ESO 717

Guides to Determining Your Position on the Proposal to Change the Limit of 8% Dividends Cooperatives Can Pay on Equity Capital

by

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Two excerpts from the Ohio Cooperative Marketing Act, which is Section 1729, are: (ESO 536)

"Associations shall be deemed nonprofit inasmuch as they are not organized to make profit for themselves as such, or for their members as such, but only for their members as producers."

Section 1729.10 F of the Ohio Cooperative Marketing Act states:

"The association shall limit its dividends on stock to any amount not greater than eight (8) percent per annum; and all its other net income, less specified reserves which shall be provided for in the bylaws, shall be distributed to its members only on the basis of patronage. Any receipts or dividends from subsidiary corporations, or from stock or other securities owned by the association, shall be distributed accordingly."

Cooperatives are one of 4 ways of doing business in the United States. They are: (1) Sole Proprietor, (2) Partnership, (3) Investor Corporation, and (4) Cooperative Corporation.

The basic cooperative principles that differentiate cooperative corporations from investor corporations are:

- Operations at Cost
- Democratic Control
- Limited Return on Equity Capital
- Financed by Members
- Education of Members About Cooperatives

The Capper Volstead Act permits farmers to join together in associations, provided the association is: (ESO 413a)

Operated for the mutual benefit of the "members" and conforms to one or both of the following requirements:

First - that no member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein, or,

Second - that the association does not pay dividends on stock or membership capital in excess of 8 per centum per annum.

Please observe that only one of the two above requirements must be met!

The National Council of Farmer Cooperatives is on record as favoring no change in the Capper Volstead Act.

It is a fact that the Capper Volstead Act and Section 1729 were both enacted nearly 60 years ago. It is also a fact that at that time (1920s) cooperatives were not required to include the dividends they paid on stock in their taxable income. In 1980 those "farmers, fruit growers or like associations organized and operated on a cooperative basis---marketing or purchasing association--ULTIMATELY TURNING BACK ALL NET PROCEEDS to member and non-member patrons on the basis of quantity or value of business conducted by each with the association, and limiting return on equity to 8 percent, and limited accumulation of reserves, and if they do more business with members than with non-members and do no more than 15% of the total business with non-members, non-producers," may have 521 classification by IRS,[1/] and can exclude the dividends they pay on stock from their taxable income. Therefore, those firms that have elected not to meet the 521 requirements of IRS must pay IRS taxes on the dividends they pay on equity capital. For example, a firm with a 46% IRS tax rate that pays $10,000 dividends on equity capital would also pay IRS $8,519 or to put it another way, to pay $10,000 stock dividend would require $18,519, with $8,519 going to IRS and $10,000 to the investor as a stock dividend. This same $18,519 could, in a cooperative, be paid out as patronage refund or used to retire old non-cash patronage (equity) with the total $18,519 going into the income of farmer members.

If the dividend rate of cooperative stock were permitted to fluctuate with the prime interest rate, would this attract more equity capital from farmer members?

If the rate of interest paid to those who purchase equity capital, as an investment, is permitted to fluctuate with the prime interest rate, would it not also be fair for these same firms to pay the prime interest rate on the non-cash portion of the patronage refund allocated to users?

Those firms that do not want to operate under Section 1729 of the Ohio Revised Code can re-charter under Section 1701 of the Ohio Revised Code. Section 1701 does not place a limit on the amount of dividend that can be paid.