

**AN INTRODUCTION TO THE
ICA MODEL BY-LAWS FOR A WORKER COOPERATIVE**

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WHAT IS A WORKER COOPERATIVE?

A worker cooperative is a democratic corporation, owned and controlled by the people who work in the company. These "worker-members" hold the basic membership rights: (1) voting rights to elect the Board of Directors, which in turn selects management, and (2) rights to share in the net earnings of the company, allocated according to relative amounts of work performed. Each member has an equal vote, in accordance with the democratic principle of one-person/one-vote.

In legal terms, a worker cooperative is a unique type of closely-held corporation. In organizational terms, however, it is a democratic community. The citizens are the people who work in the company. The Articles of Organization serve as a charter or constitution, and the By-laws define rules, rights, and responsibilities. The Board of Directors, like Congress or Parliament, is elected by the people it represents — citizens in a political community, worker-members in a cooperative.

A town or city is a democratic community of people with the common purpose of living in a certain geographical area. People qualify to vote in the town or city elections by residing within that area. A worker cooperative is also a democratic community, but it is a community of work, not a residential community. It is a business, a place to make a living by producing and selling a meaningful and useful product or service. It is an unusually structured enterprise, however, controlled by the members who qualify to vote by working in the firm.

Rights come together with responsibilities. Voting rights in a town, city, state, or country come together with responsibilities, such as paying taxes. A corresponding responsibility in a cooperative is to pay the membership fee. In corporate terms, a membership fee is a contribution to capital, representing a member's initial portion of the net worth of the company.

The corporation's net worth is reflected in a system of internal capital accounts. Each member has an individual capital account to keep track of his or her portion of the corporation's net worth and of the amount of money eventually due back to the member. Each account bears interest like a savings account. In addition to interest, a portion of the positive

(or negative) net income or profit of the cooperative is added (or subtracted) from each member's account each year. If positive, these amounts are called "patronage dividends," a term derived from Subchapter T of the Federal Internal Revenue Code, a tax provision for cooperatives.

In a conventional corporation, dividends are distributed according to each shareholder's capital investment (number and value of shares), so they are called "capital dividends." In a cooperative, dividends are allocated according to "patronage" so they are called "patronage dividends." Patronage is defined differently in different types of co-ops. In a farmers' marketing co-op, patronage is the value of the crops sold through the co-op. In a consumer co-op, patronage is the value of the member's purchases through the co-op. In a worker co-op, patronage is the amount of work (measured by hours or pay) the member performs in the cooperative.

Patronage dividends in a worker co-op differ from capital dividends in a number of ways: (1) they represent a return on labor patronage rather than a return on capital investment, (2) payment of patronage dividends (unlike capital dividends) is ultimately tax deductible by the corporation, and (3) a corporation may allocate a patronage dividend partially or entirely on paper, and retain the profits for a period of time to use for any corporate purposes. The patronage dividends retained in a worker cooperative are credited to each member's account in proportion to his or her labor patronage for that year.

HOW DOES A WORKER CO-OP DIFFER FROM OTHER CORPORATIONS?

A worker cooperative is not just a corporation where the employees own the shares. A co-op operates on principles quite different from a conventional corporation. To see the difference, we go back to the idea of a worker co-op as a democratic work community just as a city or town is a democratic living community. In a town, a resident's voting rights are not property rights which the person must buy or which the person can sell. They are personal rights which the person qualifies for by taking up residence in the town, and which the person automatically forfeits when he or she gives up residence in the town.

It is quite the same in a worker cooperative. The membership rights (voting rights and rights to patronage dividends) are not property rights which the workers must buy or which the workers can sell. They are personal rights which a person qualifies for by working (on a non-temporary basis) in the company, and which a person automatically forfeits when he or she retires or otherwise terminates work in the cooperative. A member also has the responsibility to pay in capital as a membership fee (just as citizens pay taxes), but this fee does not 'buy' the membership. The person qualifies for membership by his or her performance of work. A worker co-op is thus a labor-based membership organization, instead of a capital-based corporation.

