Patronage Dividends for Food Co-ops

A Primer on Distributing Earnings and Building Member Capital

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First published June 2010

Publishing Partners

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Introduction: Self-Help Wanted

BY DAVE GUTKNECHT

Spend more earnings now, or invest more in the future—what is the proper balance? We can see, in the current financial mess, some consequences of imbalance. For the sake of immediate benefits, the nation has sacrificed much of its potential. We are depleting critical parts of our inheritance and leaving a diminished legacy.

Fortunately, our predecessors in cooperatives over several generations didn't lack foresight, and they were organized enough to win statutory recognition through state and federal legislation that supports the cooperative way of business.

Today, as much as they ever have been, cooperative solutions are a necessity. Yet we face the same questions about cashing in versus saving for the future. Should the co-op primarily reduce member costs and distribute earnings immediately—or is investing for expanded future services and benefits of at least equal weight? Consumer co-ops, like consumer society at large, too easily discount the future.

For food cooperatives, the present publication represents much of the best current knowledge about capital and the treatment of earnings through patronage dividends. Surprisingly, the majority of food co-ops are not taking advantage of the patronage dividend option. Yet, when co-ops are managed profitably and operate within a structure supporting annual dividends on purchases, earnings are readily allocated to members. And since not all of the allocation need be in cash, by retaining some portion of member patronage dividends co-ops can use a proven, inexpensive, and tax-free method of raising capital.

Along with other reasons food co-ops may have for not offering patronage dividends (such as improper legal structure, a legacy of purchase discounts that reduce earnings, or an unfamiliarity with administrative or technical requirements), overlooking an excellent tool for capitalization appears to reflect the imbalance mentioned above: a discounting of the cooperative's future. Yet if "strength through cooperation" has any meaning, surely it applies to member capital. Those collective member-owner investments ensure the future of the co-op and its services. Increased equity or owner capital strengthens the financial balance sheet by reducing the co-op's reliance on external debt. A stronger equity component, whether used for retiring debt or financing expanded capacity, helps the co-op meet its goals.

Fundamentally, building member equity in the co-op means growth in democratic ownership of capital, and this is a realization of the cooperative mission. Co-op management and directors are charged with protecting and expanding owner investments. Certainly, immediate rewards are necessary to meet co-op goals, and they build member loyalty. But member education should balance individual rewards with building loyalty to the needs of the co-op at large—where the whole is greater than the sum of its parts.

Along with sound operating practices that maintain profitability, we need education around a vision of growth in cooperative capital, making possible stronger co-ops and benefiting everyone, including future members. The current financial tumult provides a dramatic context for this enduring lesson. As stated herein, "Now more than ever co-ops need a dependable source of capital."

Acknowledgements

Several of this publication's sections originally appeared as articles in *Cooperative Grocer*, while other sections provide a step-by-step guide to implementing patronage dividends and added detail and examples from specific co-ops.

A note on wording: While "patronage dividends" is the more common term in this collection, we have retained the words "patronage refund" when that was used in the original writing.

Thanks to the partners who made this collection possible:

- CDS Consulting Co-op (Marilyn Scholl)
- Triangle Park Creative (Dan Nordley and Dave Gutknecht)
- Wegner LLP, CPAs and Consultants (Bruce Mayer)

Thanks also to the authors for sharing their contributions:

Marilyn Scholl, who initiated the idea for this publication, is manager of CDS Consulting Co-op. She originally wrote the section, "Membership Is Ownership," for the May–June 2008 issue of *Cooperative Grocer*, and later co-authored with Joel Dahlgren and Bruce Mayer the section, "Waking the Sleeping Giant," which appeared in the May–June 2010 issue of *Cooperative Grocer*.

Bruce Mayer, CPA, works at Wegner LLP. He contributed the "Patronage Dividend Primer," which originally appeared in the January–February 2008 issue of *Cooperative Grocer*. He and Marilyn Scholl also collaborated on a new contribution here, "Implementing Patronage Dividends."

Elizabeth Archerd is the membership services manager at Wedge Co-op. She wrote "Patronage Refund Systems That Work," which originally appeared in September–October 2008 issue of *Cooperative Grocer*.

Lexington Co-op in Buffalo, N.Y., contributed materials, found in the Appendix, that were used in educating its members about adopting a patronage dividend system.

Dave Gutknecht is editor of *Cooperative Grocer*.

Membership Is Ownership: The Cooperative Advantage

BY MARILYN SCHOLL

Interest in food cooperatives is growing, due both to increased interest in local, natural, and organic foods and to increased awareness of our economic vulnerability. More and more communities want the stability and accountability that a cooperative can offer.

Cooperative ownership is an economic model that can create great benefits for our communities and member-owners. The cooperative model is powerful if we focus proper attention on the owner side of that compound word, "member-owners."

Typically, members pay fees or dues and get something, such as purchase discounts, in exchange. Owners invest and benefit if the business prospers. Cooperatives must create economic linkages with their member-owners by undertaking activities that make clear the close connection between the prosperity of the co-op and the prosperity of the member.

For cooperatives, owner equity and patronage refunds are tried and true tools that create and maintain a mutually beneficial relationship between the cooperative and its owners.

ILLUSTRATION: MELECK DAVIS.

Owner equity fundamentals

Cooperative businesses require capital, and they generate capital in part through the share investments of member-owners. Debt and earnings are the other primary sources of capital.

A member share program has two essential goals: Member shares provide the co-op with an adequate capital base, and they create a sense of ownership. The co-op's purpose is to meet member needs, and members need to understand that fulfilling that purpose takes capital.

Members own and invest in their cooperative because they trust that doing so is in their best interest. Because our culture does not have many examples of democratic ownership, member share programs must include adequate education so that owners understand how co-op ownership works.

Advantages and disadvantages: All types of capital have advantages and disadvantages, and member shares are no exception. Member shares can be limiting and slow to accumulate, especially for co-ops that are looking to expand. In a few states, however, laws allow co-op investment options that help overcome this disadvantage in capital formation.

In meeting the co-op's needs, member shares have the advantage of being a low-cost way to build capital, since the co-op doesn't typically pay interest on member shares as it does on debt capital. And member investments are more dependable and less risky than relying on earnings as the primary source of capital.

Cooperatives demonstrate the advantage of being community-based businesses, where a relatively small amount of investment from a large number of people can create a sizable base of funds from which to leverage larger amounts of capital. The share investments demonstrate member-owner

commitment to banks and other lenders.

Finally, member share investments are also advantageous because shares are not considered taxable income for the co-op.

Equity share investments, unlike fees or dues, are refundable if the member no longer wants to use the cooperative. If a member leaves, the co-op repurchases the share within pre-established limits and restrictions that protect the co-op. It also is important to have a plan for dealing with abandoned equity, so that it doesn't have to be turned over to the state due to escheatment laws.

Determining share amount: In determining the amount of the share investment, co-op leaders should first consider the co-op's long-term capital needs. Then, determine how much of that capital should come from member equity, and divide by the potential number of members. Reassess the co-op's capital needs and member equity investment amounts as needed, and do so at least every five years.

Some co-ops implement an equity plan that requires an annual investment from each member. In this way, the capital base grows year by year and member by member. Whether your co-op uses a fixed fair share or requires an annual investment, note that determining the equity requirement does not begin with the question of what we assume the member-owners can afford. Affordability can be addressed by offering payment options that allow members to meet the investment requirement through smaller payments over a longer time period.

The co-op should offer a single class of membership with the same investment requirement and the same rights and benefits for each member. For co-ops that use patronage refunds, member courtesy cards can be issued to other people in the same household so that those purchases can be included in the patronage refund calculation. Multiple tiers and classes of membership can complicate communication and lead to perceptions of unfairness.

Annual fees or dues rather than share investments have some important disadvantages. First, fees and dues do not provide true ownership; you don't own Sam's Club or Costco just because you are a member. Second, fees and dues are taxable income for the business. Third, fees and dues are not refundable to the member. Administrative fees, if any, should be minimal, keeping the focus on equity and ownership.

Best words, best practices: Careless language can interfere with member-owners understanding the distinct advantages of cooperative ownership. Whatever words you use for owners and owner investment, choose and use your terms carefully and consistently. Communicate the true meaning of ownership with terms such as invest, investment, your share, refundable, and equity. Avoid inaccurate and potentially misleading terms such as cost, fee, pay, lifetime, one-time payment, and total. Member equity is not a fee, and it will likely change over time as the capital needs of the co-op change.

We carefully tell the story of ownership and cooperation so our members will understand and will be more likely to become active participants in that story.

Building Blocks for an Owner Investment Plan

Following are critical considerations for a cooperative owner investment plan:

Ownership: a mutually beneficial relationship exists between the member-owners and the co-op.

Investment: the money belongs to the member and is invested to help the co-op better meet the member's needs.

Fair Share: the co-op's overall capital needs are divided equitably among all members; the equity requirement is based on a member's "fair share."

Flexibility: because the equity requirement is based on the co-op's capital needs, this requirement may change as the needs of the business change.

Values: member equity investment helps to accomplish the co-op's mission and create a cooperative economy.

Benefits fundamentals

Equity is one side of the ownership coin, and member benefits are the other side. The owners provide tangible support for the business with their equity investments, and in return the cooperative provides benefits to member-owners. The most important benefit for the member is the existence of the co-op itself. People invest in a co-op because they want to use its services. In addition, members receive benefit from being a part of the community, supporting the mission of the co-op as well as the community it serves.

Members should also receive some individual, tangible benefit because of their ownership investment in the cooperative. Any benefits program should be sustainable even if 100 percent of sales are to members—benefits should not be so costly to the cooperative that they become a disincentive to promoting membership. Member benefits also should be simple and easy to explain.

