

Business and Tax Planning for Tribal Enterprises and Individual Native American Farmers and Ranchers

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Overview

1. PEOPLE, LAND, AND ACTIVITIES

- A FRAMEWORK FOR STRUCTURING ANY AGRICULTURAL BUSINESS

2. AGREEMENTS BETWEEN PEOPLE

- HOW DECISIONS ARE MADE
- HOW MONEY AND LIABILITY FLOW BETWEEN PEOPLE LAND AND ACTIVITIES

3. TAXES

- BY ENTITY TYPE (HOW PEOPLE ORGANIZE THEMSELVES)
- BASED ON LAND USE
- BASED ON TYPES OF ACTIVITIES

4. ACCOUNTING

- TO MAINTAIN TRUST BETWEEN PEOPLE
- TO INFORM HOW TO MANAGE LAND AND ACTIVITIES
- FOR TAXES

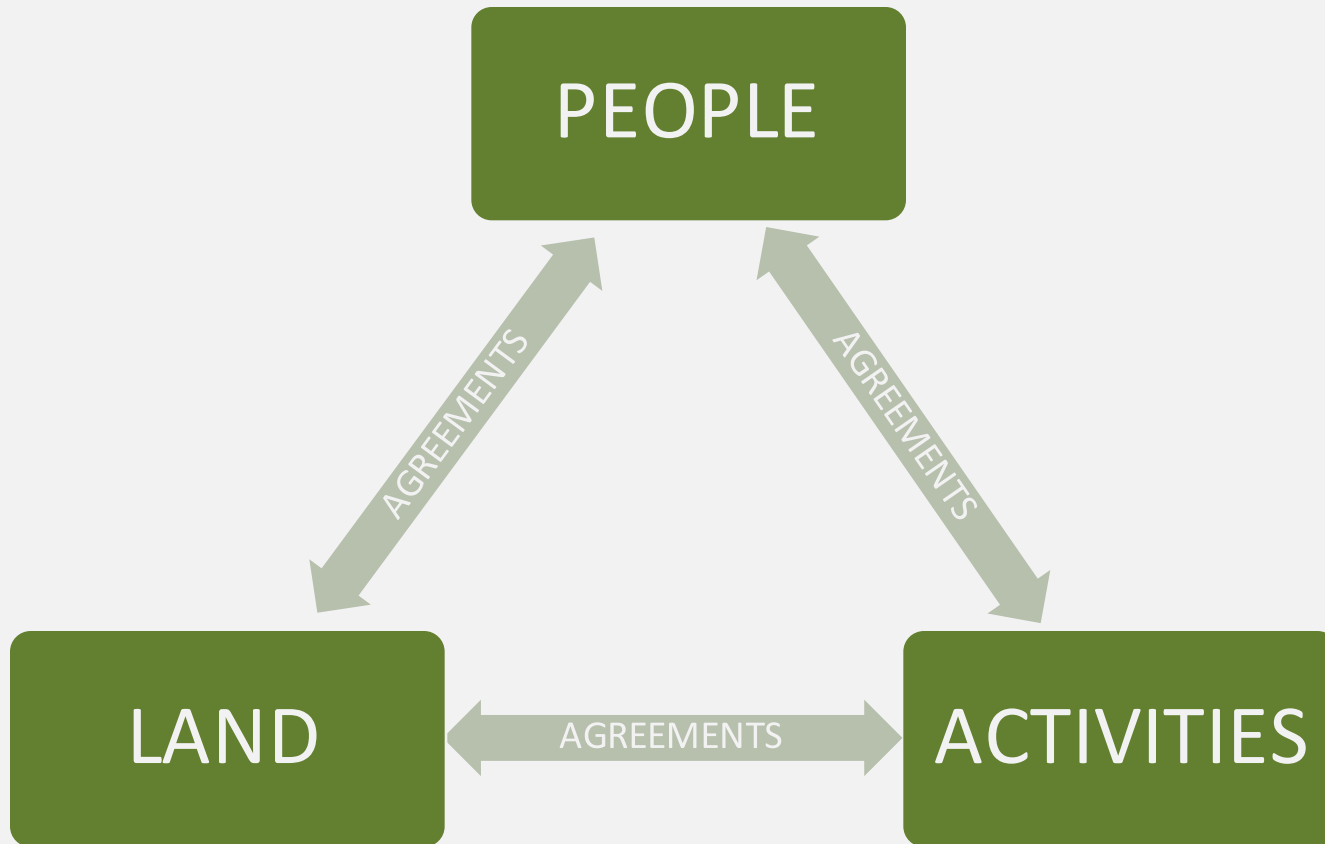
5. COOPERATIVES, NOT-FOR-PROFIT, AND MEMEBERSHIP ASSOCIATIONS

Learning Goals

Focus on big picture and concepts today.

Materials will be available – circle back later for deeper understanding and details.

1. PEOPLE, LAND AND ACTIVITIES



PEOPLE, LAND AND ACTIVITIES

What do you want to do? An activity.

Where will you do it? On the land.

Who will you do it with? Other people. (Or not.)

PEOPLE

Who will you do it with?

- Yourself alone?
- Others?
 - What exactly is the agreement with others?
 - Will you deliberately form a new legal entity with written agreements?
 - Or will you take your chances and see what happens?

LAND

Where will you do it? On the land.

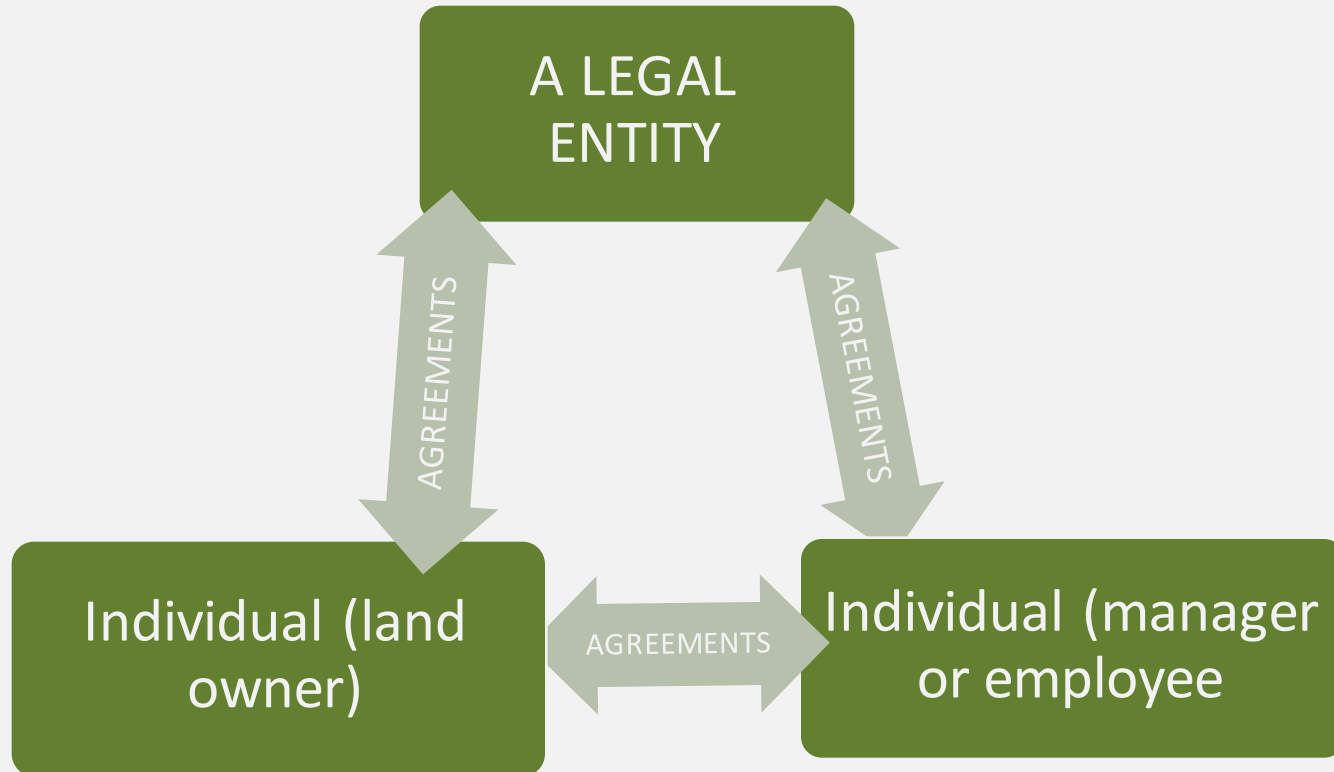
- Do you own the land? Will you buy it?
- Do you have traditional rights to the land?
- Do you have a permit for the land?
- Will you pay rent to use the land?

