, 073	\$25, 522	\$172, 071	1934	
San Joaquin Valley Poultry Producers Association.	Porterville, Calif.....	-----	° 887, 126	324, 254	1934	
Utah Poultry Producers Cooperative Association.	Salt Lake City, Utah..	° 2, 007, 106	-----	4, 529, 243	1934	Operates in Utah and part of Idaho.
District No. 12:						
Apple Growers Association.	Hood River, Oreg.....	-----	° 707, 385	2, 833, 000	1934	
Cooperative Union Oil Co.	Caldwell, Idaho.....	° 250, 179	-----	-----	1934	
Dairy Cooperative Association.	Portland, Oreg.....	-----	105, 685	1, 343, 064	1934	Operates in parts of Washington and Oregon.
Grange Cooperative Wholesale.	Seattle, Wash.....	950, 812	26, 314	-----	1934	Sales of household supplies amounted to \$167,171.
Idaho Egg Producers.....	Caldwell, Idaho.....	-----	180, 000	500, 000	1934	
Lower Columbia Cooperative Dairy Association.	Astoria, Oreg.....	77, 000	-----	520, 953	1934	Operates in Lower Columbia River Valley of Oregon and Washington.
Pacific Cooperative Poultry Producers.	Portland, Oreg.....	-----	285, 041	1, 368, 423	1934	Operates in Oregon and part of Washington.
Pacific Supply Cooperative.	Walla Walla, Wash..	311, 584	436, 218	-----	1934	Operates in Oregon, Washington, and Idaho. Began operations June 1, 1934, with 12 local units. Number of local units approximately 60.
Washington Cooperative Egg & Poultry Association.	Seattle, Wash.....	-----	5, 033, 699	9, 268, 265	1934	For further information see pp. 41 and 52.

Wenatchee Farmers Exchange.	Wenatchee, Wash.		196,984		1934	Products marketed through Wenatchee-Okanogan Cooperative Federation.
Wenoka Supply Company	do.	138,239			1934	
Yakima Fruit Growers Association.	Yakima, Wash.		* 500,298	1,913,811	1934-35	

\*Unclassified.

## APPENDIX B

EXEMPTION OF FARMERS' COOPERATIVE ASSOCIATIONS FROM CERTAIN FEDERAL TAXES<sup>1</sup>

FEDERAL statutes have for years provided for exemption of farmers' cooperative associations, if properly organized and operated, from income and certain other Federal taxes (Internal Revenue Act of 1934, sec. 101, clauses 12, 13, and 14.) There is still, however, considerable uncertainty among cooperative associations as to the necessary conditions for exemption, and the proper procedure for obtaining it. A comprehensive outline of these subjects was prepared by L. S. Hulbert (21) in 1929, and few changes in the income-tax laws have occurred since that time. Most of the problems of income-tax exemption are dealt with also in a ruling (IT:E:R.R. Min. 3886) made by the United States Bureau of Internal Revenue on July 9, 1931, which may be obtained from that Bureau upon request.

The Internal Revenue Act of 1934 provides for exemption of such cooperatives from capital-stock and excess-profits taxes if exempt from Federal income taxes (secs. 701 and 702). Exemption from these taxes, like exemption from the income taxes, is not automatic but is obtained only by making claim for it. That is, in order to obtain exemption from these taxes, application must be made to the collector of internal revenue for the district where the principal business of the association is located. This is the initial step in proper procedure for exemption. The collector will supply forms outlining information which must be submitted to show that the association qualifies for the exemption.

In order to obtain the exemption, an association or a subsidiary of an association, must satisfy the Bureau of Internal Revenue that it complies with the requirements stated in the Revenue Acts. The burden of proof is upon the applicant.

As to taxes payable for any year, the claims for exemption and refunds must be filed within two years of the time when the association filed its tax returns for such year.

By making minor changes in corporate organization or in business practices, associations are frequently able to qualify for exemption. It may be true that some associations which have been granted exemption for previous years are no longer entitled to exemption because they have not maintained the required conditions, although they might easily have done so.

