

PROPOSED MASSACHUSETTS TAX EXPENDITURES EVALUATION SUMMARY

EVALUATION YEAR: 2021-2022

TAX EXPENDITURE TITLE	Deduction for Certain Dividends from Cooperatives
TAX EXPENDITURE NUMBER	2.205
TAX EXPENDITURE CATEGORY	Deductions from Gross Income
TAX TYPE	Corporate & Business Tax
LEGAL REFERENCE	Code § 1381-1388
YEAR ENACTED	Taxable years beginning after December 31, 1962 (P.L. 87-834, Subchapter T, § 17(a) (1962))
REPEAL/EXPIRATION DATE	None
ANNUAL REVENUE IMPACT	Tax loss of \$4.0 - \$4.2 million per year during FY19-FY23.
NUMBER OF TAXPAYERS	Not Available
AVERAGE TAXPAYER BENEFIT	Not Available

<p>Description of the Tax Expenditure: Cooperatives subject to tax under Subchapter T of the Internal Revenue Code (the "Code"), including farmers' cooperatives, and most other corporations operating on a cooperative basis, may deduct amounts paid to members as patronage dividends. Massachusetts adopts the federal deduction by virtue of its conformity with the Code.</p>	<p>Is the purpose defined in the statute? The statute does not explicitly state the purpose of this tax expenditure. However, federal court cases interpreting the deduction have stated that the corporation is viewed as an agent for the members and that amounts distributed are merely a return of the members' own funds.</p>
<p>What are the policy goals of the expenditure? DOR infers that the primary function of a cooperative is to allow member businesses to band together to take advantage of economies of scale when buying supplies or selling products. The tax expenditure allows the members to do so without incurring additional tax on transactions with the cooperative. The</p>	<p>Are there other states with a similar Tax Expenditure? Every state with a corporate income tax based on federal taxable income would allow the deduction unless they specifically disallowed it. It does not appear that any state has done so.</p>

deduction promotes the formation and operation of cooperative corporations.	
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INTRODUCTION

Cooperatives are organizations comprised of separate businesses that band together for limited purposes to take advantage of economies of scale, for example when buying supplies or selling products. Farmers' cooperatives and certain corporations acting as cooperatives may deduct so-called “patronage dividends” from their gross incomes. A “patronage dividend” is a dividend paid to members of the cooperative: (i) based on the quantity or value of business done with the members, (ii) under a pre-existing obligation of the cooperative; and (iii) determined by the cooperative's net earnings from business with members. In order to deduct the dividends, cooperatives must provide notice to members of the total patronage dividend and must pay a minimum of 20% of each member's dividend in cash within 8½ months following the close of the cooperative's taxable year.

The deduction is based on the notion that the cooperative is an agent working for the members and that any funds transferred to members already belong to the members. See *Farm Service Cooperative v. Commissioner*, 619 F.2d 718, 722 (1979). In this view, the primary function of a cooperative is the allocation of the economic benefits of the cooperative, either in the form of net savings or net earnings. The deduction recognizes that taxing patronage dividends would discourage such allocation and could result in double taxation of income (first when earned by the cooperative and second as a dividend received by the member).

POLICY GOALS

DOR infers that the primary function of a cooperative is to allow member businesses to band together to take advantage of economies of scale when buying supplies or selling products. The tax expenditure allows the members to do so without incurring additional tax on transactions with the cooperative. The deduction promotes the formation and operation of cooperative corporations.

DIRECT COSTS

The revenue loss resulting from this tax expenditure is estimated to be \$4.0 - \$4.2 million per year during FY19-FY23 (see Table 1). The estimates are based on the Internal Revenue Service (IRS) data on Form 1099-PATR, individual income tax returns, and the U.S. Department of Agriculture (USDA) data on agricultural cooperatives.¹ Due to the use of

¹ Form 1099-PATR, which is displayed in the appendix (copy A for IRS), is the IRS form a cooperative files for each person to whom the cooperative has paid at least \$10 in patronage dividends and other distributions, or from whom the cooperative withheld any federal income tax under the backup withholding rules regardless of the amount of the payment. Although cooperatives that distribute patronage dividends can deduct the

external data and the limitations of this data, the estimates reported in Table 1 may have a high estimation uncertainty and should be used with caution.

Table 1. Tax Revenue Loss Estimates for Deduction for Certain Dividends from Cooperatives

Fiscal Year	2019	2020	2021	2022	2023
Estimated Revenue Loss (\$Million)	\$4.2	\$4.2	\$4.1	\$4.0	\$4.0

DIRECT BENEFITS

Cooperatives and their members are direct beneficiaries of this tax expenditure. Like other C corporations, cooperatives are taxed at the corporate level. However, cooperatives have several tax advantages over regular C corporations.

First, cooperatives avoid double taxation on patronage dividends. Recipients of these dividends include the dividends in their individual taxable income, but the cooperatives can deduct dividends paid. In contrast, dividends are not deductible at the corporate level for regular C corporations.

In addition, farmers' cooperatives may also deduct dividends paid on capital stock and amounts allocated to patrons that were paid from funds derived from non-patronage sources.

IRS Publication 6961 projects the expected count of various information and withholding tax forms. According to that publication as updated in 2020,² the actual national count for 2019 Form 1099-PATR was 1,604,471, and projections for 2020 through 2023 are reported in Table 2 below.

dividends from their tax returns, the patrons who received the dividends must include them in their taxable income.

IRS currently does not report line item data for the entries on Form 1099-PATR. To estimate this tax expenditure, DOR used actual and projected number of 1099-PATR forms filed with IRS (source: IRS publication 6961). DOR also estimated the average amount of distributions from cooperatives based on IRS' individual income tax returns line-item estimates. The product of the number 1099-PATR forms and average distribution amount generated the estimates of total deductions the cooperatives took on their returns for the whole country, which were then apportioned to Massachusetts (using the ratio of agricultural cooperative numbers) and converted into revenue loss estimates by applying Massachusetts corporate income tax rate.