ACTIVITIES

What do you want to do? One or more activities.

- Your business plan describes your activities.
 - A farm or ranch plan - what will you produce?
 - A marketing plan - where and how will you sell your products?
 - A cash-flow plan – will you need short term credit?
 - An asset acquisition plan – will you need credit to purchase equipment or build facilities?
 - A business systems plan to develop:
 - an accounting system
 - a system for managing any paid staff (human resources)
 - systems for managing regulatory compliance
 - a plan for managing your income tax liability

2. AGREEMENTS BETWEEN PEOPLE



FORMING A BUSINESS – Just yourself

- Sole proprietorship
- Single member limited liability company or corporation
- Other types of business entities

FORMING A BUSINESS with others

Who will you do it with?

- One or more people – including a tribal government - can form
 - A partnership
 - A limited partnership
 - A limited liability corporation
 - A corporation
 - C corp.
 - S corp.
 - T corp.
 - Not for profit corp.

A tribe can also form a governmental entity to perform a business function.

BUSINESS ENTITIES

WHAT ARE THEY?

- Informal
 - A sole proprietorship – you as soon as you start conducting activities with the intention of earning profits.
 - A partnership – you and someone else as soon as you start conducting activities together with the intention of earning and sharing profits.
- Key characteristic is owner(s) personally are responsible for all of the liabilities of the business.

BUSINESS ENTITIES

WHAT ARE THEY?

- Formal = Limited Partnerships, Corporations
- Deliberately formed to
 - Limit owners' liabilities to the assets of the business
 - Establish circumstances under which owners may or must contribute or withdraw funds

BUSINESS ENTITIES: WHAT LAW GOVERNS?

Federal

State

Tribal

FORMING A BUSINESS IN INDIAN COUNTRY

Tribes may also form “Section 17” tribal corporations under federal law

- Allows tribes to separate corporate assets and liabilities from government functions without putting the corporation under state law.
- Generally the Section 17 tribal corporation will have the same sovereign immunity and tax exempt status as the tribe.

BUSINESS ENTITIES: WHAT LAW GOVERNS?

Typically businesses are formed under State law

- State law governs liability, and default agreements about owners' capital contributions and withdrawals.
- Federal law still governs how federal taxes are reported and paid.

FORMING A BUSINESS IN INDIAN COUNTRY

Tribal law

- Some tribes have adopted laws to enable the formation of tribally chartered for-profit corporations.
- Immunity and tax status depend on circumstances – an unsettled and changing area of law

See: [Tribal Business Structure Handbook](#)

AGREEMENTS TO FORM ENTITIES

- BUSINESS ENTITIES
 - HOW ARE DECISIONS MADE?
 - The partnership or incorporation agreement should specify.
 - If it does not then governing federal, state or tribal law will fill in what owners did not specify.

AGREEMENTS TO FORM ENTITIES

HOW YOU WILL BE TAXED?

- Federal taxation will depend on the type of business entity you form.
- State taxation generally follows federal taxation.
- For most people taxation is the single most important consideration in choosing which type of entity to form.

More on this later.

OTHER AGREEMENTS BETWEEN PEOPLE

- Employment Contracts
- Land rents (Lease payments)
- Contracts to sell or buy
- Contracts for services

OWNERS AND EMPLOYEES

- OWNERS
 - have invested capital
 - share in profits and losses
 - often don't get paid

- OWNERS CAN ALSO BE EMPLOYEES.

OWNERS AND EMPLOYEES

- EMPLOYEES
 - protected by federal employment law
 - must be paid at least minimum wage
 - employer must withhold certain payroll taxes and pay payroll taxes and workers comp insurance
 - employer must comply with other health and safety laws to protect workers

- OWNERS CAN ALSO BE EMPLOYEES.

OWNERS AND EMPLOYEES

- CONTRACTORS ARE NEITHER.
 - From your perspective.
 - From their perspective they are owners or employees of the company you contracted with.
- Don't pretend your employees are contractors- you will owe back payroll and back payroll taxes with interest and penalties compounding daily back to the day you first should have paid.
 - Several tests – mostly around how much control you have over when and how an employee's work is done, versus how much independence a contractor has to determine when and how to do the work.

3. LAND

- OWNED
- LEASED
- PERMITTED USE

LAND OWNERSHIP

YOU MAY FORM A BUSINESS ENTITY TO OWN LAND WITH OTHERS - but you don't need to.

- JOINT TENANCY
- TENANCY IN COMMON

LEASING LAND

If a person or entity conducts business on land they don't own, they need a lease or a permit.

- LEASE => RENT PAYMENTS, CROP SHARE PAYMENTS
- PERMIT => FEE OR RENT PAYMENTS

OWNING AND LEASING LAND

TYPICALLY LAND IS NOT OWNED BY THE BUSINESS

Instead individuals own the land and lease it to the business – even if the owners are the same.

WHY?

- If the business goes bankrupt debtors can't take the land.
- It is a good way to lower taxes for land owners who are also business owners. (more on this soon).

IT ONLY WORKS IF YOU HAVE AN ACTUAL AGREEMENT AND ACTUALLY PAY RENT.

(It is ok to “swap checks” – business pays rent to owner then owner contributes cash back to the business.)

DOING BUSINESS ON INDIAN LANDS - TRUST LANDS

TRUST LANDS

- Controlled by the tribe or by individual Indian people
- Title held in trust by the Federal government
- Most trust land is within reservation boundaries
- But trust land can be off-reservation also

TRIBALLY OWNED LANDS

- Owned by a group of Indian people recognized by the federal government as an Indian tribe

www.iltf.org (Indian Land Tenure Foundation)

DOING BUSINESS ON INDIAN LANDS - ALLOTMENTS

RESTRICTED FEE LANDS

- Ownership is the same as fee simple land but there are specific government-imposed restrictions on the use or disposition of the land
- RIGHTS TO USE & TRANSFER
 - SUBJECT TO APPROVAL FROM TRIBAL LAND OFFICE or BIA

ALLOTTED LAND

- Reservation land the federal government distributed to individual Indians, generally in 40, 80 or 160 acre parcels
- Allottee – an individual who owns an undivided interest in a parcel of allotted land

DOING BUSINESS ON INDIAN LANDS – FEE LANDS

FEE LANDS

- PURCHASED OR ACQUIRED BY THE TRIBE OR BY AN INDIVIDUAL
 - Land ownership where owner holds title to and control of the property.
 - The owner makes decisions about land use or sale of land without government oversight.