Discounts or patronage refunds? While both discounts and patronage refunds are tangible member benefits, and both generally benefit the owner in proportion to how much they spend, patronage refunds are a best practice for providing benefits, superior to a discount system in a number of important ways. First and foremost, patronage refunds are directly tied to the health and profitability of the business and to the essential dual role of the consumer-owner. The cooperative's board decides to allocate earnings to the members only after ensuring that the business has actually made money. And since the business is more likely to show a profit if the members use the business, patronage refunds support a mutually beneficial relationship.

With discounts, the "earnings" are given away whether or not there are any actual earnings, because the decision about how much discount is offered is made before the sales are known. If the discount amount was set too high, then the co-op can lose money; if set too low, members may not receive as much benefit as they should. Members often have a hard time seeing how much benefit they accumulate through discounts, and shelf prices are often artificially inflated to make the discounts affordable, thereby weakening the co-op's price image. Everyday discounts can be costly and unsustainable, while discount days are not equitable for all members.

Even with all these disadvantages, the worst thing about register discounts is that they create a sense of entitlement, which makes it harder to create a sense of ownership. Surcharges to nonmembers, on the other hand, can be powerful incentives to join, but they are also off-putting to first-time customers or those who prefer not to join.

Too often discounts provide an unrealistic return on investment. If a member were to invest the same amount of money in a savings account or the stock market, they might expect a return of 2 to 10 percent a year. A $200 investment might provide an acceptable return of $5 to $20 a year. These returns should be kept in mind when considering the amount of return co-op owners should receive annually through discounts.

Patronage refunds, on the other hand, create a mutually beneficial relationship, one that encourages and rewards member investment. Members can trust that the co-op is not unduly profiting from their purchases, because surpluses are returned in proportion to those purchases. The co-op can trust that the members support the business and will wait for their benefit until

Developing Best Practices

The best practices discussed in this article are a result of a three-year project to analyze and learn from what has worked and what hasn't.

In 2001, a small group of experienced cooperators from successful food cooperatives met in Northampton, Mass., to help our friends at newly organized River Valley Market Co-op set up their member-owner policies and practices. Rosemary Fifield from Hanover, Elizabeth Archerd from the Wedge, Lisa Malmarowski from Outpost, Peg Nolan of National Cooperative Grocers Association, and Marilyn Scholl of Cooperative Development Services set about to create an ideal membership program.

A year later, over 200 people attended the "Let's SOAR" conference in the Twin Cites to share experience, knowledge and insights. Together we developed a set of best practices for member programs that any food co-op can implement and gain from. For more information, go to www.cdsconsulting.coop/bestpractices

after all sales and costs for the year are accounted for.

Members pay attention to patronage refunds: there is nothing like a check in the mail to remind one of the meaning of ownership! Some cooperatives time patronage refunds so that members receive their checks before Thanksgiving, near the end of the year, or right before April 15, as one way to enhance the value of the refund.

The management and board of the cooperative pay attention to patronage refunds because such refunds can create appropriate pressure for the co-op to generate net income, one sign of a healthy business. Patronage refunds, whether distributed or retained, reduce the co-op's tax obligations and keep more money circulating in the local economy. Since the IRS allows the co-op to retain up to 80 percent of the allocation, the retained portion provides a tax-free and interest-free way to capitalize the business. (For more information, see the next section "Patronage Dividend Primer," by Bruce Mayer.)

While patronage refunds provide the primary economic return on owner investment, food co-ops use an array of other member-owner benefits and incentives to attract new owners, show the value of membership, and thank owners for their patronage. Member appreciation events, special prices on selected products, coupons, special orders, free or reduced class fees, discounts from community businesses, and case discounts all can provide incentives to join and economic benefits for members. These benefits are usually determined by the co-op's management and should be structured and communicated carefully so they are sustainable and flexible over time.

Time to make a change?

If your co-op has not been emphasizing ownership and equity or has created a sense of entitlement with discounts, it will be a challenge to create an ownership culture. But this problem will not get easier with time. Begin by building understanding of the issues among the co-op's leaders. Plan how to educate and engage owners in the conversation.

Administration of Membership Programs

For co-ops and members to properly benefit from the decisions concerning profits and patronage refunds, the operational practices must keep pace with the desired outcomes. Membership records are the official record of corporate ownership.

To maintain and use these records requires adequate resources: labor, computer hardware and software, backup systems and support, even desk space.

Both the computerized database and the individual entry forms (paper or electronic) should have fields for: member name and number; all communication avenues (e.g., address, phone numbers, email).

In addition, the database itself should include: a record of equity payments, including the amount and dates paid, as well as the next payment due; the ability to import and update members' purchase data daily from your POS system; a record of each member's purchase amounts for the current and past fiscal years; a record of patronage refund distributions (both paid out and retained) for each member; notes of communications made to the member about membership-related issues.

As with all operational systems, the collection of members' equity and patronage data should be as seamless and simple as possible. Talented and professional staff, using appropriate technology and software, make it possible for our cooperatively owned businesses to take advantage of the patronage refund method and provide excellent member-owner services.

Overcoming resistance to change must include a clear vision of the value the co-op brings to its members and the community. When making structural and difficult change, it is preferable to make all the changes at the same time. Dragging it out with incremental changes makes communication more challenging, increases the cost, and adds to resistance. (See other *Cooperative Grocer* articles for stories of co-ops that have made membership system changes.)

Summary

In our society, we are programmed to look out for number one; we are not taught how to create, maintain and share the ownership of community assets and common wealth. The cooperative structure offers us an economic means to meet our common needs through democratically owned businesses. When many of today's food co-ops were established, we wanted to create an alternative to the capitalist society, but many of us threw out the baby with the bath water. Rejecting concepts equated with capitalism—profit, equity, ownership, and management—too many food co-ops went out of business clinging to their idealism.

Fortunately, we can look to the cooperative principle, along with the generations of businesses that existed before us throughout the worldwide cooperative movement, to establish effective and sustainable structures that balance the needs of individuals and of business, so both can prosper. If co-op members only look at personal gain, they miss the power of cooperation. The opposite is also true: if cooperatives don't offer meaningful benefits to its owners, cooperative leaders have missed the point. Cooperatives must balance the needs of the owners and the needs of the business they own. Owner equity investment and patronage refunds are effective tools to create the right balance.

Cooperatives do offer an alternative—a business model in which no one benefits at the expense of others, that builds a community rather than drains its resources. The owners of any type of business provide capital, and in return expect some control and some return on their investment. In investor-owned businesses, those with the most money to invest have the most control and get the greatest share of the benefits. In a cooperative, owners provide capital equitably, have only one vote regardless of amount of investment, and receive their benefit or return based on how much they use the co-op. Ultimately a co-op's success is dependent on its understanding and effectively implementing the economics of ownership within the principles of democracy.

The notions of ownership and patronage refunds are embedded in the third cooperative principle: "Member Economic Participation." Rising from the successful innovations first realized by the Rochdale Pioneers some 160 years ago, this principle outlines the way cooperators contribute to, control, and share the wealth created by their business. This distinctly cooperative advantage has proved itself for generations, and it is even codified in our current tax laws and IRS rules.

Cooperative membership is cooperative ownership. Our owners and directors, staff and management, should all understand that this economic model offers us many advantages, including the ability to serve members, build equity, and share in the common wealth.

A Patronage Dividends Primer

BY BRUCE MAYER

Should your cooperative consider patronage dividends to owners? If you are already issuing patronage dividends, is your cooperative following the rules? If your cooperative receives patronage dividends from other cooperatives, do you understand what the rules are?

Patronage dividends represent a unique opportunity for retail food cooperatives to avoid taxation at any level on some or all of the cooperative's earnings. The tax laws allow patronage dividends to your individual members to be exempt from taxation. Since these are deductible by the cooperative and not taxable to members, the patronage dividend amount is not taxed at either level. While there are potential under-capitalization problems if a cooperative distributes 100 percent of the patronage dividend, avoidance of taxation is a significant advantage to patronage refunds for retail food cooperatives.

Patronage dividends originated with the Rochdale Society cooperative principles that included "net margins distributed according to patronage." Since cooperatives had a long history prior to the enactment of the U.S. income tax laws, cooperatives were accommodated in the tax code. The Internal Revenue Service (IRS) rules formalize the procedures that result in a tax deduction. These rules treat a cooperative as having the option of operating as a pass-through entity where profits are considered an overcharge to be returned to patrons.

Prepared by Marilyn Scholl, Cooperative Development Services.

Subchapter T

The IRS rules for patronage dividends are outlined in Subchapter T of the Internal Revenue Code. The five code sections comprising Subchapter T are:

- 1381—what is a cooperative under Subchapter T?
- 1382—how are income and patronage dividends calculated?
- 1383—what is nonqualified patronage?
- 1385—how are patrons taxed on the dividend?
- 1388—what do the terms mean?

These rules apply to non-exempt cooperatives. There are exempt cooperatives, normally only agricultural, which must apply for exempt status and follow somewhat different rules. All cooperative accountants and their outside accounting advisors should be familiar with Subchapter T, even if the cooperative only receives patronage dividends from other cooperatives. Accountants should also utilize the accounting guidance available in the American Institute of CPAs (AICPA) Audit and Accounting Guide, *Agricultural Producers and Agricultural Cooperatives*. Additional information on accounting and tax issues is available by joining the

National Society of Accountants for Cooperatives (www.nsac.coop). Your accountant on staff and your outside advisor should both be members of NSAC in order to keep up on cooperative tax and financial issues.

Subchapter T lays out three basic criteria for patronage dividends. To be deductible the patronage dividend must be paid:

1. "on the basis of quantity or value of business done with or for such patron,
2. "under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount paid, and
3. "which is determined by reference to the net earnings of the organization from business done with or for its patrons."

Item 1 requires the cooperative to specify the basis for calculating patronage. For a consumer-owned cooperative it will be sales. For a worker-owned cooperative it will be hours worked by workers or dollars paid to workers. We will use consumer-owned cooperatives in the examples below. The patronage dividend must be proportionally allocated based on business done with everyone, including non-members.