In a conventional corporation, the ownership rights (voting rights and rights to capital dividends) are property rights which may be bought and sold as chunks of capital, the shares. The owners need have no qualifications, so the owners may be, and often are, quite separate, distant, and otherwise unrelated to the company. It is a capital-based corporation; whoever owns the shares 'owns' the organization.

When the voting rights are assigned to the people who live or work somewhere, then a person either has the vote or not. A person cannot have more than one vote. But when the voting shares may be bought and sold, as in a conventional company, then a person or even another company with sufficient wealth can purchase a large number of shares and have that many votes. Voting in a conventional corporation is on the basis of one-share/one-vote instead of one-person/one-vote.

A town and a worker cooperative are democratic or self-governing communities because the people who are the governed (the town residents or the people working in the firm) are the ones who automatically qualify for the vote to elect the people who will govern or manage them. It is this circular flow of authority that constitutes self-government or democracy. In a conventional corporation, the people working in the company, the employees, are still the ones being governed or managed, but the people electing the board and thus determining the management are the stockholders. Hence a worker cooperative applies the ideal of democracy to the workplace; a conventional corporation does not.

Another fundamental difference between a worker cooperative (using these By-laws) and a conventional corporation is in the capital structure. The net worth of a conventional corporation is reflected in the stock shares. If the company succeeds and retains earnings, the net worth of the company (and thus the shares) increases over time. If such stock shares are used as membership shares in an employee-owned company, then their appreciated value might make them too expensive for new members to purchase. Historically, use of such capital shares has led to the demise of democratic structure in a variety of employee-owned firms. In some cases, the older members sold the entire company to a conventional investor to cash in on their share of equity. In other cases, the older members have hired non-member employees or members with lesser rights, in either case causing destructive tension in the firm.

In a worker cooperative using these By-laws, the function of carrying the net worth of the company is shifted away from the shares and into the internal capital accounts. Increases in net worth will increase the balance in members' accounts, due back to them eventually in cash. Thus, the older members still get the value of the fruits of their labor, paid by the corporation over a period of time. The shares, however, remain at a reasonable value, enabling new members to pay an affordable membership fee when they join. At any given time, members may have differing claims on the company's net worth, but they all have the same membership rights. This worker cooperative structure is designed to sustain the democratic corporate structure over time. (For more detail about the purpose and function of internal accounts, see the annotations below on Article III, as well as ICA publication entitled "Internal Capital Accounts: Theory and Practice".)

ROLE OF THE ARTICLES AND BY-LAWS

In order to create a corporation, states require the filing of a form (and fee) with the state government — usually, the Secretary of State's office. In most states, this form is called the "Articles of Organization" or "Certificate of Incorporation" (or simply "Articles"). A corporation's existence begins when the Articles are accepted by state officials. Different types of corporations require use of different forms.

The Articles include basic information, such as: (1) corporate name and address, (2) corporate purposes, (3) authorized stock, (4) restrictions on the transfer of stock, and (5) other details such as a list of initial directors. Some of this information will reflect basic cooperative attributes — in particular, corporate purposes and capital structure. (For more detail, see "A Brief Guide to the Articles of Organization," following.) Most of the details of cooperative structure, however, will be reflected in the By-laws.

The purpose of the ICA Model By-laws and Articles is to create a democratic cooperative structure within a legal shell incorporated under an appropriate corporation statute. Fortunately, most business corporation statutes are flexible enough to use in creating a democratic worker cooperative. Some cooperative corporation statutes can also be used. However, most existing cooperative statutes are designed primarily for agricultural cooperatives, include troublesome limitations, and are essentially inappropriate for this model of a worker cooperative. You should examine the statutory framework in your state, and choose the most appropriate incorporation statute.