DOING BUSINESS ON INDIAN LANDS – FRACTIONATED LAND

FRACTIONATED LAND

- FEE OR ALLOTMENT LAND CAN BECOME FRACTIONATED IF MULTIPLE GENERATIONS PASS TO MULTIPLE HEIRS
- Occurs when a trust parcel is owned by more than one owner as an undivided interest
- Occurs when ownership interests divide again and again when an owner dies without a will
- By law, a majority of owners must agree to a particular use of the land
- Makes it difficult for any one of the owners to use the land
 - HOW MANY OWNERS MUST CONSENT to a use DEPENDS ON HOW MANY OWNERS IN TOTAL

FARMING OR RANCHING ON INDIAN LANDS

USDA PROGRAMS ARE AN IMPORTANT WAY TO BUILD AND MAINTAIN YOUR FARMING OR RANCHING BUSINESS

- BUT BEFORE YOU CAN ACCESS Some USDA PROGRAMS YOU NEED TO SHOW THAT YOU HAVE THE PROPER RIGHTS TO USE THE LAND
- The type of approval you need depends on the type of the land you are trying to use
 - Tribal government approval
 - BIA approval
 - Co-owner approval
- Some USDA programs require (by law) proof of Schedule F filing (tax) or a reasonably similar substitute

FARMING OR RANCHING ON INDIAN LANDS

MORE INFORMATION:

- TRIBAL REALTY DEPARTMENT OR LAND OFFICE
- COUNTY AUDITOR OR CLERK'S OFFICE
- OFFICE OF THE SEPCIAL TRUSTEE, TRUST BENEFICIARY CALL CENTER (888-678-6836)
- BUREAU OF INDIAN AFFAIRS, REGIONAL OFFICE (WWW.BIA.GOV)
- INDIAN LAND TENURE FOUNDATION (WWW.ILTF.ORG)
- INSTITUTE FOR INIDAN ESTATE PLANNING AND PROBATE (WWW.INDIANWILLS.ORG)
- UNITED STATED DEPARTMENT OF AGRIUCULTE (WWW.USDA.GOV)

3. TAXES

TAXES

- BASED ON ENTITY TYPE
(how people organize themselves)
- BASED ON LAND USE
(rents and royalties)
- BASED ON TYPES OF ACTIVITIES
(operating a business, gain or loss from sale of assets)

TAXES BASED ON ENTITY TYPE

- SOLE PROPRIETOR
 - Reports activity on personal income tax returns, pays income and self-employment tax
- PARTNERSHIPS, S-CORPS, SOME LLCS
 - Report activity on a business tax returns but taxable income “passes through” to the owners who report and pay taxes on their personal income tax returns.
- OTHER CORPORATIONS
 - Report and pay taxes on their business tax returns.

TAXES BASED ON LAND USE OR ACTIVITY TYPE

- **BASED ON LAND USE**
 - Rent income is “passive” subject to income tax but not subject to self-employment tax
 - Royalty for mineral extraction is “passive” subject to income tax but not subject to self-employment tax
- **BASED ON BUSINESS ACTIVITIES**
 - Net earnings from business activities are “active” income – subject to income tax and may be subject to self-employment tax depending on how the business is structured – meaning what entity the owners form.

TAXES BASED ON LAND USE OR ACTIVITY TYPE

INCOME DERIVED FROM THE LAND

- For some Indian lands income derived from the land (farming, ranching, hunting, fishing, mineral extraction, etc.) is completely tax exempt.
- The LAND must be a special type of Indian land and the PERSON claiming the exemption must be an enrolled tribal member.

Internal Revenue Service Revenue Ruling 67-284

*“The [Internal Revenue] Service will ... recognize the exempt status of income received **by an enrolled member of an Indian tribe** where each of the following **[five]** tests are met:*

Internal Revenue Service Revenue Ruling 67-284

- 1) *The land in question is held in trust ...*
- 2) *such land is restricted and allotted...*
- 3) ***the income is “derived directly” from the land;***
- 4) *the statute, treaty or other authority...evinces congressional intent [to protect]...*
- 5) *the authority in question contains language indicating clear congressional intent that the land...is...not to be subject to taxation.*

EXEMPT INCOME DERIVED FROM THE LAND

- Income derived from the land is income from
 - FARMING & RANCHING, HUNTING & FISHING, OR MINERAL EXTRACTION AND LEASE PAYMENTS (RENTS)
- Depending on the individual tribal treaties or the individual allotment act such income may be completely tax exempt.
- The only way to know is to know what it says in the tribal treaty for the trust land or in the allotment act that created the allotment.
 - FOR MORE INFORMATION
 - [IRS REVENUE RULING 67-284](#)
 - [INTER-TRIBAL AG COUNCIL TAX GUIDE](#)

EXEMPT INCOME MUST STILL BE REPORTED

“Any exemptions from federal tax are expressly stated in the language of the treaty [or Act]. Taxpayers who are affected by such treaty language ...must cite that specific treaty [or Act] in claiming any exemption. There is no general treaty that is applicable to all Native Americans.”

*Internal Revenue Service Bulletin IRB
2006-15*

IS EXEMPT INCOME A GOOD THING?

- Since income derived from the land is exempt from taxation, losses from the same business can not be used to lower your taxable income.

Reported Income	With Exempt Income Derived from the Land	With Taxable Income Derived from the Land
Wages	30,000	30,000
Loss from ranching	<u>EXEMPT</u>	<u>-10,000</u>
Taxable Income	30,000	20,000

IS EXEMPT INCOME A GOOD THING?

- Also, exempt income (or loss) can not be used to increase or decrease your taxable income for purposes of calculating the Earned Income Tax Credit.

REPORTING EXEMPT INCOME

- If or how exempt income derived from the land will flow to you and how you will report it on your tax return depends on how the business is organized, meaning on the type of entity you choose.

Important Note

The issues related to tax exemption and “income derived from trust land” (and the 5-prong test) are matters that depend on very specific facts person-to-person, use-to-use, land-to-land.

You should seek advise from your regular tax advisor as to how best to claim this exemption and whether you will choose to claim the exemption.

These issues have not been tested in the courts and there is very little legal interpretation in this area (as to individual Indian farmers and ranchers) so proceed forward after carefully analyzing your risk.

Even if exempt, you may still decide to file and IRS has taken the position in individual cases, that regardless of the exemption, you still need to file and report.

SOLE PROPRIETORS

1040

W-2 WAGE
EARNINGS

Medicare & FICA is withheld and paid by employer – half comes from the employee, half is paid by the employer.

Non-Farm Self-employment earnings

Self-employed people pay employee and employer portions of payroll tax on net self-employment earnings.

Farm/Ranch Self-employment earnings

Pass-through &
Rental income

Pass through income may be subject to self-employment tax. Generally rental income is not subject to SE tax.

Dividends & Interest

Capital Gains

Pension, Retirement, Other...

LESS: Adjustments & Deductions

TOTAL INCOME SUBJECT TO INCOME TAX

Income tax is calculated on all income. SE Tax is in **addition** to income tax.