## SUBSIDIARIES ALSO EXEMPT

Corporations organized by exempt cooperatives, or their members, to finance the ordinary crop operations of such members, or other producers, and operated in conjunction with the exempt associations,

<sup>1</sup> Prepared by J. M. Wright, of the Legal Division, Farm Credit Administration.



will likewise be exempt from the payment of these taxes. Restrictions on stock ownership and dividends, and on reserves of these corporations are the same as for the cooperative marketing or purchasing associations.

Cooperatives organized by exempt cooperatives to hold title to property and pay over the income derived from it, less expenses, to the exempt cooperatives are similarly exempt from the payment of these taxes.

Exemption of subsidiaries, like that of ordinary cooperatives, is not automatic, but is obtained by the procedure outlined above.

A subsidiary corporation, therefore, is not exempt unless it meets the stated requirements as to its operations, and unless the cooperative association with which it operates is exempt.

#### CONDITIONS FOR EXEMPTION OF COOPERATIVES

In substance, the conditions required for exemption as a farmers' cooperative association from the payment of Federal income taxes are described below.

1. The association must be both organized and operated on a cooperative basis for the purpose of marketing products and returning the proceeds, less necessary expenses, to the producers on the basis of either quantity or value of the products marketed; or for the purpose of distributing supplies to farmers at cost plus necessary expenses. Of course, one association may engage in both activities.

2. Substantially all of the stock (except nonvoting preferred stock, entitled only to fixed dividends and to redemption at the price for which issued) or of the voting memberships in nonstock corporations, must be owned by producers who patronize the association.

3. In regard to an association's marketing business, producers who are members and producers who are nonmembers must be "treated alike" with reference to patronage dividends. In regard to purchasing activities, all persons who buy supplies from or through the association, whether members or nonmembers, must be treated alike as to patronage dividends.

4. Associations organized with capital stock must not pay dividends on such stock, directly or indirectly, in excess of the legal rate of interest in the State of incorporation, or in excess of 8 percent per year, whichever is greater, on the amount paid for the stock when it was issued.

5. At least 50 percent in value of both the marketing and the purchasing business of the association must be done with members, and not more than 15 percent of the purchasing business may be done with persons who are neither producers nor members.

6. Any reserves or surpluses set up by the association must be required by State law, or must be reasonable reserves for necessary purposes of the cooperative business.

*Associations Must Be Cooperative*

Although the Bureau of Internal Revenue does not require that an association keep ledger accounts with its patrons, it must have records showing, among other things, the amounts of its receipts, expenses, and earnings, and the funds carried to reserves or distributed as dividends, patronage, or otherwise. This is necessary because the exemption provisions require that the association be both organized and operated on a cooperative basis. Therefore, in order to show that it has complied with the statute, the association must prove that it has turned back to the producers (if it is a marketing association) and to the purchasers (if it is a supply-distributing organization) all of its earnings other than amounts required for expenses. Subsidiary corporations must show that the associations in connection with which they operate are exempt, and also that such corporations meet the requirements specified for them.

Purchasing associations may treat as supplies and equipment anything that is used in the operation or maintenance of the farm or farm household, and for the purposes of the income tax its distributing business is not limited to articles and supplies used directly in farm operations, such as farm implements, stock feed, and fuel for farm motors.

*Voting Control in Producers*

In order to obtain exemption, an association is not required to show that farmers hold direct ownership of substantially all its stock or memberships. It is sufficient if such stock or memberships are owned by exempt cooperative associations, engaged in similar activities, whose members, in turn, are farmers. Similarly, it is sufficient if voting stock is held in trust for farmer-members by a State educational and cooperative nonprofit association, conducted for the benefit of such members. The ownership of small amounts of stock by, or for the benefit of, persons who presently cease farming operations will not necessarily exclude an association from exemption. The association will be required to explain such ownership of such stock or memberships. Generally it is necessary to show that the association is doing all that reasonably can be done to see that such stock or memberships are transferred to or owned only by farmers or their cooperatives.

