FARM BUSINESS NOTES

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Cooperatives and Income Taxes

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What should the status of cooperative organizations be with respect to the payment of income taxes? This question is the center of a heated controversy at the present time, so it is appropriate to review some of the basic factors involved. Much of the discussion refers to "exemption" of cooperatives from income taxes. While it is true that the present federal income tax law and the regulations thereunder provide that some farmers' cooperatives which meet certain specifications as to plan of organization and method of operation may be exempted from filing the customary corporate income tax returns, this is not in itself the basic issue at stake.

Cooperative marketing associations seek to obtain better returns for the products which farmers sell through them, while cooperative purchasing associations endeavor to reduce the costs of goods and services that they supply their patrons. In carrying out this objective, cooperatives aim to apportion benefits in accordance with patronage. A marketing association at the end of the year may find that it has withheld a larger margin from the returns received from sales than is needed to cover expenses. In the usual business company, such margin can be drawn upon for distribution to stockholders as dividends on capital stock. Cooperatives normally limit such dividends to a reasonable interest payment for the use of capital, and distribute the balance as a patronage refund to patrons. The patronage refund becomes in effect an addition to the price of the product, and therefore represents income to the patron and not to the association. In a purchasing cooperative, a similar distribution to patrons is a reduction or saving in the cost of supplies and services furnished.

The basic issue involved is, "Are the amounts distributed as patronage refunds income to the association and therefore taxable as such?" Marketing and purchasing cooperatives, as customarily organized and operated, in effect serve as an agent for their patrons. The state laws under which cooperatives are incorporated and the articles of incorporation, by-laws, and marketing agreements of such associations usually require the marketing cooperative to return to its patrons the proceeds from the sale of their products after the costs of operation have been deducted. Cooperative purchasing associations similarly are required to return to the patrons the amount by which the purchase price which has been deposited for supplies exceeds the cost of the supplies and the expenses of operation.

Instead of distributing patronage refunds in cash at the end of the year, some cooperatives allocate and record on the books of the association the amount available for distribution to each patron, and retain the funds for a period to provide capital needed in their operations. This is a convenient way of getting patrons to provide capital in accordance with the use each makes of the association. Distribution in this manner is in line with the basic principle suggested earlier of apportioning benefits in accordance with patronage. However, it is important for cooperatives employing this method to be sure that patrons are dealt with fairly. Adequate records of such allocations are essential. Moreover, such withholding ought not to become a permanent investment in the business, and the amounts involved should be distributed in cash within a reasonable period of time. The revolving plan of financing under which current withholdings are used to pay those of longer standing may be employed to accomplish this purpose.

As suggested earlier, federal income tax laws and regulations provide certain exemptions for some cooperatives. These exemptions at present are limited to farmers' cooperatives engaged in marketing farm products, buying farm supplies, and related activities which meet certain specifications. Organizations desiring to avail themselves of these provisions must file an application. If approved, a "letter of exemption" is provided by the Bureau of Internal Revenue. Exempt cooperatives file an informational return in place of the usual one. If organized with capital stock, they are not required to pay any tax on the limited dividends on stock which they are permitted to pay. They are also relieved of certain other taxes, such as the excess profits tax, the capital stock tax, the documentary stamp tax, and, to a limited extent, the social security tax. It should be borne in mind that these exemptions do not apply to all cooperatives. There is some feeling that the distinctions between "exempt" and "nonexempt" cooperatives lack justification. However, the issues involved in the matter of exemption provided by law are not as significant as those relating to distributions on patronage considered above.

The view that patronage refunds are not income to the association and therefore are not taxable as such is not confined to the "exempt" cooperatives, but applies to all cooperatives or to any other corporation. The principle that cooperatives are not required to pay income taxes on patronage refunds has been upheld in a number of court decisions. Among the most recent of these was the decision of the U. S. Tax Court in the case of *United Cooperatives, Inc., vs. Commissioner,* 4 T. C. No. 12 (decided September 29, 1944). In this case the court held that the patronage refunds of this nonexempt cooperative were excludable from gross income and were not subject to the tax on the ground that the by-laws required refund to the patrons of receipts in excess of expenses and dividends on capital stock. Similar conclusions have been reached in the case of ordinary business companies. For instance, in the case of *Uniform Printing and Supply Co. vs. Commissioner* (1937), it was decided that the patronage refunds of the company were not taxable, since it operated under an agreement incorporated in its by-laws and printed on its stock certificates to refund to its customers on a prorata basis all receipts in excess of the cost of operation. It is apparent that in the exclusion of patronage refunds from gross income, the "exempt" cooperative enjoys no preference or advantage over other cooperatives or business companies which operate in a similar manner.