PASSTHROUGH ENTITIES

PARTNERSHIPS, S-CORPS, electing LLCs

ENTITY files a 1065 or 1120

NET
TAXABLE
INCOME is
reported to
IRS and to
owners on
a K-1
(like a W-2)

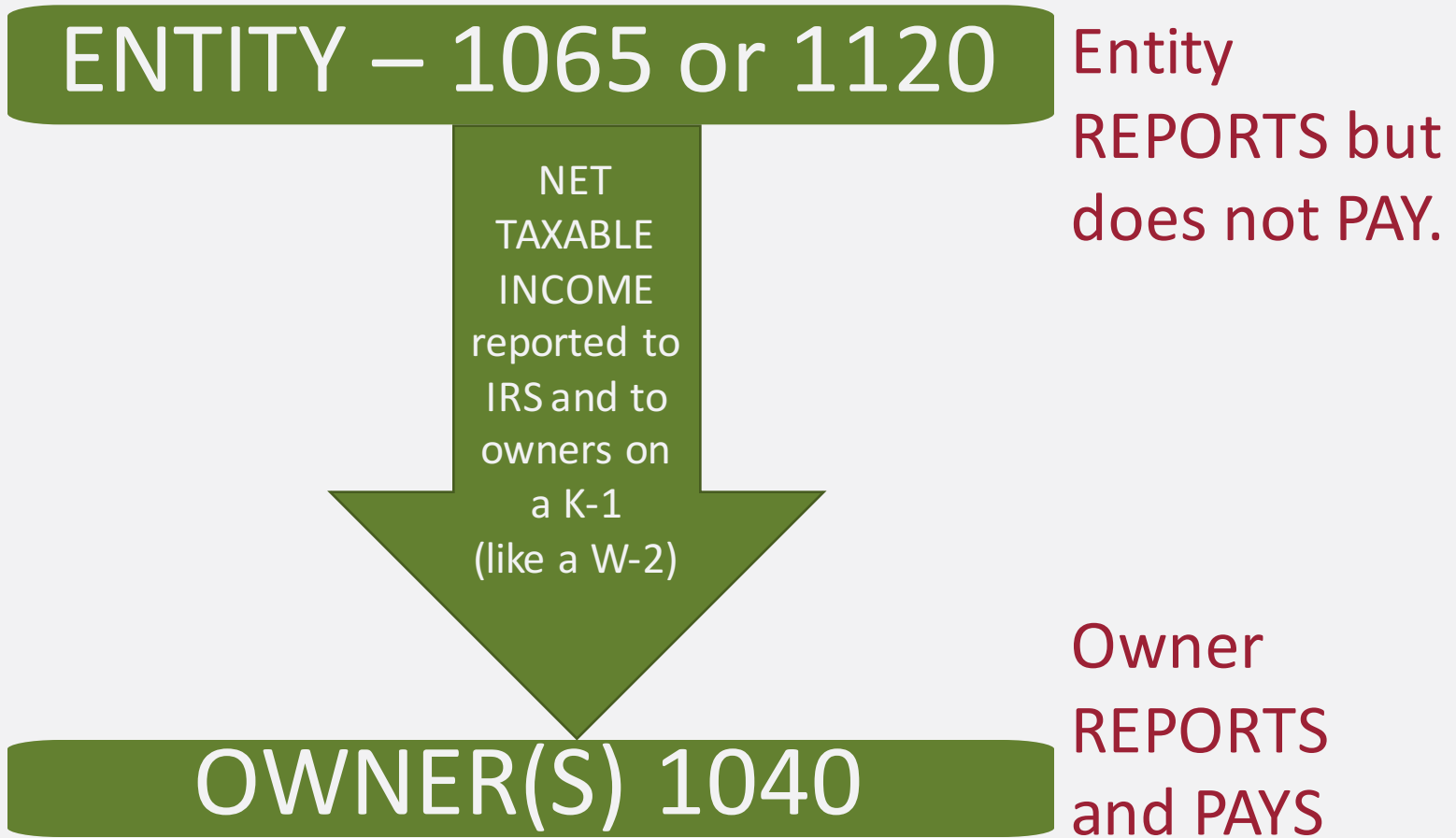
OWNER(S) file 1040

Entity reports income and expense but does not calculate or pay tax.

Net taxable income passes through to the owner.