Item 2 requires that the cooperative operate under a pre-existing obligation to pay patronage dividends. This is normally part of the bylaws but may also be in the form of a written agreement with the members. State law normally allows a board of directors to determine that some or all of income be set aside as a reserve not to be paid out as patronage. This tempers the pre-existing obligation. But patronage dividends are not allowed if there was not an obligation established at the beginning of the tax year from which patronage is paid. Part of establishing the obligation is informing members that they may receive a patronage dividend. This is one reason cooperatives should distribute their bylaws to new members. Be sure you consult a qualified attorney on the precise wording of your bylaws, since they must be in accordance with the IRS rules and with applicable state laws.

Item 3 specifies that the base for patronage is net income. The IRS prefers taxable income as the patronage base. This is what most cooperatives use, although book income may also be used. The basis for patronage should be used consistently and should be specified in the bylaws.

Determine amount eligible for patronage dividend

The starting place in allocating patronage is to determine net income for tax or for book purposes. Using this, most cooperatives simply apply a percentage of sales to members and to non-members to determine the net income generated by members (patronage income) and the net income generated by non-members (non-patronage income). A more detailed analysis might allocate revenue and expense items such as member discounts, member only sales, advertising, member communications, and non-member mark-ups to the appropriate member or non-member calculation of net income. The member (patronage) net income is then allocated to each member based on the percentage of that member's purchases of total member purchases. The non-member (non-patronage) net income is not allocated to members and will potentially be subject to taxation.

The practical method of determining the patronage allocation to each member is to download the annual sales by member from your point of sale system to a spreadsheet. This can then be sorted from largest to smallest. A ratio of each member's sales to all sales is then an easy calculation, as is multiplying this percentage times net income to calculate the amount of patronage that could be

allocated to each member. A mail merge can then be used to generate the actual notices to members of their patronage. Most cooperatives apply a minimum dividend amount that they will process. For instance, anyone who would receive under $2 could be cut out of further processing. This does mean that the cooperative will pay tax on those earnings of members who would have received under $2.

The board will determine the actual dividend payout. The maximum dividend amount will be the net income earned from members. The dividend may be paid out with a minimum of 20 percent either as cash or as a store certificate, with the balance being held by the cooperative as equity in the name of the member.

Qualified notices

In order for the cooperative to retain part of the patronage dividend, members must receive a qualified notice of allocation. This notice indicates that by cashing their check, or using their certificate, they also accept the non-cash portion retained by the cooperative. This notice must specify a deadline to cash the check/certificate of at least 90 days after issuance. The IRS allows the cooperative, through the issuance of a qualified notice of allocation, to deduct the non-cash portion of the patronage dividend.

Food cooperatives will normally only use qualified patronage dividends. The non-qualified patronage dividend is non-deductible at the time it is issued but is deductible when cash is paid. The National Cooperative Grocers Association issued non-qualified patronage dividends on 2005 income as a tax-planning tool.

Form of payment

The minimum 20 percent paid out portion of a patronage dividend may be in the form of a store certificate that is redeemable in the store for purchases. You must also allow members to ask for cash if they prefer that option. This is much easier than issuing checks and limits the problems with un-cashed checks. Using a certificate also encourages members to use the dividend on groceries and keep the funds in the cooperative.

Anyone who does not cash a check or use a certificate by the deadline you specify in the written allocation notice gives up his or her claim to the patronage dividend including the non-cash portion. The cooperative will then need to pay tax on the entire patronage allocation to that member. Due to timing and practicality many cooperatives adjust for the unclaimed patronage in the next year, paying the tax at that time.

Some patrons may deliberately not cash their patronage check/certificate, thinking they are making a contribution to the cooperative. One way to encourage cashing the checks/certificates is to set up a donation fund either to the cooperative or as part of the community contributions program of the cooperative. If the person gives the cash portion back, it is taxable to the cooperative in the next year, but the retained portion of equity would still be held in that member's name and would not be taxed.

Payouts to members from the income of a given tax year must be made no later than 8.5 months after that year-end. This allowable timeframe is called the payment period. The deadline for cashing the check/certificate must be no later than 90 days after the end of the payment period. The IRS is very particular about this and will classify any payment made outside of the allowable payment period as an ordinary corporate dividend—nondeductible for the cooperative and taxable to the

recipient. A 1099-DIV would need to be issued to each member. Any non-cash portion held by the cooperative would also not be deductible.

Filing 1099-PATR forms Is not required

Food cooperatives should file IRS form 3491 to elect not to issue the 1099-PATR form. Form 3491 is filed in the first year patronage dividends are paid and does not need to be filed again. This exemption is allowed for cooperatives that have at least 85 percent of gross receipts from the sale of "personal, living, or family items." The tax code allows persons who purchase such items from a cooperative to exclude any patronage dividend from taxable income even if they receive a 1099-PATR. The reasoning is that individuals may not deduct personal use items and therefore any dividend on them is not taxable. Not issuing the 1099-PATR does not relieve members who are required to claim the patronage dividend as income from doing so. Examples of some possible members who should claim a patronage dividend as income are restaurants and day care centers.

One more issue with patronage dividends is the financial statement presentation. There is no definitive requirement for treating patronage as a deduction from income or as an equity transaction similar to corporate dividends. The guidance from the AICPA in the Audit and Accounting Guide mentioned earlier is that patronage is an equity transaction. The reporting examples given in the AICPA Guide follow that format. On the other hand, the CoCoFiSt format uses the income statement treatment.

New for 2006 was a specific IRS income tax form for cooperatives, the 1120-C. This will be mandatory for all cooperatives starting with the 2007 tax form. The primary difference from the 1120 is the addition of Schedule G that specifically requires the allocation of all income and expense items into patronage and non-patronage columns for all cooperatives with over $250,000 in gross receipts. Previously such an allocation was only explicitly required for cooperatives over $10 million in gross receipts. This allocation has always been required for all cooperatives but has generally been ignored by smaller entities.

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Schedule E **Compensation of Officers** (See instructions for line 11, page 1.)
Complete Schedule E only if total receipts (line 1a plus lines 4 through 9, of page 1) are $500,000 or more.

(a) Name of officer	(b) Social security number	(c) Percent of time devoted to business	Percent of corporation stock owned (d) Common	(e) Preferred	(f) Amount of compensation
1					

2 Total compensation of officers	2	
3 Compensation of officers claimed on Schedule A and elsewhere on return	3	
4 Subtract line 3 from line 2. Enter the result here and on line 11, page 1	4	

Schedule G **Allocation of Patronage and Nonpatronage Income and Deductions.** Before completing, see Question 14 of Schedule K.

		(a) Patronage	(b) Nonpatronage
1 Gross receipts or sales	1		
2 Cost of goods sold	2		
3 Gross profit. Subtract line 2 from line 1	3		
4 Other income	4		
5 **Total income.** Add lines 3 and 4	5		
6 a Domestic production activities deduction (attach Form 8903)	6a		
b Other deductions	6b		
c Total deductions (add lines 6a and 6b)	6c		
7 Taxable income before section 1382, NOL, and special deductions. Subtract line 6c from line 5	7		
8 Deductions and adjustments under section 1382	8		
9 a Net operating loss deduction (attach schedule)	9a		
b Special deductions (see instructions)	9b		
10 **Taxable income.** Subtract the total of lines 8, 9a, and 9b from line 7	10		
11 Unused patronage loss (see instructions)	11		
12 Unused nonpatronage loss (see instructions)	12		

Schedule H **Deductions and Adjustments Under Section 1382** (see instructions)

1 Dividends paid on capital stock (section 521 cooperatives only)	1	
2 Nonpatronage income allocated to patrons (section 521 cooperatives only)	2	
3 Patronage dividends:		
a Money	3a	
b Qualified written notices of allocation	3b	
c Other property (except nonqualified written notices of allocation)	3c	
d Money or other property (except written notices of allocation) in redemption of nonqualified written notices of allocation	3d	
4 Domestic production activities deduction allocated to patrons	4	( )
5 **Total.** Combine lines 1 through 4. Enter here and on line 26a, page 1	5	

Form **1120-C** (2006)

One result of allocating income in Schedule G is that net operating losses stay segregated by patronage and non-patronage sources. The IRS rules prevent patronage losses from offsetting non-patronage income. This can result in some pitfalls as a cooperative uses up a net operating loss. In loss years the loss is normally not allocated to members, resulting in an accumulation of patronage and non-patronage net operating losses. When the cooperative begins generating a positive net income, it may issue patronage dividends before its patron net operating loss is used. This can result in a situation where it will not be able to use up its patronage net operating loss and will pay more tax on its non-patronage income than would be expected by only looking at the overall net operating loss carry-forward.

In considering your cooperative's treatment, a question to ask is: we are retaining 80 percent of the payment, so why should it be expensed? Showing patronage dividends as an expense reduces net income, which may make your cooperative look weaker to a banker or other evaluator who does not understand cooperatives.

Related issues include the balance sheet presentation of the retained patronage dividend and the policy for eventually paying it out to members. The retained portion of a patronage dividend is equity of the cooperative and should be presented along with retained earnings and member shares in the balance sheet. This retained patronage is only paid out by the decision of the board. Most cooperatives do not return the retained patronage even if a member requests it back. This is also generally the case in agricultural cooperatives.

One advantage food cooperatives have in withholding retained patronage is that almost all members never paid tax on it and already received some cash. This removes the basic fairness argument that agricultural cooperatives must face since their members normally did pay tax on the retained patronage. If your cooperative does plan to revolve back this equity, it should lay out a plan for it. If it does not plan to revolve it back, that should be made clear. Most cooperative members should be receptive to the idea that they get some cash back and the rest is an easy way to avoid paying taxes and keeping the money in the cooperative working for them.

Patronage involves a simple set of rules but you need to actually learn them and keep them in mind so your cooperative can follow the applicable laws and make sound decisions.