Massachusetts has a special statute exclusively for worker cooperatives. Drafted by the ICA, M.G.L. Chapter 157A ("The Employee Cooperative Corporations Law") embodies the ICA model legal structure. Mirror legislation was enacted in Maine (see 13 MRSA ch. 85, subchapter III) and is under consideration in a number of other states. In states with such a special worker cooperative statute, a worker co-op should incorporate under the statute and the Model By-laws will closely track the statutory guidelines. In other states, a worker co-op may incorporate under

business corporation law or under general cooperative corporation law. The Model By-laws will, in effect, convert a normal business corporation or cooperative corporation to a unique type of democratic worker cooperative with internal capital accounts.

A BRIEF GUIDE TO THE ARTICLES OF ORGANIZATION

The form for Articles of Organization will vary, depending upon your state and your choice of incorporation statute. This description tracks the form for Massachusetts business corporations organized under MGL ch. 156B, which is also used for Employee Cooperative Corporations under MGL ch. 157A. The following guidelines for worker co-op Articles can be adapted to your appropriate state law and incorporation form available from state officials. Remember, however, that specific state law requirements for Articles of Organization will differ slightly from state to state.

The Articles ordinarily begin with a list of the names and addresses of the "incorporators". In most cases, the incorporators will be one or more of the initial organizers of the cooperative corporation. The incorporators meet to adopt By-laws, select initial directors and officers, and take any other action which might be taken by members after the Articles become effective. The Articles ordinarily become effective when filed, if approved by the Secretary of State or other appropriate state official.

1. Name.

When choosing a name for the corporation, be sure to check the applicable state incorporation statute for requirements or restrictions. Many cooperative statutes, for instance, require use of the word "cooperative" in the name. Many business corporation statutes, on the other hand prohibit use of the word "cooperative" (or any variant) but require a term such as "Incorporated" or "Corporation" or "Limited" in the name.

The corporate name must not duplicate that of any other existing corporation in the state. In order to avoid delay in state approval of your Articles, you can first call or write the Corporations Division of the Secretary of State's office (or other appropriate official) to check for the availability of a particular name.

2. Purpose.

This provision of the Articles should communicate the basic purposes of the corporation, but should also be broad enough to allow for flexibility. Thus, we suggest three basic provisions.

(a) A description of the general business purpose of the corporation; for example: "To conduct the business of selling data processing consulting services; to buy, lease, sell, exchange and otherwise deal in computer programs and software; to enter into relationships with others for any of these purposes; and to do all other things necessary, appropriate, or incidental to the accomplishment of these purposes."

(b) A general statement of any lawful purpose; for example: "To carry on any business or other activity which may be lawfully carried on by a corporation organized under the _____ corporation law of the state of _____, whether or not related to those purposes described in the previous paragraph."

(c) A statement of democratic structure of organization; for example: "To operate as a corporation controlled democratically by the membership, as defined in the By-laws."

In Massachusetts, Maine, and other states with worker cooperative statutes modeled on MGL chapter 157A, add the following provision to the list of purposes: "To operate on a cooperative basis as an employee cooperative corporation as defined in MGL ch. 157A. The corporation hereby elects to be governed by MGL chapter 157A."

3. Authorized Stock.

A corporation can issue shares of stock to shareholders only if the number and type of shares is authorized in the Articles. In a worker cooperative, this section of the Articles is used to authorize membership shares to be issued to the members.

A conventional corporation might issue several different "classes" of stock with different rights attached to each class. Some classes might be termed "preferred" stock which, in the event of bankruptcy, gets cashed out before other stock shares. Ordinarily, preferred shares have a fixed dividend rate and only limited voting rights. Other classes might be termed "common stock" which, in the event of bankruptcy, gets cashed out last. Since common stock is most at risk, it usually carries the right to substantial return in dividends if the corporation is successful. At least one class of common stock always carries voting rights.