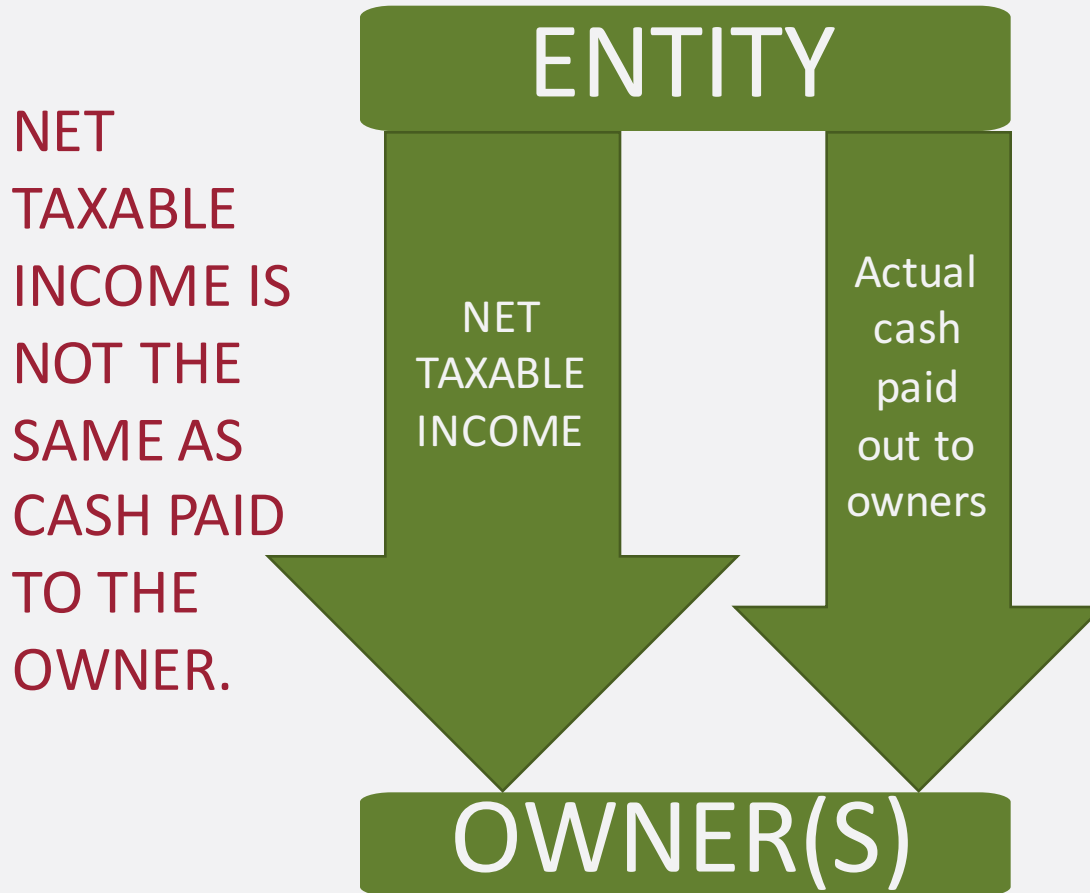
PASSTHROUGH ENTITIES

PARTNERSHIPS, S-CORPS, electing LLCs



PASSTHROUGH ENTITY

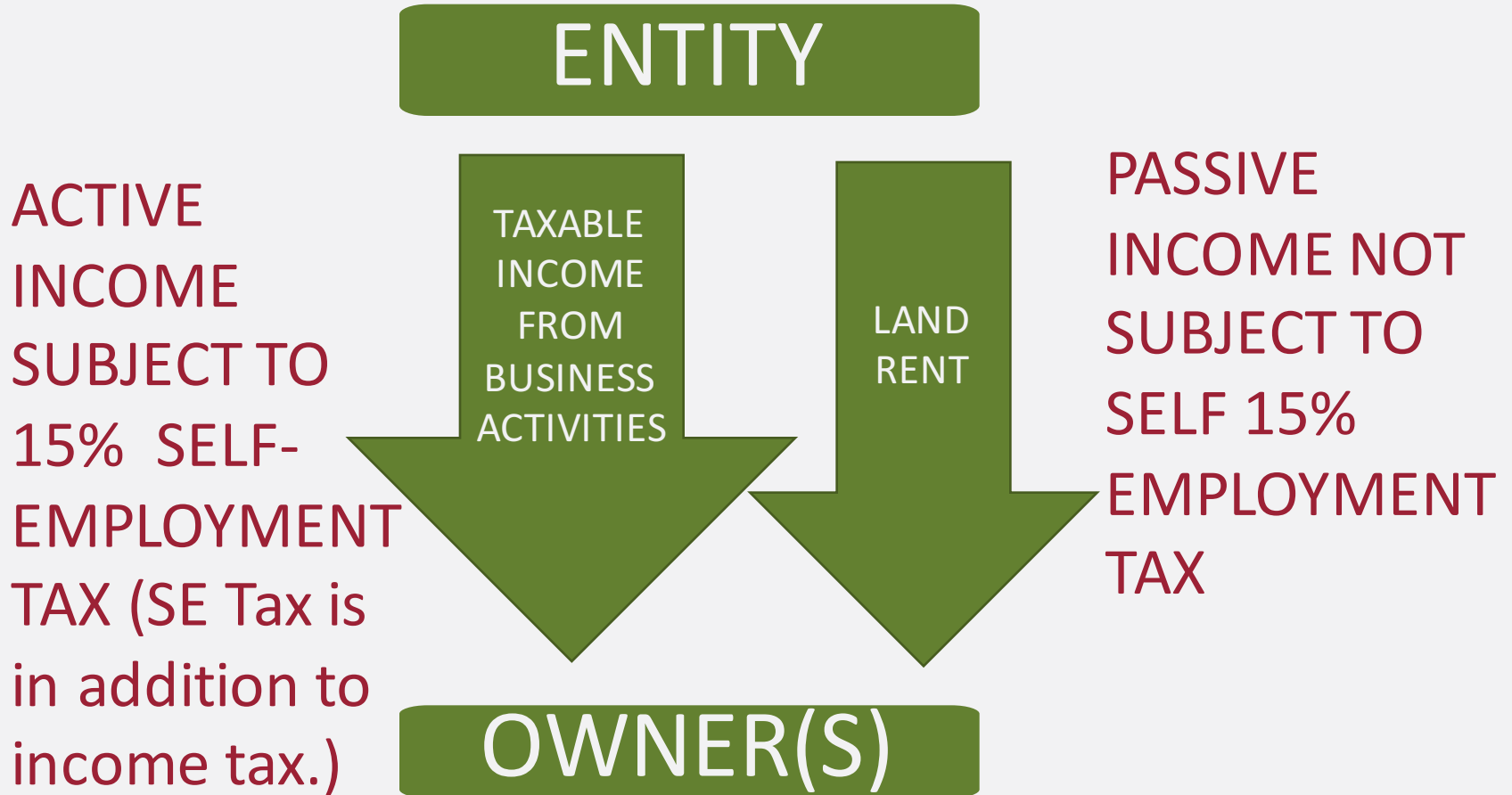
PARTNERSHIPS, S-CORPS, electing LLCs



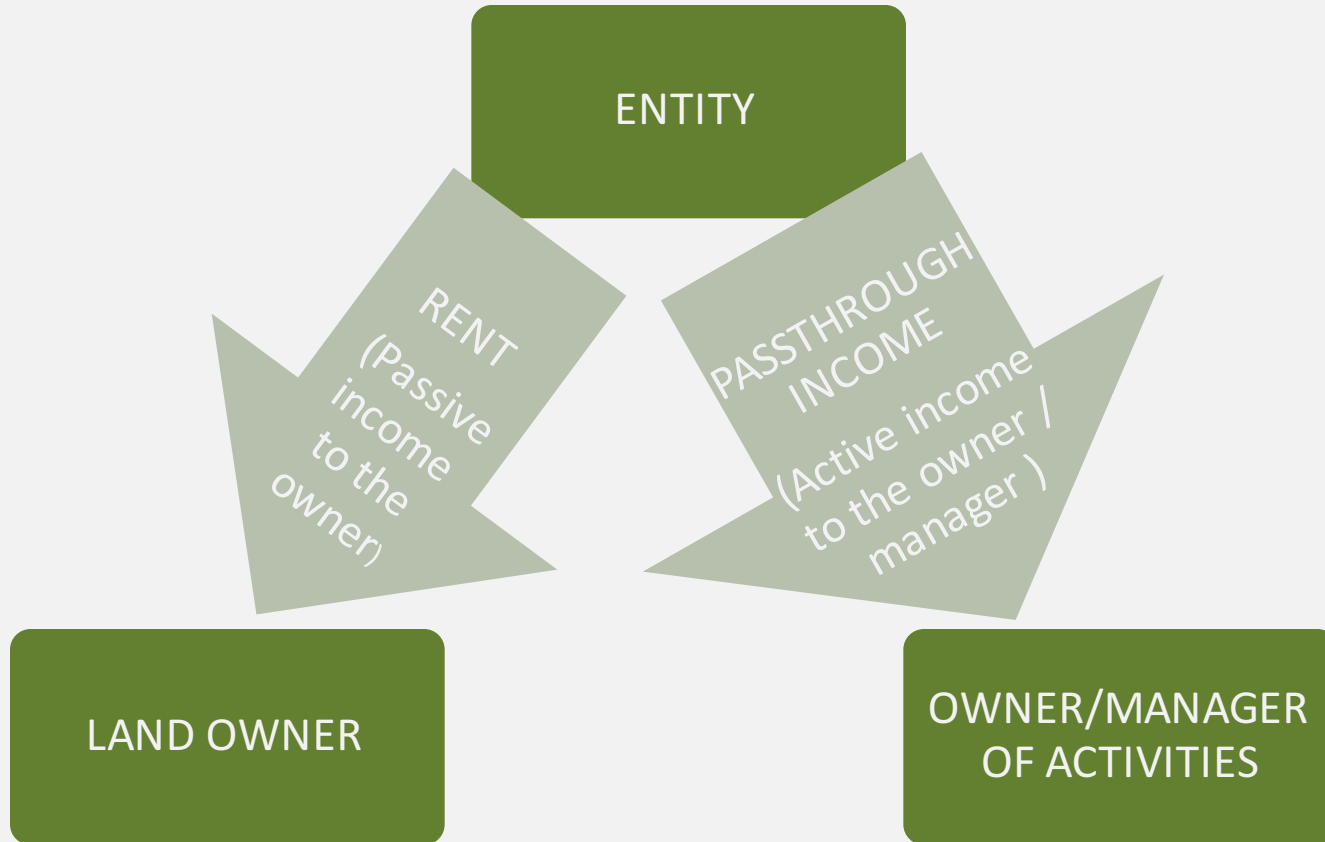
Actual cash paid to owners has nothing to do with how the owners' tax liability is calculated.

Owners may owe taxes on business income but not have taken home enough cash to pay the tax.