Waking the Sleeping Giant

Recognize patronage dividends for what they are—co-op capital

BY MARILYN SCHOLL, WITH JOEL DAHLGREN AND BRUCE MAYER

Creating solutions begins with building the foundation for the future you want. One of the remarkable things about cooperation is that mutualism encourages solution-oriented growth, built on a vision of the common good. How profitability and capitalization are handled in cooperatives is an indicator of how much the co-op is actively taking advantage of the opportunity to develop its potential.

For far too long, consumer co-ops have under-utilized the potential of the patronage-dividend system to provide capital for the cooperative and fulfill its mission. Most cooperators know that profits generated with members can provide a tax shelter and that patronage refund checks raise member good will. But beyond that, have we as a sector really thought deeply or strategically about what retained patronage equity could be doing for our cooperatives? It's time for us to wake that sleeping giant. Our ability to leave a legacy for the next generations in our communities depends upon it.

Now more than ever, co-ops need a dependable source of capital. And one of the responsibilities of ownership is to provide capital. Retained patronage dividend equity is a way for co-op owners to provide capital without having to put in any additional cash. All they have to do is shop. And the co-op saves taxes!

Why don't more co-ops take advantage of this method of building co-op equity? Let's take a closer look at how your co-op and its board of directors can think strategically about its annual patronage-dividends decisions.

Understanding the value of equity

It's easy to see why there has not been a widespread grasp of the strategic value of retained patronage equity. Quite simply, not everyone understands its long-term value. Historically, the frame of reference for both food co-op management and governance has been that patronage equity belongs to the members and, for that reason, members should "get it back" during profitable years. Compounding this mindset is the fact that the Internal Revenue Service (IRS) requires that patronage equity be allocated to each member, making it feel like it "belongs"

Heres a sample motion that documents the board's annual decisions:

I move that the co-op allocate 100 percent of eligible profits to patronage dividends ($XX,XXX) to members and that 20 percent of those patronage dividends ($X,XXX) be distributed to members in the form of a store credit and according to rules outlined by Internal Revenue Service Chapter T and the state laws. Any distribution that would be less than $2.00 shall not be distributed and the related profits shall not be allocated.

to these individuals. What's more, not everyone expects the co-op to make enough profit to distribute or even to reinvest in the business. "Food for people" is a very powerful idea, whereas "profits reinvested in the people's interest" isn't catchy—but it could enhance our ability to change the world.

What the IRS requires (after a co-op board approves a patronage dividend) is that a minimum of 20 percent of the allocated profit be refunded back to the members as a "cash" portion. The cash portion of the dividend can be paid out in a check, voucher or store credit, or it can be given back to the co-op by the member to support its charitable programs. The only imperative is that these checks or vouchers be cashed in order to avoid tax liability on the profits earned from sales to that member. The rest, up to 80 percent, can be withheld as retained patronage equity in the cooperative.

The legal and financial reality regarding this money is twofold: Unless a co-op officially and explicitly states it, the co-op is not required to return any profits to the members, nor is it ever obligated to pay out retained patronage equity. Until you have taken a class of patronage and declared it payable, it is not owed to anyone until the board declares an obligation. If no declaration is made, the funds can remain in the co-op in perpetuity. If the co-op ever decides it has too much capital and has no vision or plans that would require capital, then the retained patronage could be returned to members. Although this is generally true in most states, it is also important to obtain professional legal and financial advice from experts knowledgeable about cooperatives on how your co-op can properly handle profits and retained patronage equity in your jurisdiction.

Given today's economic climate, retained patronage equity represents an outstanding opportunity to build capital for the co-op that is not leveraged by outside financing, as well as an opportunity to enhance the co-op's balance sheet for times when it does need to borrow. As banks become more conservative and capital harder to raise, co-ops can take matters into their own hands and build capital with retained patronage dividends.

That the business can be capitalized through the profits from the patronage of its owners is another one of the impressive things about cooperation—individually, owners don't need great sums of money to provide for their business. The owners' pooled resources through patronage equity can do a lot of heavy lifting in capitalizing the business. Looked at this way, retained patronage equity is not for the individual owner at all and shouldn't be considered as such. It is everyone's money, set aside for the good of the cooperative.

Of course, there is a balance that must be struck, and thinking about what's best for the co-op should take precedence. It's not necessarily prudent to hang onto the members' money in perpetuity, which takes us back to those tax advantages and the idea that patronage dividends tangibly demonstrate ownership in the co-op. However, annual decisions about what to do with co-op profits should be made in the context of the long-term needs of the co-op and what outcomes members expect the co-op to deliver.

The potential for retained patronage equity capital is huge. Of over 100 co-ops in the Common Cooperative Financial Statement (CoCoFiSt) database, only 29 co-ops show retained patronage on their balance sheets. The range reported is from $5.1 million to $3,677. The average amount of those

with retained patronage dividends is $494,000 and the median is $165,000. Five co-ops have over a million dollars in retained patronage equity.

What if all 100 co-ops had a half-million dollars in retained equity? That would be $50 million in equity, giving the food co-ops, as an aggregate group, much more control over their future destiny. Clearly, if our sector focused on strategically and systematically building retained patronage equity, it could see enormous benefit.

Annual decisions

Every year, the question comes up—what do we do with our profits? Since it is an annual decision, being prepared for it will enhance co-op leadership's ability to think about it strategically. Before determining how much of eligible profits should be allocated for any potential distribution, addressing the question of what the co-op's long-term needs are is imperative. This is not a once-a-year talk, but part of an ongoing dialogue. The ideal board conversation about this would start with the co-op's long-term objectives and how the co-op's capital needs are connected to any patronage dividend or retained-equity decision.

Does the co-op plan to expand and build its balance sheet? What activities do owners want the co-op to support? Does the co-op have debt and want to lower its risk? It's wise to assume that the co-op will need capital to pursue business opportunities. When you are focused on your long-term plans, the questions about what to do with the co-op's profit and retained patronage equity become much clearer. It becomes a matter of process and taking best advantage of the opportunity to either distribute or retain earnings.

Decision #1: How much of the eligible profits should be allocated?

After you have calculated profit that is eligible for allocation and determined whether there is a reason not to allocate all eligible profit, you can move on to the following considerations:

- **Are all profits eligible for distribution?** Some state laws allow profits allocated to all patrons to be tax-exempt for the cooperative. Most food co-ops restrict patronage allocation to members only. Profits on nonmember sales cannot be distributed to members and will be taxed.
- **Does the co-op need to build a cash reserve?** Some state laws and bylaws allow a percentage of profits on member sales to be set aside to build reserves. For many co-ops, the after-tax profit on nonmember sales will build adequate cash reserves.
- **Tax implications.** If the co-op has other available tax deductions (such as prior losses or investment tax credits) that are more valuable than patronage dividends, the co-op may allocate less than 100 percent of eligible profit to reduce the cash outlay of the 20 percent distribution requirement.
- Always consider **state law** requirements.
- Unless there is a compelling reason not to, we recommend **allocating 100 percent of eligible profits** for patronage dividends.

Decision # 2: What percentage of the allocated profits will be distributed?

- The minimum **required by the IRS is 20 percent**. Determine if there is any reason to distribute more than what's required.
- **Cash needs**. Does the co-op have long-term debt or other liabilities that will need to be repaid? If so, conserve cash by distributing the minimum amount.

• **Capital investment needs**. Does the co-op have a vision or strategic goals that will require future capital investment? If so, conserve cash by distributing the minimum amount.

• **Balance sheet strength**. Does the co-op have expansion or other plans that will require outside capital? If so, strengthen the balance sheet and the co-op's ability to leverage debt capital through retained patronage equity—conserve cash by distributing the minimum amount.

• **Fair return to members**. What is a fair return to members? While patronage dividends are a return on purchases, not a return on a member's equity investment, co-op boards often find it helpful to compare the cash portion of the dividend with the return on other possible investments such as a savings account. For example, if the member equity investment is $100, a goal for cash distribution could be $5–$10, significantly higher than what would be earned in a savings account. If a co-op member spends $100 each week and the co-op earns a net profit of 2 percent, that member's allocation would be $104 and the cash portion would be $20.80. Actual dividends will vary widely depending on profitability, the portion allocated in cash, and the member's total purchases.

• **Member needs and expectations**. What do members want from the co-op? What capital will be needed to provide that?

• **State law requirements**. Be sure you are current and in compliance.

• **Building capital**. Unless there is a reason to distribute more, or the co-op has all the capital it will need in the foreseeable future, we recommend distributing the minimum amount (20 percent) of allocated patronage dividends.

Decision # 3: What is the method of distribution, and what minimum amount will the co-op be distributing?

• **What method encourages use?** If members don't cash their refund checks or use their refund credits, the co-op will owe taxes on the full amount of their allocations (both the distributed and retained portions). Store credits, especially those that can be implemented through the POS system, are more likely to be used. Members must be given the option of getting their patronage dividend distribution in cash.

• **What is the cost of distribution compared with the value to the co-op and to the member?** What does it cost to prepare and mail checks or allocation notifications? Set the minimum amount of distribution so that the cost is not greater than the distribution amount. Remember that the tax implications are on the entire amount of the allocation, not just the distributed amount.

• **State law requirements:** Be sure you are current and in compliance.

• We recommend setting a **minimum distribution amount between $2.00–$5.00** and using store credits if allowed in your state.

Putting it into practice

Food co-ops around the country are thinking strategically about patronage dividends. Following are a few examples.

In 2008, the board of directors of Lexington Co-op in Buffalo, N.Y., decided to eliminate its member discounts and institute sustainable, flexible member benefits. The core of the new benefits program was a patronage-dividend system that would build up profits as well as equitably distribute profits. The co-op has a large debt load for its size, and when they looked to the future, the board felt the co-op needed much more growth in equity to continue to meet the owners' needs. Other new

benefits available only to co-op owners include monthly specials, everyday low prices on basic food items, and case order discounts.

Almost immediately, the co-op felt its impact on the bottom line, and member reaction has been overwhelmingly positive.