² <https://www.irs.gov/pub/irs-pdf/p6961.pdf>

Table 2. Projection of the Number of Form 1099-PATR Filed

Year	2019 (actual)	2020	2021	2022	2023
National count of Form 1099-PATR	1,604,471	1,584,000	1,563,400	1,542,900	1,522,400

Source: The Internal Revenue Service (IRS), Statistics of Income, Publication 6961, 2020 Update.

Direct data on all cooperatives, and for Massachusetts in particular, are limited. We are not aware that any such data has been compiled and released by federal government agencies such as the Census Bureau, the Bureau of Labor Statistics, or the Internal Revenue Service. A study conducted by the Center for Cooperatives at the University of Wisconsin in 2009³ describes and quantifies the magnitude of economic activity accounted for by U.S. cooperative businesses. According to that report, the U.S. has nearly 30,000 cooperatives, owning more than \$3 trillion of assets, accounting for \$650 billion plus in revenue and more than 2 million jobs.

EVALUATION: COMPARING COSTS AND BENEFITS

In the previous sections, we report the direct costs (to the Commonwealth, or to the residents and businesses who ultimately bear the costs when the Commonwealth cuts government spending or increases taxes to finance deduction for patronage dividends from cooperatives) and direct benefits (to cooperatives that distribute these dividends) of this tax expenditure. In this instance, the direct costs to the Commonwealth, namely the corporate and business tax that would have been collected from these dividends, are equal to the direct benefits afforded by the tax expenditure to cooperatives, which is the corporate and business tax they would have had to pay to the Commonwealth.

Besides the direct costs and benefits, there are indirect and induced costs and benefits associated with this tax expenditure. Generally, the indirect impact (cost or benefit) is felt by the chain of businesses that provide intermediate products and services to the first impacted businesses. The induced impact (cost or benefit) occurs when an impacted business passes on the costs or benefits to households, such as those of its employees, in the form of lower or higher income, such as wages and salaries, who then in turn reduce or increase purchases of goods and services from other businesses. The total costs or benefits to the whole economy are larger than the initial direct impacts. This phenomenon is called the “Multiplier Effect”.⁴

To measure these indirect and induced costs and benefits, economists often need to utilize complicated models, such as REMI (Regional Economic Models, Inc.) or IMPLAN (Impact

³ http://reic.uwcc.wisc.edu/sites/all/REIC_FINAL.pdf

⁴ For an illustration of “Multiplier Effect”, see Slide 4 of: <https://www.ilw.com/seminars/JohnNeillCitation.pdf>

Analysis for Planning) models. DOR did not attempt to use such models given their complexity and the data limitations present in this instance.

DOR infers that the goal of this tax expenditure is to promote the formation and operation of cooperative corporations by providing a deduction for dividends paid to members of such corporations. Although DOR is not aware of empirical studies assessing whether this goal is achieved, there are studies indicating the positive impact cooperatives have on their members. According to Grashuis & Su (2019), “Generally, [farmer] cooperative membership is found to positively impact price, yield, input adoption, income, and other indicators of member performance, yet there is growing evidence of an uneven distribution of benefits for small and large producers.”

Similar Tax Expenditures Offered by Other States

Every state with a corporate income tax based on federal taxable income would allow the deduction unless they specifically disallowed it. DOR is not aware of any state that has done so.

References

- About Form 1099-PATR, Taxable Distributions Received From Cooperatives*. (n.d.). Retrieved from IRS: <https://www.irs.gov/forms-pubs/about-form-1099-patr>
- Grashuis, J., & SU, Y. (2019). A review of the empirical literature on farmer cooperatives: Performance, ownership and governance, finance, and member attitude. *Annals of Public and Cooperative Economics*, 90(1), 77–102.
- Internal Revenue Service. (2019). *Statistics of Income, Publication 6961 - Calendar Year Projections of Information and Withholding Documents for the United States and IRS Campuses 2019 Update*. Department of Treasury. Retrieved from <https://www.irs.gov/pub/irs-pdf/p6961.pdf>
- Internal Revenue Service. (2017). *Statistics of Income, Individual Income Tax Returns Line Item Estimates 2017, Publication 4801 (Rev. 9-2019) Catalogue Number 59952D*. Department of Treasury. Retrieved from <https://www.irs.gov/pub/irs-prior/p4801--2019.pdf>
- U.S. Department of Agriculture. (2019). *AGRICULTURAL COOPERATIVE STATISTICS 2019, USDA Rural Development Service Report 83*.

Appendix

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PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Patronage dividends \$	OMB No. 1545-0118 2021 Form 1099-PATR	Taxable Distributions Received From Cooperatives Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2021 General Instructions for Certain Information Returns.
		2 Nonpatronage distributions \$		
		3 Per-unit retain allocations \$		
PAYER'S TIN	RECIPIENT'S TIN	4 Federal income tax withheld \$	5 Redeemed nonqualified notices \$	
RECIPIENT'S name		6 Section 199A(g) deduction \$	7 Qualified payments (Section 199A(b)(7)) \$	
Street address (including apt. no.)		8 Section 199A(a) qual. items \$	9 Section 199A(a) SSTB items \$	
City or town, state or province, country, and ZIP or foreign postal code		10 Investment credit \$	11 Work opportunity credit \$	
Account number (see instructions)	2nd TIN not. <input type="checkbox"/>	12 Other credits and deductions \$	13 Specified Coop <input type="checkbox"/>	

Form **1099-PATR**

Cat. No. 14435F

www.irs.gov/Form1099PATR

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