*Equal Treatment of Members and Nonmembers*

The requirement of equal treatment of members and nonmembers will be complied with: (1) If the cooperative shows that, although its charter and bylaws are silent on the subject, it has consistently paid patronage dividends to members and nonmembers equally, in cash or its equivalent, within a reasonable period after the close of the

fiscal year involved; or (2) if the bylaws provide for payment equally to members and nonmembers and a general reserve has been set up for the payment of patronage dividends; or (3) if the bylaws are silent as to the payment of patronage dividends to nonmembers, and a specific credit to the account of each nonmember is set up on the association's books in the same manner as for members.

The requirement of equal treatment is not violated by applying patronage dividends, distributable to a nonmember who is eligible for membership, to the payment of the price of a share of stock or of the membership fees in the association.

It has been held that a marketing association may make certain limited emergency purchases from persons who are not producers, and does not lose the exemption by failing to distribute patronage dividends to such persons; but fundamentally all producers who market their products through the association, whether they are members or nonmembers, must be treated alike. Purchases of products from nonproducers who are not granted patronage dividends, if made for other than emergency purposes, may cause the association to lose exemption. With reference to the distribution of farm supplies, it has been held that sales to nonmembers, although constituting only a small proportion of the total business, and purely incidental to business done with members, would subject the association to the payment of taxes if such nonmembers were not allowed patronage dividends.

#### *Capital Dividends Must Be Limited*

In order to comply with the limitations on stock dividends, and to show that returns to producers, or purchasers of supplies, are properly made, the corporate papers of the association should show that no gains will accrue to members or stockholders in amounts exceeding the permitted dividends, unless such gains are in proportion to their business done with the association. To do this, the association's articles of incorporation or bylaws should provide that whenever assets of the association, including reserves deducted by it, are distributed to members or stockholders, any of such assets resulting from the proceeds of products marketed or of supplies sold shall be credited to the producers or purchasers in proportion to their business with the association.

#### *Business With Nonmembers Limited*

The Bureau of Internal Revenue has ruled that an association may treat as a member anyone who shares in the profits of a cooperative association and who is entitled to participate in its management. Thus patrons who are entitled to vote as stockholders, or in nonstock associations as members, may be considered to be members for the

purpose of determining amounts of member and nonmember business. But persons may not be considered members because they hold nonvoting stock, or certificates of interest or indebtedness.

*Reserves Must Be Reasonable and for Necessary Purposes*

Funds accumulated or maintained by an association to meet capital expenditures of the association in connection with its cooperative business may be included in reserves, and are permissible if reasonable in amount. The applicant for exemption must show that the amount is not larger than is reasonably necessary to its business and that the funds are not used for purposes unrelated to the cooperative business.

**PATRONAGE DIVIDENDS DISTRIBUTED NOT TAXABLE**

If a farmers' association does not meet the requirements for exemption from income taxes, it still is not required to pay taxes on savings or earnings which it has returned, or has obligated itself to return, to its members or others in the form of patronage dividends. The theory upon which this rule is based is that the dividends when distributed, or the liabilities for them, constitute an expense which must be deducted from receipts in order to determine the net income. In order to meet this requirement, the patronage dividends must be paid during the tax year, or the obligations to pay them must have become binding on the association during the tax year by contract, bylaw, or provision in its articles of incorporation, which requires the distribution, on a patronage basis, of net earnings above the stock dividends and reserves allowed. Where patronage dividends have not been paid, or the amount due to each patron declared by resolution of the board of directors, it is desirable that the corporate papers or a resolution of the board make the obligation as easy to determine and as definite as possible, both as to the basis of the dividend and as to the amount.

Where patronage dividends are distributed, or the association has become obligated to pay them, during the tax year, they may be deducted from the receipts for the purposes of the excess profits tax which is provided by the Internal Revenue Act of 1934. However, such payments or obligations would not affect the amount of the capital stock tax, provided by that Act. Under the Revenue Act of 1934 the excess profits tax is equivalent to 5 percent of all net income for the year in excess of 12½ percent of the adjusted declared value of the association's capital stock at the close of the preceding tax year. Under the same Act the capital stock tax is \$1 for each \$1,000 of the adjusted declared value of the capital stock.