In a worker cooperative envisioned in the ICA Model By-laws, the corporation would authorize only one class of common stock and no preferred stock. The initial Articles should authorize a sufficient number of shares to cover all potential future issues of stock to members. Otherwise, the later addition of new members would require an amendment to the Articles (which includes a filing and a fee). The upper limit of authorized shares is tied to the fee structure for incorporation. In Massachusetts, for instance, the filing fee is one cent a share, with a minimum fee of \$150. Thus, up to 15,000 shares can be authorized without increasing the \$150 filing fee — any more would increase the cost of filing, although there is no legal limit to the number of shares. (Note that this explanation assumes the authorization of stock "without par value." Alternatively, stock can be authorized with a "par value," in which case the filing fee is a percentage of total par value. The meaning of par value is more historical than practical. To avoid unnecessary complexity, we suggest the authorization of "no par" stock.)

4. Relative rights of different classes of stock.

This section is not applicable to an ICA Model worker cooperative, since only one class of stock is authorized. The space can be left blank or filled in with the words "not applicable."

Confusion could result from mixing the internal capital account system with a more conventional capital structure using multiple classes of stock (such as preferred in addition to common stock). We suggest that any non-member investment be structured as debt, which need not be authorized in

the Articles. However, if external reasons compel the use of more than one class of stock, the relative rights and qualifications of the different classes should be spelled out here carefully.

5. Restrictions on the transfer of stock.

In a worker cooperative, the transfer of stock shares is severely restricted so that only the members can hold shares. The terms of any such restrictions may appear in the Articles, and may anticipate such events as death, bankruptcy, attempted attachment, or other legal directives. (Check your applicable state law to determine if such restrictions, if any, are required to appear in the Articles.) At the very least, the following language should appear in the Articles:

"Shares of common stock may be held only by natural persons employed by the corporation on a full-time or part-time basis and accepted as members by the Board of Directors. No person may hold more than one (1) share of stock. No stock or interest therein may be sold, assigned, or otherwise transferred, voluntarily or involuntarily, by operation of law or otherwise, except for a transfer to the corporation. Upon termination of his or her employment in the corporation, a shareholder must transfer his or her share back to the corporation at redemption terms determined in accordance with the By-laws."

In Massachusetts, Maine, and other states with a worker cooperative statute modeled on MGL ch. 157A, add the following language to this section: "Shares of common stock shall be referred to as 'membership shares' and holders of such shares shall be referred to as 'members'."

6. Other Lawful Provisions.

This is an open-ended section for any additional provisions. A simple answer would be "none," but there may be reasons for including other provisions. In Massachusetts, election of MGL ch. 157A can appear in this section, whether or not it appears in the "purposes" section. In any state, you may use this section to reinforce basic cooperative attributes by

including such provisions as: "Each member shall be entitled to one and only one vote on any subject that requires voting by members, and only members may vote." And, "The net earnings and losses of the corporation shall be apportioned and distributed in accordance with the By-laws."

In many states, certain director authority or corporate powers are available only if authorized in the Articles. In Massachusetts, for instance, the following two provisions should appear in the Articles: "The corporation may be a partner in any business enterprise which the corporation would have power to conduct by itself." And, "The directors may amend the By-laws except as limited by law or the By-laws."

Check with local counsel or with state officials to learn what additional provisions should be in the Articles in your state. For instance, local counsel might advise you to include liquidation preferences in the Articles. For more detail, see Article III, section 3.D, and the accompanying annotations following.

7. Other Details.

The remainder of the Articles ordinarily is limited to basic information not treated as a permanent part of the Articles. Changes in these initial facts usually appear in annual reports or other filings, but do not require amending the Articles. Such information may include: the initial address of the principal office of the corporation, names and addresses of initial directors and officers, fiscal year, and date of the annual meeting of shareholders. Such information should be consistent with parallel provisions in the By-laws. The By-laws should be drafted and adopted before filing the Articles of Organization.

After the Articles are approved by the Secretary of State or other appropriate official, they are filed with the state records and a photo-copy is sent to whomever the incorporators choose. The copy should be kept on file by the Clerk of the corporation, along with other filings, By-laws, and corporate records.