As part of the process for making this change, co-op leadership had to address its own fears that the members would be unhappy with the change. "We had to approach it from what would be sustainable for the co-op and worthwhile for the members. We had to change the things that were not working," said General Manager Tim Bartlett. The co-op's first patronage dividend included all profits on member sales and a 20 percent cash distribution with a $1 minimum. Members who spent an average of $53 per week received a $10 patronage dividend check. That's in addition to great member specials throughout the year. Board President Amy Holt added, "I think our members understand the co-op better and see it as a different business. They can see how they benefit when the co-op succeeds."

At the Wedge Co-op in Minneapolis, Minn., it wasn't until the 1990s, when the co-op started to consider the potential impact of retained patronage equity on its business, that things really came together for the co-op, according to Financial Manager Elka Malkis. "You can't do other things without being successful as a business, and patronage refunds and retained equity are part of the model of cooperation," Malkis said.

The Wedge Co-op board also established guidelines for determining how much would be retained and how much would be distributed to members. "Before that, it was pretty subjective," Malkis said, but when the board realized the importance of the capital, they knew they had to safeguard it by developing a strategy and course of action for it.

Currently, the Wedge Co-op's retained patronage equity stands at $5.1 million. That's an inspirational number, to be sure, but Malkis is clear that the retained equity level is the result of years of foresight and planning and the commitment of the co-op's 14,000 members. And it's not a big pile of money sitting around in a bank account. That money has been busy! Over time, the retained patronage equity has served as a nest egg and a way to raise capital for the co-op's warehouse, online store and organic farm.

Both Malkis and General Manager Lindy Bannister said they see retained patronage equity as the co-op's legacy to the community. "We're not just about bringing people groceries. There's so much more to what we are doing with our members' money, and it benefits them in different ways," Bannister said.

Whole Foods Co-op in Duluth, Minn., has traditionally not distributed amounts under $5, choosing instead to pay taxes on those profits. This year, however, the co-op decided to reach out to those members whose purchases were so small that they would not receive a distribution. The co-op sent even the smallest of refunds and offered those members a 5 percent discount if they cashed the check toward a purchase at the co-op. The offer got members back in the store, and sales currently are growing in double digits.

Creating solutions is what co-ops are all about. By thinking strategically about patronage dividends, your co-op can build the capital it needs to accomplish its dreams. At the same time, you can communicate to co-op owners what cooperative ownership means! Member owners get a fair return, the co-op gets the capital it needs to better serve members' needs, taxes are reduced, and more money stays in your community. What's not to like?

Patronage Refund Systems That Work

BY ELIZABETH ARCHERD

One of the great gifts of the cooperative pioneers is the unique way that co-ops handle profit. Profit. Say this aloud: "Co-op profit is good." Repeat several times.

Natural food co-ops have wrestled since their beginnings with the idea that there is something wrong about co-ops earning a profit. Early food co-ops were prone to minimizing profit—thus reducing their ability to pay for equipment, services, and improvements—by offering generous discounts in exchange for minimal stock or share payments or, even worse, small annual fees. It appears that we thought we needed to bribe people to join the co-op.

Member-owned businesses can generate wealth that is sustainable, equitable, and used in service to the community. Co-ops change the nature of how a business is conducted and serve as beacons of integrity. We should all be exemplars of the deep cooperative tradition of businesses built on the concepts of member equity and equality. We are not about fast deals and cut-rate sales—we are not Sam's Club or Costco!

The traditional cooperative way of handling surplus income (an old co-op term for profit) puts the needs of the many before the needs of the few. Additionally, patronage refund systems keep control of profit earned by well-run co-ops in the hands of co-op members.

A cooperative board's primary task is to ensure the financial soundness of the co-op. Among other things, that means distributing only what the co-op can afford. For start-up co-ops and those in the midst of major projects, this may mean that cash distributions to the members are limited to 20 percent. That is the minimum required by Internal Revenue Service code in order to shelter from taxation all member-generated profit in a given year. Distributions can be higher as business stabilizes.

Patronage refunds are a return of surplus profit, the extra the co-op does not need to retain while still effectively meeting member needs. Distribution is based on each member's patronage of the business. Effectively, members get back any excess profit generated by their own purchases.

There follow five examples of co-ops that distribute patronage refunds, with notes on why and how these co-ops adopted and adapted this time-honored practice—the real cooperative way.

Good Foods Co-op, Lexington: Building a Strong Foundation

For years, dating from the 1970s, Good Foods Co-op was a Kentucky non-profit corporation. Annual dues of $15 bought members a 5 percent discount on purchases. Annual fees engendered no real sense of ownership and were taxable income for the co-op—meaning that Good Foods did not even get to keep all $15 for its capital base. In 2002 the Good Foods board proposed to reincorporate as a Vermont co-op. The transition was supported by a membership vote and became effective on January 1, 2003.

While board and management were solidly behind the change, they knew that the views of the membership were susceptible to doubts among the staff. The co-op hired a consultant (yours truly) to teach employees about the advantages of equity-ownership and patronage refund systems. Staff members were reassured by hearing about the experiences of co-ops around the country. To visualize the difference in the membership structures, we used the image of houses built on a pile of pebbles (small annual fee) versus concrete blocks ($200 share purchase).

Once staff members were confident and positive about the change, management moved ahead with a comprehensive communication plan for the members, who approved the change by an

overwhelming margin. Owner benefits now include NCGA coupon books and Good Foods Owner Discount Days, but the primary benefit is the patronage refund in profitable years.

Good Foods had nearly 5,000 members under the dues-for-discount system. After changing to equity, ownership was at 1,425 by year-end 2003. At the time of my 2008 interview with general manager Anne Hopkins, membership totaled over 3,700. Ownership increased 34 percent in 2007 and an additional 22 percent over 2007 from January to May 2008—an amazing 70 percent increase in 16 months. The secret? One highly motivated 17-year-old cashier decided to make a point of selling shares. He showed the front end how easy it could be, and the department revamped its procedures.

There was no patronage refund the first year following the change, since Good Foods experienced a loss when Wild Oats opened nearby. For the next two years the board refunded 100 percent of owner-generated profit in cash! More recently, Good Foods refunded 20 percent in cash, retaining 80 percent for a planned expansion. Checks are cut in-house by the accounting department, with supervision and database management handled by the membership manager.

Most years, the general manager recommends a percentage of cash refund for board consideration. Last year the board took a straw poll of the owners about how much to distribute, and the overwhelming response was to retain 80 percent for the co-op's expansion.

Good Foods Co-op has built a solid foundation and is poised for more growth. With owners who have embraced ownership and reinvestment concepts, it will be exciting to watch this little co-op that could over the next several years.

Wedge Co-op, Minneapolis: Debt Free, Ready for Opportunity

The Wedge Co-op has sent its members a patronage refund every year since 1990—over $2.5 million in cash since 2002. Open since 1974, the Wedge originally required members to work for the store in some capacity in exchange for discounts. As the volunteer pool shrunk in the mid-1980s, board members researched reconsidered co-op traditions and practices. The board increased the share purchase requirement and made member labor optional, expanding the membership and setting the stage for future growth.

After several reorganizations, the current system was adopted in 1989, in preparation for building a new store in 1991. Central to the plan was the patronage refund system, which would keep the board of directors in charge of the growing percentage of co-op profit that was generated by sales to member-owners.

After each annual audit, board and management assess plans for the coming year. A formula is then applied to determine the cash portion of the refund. The cash portion has been as little as 22 percent and as high as 60 percent. Checks are cut in-house and mailed to members with a letter from the board. The check stubs detail each member's purchases and the cash portion of the refund and also serves as the record of non-cash, non-voting stock that represents the retained portion. Checks are mailed in November, and many members use them to buy Thanksgiving groceries.

The Wedge board of directors has chosen to give low cash returns in years immediately following expansions, preferring to use the extra cash to retire loans. As a result, the co-op has no long-term debt and has been in that enviable position for a number of years. Because of its strong financial position, in the past three years the co-op tripled its wholesale warehouse operation (which delivers

perishable products in five states), started an online store and bought an organic farm.

The member-owners vote every year on charitable distributions, amounting to tens of thousands of dollars, to non-profit organizations with missions that align with the co-op's values. Additionally, along with other Twin Cities co-ops, the Wedge funds an educational program that pays two teachers to deliver innovative lessons about food and agriculture in area schools.

With 76 percent of sales to members, the patronage refund system allows the Wedge board and management to retain control of 76 percent of the profit—a considerable resource for advancing co-op values and services.

Three Rivers Market, Knoxville: Turned Around and Poised for Growth

The co-op opened in 1981 and was the only food co-op in the state of Tennessee. Although incorporated as a non-profit, it operated as a for-profit business. Annual $25 dues (free for seniors) bought the members a 5 percent discount on every purchase. For years the co-op gave out twice as much in discounts as it collected in dues. It was truly more supportive of the co-op to shop without joining, unless one joined and did not shop!

In April 2005, Three Rivers Market became a Minnesota cooperative and adopted an equity-based system. It took several years to make that change. Jackie Arthur started as general manager in 2001 and realized that Three Rivers Market was not truly a cooperative. The board considered adopting cooperative status in preparation for an expansion. Once the board was in agreement, they pushed the structural change through fast.

After the switch from "members" to "owners," Three Rivers Market doubled co-op ownership in three years! Owners feel that they are offered more than they were as members of a club. The financial position has changed dramatically: owner equity went from $0 to over $86,000 after three years.

The new system requires members to purchase one $25 share per year. Eight shares are required for participation in the patronage refund system (paid in full is called Fair Share). After year nine, members still have to buy one share a year, to allow ongoing accumulation of capital for the co-op. A member may buy eight shares this year, get access to the patronage refund, and not have to purchase shares again until year nine.