ACTIVE AND PASSIVE INCOME



ACTIVITIES AND LAND



DOUBLE TAXATION ENTITIES

“C” corporations

CORPORATE TAX IS PAID ON NET EARNINGS

AFTER-TAX
CASH IS PAID TO
OWNERS AS
TAXABLE
DIVIDEND
INCOME

OWNER PAYS TAXES ON DIVIDENDS

THE BEST OF ALL WORLDS

“S” corporations

S CORPORATION DEDUCTS SALARIES & RENT & PASSES THROUGH NET INCOME AFTER SALARIES & PAYROLL TAXES AS PASSIVE INCOME

OWNERS GET THEIR SHARE OF NET EARNINGS AFTER SALARY AND PAYROLL TAXES AS PASSIVE PASSTHROUGH INCOME

OWNERS GET SALARY AS W-2 EARNINGS

OWNERS GET LAND RENT AS PASSIVE RENTAL INCOME

OWNER

TAXES BASED ON ACTIVITY TYPE: VALUE ADDED ACTIVITIES

ONE MORE THING...

- Income from farming and ranching is subject to more favorable tax accounting treatment than other kinds of income so it is important to know the TAX definition of farming and ranching income.
- This applies to general tax law and also to the definition for “income derived from the land.”

FARMING AND RANCHING and VALUE ADDED ACTIVITIES

- FARMING AND RANCHING ACTIVITIES END WHEN THE PRODUCT IS IN THE CONDITION IN WHICH IT IS USUALLY SALEABLE IN THE REGION.

FARMING AND RANCHING and VALUE ADDED ACTIVITIES

- Processing an agricultural product beyond basic cleaning and packing needed to safely transport it to the first point of sale is considered a value-added manufacturing activity.

WHEN FARMING AND RANCHING ENDS AND VALUE-ADDED BEGINS

- Fruits and vegetables are sold cleaned and bunched, boxed or bagged
 - Not as jams and sauces.
- Milk is sold as a fluid
 - Not as ice-cream or cheese
- Meat-animals are sold live or as whole or half-carcasses or broken down into primal cuts
 - Not as sausage, ham or jerky

INCOME FROM VALUE ADDED ACTIVITIES

- INCOME AND EXPENSE ASSOCIATED WITH VALUE-ADDED MANUFACTURING ACTIVITIES ARE NOT FARM OR RANCH INCOME AND EXPENSE:
 - Sole Proprietors and Partnerships can not include these activities on Schedule F.
 - Other entities report pass-through income on a K-1 with a notation regarding the amount of farm and non-farm pass-through income.
 - This type of income will not qualify as tax exempt “income derived from the land” even if conducted on otherwise qualifying Indian lands.

4. ACCOUNTING

ACCOUNTING

- SYSTEMS
- STRUCTURE
- PROCEDURES
- HOW TO GET HELP

ACCOUNTING SYSTEMS

SET IT UP WITH YOUR GOALS IN MIND

- To maintain trust between people
- To manage land and activities
 - Do you need credit?
 - Can you expand?
 - Should you do more or less of one thing or another?
- For taxes

ACCOUNTING SYSTEMS

- Manual system
- Low cost software
- Expensive software

ACCOUNTING SYSTEMS

How much software you need depends on the size and complexity of your organization

- QuickBooks is widely used
 - Easy to hire someone who already knows how to use it
 - Can handle most small and mid-sized business.
 - Has real limitations as your business becomes more complex.
- Peachtree, SAGE and other mid-range systems are good for more complex operations.
- High end systems are expensive and hard to use and understand. They are not needed until you have something at the scale of a tribal government or college or a corporation with multiple divisions.

ACCOUNTING STRUCTURE

BALANCE SHEET:

ASSETS

minus LIABILITIES

equals NET ASSETS (EQUITY)

INCOME STATEMENT:

INCOME

minus EXPENSE

equals NET INCOME/LOSS

(and net income or loss increases or
decreases net assets or equity)

ACCOUNTING PROCEDURES – SYSTEM SET-UP

- CREATING A CHART OF ACCOUNTS FOR YOUR BUSINESS
 - A chart of accounts lists all the different categories of assets, liabilities, income and expense.
 - ASSETS: Bank accounts, Accounts Receivable, Equipment
 - LIABILITIES: Accounts payable, Loans Payable
 - INCOME: Sales of products raised, some government program payments
 - EXPENSE: All ordinary and necessary expenses to generate the income: feed, seed, salaries, rent, supplies, marketing costs,

ACCOUNTING PROCEDURES – SYSTEM SET-UP

THE EQUITY SECTION OF THE CHART OF ACCOUNTS

- Depending on the type of entity the net assets or equity section will use different terms for amounts contributed and withdrawn by owners and to record each owners' annual change in ownership value.
- THIS IS THE MOST TECHNICALLY DIFFICULT PART OF ACCOUNTING.
- TYPICALLY AN OUTSIDE ACCOUNTANT, USUALLY A CPA, HELPS WITH CREATING THESE ACCOUNTS AND ADJUSTING THEM AT YEAR END AS PART OF TAX PREPARATION.
- EVEN VERY EXPERIENCED BOOKKEEPERS MIGHT NOT KNOW HOW TO GET THIS PART RIGHT.

Note to QuickBooks users - QuickBooks won't get this part right, but it can help you keep track during the year until your CPA can get it cleaned up.

ACCOUNTING PROCEDURES – SYSTEM SET UP

If the business has been operating for a while without a good system then setting up a new system with correct opening balance is also difficult and something you should seek outside help to do.

- If you hire an experienced CPA or bookkeeper to get you set up they will also train you – then you will be in good shape to do it on your own during the year.
- If you do it on your own you are likely to get it wrong and end up paying more in the long run to get it fixed.

ACCOUNTING PROCEDURES – SYSTEM SET-UP

CHART OF ACCOUNTS FOR YOUR BUSINESS

- *A note to those planning to use QuickBooks, do not use their default chart of accounts for a farm – make your own using the categories on both the Schedule F and the Schedule C.*

ACCOUNTING PROCEDURES

NEXT: ROUTINE PROCEDURES

ACCOUNTING PROCEDURES

- SALES CYCLE

- Recording money due to you
 - Billing/ Invoicing
 - Accounts Receivable – a list of what is owed to you
- When you make the sale you either receive the payment or you bill the person to pay you later.
- When they pay you record the cash coming in and the decrease to the amount they owed you.

(This is an example of the “double entry” accounting system we use – every entry has two sides – cash goes up and sales go up or cash goes up and accounts receivable goes down.)

ACCOUNTING PROCEDURES

- PAYABLES CYLCE

- Recording amounts you owe – usually bills as they come in.
- Recording payments you make.

If you pay cash then cash goes down and expenses go up. If you record a bill to be paid then accounts payable goes up and expenses go up. When you pay that bill then cash goes down and accounts payable goes down.

ACCOUNTING PROCEDURES

- PAYROLL CYCLE
 - Making timely payroll payments
 - Making timely payroll tax payments
 - GET A PAYROLL SERVICE! This is difficult and time consuming and when you make a mistake you will pay a lot more to fix it than you would have paid if you had hired a payroll service in the first place.

Note to QuickBooks users – QuickBooks offers a payroll service but it is more work and much more confusing than other payroll services.

ACCOUNTING PROCEDURES

- RECONCILIATIONS

(checking your work)

- MONTHLY BANK RECONCILIATION
- QUARTERLY AND ANNUAL PAYROLL RECONCILIATION
- ANNUAL RECONCILIATION OF ALL ASSET AND LIABILITIES ACCOUNTS

ACCOUNTING PROCEDURES

- FINANCIAL STATEMENTS

(stepping back and thinking about the big picture)

- QUARTERLY IS BEST

- AT LEAST ANNUALLY AS PART OF GETTING READY TO FILE TAX RETURNS.