The procedure for amending the Articles is governed by state law.

Amendments ordinarily require the filing of Articles of Amendment and the payment of a filing fee to the Secretary of State. Amendments to the Articles require a shareholder vote. State law may require a supermajority vote of shareholders to amend the Articles. Given these requirements, the Articles should only be amended when absolutely necessary.

ANNOTATIONS TO THE BY-LAWS

INTRODUCTION AND DISCLAIMER

The ICA Model By-laws are a legal document, providing for democratic cooperative attributes within the context of conventional corporate law. Thus, the document includes many legal "artifacts" (such as membership agreements and Articles of Organization) and many legal terms (such as indemnification agent, and patronage.) These are designed to be consistent with typical corporation laws, while maintaining the basic attributes of a democratic organization.

A corporation structured by and operating in accordance with the ICA Model By-laws is designed to qualify for the "cooperative" tax benefits of Subchapter T of the Internal Revenue Code. (See Appendix: "Taxation of Worker Cooperatives.") However, we can provide no guarantee that operation under these By-laws will ensure compliance with all relevant laws and regulations, including Subchapter T.

The particular needs and governing law will vary from co-op to co-op and from state to state. These By-laws can be adapted accordingly. We recommend that you consult with a local lawyer when adapting these By-laws to your corporation.

Following is an article-by-article guide to the ICA Model By-laws for a Worker Cooperative.

ARTICLE I: Corporate Affairs

The By-laws begin with standard information about the corporation, such as name, location, and fiscal year. These items will be duplicated in the Articles of Organization, but they are so basic that they should appear in both documents. Later, if you amend overlapping items in the Articles, be sure also to amend the By-laws accordingly. If any By-law provisions are inconsistent with the Articles, initially or by later amendment, the

Articles will override the By-laws. This is stated in SECTION 6 of the By-laws and reinforces the corporation law notion that the Articles serve as the fundamental "constitution" of the organization, providing a framework for the more specific operational "laws" of the By-laws.

In order to make the By-laws a more complete blueprint for the corporation, SECTION 6 incorporates by reference the content of the Articles of Organization. Some cooperatives choose to repeat in the By-laws the full text of the purposes which, by law, must appear in the Articles.

For guidance in filing Articles of Organization, see the section above entitled, "A Brief Guide to the Articles of Organization." Note that some states call the analogous document the "Articles of Incorporation" — in the By-laws, use whichever term is appropriate in your state.

When choosing a corporate name (SECTION 1), check the applicable state incorporation statute for requirements or restrictions. Many states, for instance, prohibit use of the word "cooperative" in the name, unless the corporation is incorporated under the state "cooperative" statute. For further explanation of the choice of a corporate name, see section 1 of the "Guide to the Articles of Organization" above.

A corporation is a "legal person," a separate entity chartered and regulated by the state. A registered office and agent (SECTION 2), also listed in the Articles, provides a bit of practical reality to the fiction of a "corporate person". That is, state officials know where to find the corporation (registered office) and whom to serve with legal papers in the event of litigation (the Clerk at the registered office). If the Clerk works or lives out of state, the corporation may be required to designate a "resident agent for service of process." Check your appropriate state law. These By-laws assume that the Clerk resides or works in the state of incorporation, and thus do not designate a resident agent.

Your choice of fiscal year (SECTION 3) has important tax and accounting implications. The most common fiscal year is the calendar year. You might speak with an accountant or lawyer to determine if a different fiscal year would be appropriate for your corporation. A later change of fiscal year will usually require a simple filing with the state, along with amendment of

the By-laws.

A natural person (a human being) must sign contracts and other instruments on behalf of the corporation. SECTION 4 authorizes the president or treasurer to so act on behalf of the corporation, subject to any limitation, delegation or expansion directed by the Board. This ensures a degree of order and coordination of corporate commitments, while retaining some flexibility for the Board to alter the normal routine.