Prior to the equity change, Three Rivers Market was barely profitable. The co-op became strongly profitable immediately after the change and has distributed a patronage refund every year so far. Stable and growing, Three Rivers Market is now planning its expansion, with the three years of data as a "real co-op" needed for the pro forma. Sales are strong, as local and organic food gain credibility in their area.

Because Three Rivers Market organized under a relatively new form of cooperative statute, its method of distribution is unusual in the food co-op world. Fifteen percent of Three River's total profit must be returned every year. So far, they do not have enough Fair Share members to generate 15 percent of the profit, so the required 15 percent is distributed among the Fair Share owners.

Outpost Natural Foods, Milwaukee: Turning Profit Into More Stores

Outpost was a pioneering natural foods co-op, begun in 1970. It operated according to the customs of new food co-ops of the times. Owners received discounts of 5 percent on most purchases. When seri-

ous financial troubles hit in 1990, Outpost started searching for a more stable structure.

They took their time! Jessie Singerman, CEO of co-op wholesaler Blooming Prairie Foods, in Iowa City, suggested in 1993 that they consider a patronage refund system. The co-op started informing owners in November 1995 that the switch to a patronage refund system was coming in fiscal year 1997.

The long communications process with owners included education about co-op principles. Members approved the change at an annual meeting that was well attended for that time—about one hundred participants. Predictably, some members who had not attended the meeting were upset about the new arrangement. Even after it was a done deal the dialogue continued in the store, and sometimes managers had to be called to the sales floor to talk to shoppers who were upset.

The redesigned benefits package currently includes coupons at local businesses, Owner Bonus Buys, Get Fresh Sales (member-only specials in perishable departments), Owner Appreciation Days, and Bonus Cards. A unique feature at Outpost is the Early Bird Rewards Program, an incentive program that involves an early return on the patronage refund, distributed on a quarterly basis. The co-op sends out postcard coupons, based on patronage for the previous quarter. Owners have to spend a certain amount of money to earn a coupon.

During 10 years since the change, Outpost has had a good financial track record. The co-op sent out patronage refunds amounting to 20 percent in cash of owner-generated profits each year until 2000, when it opened a second store. And in 2003 there was no profit due to a major remodeling. The most recent distribution was in 2004.

Outpost opened a third store in 2005. No checks have been sent for the past three fiscal years, but the co-op has weathered increased competition and several expansions much better than it would have if it had been giving discounts on every purchase. The co-op is keeping its head above water, and profitability is in sight.

Rather than revisit the decision of how much to distribute each year, Outpost uses the IRS requirement as its guide. In profitable years the co-op returns 20 percent and retains 80 percent of owner-generated profit. It is a wonderful example of using co-op profit to increase access to good food, and to the cooperative way of doing business.

City Market, Burlington: Refreshing the Members, Renewing the Community

Located in northern Vermont, Onion River Co-op started in 1976. Several years ago the co-op moved and expanded from its small store to downtown Burlington, at which time it started doing business as City Market.

In the past, the co-op distributed coupons to members every year as a primary financial benefit. While the option of sending patronage refunds was in the bylaws, loan agreements that financed the move into the bigger store gave lenders the final say about actually sending a patronage refund to members. These lenders gave the green light last year but still want to approve the percentage that will be sent in cash.

To thank co-op members for their support, the board of directors decided to start the patronage refund program by eliminating the coupon program in December 2007 and giving a refund based on half a year of purchases, beginning January 2008. The board communicated the coming changes to

Talking Points

Explaining Patronage Refunds: How to talk with members and potential members

- The amount of the refund varies from year to year based on: how much profit the co-op made and any upcoming projects.
- The decision about how much to return in cash is made by the cooperative's board of directors.
- In the past XX years, the cash return has ranged from X percent to X percent of purchases. (Last year it was X percent.)
- We hope returns will continue to be in this range, but there is no guarantee, since it is based on our profitability each year, and takes into account plans for [Choose from what is coming up, in process, or just completed at your co-op, such as: a new roof, truck, heating system, equipment, remodeling, etc].
- A patronage refund is not guaranteed—the store has to make a profit to send a refund.
- The more you shop, the more you get back, but all members get the same percentage.
- The percentage we hold back from distribution stays in the co-op. It belongs to the members as a group, not as individuals, and becomes part of what we own together.

A great way to talk about this is based on your own experience as a member. This can help people who think that co-op membership is a "too good to be true" sales pitch. Tell it like a story: "I plunked XX bucks down for membership in [year] and earned that back within a year [or two] of shopping here. I've already been paid back for my membership several times over."

Ways to characterize patronage refund:

- We're all in this together.
- We share the good times and bad.
- It's like recycling profit.
- Co-ops are the original "community reinvestment" program.
- We keep profits local.

Lastly, a patronage refund is just that—a refund. Co-op membership will not fund your retirement! It is an investment in community ownership and all things cooperative.

members through newsletter articles and at meetings, and the transition went pretty smoothly.

City Market also added a member benefit at the same time: a bulk water machine (reverse osmosis) providing the water free to the members! That helped sweeten the loss of the coupons.

While the co-op follows standard procedures to track member sales, and the board (with lender approval) makes the decision about how much the co-op needs to retain, the City Market approach is unique in how it plans to deliver the money. The co-op sends out a notice to members that patronage refund checks are available at the store. Members can come in for checks instead of having them mailed. The co-op has established ties with several philanthropic funds. At the store, a member can take the check or sign it over to any of the funds. One fund has a mission of supporting local food systems. There also is a childhood hunger initiative and a fund with an international component.

The first refund will be this fall, at which point the board can assess how popular these options are among the membership. This will be an interesting experiment in offering members on-the-spot opportunities to use the distribution of their co-op profit for charitable purposes.

Steps for Implementing Patronage Dividends

BY MARILYN SCHOLL AND BRUCE MAYER

Following are some suggested steps for implementing a patronage dividend system. Excerpts from **Patronage Dividends: A Primer** by Bruce Mayer are included in italics to help explain various steps. Also included are sample bylaws from the **Legal Primer: For Formation of Consumer-Owned Food Cooperatives**, by Joel Dahlgren, sponsored by Cooperative Development Services and Food Co-op 500.

Please note that Patronage Dividends require careful planning and implementation to comply with laws and IRS regulations. This outline should not be used as a substitute for legal or accounting advice. Your co-op should seek appropriate professional counseling (legal and accounting) before embarking on decisions and implementation of patronage dividends!

1. Board education.

2. Board decisions:

a. Will we use the patronage refund system? yes/no

b. Why are we proposing this change? Clarify values about patronage: tax planning tool, source of capital, member benefit.

c. Will all patrons be eligible for refunds or only member patrons?

d. Will there be a plan for retained allocated patronage to be refunded?

One advantage food cooperatives have in withholding retained patronage is that almost all members never paid tax on it and already received some cash. This removes the basic fairness argument that agricultural cooperatives must face since their members normally did pay tax on the retained patronage. If your cooperative does plan to revolve back this equity, it should lay out a plan for it. If it does not plan to revolve it back, that should be made clear. Most cooperative members should be receptive to the idea that they get some cash back and the rest is an easy way to avoid paying taxes and keeping the money in the cooperative working for them.

e. Will the basis be tax or book net income?

IRS prefers tax and that is what most co-ops use.

f. Can patronage refunds be used to make any share payments due? What process is in place for member informed consent?

g. Do we want to set up a fund for members who do not want their refunds to donate their refund checks?

Some patrons may deliberately not cash their patronage check/certificate, thinking they are making a contribution to the cooperative. One way to encourage cashing the checks/certificates is to set up a donation fund either to the cooperative or as part of the community contributions program of the cooperative. If the person gives the cash portion back, it is taxable to the cooperative in the next year, but the retained portion of equity would still be held in that member's name and would not be taxed.

3. Bylaws

a. Prepare draft bylaws. See sample below.
b. Create pre-existing obligation (in bylaws)
c. Have attorney review

4. Member education. Build member support.

5. Member vote on bylaw changes.

6. File form 3491

Food cooperatives should file IRS form 3491 to elect not to issue the 1099-PATR form. Form 3491 is filed in the first year patronage dividends are paid and does not need to be filed again. This exemption is allowed for cooperatives that have at least 85 percent of gross receipts from the sale of "personal, living, or family items." The tax code allows persons who purchase such items from a cooperative to exclude any patronage dividend from taxable income even if they receive a 1099-PATR. The reasoning is that individuals may not deduct personal use items and therefore any dividend on them is not taxable. Not issuing the 1099-PATR does not relieve members who are required to claim the patronage dividend as income from doing so. Examples of some possible members who should claim a patronage dividend as income are restaurants and day care centers.

7. Conduct reviews.

Review accounting, bookkeeping and POS systems to enable tracking of patronage purchases by member number.

8. Revise membership brochures, cards, signs and printed information as needed.

9. Distribute bylaws to all members (including as new members join).

10. Make annual year-end calculations, decisions, and distributions.

a. Determine profit eligible for patronage dividends
b. Determine % of eligible profit that will be allocated to patronage dividends. Ensure adequate reserve, then to minimize tax obligations allocate remaining eligible profit to patronage.
c. Determine the % of patronage dividend that will be distributed. Minimum amount, required by IRS is 20%. The rest will be booked to each member's allocated equity account.
d. Determine the method of distribution -- store credit or check.
   The minimum 20 percent paid out portion of a patronage dividend may be in the form of a store certificate that is redeemable in the store for purchases. You must also allow members to ask for cash if they prefer that option. This is much easier than issuing checks and limits the problems with un-cashed checks. Using a certificate also encourages members to use the dividend on groceries and keep the funds in the cooperative.
e. Determine the minimum amount of funds that will be distributed.
   Most cooperatives apply a minimum dividend amount that they will process. For instance, anyone who

would receive under $2 could be cut out of further processing. This does mean that the cooperative will pay tax on those earnings of members who would have received under $2.

f. Calculate amount of patronage allocated and the amount of patronage distributed to each member.