Patronage Refunds Not Association Income

This makes clear the basic principle that patronage refunds are not income to the association and hence are not taxable in its hands. If these amounts were distributed currently as higher prices for products sold or as lower costs for goods purchased through the organization, the question of taxability would not arise. If patronage refunds were taxable, many cooperatives would shift their methods to current distribution. This would intensify rather than reduce price competition, and hence would not ease the problem for those who think present tax treatment results in unfairness to them. Any business which prefers to pay higher prices for the commodities it buys, or to charge lower prices for the things it sells, can reduce its net income and thereby reduce its tax payments.

The contention that amounts distributed as patronage refunds are income or savings to the patrons rather than taxable income of the organization appears to be sound in principle. The qualification should be kept in mind that the distribution must be to all participating patrons on the basis of the volume of business of each. If a cooperative does business with both member and nonmember patrons but makes the distribution only to members, part of it is in reality a profit made on nonmember business and the association is liable for the payment of income taxes on that part.

The patronage refund has a counterpart in other lines. Thus life insurance premiums usually include a margin for safety, and the policy holder is allocated a dividend which lowers the annual premium he is required to pay. No one contends that such dividends represent income to the insurance company. In short, this should be viewed as a basic principle rather than as a dispensation granted to a special type of organization. As a general principle it appears appropriate for application to any situation where such refunds occur rather than to depend upon certain arbitrary features of the organization which may be involved.

Best to Tax Receiver of Dividends

The point is made by some that the controversy would be solved if corporations generally were relieved of paying income taxes. There is merit in the contention that amounts distributed as dividends by corporations can be taxed more equitably by assessing the taxes against the receiver of the dividend rather than against the corporation as such. Were this plan to be followed, it would still be necessary to apply taxes against undistributed earnings retained by the corporation in order to keep them from becoming the means of tax evasion.

A contention frequently heard is that the failure to tax patronage refunds of cooperatives will enable such enterprises to usurp the entire field of business operations, and thereby "dry up" the source of tax revenue. This assigns greater advantage to the tax aspect than appears warranted. Moreover, business corporations are not the final resting place of taxes. Recurring taxes must be paid from income, and taxes levied on corporations eventually come out of incomes of individuals. Thus, taxes on corporations may result in lower returns to their owners or higher costs to their customers. Ability to pay taxes rests on productive activity which yields an income rather than on any particular form of organization.

Bonus and Other Incentive Payments for Farm Workers

J. B. McNulty

Agreements allowing hired farm workers to share in the earnings have increased materially in Minnesota since the beginning of the war. The purpose of these arrangements is to help secure and keep experienced farm help. A large proportion of these "share the earnings" agreements provides that the worker will receive a definite wage per month or salary per year plus a share in the earnings from one or more of the farm enterprises, or from the entire farm business. Usually the cash wage or salary agreed upon is the same or slightly less than the prevailing wages in the community.

One operator who furnishes a house, electricity, and all of the usual perquisites except meat to a married hired worker has been using the following plan for the past five years.

A base wage is agreed upon for the months of January, February, and December. From March to July, inclusive, wages are increased $10.00 each month. Beginning with August, wages are reduced $10.00 each month, bringing them down to the base wage in December. These adjustments in monthly wages are designed to provide more pay per hour as well as more wages per month when the farm work is most strenuous.

After the first year, the hired worker is eligible to a bonus of 3 per cent of his employer's "net farm profit" as calculated on a cash basis for his federal income tax return. In the third and subsequent years this is increased to 5 per cent. This farmer states that in his opinion the bonus provision of his agreement is much more effective than the adjustable wage provision.

The farm accounts of this operator were supervised by a disinterested party; hence the possibility of a disagreement on the calculation of the "net farm profit" was practically eliminated. Success with bonuses based on net earnings requires that accurate farm accounts be kept. This is probably the principal reason for a large proportion of the incentive plans in use being based on "gross sales."

An example of compensating hired help with a regular wage plus a share of the gross sales was furnished by a farmer who paid his hired worker a specified cash wage per month plus 10 per cent of the milk and hog sales. While most of the feed for the livestock was produced on the farm, the agreement allowed the employer to deduct 10 per cent of the cost of any feed purchased for the cows and hogs before dividing the milk and hog sales. Sales were divided as received.