Maintenance of corporate records (SECTION 5) is extremely important. Articles and By-laws are useless if unavailable; stock records define who has the rights and responsibilities of membership; and records of meetings provide a written account of corporate decisions. In the event of disputes or litigation, corporate records serve as crucial evidence. Inability to prove compliance with corporate formalities can lead to the unraveling of external contracts or internal relationships. On a more positive note, a clear record of activities and relationships within the corporation can help in orderly planning and communication.

Since a cooperative is a membership organization, the second part of SECTION 5 allows members access to the corporate records, subject to reasonableness and good faith. Thus, a member should be permitted to see a membership list in order to campaign for election to the Board, but not in order to sell that list to a competing corporation.

Article I contains basic items of corporate affairs. You might choose to include additional items. For instance, some By-laws describe a corporate seal, usually a circular stamp with the name of the corporation and state. In some states, a seal is useful in execution of contracts or opening of bank accounts. Check your state law for any requirements or advantages of a seal, which can be purchased at most legal stationery stores.

ARTICLE II: Membership and Membership Shares

This portion of the By-laws establishes the groundwork for creating a membership organization within a corporate shell. Whether you begin with a

business corporation or a statutory cooperative, Article II defines membership criteria and re-characterizes capital stock shares as non-transferable membership certificates. The result is a corporation controlled democratically by its worker-members. Different capital stakes for different members may be implemented through an internal capital accounting system (see Article III), without compromising the basic democratic structure.

The substantive provisions for "operating on a cooperative basis" (as required by Subchapter T of the Internal Revenue Code) are spread throughout the By-laws. Voting control by members, on a one-member/one-vote basis, appears in Article IV; allocation of earnings and losses on the basis of patronage (relative amount of work) appears in Article III. SECTION 1 of Article II cross-references these other provisions in order to provide a context for defining membership criteria and membership shares. Although not explicit in the By-laws, wages or salary to members are presumably calculated and paid as a matter separate from any year-end allocation of earnings or losses on the basis of patronage.

A key provision of any cooperative blueprint defines membership eligibility (SECTION 2). In a worker cooperative, the crucial eligibility requirement is that a member works in the company. In the language of cooperative law, this means the person will "patronize the corporation through contribution of his or her labor on a full-time or part-time basis." In determining membership, the permanent versus temporary distinction is more important than the full-time versus part-time distinction. A permanent part-time worker (e.g., a bookkeeper) should be considered a part of the cooperative, whereas there is little point in making a full-time but temporary worker (e.g. a student with a summer job) into a member. The definition of temporary could be any time shorter than the "trial period" (e.g., six months, or one year) specified in SECTION 2.

Once a person has worked in the cooperative for the trial period, a decision ordinarily must be made. The person must either be accepted as a member or terminated. This helps avoid the problems that tend to arise when a cooperative includes a significant number of non-member workers. For the sake of flexibility, however, SECTION 2 allows the Board to make exceptions — e.g., to continue employing people who worked for the company prior to a

cooperative conversion, but who do not want to join the new cooperative as members. The Board may, of course, accept a person into membership at any time before the end of the trial period.

The second eligibility condition is that the Board or a committee designated by the Board must approve workers for membership after completion of their trial or probation period. The trial period gives the members a chance to evaluate the prospective member (and vice-versa) on such issues as job performance, compatibility, and cooperative commitment. At that point, absent unusual circumstances, the Board will either accept the person as a member or terminate his or her employment. This decision should be made on a nondiscriminatory basis, as required in SECTION 2. Most corporations do not include such a nondiscrimination clause in the By-laws, in order to avoid additional litigation by terminated employees. A non-discrimination clause in the By-laws, in fact, may create legal rights for terminated employees that do not otherwise exist in many states.