The practical method of determining the patronage allocation to each member is to download the annual sales by member from your point of sale system to a spreadsheet. This can then be sorted from largest to smallest. A ratio of each member's sales to all sales is then an easy calculation, as is multiplying this percentage times net income to calculate the amount of patronage that could be allocated to each member. A mail merge can then be used to generate the actual notices to members of their patronage.

g. Prepare and mail notices to members. Include check or store certificate.

In order for the cooperative to retain part of the patronage dividend, members must receive a qualified notice of allocation. This notice indicates that by cashing their check, or using their certificate, they also accept the non-cash portion retained by the cooperative. This notice must specify a deadline to cash the check/certificate of at least 90 days after issuance. The IRS allows the cooperative, through the issuance of a qualified notice of allocation, to deduct the non-cash portion of the patronage dividend. Food cooperatives will normally only use qualified patronage dividends.

Payouts to members from the income of a given tax year must be made no later than 8.5 months after that year-end. This allowable timeframe is called the payment period. The deadline for cashing the check/certificate must be no later than 90 days after the end of the payment period. The IRS is very particular about this and will classify any payment made outside of the allowable payment period as an ordinary corporate dividend --nondeductible for the cooperative and taxable to the recipient.

11. Plan to adjust next year's tax obligations for unused certificates.

Anyone who does not cash a check or use a certificate by the deadline you specify in the written allocation notice gives up his or her claim to the patronage dividend including the non-cash portion. The cooperative will then need to pay tax on the entire patronage allocation to that member. Due to timing and practicality many cooperatives adjust for the unclaimed patronage in the next year, paying the tax at that time.

12. Plan for the financial statement presentation.

One more issue with patronage dividends is the financial statement presentation. There is no definitive requirement for treating patronage as a deduction from income or as an equity transaction similar to corporate dividends. The guidance from the AICPA in the Audit and Accounting Guide (Agricultural Producers and Agricultural Cooperatives) is that patronage is an equity transaction. The reporting examples given in the AICPA Guide follow that format. On the other hand, the CoCoFiSt format uses the income statement treatment.

13. Plan for tax filings.

New for 2006 is a specific IRS income tax form for cooperatives, the 1120-C. This will be mandatory for all cooperatives starting with the 2007 tax form. The primary difference from the 1120 is the addition of Schedule G that specifically requires the allocation of all income and expense items into patronage and non-patronage columns for all cooperatives with over $250,000 in gross receipts. Previously such an allocation was only explicitly required for cooperatives over $10 million in gross receipts. This allocation has always been required for all coop-

eratives but has generally been ignored by smaller entities.

One result of allocating income in Schedule G is that net operating losses stay segregated by patronage and non-patronage sources. The IRS rules prevent patronage losses from offsetting non-patronage income. This can result in some pitfalls as a cooperative uses up a net operating loss. In loss years the loss is normally not allocated to members, resulting in an accumulation of patronage and non-patronage net operating losses. When the cooperative begins generating a positive net income, it may issue patronage dividends before its patron net operating loss is used. This can result in a situation where it will not be able to use up its patronage net operating loss and will pay more tax on its non-patronage income than would be expected by only looking at the overall net operating loss carry-forward.

Sample bylaw language

BYLAW VI: Finance

Section 6.01. Financial Operation. This corporation operates on a cooperative basis and allocates earning and losses to patron-members on the basis of the business done with or for such patrons. Thus, in accordance with Subchapter T of the Internal Revenue Code, this corporation may declare a patronage dividend to be distributed among the members in accordance with the total amount of purchases made by each such patron during the preceding fiscal year.

Section 6.02. Patronage Dividend. The patronage dividend, as determined by the Board of Directors, shall be paid in cash, property or written notices of allocations as defined in Subchapter of the Internal Revenue Code.

Each member shall have an internal capital account in his or her name. The surplus earnings of the company after paying taxes, interest on loans, and allocations to the Reserve Fund (See Section 10 below) shall be allocated to members as a patronage dividend. Unless otherwise decided by the Board of Directors, the patronage dividend shall be credited to the owners' Internal Accounts. At least 20% of each year's patronage allocation must be paid out in cash/check to members.

Section 6.03. Equity Capital. The Board of Directors shall manage the Cooperative's equity capital in a way to preserve and build upon the Cooperative's financial position while also allowing for redemptions of equity as and when the Cooperative has the financial strength to redeem equity. The Board of Directors may, from time to time, establish policies for redeeming equities, stock, or other forms of equity used for qualified or non-qualified notices of allocation, or the Board may eliminate equity redemption policies in favor of a capital management policy. Any of these policies may contain offers of discounts or required retentions of capital as part of any redemption of allocated equity. The Board retains the power to amend, modify or repeal these policies and may do so retroactively, all in the Board's sole discretion. For example, if the application of a policy to a specific circumstance suggests that the

equity of a deceased member should be paid to the member's estate, the Board of Directors retains the right and power to determine whether to approve the expenditure. In each case, the Board of Directors may refuse any expenditure(s) if the Board determines that such expenditure(s) is (are) not in the interest of the cooperative. Therefore, no equity redemption policy shall be interpreted to require any expenditure of capital and the Board of Directors retains all right and power to the final review and approval of each expenditure of capital for any redemption of equity. No person shall have any right whatsoever to require the retirement or redemption of any patrons' equities except in accordance with their term, or of any allocated capital reserve. Any redemption or retirement is solely within the discretion and on such terms as determined from time to time by the Board of Directors of this Cooperative, which may, in making any such redemption or retirement, distinguish natural members from unnatural members (corporations, partnerships, LLCs and other business organizations, etc.) and, in doing so, favor natural members with respect to estate retirements and redemptions at specified ages.

BYLAW VII: Consent

Section 7.01. Consent to Take Patronage Distributions Into Income. Each person who hereafter applies for and is accepted to membership in this cooperative and each member of this cooperative as of the effective date of this bylaw who continues as a member after such date shall, by such act alone, consent that the amount of any distributions with respect to its patronage which are made in written notices of allocation (as defined in 26 U.S.C. § 1388), and which are received by the member from this cooperative, will be taken into account by the member at their stated dollar amounts in the manner provided in 26 U.S.C. § 1385(a) in the taxable year in which the written notices of allocation are received by the member.

Examples of Communication

Telling members about patronage refunds/dividends/rebates

APPENDIX A

Example 1

Share our profit. Co-op owners receive a portion of the Co-op's profits through annual patronage dividends. The Board of Directors determines annually if the Co-op can afford to distribute dividends. Yours is determined by the amount you spent in that year. There's no guarantee, but if the Co-op's fiscally healthy, we all benefit.

Example 2

From a list of member benefits:

- Patronage refunds during profitable years, as determined by the board

Example 3

From a River Valley Market member brochure:

What is a patronage rebate?

A patronage rebate is a more traditional form of co-op member discount. Cooperatives are structured so that when business operations are profitable, the annual surplus may be returned to member-owners as patronage rebates based on their purchases. For example if the co-op had a 2% profit for the year, the board could allocate 2% of your purchases for that year to you as patronage rebate. The co-op would send you 20% of the total rebate amount for that period and retain 80% of that total in a retained patronage account in your name for working capital for the business. As the cooperative matures and builds a stronger capital base, the retained portion may also be rebated over time.

From a list of member benefits:

Eligibility for patronage rebates when the co-op is profitable

Example 4

From www.Wedge.coop

What Does it Mean to be a "Member-Owner" of the Wedge?

Joining a co-op means that you co-own this store! As Owners of this Business you may:

- Receive all financial benefits of membership.
- Vote for the directors-annual election held by mail ballot.
- Receive a copy of the co-op Articles and Bylaws upon joining.
- Review reports on financial performance at the annual meeting and in the newsletter.
- Run for the board of directors.
- Vote on questions put before the membership.
- Vote for changes in the articles and bylaws as proposed by the board of directors.

• Attend board meetings. Meeting dates are in the newsletter.
• Participate in member surveys.

There are, of course, some technicalities. A membership belongs to the person(s) who signs the membership application form. Spouses, partners, children or other household members may use the member number when shopping at the store, but all official business must be conducted with the signer(s). That means: only the signer(s) may vote in elections, patronage refund checks will be made out to the signer(s) and only the signer(s) may request a membership withdrawal.

Also, if you chose a payment plan, be sure to purchase all 8 shares of stock on time so your member benefits are not interrupted.

If you wish to withdraw your membership, Member Stock Refund Request forms are available at the Customer Service Desk and on the Membership page.

What is a Patronage Refund?

Patronage refund is the official name for how co-ops send profits back to their members. As owners of the co-op, members also own the profit. Here's how it works:

The Wedge provides its members delicious food and other fun things. Every member purchase is recorded in the membership records. When the Wedge is profitable, the board and management review plans and financial obligations. The co-op sets aside any profit needed to pay for those and records it in each member's account as non-voting shares in the Wedge. The money that is not needed to reinvest in the business is returned by check to the members. Your patronage refund is based on the amount of your purchases over the fiscal year (July 1-June 30). Checks are mailed in November or December for the year that ended the previous June 30.

When you get your check, the stub will mention the part of the profit the Wedge is reinvesting in the business. This is called "qualified equity certificates," a type of stock share. The law requires us to let you know about the retained portion of the year's profits in this manner. Co-op shares are not like stock in other kinds of business because they do not change in value, cannot be sold, and does not increase your voting power in the co-op. It is really an accounting method that shows who the co-op belongs to. These reinvested (retained) shares are our legacy to future generations.

Patronage refunds are NOT taxable income when they are returned to member-owners. It's a refund, not a dividend. We'll remind you of this on the check stub, as well!

—Compiled by Marilyn Scholl, May 2008

Lexington Co-op Educates Its Members

APPENDIX B

[Lexington Co-op was very successful in its transition to patronage dividend because they created a clear goal to create benefits that were exciting to owners, sustainable for the co-op, and flexible enough to achieve both over and over. That mantra provided the focus to lead the co-op through such a big and fundamental change. The materials in this appendix are taken directly from what Lexington Co-op used in its successful campaign.]

