“Introduction and Overview” for the Tennessee Processing Cooperative Law

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“Tennessee Processing Cooperative Law”

- Passed in May 2004.
- Available as Public Chapter No. 534.
- Amends Tennessee Code, Title 43 (Ag. & Horticulture).
- Written as Sections 1 – 35 . . . . Adds new Chapters 38 – 70.
- Effective January 1, 2005.
- Modeled after similar laws in Wyoming & Minnesota . . . Drafted according to Tennessee’s LLC law.

Overview

- Why do we need it?
- What does the new law do?
- How can we better understand it?

Why do we need it?

- Start-up costs for large-scale value-added processing businesses are higher than many farmer groups can raise.
- Outside or non-farmer investment is often needed.
- Traditional coop law does not allow non-member investors.
- LLC law does not have the favorable tax advantages as cooperatives.

What does the new law do?

- Forms a new legal business structure.
- Specifies that the business is to market, process or change the form of ag commodities.
- Is a hybrid of a traditional coop and a LLC.
- Has two (2) membership classes.
  - Patron (farmer) and non-patron (investor).
- Provides patrons with:
  - Membership, Capital Investment and Commodity Investment.

How can we better understand it?

- Understand some important terms.
- Understand how it compares to existing legal business structures.
- Understand how it is a “hybrid.”

Important Terms:

- State Taxes
- Federal Taxes
- Legal Business Structure
- Patron and Non-Patron Membership
- Commodity Investment
- Capital Investment

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?
- What is the organizational difficulty?

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 ptnr.)
- 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?

- **<u>Traditional Coop Law:</u>**
  - 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

- **<u>LLC Law:</u>**
  - Offers membership/investor/capital flexibility
  - Does not exempt the firm from state franchise and excise taxes.
  - Allows for greater flexibility in obtaining capital.

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- LLC
- **Processing Cooperative**

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.

Summary!

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