WHAT ARE YOU MANAGING FOR?

CREATING AND PRESERVING WEALTH
BALANCE SHEET:

ASSETS

minus LIABILITIES

equals NET ASSETS
(EQUITY)

WHAT ARE YOU MANAGING FOR?

ANNUAL INCOME

INCOME STATEMENT:

INCOME

minus EXPENSE

equals NET INCOME/LOSS

HOW TO GET HELP

- Certified Public Accountant
- Enrolled Agent
- Unlicensed accountant
- Bookkeeper

REVIEW

1. PEOPLE, LAND, AND ACTIVITIES
2. AGREEMENTS BETWEEN PEOPLE
3. TAXES
4. ACCOUNTING
5. COOPERATIVES AND NOT-FOR-PROFIT CORPORATIONS

COOPERATIVES, NOT-FOR-PROFIT AND MEMBERSHIP ASSOCIATIONS

- COOPERATIVES

- Membership owned corporations taxed under IRC Section T

- NOT-FOR-PROFIT AND MEMBERSHIP ASSOCIATIONS

- Corporations granted tax exempt status under IRC Section 501

COOPERATIVES

A business or organization owned by and operated for the benefit of those using its services.

Profits and earnings generated by the cooperative are distributed among the members, also known as user-owners.

Typically, an elected board of directors and officers run the cooperative while regular members have voting power to control the direction of the cooperative.

Members can become part of the cooperative by purchasing shares, though the amount of shares they hold does not affect the weight of their vote.

TYPES OF COOPERATIVES

- **WORKER**

- Facilitates workers in sharing in the profits of the business where they work

- **SERVICE or RETAIL**

- Facilitates those who use a certain type of services or purchase a particular type of goods to establish and run the business and to participate in any net profits

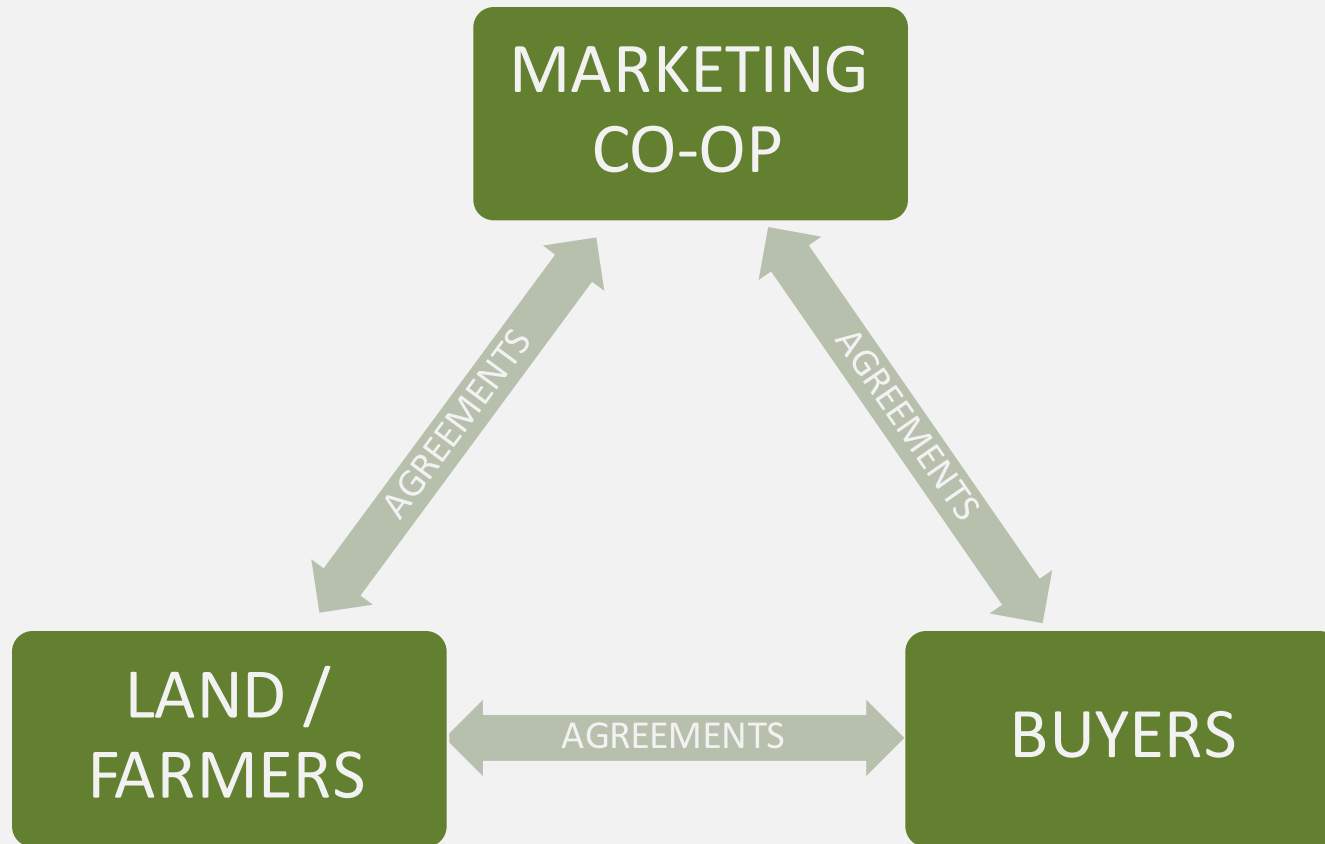
- **HOUSING**

- Facilitate group ownership of common structures

- **PRODUCER or MARKETING**

- Facilitates sales, particularly as in agriculture where individual farms have little market power but collectively can secure good contracts and prices

PEOPLE, LAND AND ACTIVITIES



CO-OP OWNERSHIP

- MEMBERS ARE OWNERS
 - They make a membership investment (equity)
 - They participate in profits and losses – but not in accordance with membership shares, in accordance with “patronage” or the value of the co-op services received during the year.
 - They vote to elect the Board of Directors and on other decisions as specified in the articles of incorporation

COOPERATIVE PRINCIPALS

The International Co-operative Alliance, has accepted seven principles that guide co-operative organizations:

- Voluntary and open membership
- Democratic member control
- Member economic participation
- Autonomy and independence
- Education, Training and Information
- Co-operation among co-operatives
- Concern for community

CO-OP TAXATION

- NET INCOME MAY BE TAXED AT THE CORPORATE LEVEL OR PASSED THROUGH TO OWNERS
- Patronage dividends (also called patronage refunds) are the amount of net co-op income the board elects to return to members. The cooperative does not pay taxes on the amount of net income allocated to members – PROVIDED THE ALLOCATIONS COMPLY WITH THE REQUIREMENTS OF IRS SECTION T.
- As with a partnership – the amount of taxable income attributed to members may not correspond to the amount of cash paid out to members.
- Members are responsible for paying tax on the amount of net profit attributed to their patronage.

CO-OP TAXATION

- NET INCOME MAY BE TAXED AT THE CORPORATE LEVEL OR PASSED THROUGH TO OWNERS
 - Net income not passed out to membership is taxed at the regular corporate rate.
 - Payments to members that do not qualify as patronage dividends under IRC Section T are taxable to the recipients – i.e. double taxed as with dividends from C corporations.