Plan for Engaging Members 4/1/2008

Desired Outcomes:

1. Members experience transparency. They can see how decisions are made at the Co-op. They can see the diversity of member interests. They understand cooperatives better.
2. Members can articulate how patronage dividends are equitable, and can strengthen and sustain the Co-op
3. Members are excited about patronage dividends & the new economic benefits.

Timeline: (Board decision points in Bold)

3/2008	New signage in store: "our profits go back to our neighborhood and store" (Engage All)
4/7/2008	**Board approves plan for engaging members. Board clarifies commitment to:** • Vision for meaningful economic benefits (exciting to owners, affordable to the Co-op and flexible enough to accomplish both) • Initiating Patronage Dividend System • Ending discounts • Delegating other economic benefits to staff • Executing plan for engaging members
4/8/2008	Staff plans three engagement sessions $100-$150 each (Engage Active) Staff plans one engagement session for Co-op employees (Engage All) Amy writes newsletter article clarifying commitment & laying out process for member engagement
4/27–5/3	Engagement sessions with active members
5/2008	Refine message
6/2008	**Board calls a BIG meeting where ALL of the members are invited (Engage All)**
7/2008	Newsletter Jul/Aug Lextalk info from engagement sessions and announce BIG meeting (Engage All) Brochures in the store with message and plan (Engage All) Big Meeting (Engage All) Board presence at Member Appreciation Day to answer questions re Patronage Dividends

9/2008	Newsletter Article—report on meeting, discuss issues, next steps (Engage All Survey—Educate and test messages (Engage All) Staff finalize initial other economic benefits
10/2008	**Board approves plan for patronage dividends and delegating other economic benefits**
	Share Survey results (Engage All)
	Annual Meeting: Board announces final plan (Engage All)
1/2009	No discounts/new economic benefits are in place
9/2009	**Board decides on patronage dividend (or not) for 1/1/2009–6/30/2009**
10/2009	Annual Meeting—Announce patronage dividend (or not)

Plan for Engaging Active Members

What? Three small-group sessions with active member owners during a 7-10 day period in late April or early May

Who? Active members: Old timers/founders, Member lenders, former member-workers, Ex-board members, & opinion leaders in the Co-op community (Credit Union, Nickel City Co-op, Urban Roots). Each session will include a proportionate mix of "active" sub-groups by gender, zip code and age (if we can get that data).
1–2 board members that participate (others can attend to observe)
1–2 staff

Agenda for Engagement Sessions

1. **Build alignment on vision** — 30 minutes
   - Present vision for meaningful economic benefits (exciting to owners, affordable to the Co-op and flexible enough to accomplish both)
   - Get feedback on vision—shoot for alignment

2. **Present the Plan** — 30 minutes
   - Present history of benefits at the Co-op
   - Talk about the problem with discounts
   - Research & process for arriving at plan
   - Present the Plan

3. **Listen and assess level of understanding and support** — 60 minutes
   - What do you love/ not love about the economic benefits plan?
   - Do you see how this new plan will strengthen the Co-op?

Following are:

- **Handouts on dividend calculation and FAQs**
- **Eight PowerPoint slides that were used during the membership meeting in October 2008 to announce that the Board had decided to switch from discounts to dividends.**

Lexington CO-OPERATIVE MARKET

How Your Dividend is Calculated in 3 easy steps !

Step 1: The Co-op earns a profit

- Our goal is to earn 2% profit every year.
- In 2009, the Co-op earned a profit of 1.8% of sales, or $127,000.

Step 2: We make a few decisions.

Decision 1: The Board decides whether or not to declare a dividend.
In 2009, the Co-op Board declared 100% of profits from owners as dividends, or $68,000

- Co-operatives can declare up to 100% of profits from owners as dividends.
- In 2009, 55.1% of profits came from sales to owners. This made $68,000 in profit available for Dividends.

Decision 2: The Board decides what percentage of the declared dividend to return to the owners.
In 2009, the Co-op Board decided to distribute 20% of declared dividends, or $13,705.

- Co-operatives have to distribute at least 20% of declared dividends.
- The 80% of the dividends that is not distributed to owners is retained in the Co-op in a non-refundable equity account.

Decision 3: The Board decides on a minimum distribution.
In 2009, the Co-op Board decided to not distribute dividends under $1.

Step 3: We do some math.

2009 Dividend Distribution	Your Purchases for the Year	÷	Total Eligible Purchases by all Owners	=	Your Share of the Dividend	x	Total Distribution	=	Your Dividend
Example 1: Joe Sixpack	$1,000	÷	$3.75 million	=	.027%	x	$13,705	=	$3.65
Example 2: Reg Ularshopper	$5,000	÷	$3.75 million	=	.133%	x	$13,705	=	$18.27
Example 3: Crun Chi Granola	$10,000	÷	$3.75 million	=	.267%	x	$13,705	=	$36.54

...and we're done

Patronage Dividends Frequently Asked Questions

1. ***How much will my dividend be?*** Every year is different, but this year, if you spent about $10 per week this year, you will be getting a $2 dividend.
2. ***How can I increase my dividend?*** The more you shop, the more you are eligible to earn in a dividend.
3. ***How does the dividends program compare to the discount program (for me and for the coop)?***
   - For you: We are finding that owners are experiencing almost three times the savings under the new benefits program (including dividends and owner only specials) as they did with discounts at the register.
   - For the Co-op:
     - It's a more sustainable method of distributing profits. All co-ops return profits to owners based on how much they use the services. The discount program returned these profits before we made them. The dividend program allows the board to decide how much to return after the books are closed.
     - Patronage dividends allow the Co-op to realize significant tax savings. The dollars that we allocate as patronage stay here in the community rather than going to the IRS.
     - The retained portion of patronage dividends builds financial stability.
4. ***How many other co-ops use this form to return profits to their owners?*** Just about all co-ops use dividends. (More and more natural foods co-ops are using dividends, but nearly all co-ops in other sectors use them.)
5. ***How is the Co-op doing? Are we making a profit?*** The Co-op is doing great. We continue to enjoy strong support from the community. Our sales have grown steadily since we opened four years, and we have been profitable in each of the past three years. This year we earned over $100,000 in net profit.
6. ***Will this affect loan repayments?*** The two are not related. We are paying back our loans as agreed.
7. ***Why can't we take our dividend from the overall profits? Why is it limited to profits from sales to owners?*** Dividends are a common way for co-ops to distribute profits, so they are strictly regulated by the IRS. This is one of those requirements.
8. ***Are taxes taken out of my dividend?*** No. However, if you use your membership for business purchases you should consult your accountant.
9. ***When were the owners told about this?*** During the spring and summer of 2008 the board engaged with Co-op owners around the issue of dividends. There were meetings, newsletter articles and other opportunities for owners to ask questions and shape the plan. Last October, the board unanimously voted to make the switch, and announced their decision at the annual meeting, in the newsletter, on the website and in the store.
10. ***Will the Co-op distribute dividends every year?*** No. Only in years when the Co-op generates sufficient profits.
11. ***Without an owner worker program and discount, aren't we just like any store now?*** The member work program was a wonderful way for our owners to invest their sweat equity in the store and to feel ownership on a deeper level. For a long time, it was a big part of what made us who we are, but it was never what made us a co-op. The seven co-op principles govern all co-ops. None of these principles mentions a work program for member-owners or discounts. Member work is not a typical part of the co-op structure and was never what made us a co-op.

    Here are five ways the Co-op is still different from other stores…
    - You own the Co-op.
    - The Co-op can only be owned by the people who use it. Publicly traded corporations can be owned by anyone.
    - The Co-op exists to provide a service, while publicly traded corporations exist to make a profit for their shareholders.
    - Our Co-op returns profits based on how much our owners use the service, not how much stock they own.
    - Our Co-op is democratically owned by community residents, lending accountability and oversight to store operations.

exciting sustainable & flexible

"We have prevailed because we are a community owned business with the sole purpose of meeting member and community needs. Our Co-op Entity is here forever, in a constantly changing form, so long as we do our total job and do it on a financially sound basis"

– Howard Bowers
General Manager
Hyde Park Co-op
1988

Lexington CO-OPERATIVE MARKET

ALL NEW OWNER BENEFITS TIMELINE

Sept 07-April 08
Board studies dividends

April 08
Board commits to making the change from discounts to dividends pending owner input

April – Sept 2008
Engagement w/ member owners

Oct 2008
Board unanimously votes to switch from discounts to dividends
ANNUAL MEETING

Jan 2009
ALL Discounts at register end
New benefits begin.

Oct 09
Board evaluates end of year financials and decides whether to distribute a patronage dividend.

ALL NEW OWNER BENEFITS 2009

#1

"patronage dividends"

When the Co-op is profitable, the money that is not needed to reinvest in the business is returned to owners in the form of patronage dividends.

ALL NEW OWNER BENEFITS 2009

other flexible benefits…

In addition to Patronage Dividends, our staff will create ongoing owner benefits that are exciting to owners, sustain the Co-op, and flexible enough to accomplish both. These benefits will change over time.

ALL NEW OWNER BENEFITS 2009

#2

"monthly specials"

Owners will receive 15-25% off regular price on a variety of monthly specials. This is in addition to CAP flyer specials.

ALL NEW OWNER BENEFITS 2009

#3

"everyday basics"

Owners will pay everyday low prices on at least 25 basic food items throughout the store. Items will include staples like milk, eggs, butter, rice tofu and bread.

ALL NEW OWNER BENEFITS 2009

#4

"special ordering"

Our "owner's only" special order program will be easy and transparent, with published case pricing on the foods you buy the most and one stop ordering for all store departments.

ALL NEW OWNER BENEFITS 2009

#5

"educational information"

Seminars and newsletter articles on topics like how to cook using whole ingredients and how to eat well on a budget.