The hired worker had full responsibility for the care of the dairy cattle and the hogs. A milking machine made it possible for him to do the milking alone. The employer did most of the work with the poultry and got all of the receipts from this enterprise. Both families lived in separate houses on the farm. The hired worker was allowed all of the usual perquisites except meat. Meat from the farm was deducted from his 10 per cent of the hog sales.

A monthly wage plus a share of the crop from rented land is a popular arrangement in situations where there are opportunities to rent land reasonably close to the employer's farm.

In one instance, 30 acres of corn were rented for cash. The operator furnished all of the machinery without charge. The cost of the gasoline for the tractor was shared equally. The hired man paid for husking all of the 30 acres of corn. The crop was shared on a 50-50 basis. Agreements of this kind tend to enlarge the size of the farm business. Unless the advantage of a larger business is more than offset through a loss in efficiency, this type of agreement provides an opportunity to increase the earnings of the operator as well as of the worker.

Saving Seconds

S. A. Engene and V. G. Dose

The experience of a Nicollet County dairy farmer illustrates the savings in chore time and travel that could be made on many farms. The time he spent on dairy chores was reduced from 3 hours 39 minutes per day to 2 hours 45 minutes, without increasing his speed and without decreasing the quality of his work. This farmer was already more efficient than the average of his neighbors in doing his dairy chore work. Time and travel for each part of the dairy chores are presented in the accompanying table.

This saving was the result of systematic study and planning of the work. Details and time of the original chore work were recorded, and this record was carefully studied to determine opportunities to (1) eliminate unnecessary tasks, (2) use new or better methods, (3) combine tasks, (4) rearrange the order in which jobs are done, (5) use equipment suitable for the job, or (6) rearrange the barn and other working areas.

Chore work shown in the table includes only those jobs which were performed regularly every day. Time and travel for both dates are for caring for 13 cows, 1 bull, 2 two-year-old heifers, 4 yearling heifers, and 7 calves.

Saving in time on this farm, adjusting for seasonal variations in work, is almost 300 hours per year, or one month of work. Travel was reduced by 138 miles per year, or 37 per cent.

This saving is the total of a large number of small savings, many of only a few seconds a day. By themselves, some of these savings seemed too small to be worthy of serious consideration, but when added to a large number of similar changes, they accumulated to a substantial total.

The changes that effected the largest savings were:

(1) Fast milking methods were adopted, eliminating hand stripping and other operations for most cows.

(2) Whole milk instead of cream was sold, eliminating separating and washing of the separator. Availability of a profitable market for whole milk was the primary factor responsible for this change.

(3) A slightly longer period of whole milk feeding and the use of calf meals were substituted for skim milk feeding for calves.

(4) A homemade cart was substituted for a basket for feeding silage.

(5) A homemade cart was substituted for two pails for feeding grain and supplement.

(6) Drinking cups were installed, reducing the number of times the cattle were turned out.

Time and Travel per Day for Dairy Chores

Date	March 31, 1944		March 7, 1945	
Operation	Minutes	Feet	Minutes	Feet
Assemble milkers and separator	5.6	....	3.8	....
Milk cows	95.5	1,818	70.2	1,844
Separate, care for milk, wash milk utensils	22.4	....	15.0	....
Feed milk to calves	9.0	260	5.0	100
Feed hay to cows and heifers	15.2	536	14.1	426
Feed silage to cows and heifers	24.6	1,374	17.7	408
Feed grain and supplement to cows and heifers	15.2	1,344	11.4	373
Feed grain and meal to calves	2.2	160	1.6	15
Let cows and bull in and out	6.8	662	3.1	257
Let heifers in and out	1.5	169	1.1	44
Clean barn	16.4	813	17.8	562
Spread bedding	4.7	259	4.7	259
Total per day	219.1	7,395	165.5	4,288
Total for year	1,116 hours	376 miles	817 hours	238 miles

Minnesota Farm Prices For April, 1945

Prepared by W. C. WAITE and R. W. COX

The index number of Minnesota farm prices for April, 1945, is 173. This index expresses the average of the increases and decreases in farm product prices in April, 1945, over the average of April, 1935-39, weighted accordingly to their relative importance.

