

Tennessee Processing Cooperative Law: Overview, Comparison and Applications



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Terms

- **Federal Taxes**: IRS taxes on income.
- **Legal Business Structure**: Businesses must have a legal structure in a state. Tennessee has 5 categories (with numerous sub-categories). The business/organization name does not always accurately disclose the legal structure: society, club, association, alliance, group, organization, cooperation). Businesses must be state chartered.
- **Section 521**: IRS code which provides limited exemption for cooperatives.
- **New Generation Cooperative**: Not legal structure. A way to describe closed-member businesses that raise large amounts of up-front capital and tie delivery of inputs proportionately to investment capital. Not necessarily a coop. Do not always allow non-patron investors.

Terms Continued

- ❑ **State Excise Tax**: Tax imposed on the privilege of doing business, based on net earnings.
- ❑ **State Franchise Tax**: tax ...based on net worth.
- ❑ **Antitrust protection**: 1914 Clayton Act & 1922 Capper-Volstead Act provide specific protection to cooperatives from prosecution for joint ventures.
- ❑ **SEC Registration Exemption**: Sale of an equity interest is regulated by the SEC. Registration of a security offering is required (bureaucratic and expensive). Cooperatives are exempt.
- ❑ **Patron and Non-Patron Members**: Types of membership (stock owners) based on use of the coop or delivery of inputs to the coop.



Tennessee Processing Cooperative Law

- ❑ The law was passed in May 2004.
- ❑ The law amends Title 43 [*Agriculture and Horticulture*] of the Tennessee Code by adding new chapters 38 – 70.
- ❑ The law was modeled after similar laws in Wyoming and Minnesota - - the only other states with a similar law.
- ❑ The law creates a new legal structure for business organization.

Forms of Legal Business Structures

- Sole Proprietorship
- Partnership
 - General Partnership
 - Limited Partnership
- Corporation
 - Non-profit
 - For Profit
 - C Corp
 - S Corp
- (traditional) Cooperative
 - Marketing
 - Supply (feed, seed, fertilizer, natural gas)
 - Service (electric, telephone, farm credit, AI breeding)
 - Education
- LLC

“Primary” criteria affecting the selection of the best legal structure for a business

- Who Controls the business?
- Where does Capital come from?
- Who is Liable?
- How are Earnings distributed?
- How are Taxes paid/incurred?
- What is the Business Lifespan?

Sole Proprietorship

- Control - - The owner
- Capital - - The owner
- Liability - - The owner
- Earnings - - The owner
- Taxes - - “as income of the owner”
- Business Lifespan - - Life of the owner
- Degree of Organizational Difficulty - - “2”

Partnership (limited and/or general)

- Control - - The partners
- Capital - - The partners
- Liability - - The partners(*)
- Earnings - - The partners (*)
- Federal Taxes - - “as income of the partners”(*)
- State Taxes - - Franchise and Excise Taxes (limited ptrn.)
- Business Lifespan - - Life of the partners
- Degree of Organizational Difficulty - - “+/-5”

Corporation

- ❑ Control - - Board of Directors elected by stockholders.
- ❑ Capital - - Shares/Stock of investors.
- ❑ Liability - - The “business” (stockholders limited to investment).
- ❑ Earnings - - Distributed to stockholders as dividends.
- ❑ Federal Taxes - - Double taxation . . . Income to the firm and as income of the owner
- ❑ State Taxes - - Franchise and Excise Taxes
- ❑ Business Lifespan - - Continual
- ❑ Degree of Organizational Difficulty - - “+/-10”

LLC

- Control - - Decided by members/owners
- Capital - - Members/owners
- Liability - - Members/owners are limited
- Earnings - - Shared by the members/owners
- Federal Taxes - - Either as a partnership or corporation.
- State Taxes - - Franchise and Excise Taxes
- Business Lifespan - - Perpetual or life of the owners
- Degree of Organizational Difficulty - - “+/-10”

Traditional Cooperative

- ❑ Control - Board of Directors elected by members.
- ❑ Capital - Members (fees, stock, retained earnings)
- ❑ Liability - The “business” (members limited to investment).
- ❑ Earnings - Distributed to members based on use of the COOP (cash and/or equity).
- ❑ Federal Taxes - **Once** (Income to the firm **OR** of the owner)
- ❑ State Taxes - Exempt from Franchise and Excise Taxes
- ❑ Business Lifespan - Continual
- ❑ Degree of Organizational Difficulty - “+/-10”



The law is a hybrid of a traditional cooperative and an LLC.

Why do we need a new
business structure
with components from a
traditional coop and an LLC?

□ **Traditional Coop Law:**

- Mandates strong organizational & operational principles
- Offers state and federal tax advantages
- Offers federal SEC protection
- Offers federal antitrust protection
- Is based on legal language that is outdated (Tennessee marketing coop laws were written in 1923)
- Does not allow non-member investors

□ **LLC Law:**

- Offers membership/investor/capital flexibility
- Does not exempt the firm from state franchise and excise taxes.
- Allows for greater flexibility in obtaining capital.

Processing Coop

- ❑ Control - - Board of Directors elected by members.
- ❑ Capital - - Members (fees, stock, retained earnings)
- ❑ Liability - - The “business” (members limited to investment).
- ❑ Earnings - - Distributed to members based on use of the coop (cash and/or equity).
- ❑ Federal Taxes - - Once (Income to the firm OR as income of the owner)
- ❑ State Taxes - - Exempt from Franchise and Excise Taxes
- ❑ Business Lifespan - - Continual
- ❑ Degree of Organizational Difficulty - - “+/-10”



Why not just use the existing LLC law?

- ❑ Not specific to processing.
- ❑ Not specific to agriculture.
- ❑ Not exempt from state franchise and excise taxes.
- ❑ Not likely to be eligible for federal anti-trust protection.
- ❑ May not be eligible for federal IRS tax exemptions as a coop.
- ❑ Does not inspire the use of cooperative principles.
- ❑ Not protected under Federal SEC.



Why not use the existing coop law?

- ❑ Based on practices and terms of the 1920s.
- ❑ Requires a minimum of 11 members (majority from Tn).
- ❑ Does not allow non-patron members.
- ❑ Does not clearly allow for processing by-products.
- ❑ Does not clarify that LLCs can be members.
- ❑ Does not allow directors to be non-members.
- ❑ Does not allow stock transfers to non-members.
- ❑ Does not allow much organizational flexibility through the by-laws.

How can we summarize what the new law offers?

- A new structure to legally organize a business.
- Combines elements of a LLC and a Cooperative.
 - Coop principles, outside/non-member investors.
- Exempt from state franchise & excise taxes.
- “May be” exempt from federal taxes and SEC registrations, protected under federal antitrust laws.
- Allows for capital to be raised from farmer members (patrons) **and** non-farmer investors (non-patrons).
- Patron membership based on delivery of inputs and capital invested.