For more information see:

www.uwcc.wisc.edu/pdf/CIR45-8.pdf

[cooperatives.dyson.cornell.edu/pdf/legalTaxation/Taxation\(1\).pdf](http://cooperatives.dyson.cornell.edu/pdf/legalTaxation/Taxation(1).pdf)

HYBRED TAXATION

CO-OP FILES A 990-C or 1120-C

QUALIFYING PATRONAGE DIVIDENDS are deducted from taxable co-op income and reported to the owners and the IRS on a 1099-PATR

NET TAXABLE INCOME NOT PAID AS QUALIFYING PATRONAGE DIVIDENDS IS TAXED AT THE CORPORATE LEVEL.

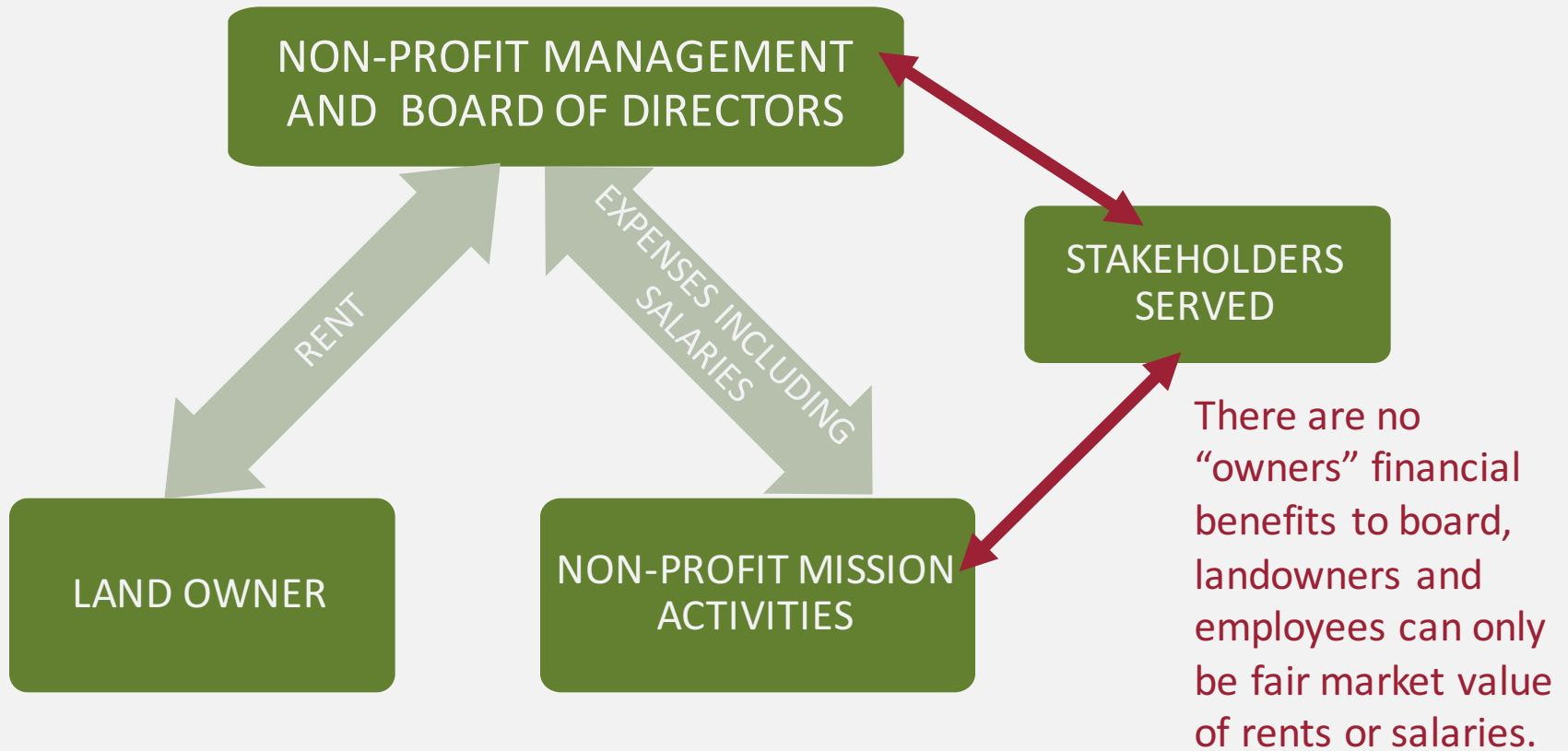
If non-qualifying distributions are made they are also taxable to the member

OWNERS file 1040 and pay tax on income from qualifying & non-qualifying dividends.

NOT-FOR-PROFIT and MEMBERSHIP ORGANIZATIONS

- Granted tax exempt status under IRC Section 501
- There are 29 different types of exempt entities listed under 501 subsection C:
 - C (3) IS MOST CHARITABLE NON PROFITS
 - C (4) IS MOST MEMBERSHIP ASSOCIATIONS
 - C (5) IS LABOR, AGRICULTURAL AND HORTICULTURAL ORGANIZATIONS
 - C (6) IS BUSINESS LEAGUES
 - C (7) IS SOCIAL CLUBS
 - C (8) IS FRATERNAL BENEFICIARY SOCIETIES, ORDERS OR ASSOCIATIONS

PEOPLE, LAND & ACTIVITIES: The non-profit model

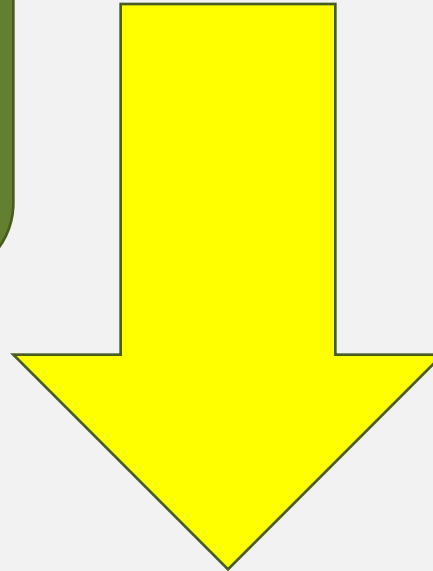


NOT TOTALLY EXEMPT FROM TAXATION

NON-PROFIT FILES A 990

INCOME RELATED TO
THE ORGANIZATION'S
EXEMPT PURPOSE IS
EXEMPT FROM
TAXATION

NET INCOME FROM AN
UNRELATED BUSINESS
ACTIVITY IS TAXED AT
REGULAR CORPORATE
RATED



ANY ONE WHO AUTHORIZES OR RECEIVES AN IMPROPER PAYMET IS
SUBJECT TO A 125% PENALTY.

UNRELATED BUSINESS INCOME

- YOU JUST HAVE TO PAY THE TAX – YOU DON'T LOOSE YOUR EXEMPT STATUS.

For more information:

[IRS Publication 598](#)

PRIVATE INURMENT/EXCESS BENEFIT TRANSACTIONS

- Immediately repay
- Report to IRS if indicated
- IRS will not automatically revoke exempt status – but may do so in some cases.

For more information:

[IRS Guidance on Excess Benefit Transactions](#)

NOT-FOR-PROFIT and MEMBERSHIP ORGANIZATIONS

- Non-profit organizations can access federal and foundation funds that for-profit organizations can not access
 - For example funds to provide educational opportunities and resources such as this series of webinars
 - Or funds for community gardens and nutrition education.
- Membership organizations play an important role in representing the interests of members
 - Advocating for changes to local state and federal policy
 - Informing members about important developments in local state and federal law

QUESTIONS?

Thank you!