Average Farm Prices Used in Computing the Minnesota Farm Price Index, April, 1945, with Comparisons*

	Apr. 15, 1945	Mar. 15, 1945	Apr. 15, 1944		Apr. 15, 1945	Mar. 15, 1945	Apr. 15, 1944
Wheat	$ 1.51	$ 1.50	$ 1.49	Hogs	$14.00	$14.00	$13.10
Corn	.84	.83	1.01	Cattle	12.20	11.80	11.80
Oats	.63	.68	.72	Calves	13.50	13.10	13.00
Barley	.99	1.03	1.10	Lambs-Sheep	12.72	12.62	12.82
Rye	1.14	1.08	1.11	Chickens	.21	.21	.20
Flax	2.91	2.91	2.86	Eggs	.32	.32	.28
Potatoes	1.60	1.50	1.05	Butterfat	.53	.53	.54
Hay	9.10	11.70	10.30	Milk	2.60	2.65	2.60
				Wool†	.41	.42	.40

* These are the average prices for Minnesota as reported by the United States Department of Agriculture.
† Not included in the price index number.

Prices of oats, barley, and hay declined and prices of other grains and of potatoes increased slightly during the month ending April 15. Hog prices were unchanged, but prices of other classes of livestock were somewhat higher. Prices of livestock products, with the exception of milk, remained at their March levels. The indexes of crop, livestock, and livestock product prices are all significantly higher than in April, 1944, resulting in an increase of 5.8 points in the Minnesota farm price index. The higher crop price index is due mainly to the change in potato prices.

The feed ratios are about the same as in March, but all are much higher than one year ago. Producers of butterfat received a feed payment of 17 cents per pound in April. If this amount is added to the reported price of butterfat, the butterfat-farm-grain ratio would be raised to 37.3.

Indexes and Ratios for Minnesota Agriculture*

	Apr. 15, 1945	Apr. 15, 1944	Apr. 15, 1943	Average Apr. 1935-39
U. S. farm price index	185.5	179.2	180.1	100
Minnesota farm price index	173.4	167.6	174.2	100
Minn. crop price index	175.8	170.2	155.0	100
Minn. livestock price index	173.2	165.3	180.3	100
Minn. livestock product price index	172.8	168.9	175.1	100
U. S. purchasing power of farm products	129.4	128.6	137.1	100
Minn. purchasing power of farm products	121.0	120.3	132.6	100
Minn. farmers' share of consumers' food dollar	64.0†	60.7	62.4	47.9
U. S. hog-corn ratio	13.2	11.3	14.3	12.5
Minnesota hog-corn ratio	16.7	13.0	16.4	15.4
Minnesota beef-corn ratio	14.5	11.7	14.9	12.6
Minnesota egg-grain ratio	15.6	12.9	18.2	13.7
Minnesota butterfat-farm-grain ratio	28.3	25.1	32.6	31.8

* Explanation of the computation of these data may be had upon request.
† Figure for February, 1945.

World-Wide Trends Toward Inflation

Prices have risen markedly in most parts of the world since the beginning of the war. Despite inadequacies of data certain broad trends are revealed, and are indicated in the tabulation below.

Percentage rise in wholesale price index since 1939	Countries
Under 20 per cent	Germany
20 to 40 per cent	United States, Canada, Brazil, Colombia
40 to 80 per cent	United Kingdom, Mexico, Sweden, Ecuador, Cuba, Peru
80 to 120 per cent	Chile, Argentina, Bolivia, Peru, Switzerland, Finland, Denmark, Bulgaria, Hungary
Runaway inflations	China, Turkey, Rumania, India

The greatest price rise has occurred in China. The cost of living in Shanghai has increased several hundred per cent in the last few years. In free China, food prices have apparently risen by 30 to 40 times, although accurate indexes are not available. In the Near East and in the southeastern European countries conditions appear to have gotten out of hand, with very great price increases resulting. India is also experiencing considerable inflation. In the European countries, prices have generally risen from 75 to 100 per cent since the war began. Indexes are not available for France, Italy, Belgium, and Holland, but reports indicate the rapid progress of inflation, and it is probable that prices have more than doubled in these areas. The South American countries have also experienced price increases; in Argentina, Chile, and Peru prices have doubled, but in Brazil and Colombia the rise has been held below 40 per cent. In Mexico the rise in prices did not begin until 1941, but has proceeded steadily since. The situation in Japan is unknown, but prices had been rising for some years prior to the beginning of the war, having increased by 70 per cent between 1936 and 1941. Price increases in the United States and Canada have been moderate as compared with those of the rest of the world.

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