The third eligibility condition is the payment of a membership fee. The payment of such a fee by a prospective member tends to reinforce his or her commitment to and understanding of the responsibility and risk of membership in a co-op enterprise. The alternative condition — "or agreed to pay" — provides flexibility to extend membership rights while an employee is in the process of paying his or her fee over a period of time, such as through payroll deductions. The membership fee should be set high enough to meet certain capital needs of the corporation and to demonstrate a serious commitment by the member. It should be set low enough to be affordable, perhaps through direct payments or payroll deductions. The Board of Directors has responsibility for establishing the amount of the membership fee, and the terms for payment. The fee could be a flat rate (periodically changed to account for inflation) or a percent of starting salary, but should not be changed in an arbitrary or discriminatory manner. Many states permit payment for stock in installments, but the law and procedure vary from state to state. Be sure to consult with local counsel.

You might consider adding a fourth eligibility criterion — i.e., "(4) are residents of the state of _____ when the corporation issues stock to them." This criterion, which need not appear in the By-laws, would be

relevant primarily in the area of securities registration. The Securities Exchange Commission (SEC) requires costly registration of many interstate offerings of stock (perhaps including some offers of cooperative membership shares). By limiting members to a single state, a co-op can avoid SEC registration through an "intrastate exemption," although state level registration may still be required. If your potential members (even just one) reside in more than one state, we suggest you forego this fourth membership criterion and consult with a lawyer familiar with securities law.

The notion of a membership share and membership fee (SECTION 3), although well established among cooperatives, is unusual in the context of a conventional business corporation. This gives rise to one rather confusing aspect of a corporation internally restructured by its By-laws as a cooperative. Since the outer shell of the corporation might not be designed for cooperative purposes, some parts of the structure have two meanings: (1) the outside conventional corporate meaning, and (2) an inside cooperative meaning. Perhaps the best example of this inside/outside distinction is the membership fee. From the inside cooperative viewpoint, it is a financial obligation of membership; it does not "buy" membership since the membership is based on labor. But from the outside conventional viewpoint, the "membership share" is a share of common voting stock which must be purchased for some cost — the legal consideration for the share. To satisfy this outside legal requirement, the By-laws state (SECTION 3) that the membership fee will be the cost for the membership share.

A new member might well be confused. "Am I buying the share or not?" "Is the share a piece of property which I own, or is it a membership certificate which I qualify for by working in the co-op?" The answer is that the external corporate law does consider it to be property, but the By-laws have restricted the use of the share so that it serves, in effect, as a "membership certificate".

Hence, SECTION 3 defines the only class of common stock as "membership shares" whose ownership is restricted to worker-members. Moreover, unless otherwise required by the law, no other corporate stock shares can carry any voting rights. Also prohibited are "pre-emptive" rights of shareholders, which refers to the rights of a first option on a proportional share of a new stock issue (used in some corporations to maintain a person's

proportional control). Instead, the co-op always maintains a one-member/one-vote system.

In order to continue serving as membership certificates, transfer of these stock shares is severely limited (SECTION 4). They may not be transferred during the course of membership. When a member's employment by the corporation is terminated (SECTION 5), except in the case of temporary lay-offs, his or her share must be transferred back to the corporation at a redemption formula determined according to the internal accounts as described in Article III. No member may be involuntarily terminated without due process — i.e., written notice and an opportunity for a hearing before a body designated in the Operating Rules. Such a clause is unusual in corporate by-laws, since it provides an additional handle for litigation by terminated employees. Nevertheless, this By-law provision only provides for the most minimal due process rights. We suggest that each co-op establish, in the Operating Rules and/or policy resolutions, a clear and equitable procedure for processing grievances and for avoiding unfair termination of membership. (See the ICA publication, "The Design of Governance Systems for Small Worker Cooperatives".)

Stock share transfer restrictions appear on the membership certificate (SECTION 6), which serves as a binding contract between the corporation and the member. Stock certificates can be purchased at a legal stationery store. Following is sample language for the transfer restrictions appearing on the stock certificate:

"The holder of this share of stock may not sell, assign any interest in, or otherwise transfer this share during the period of his or her employment in the corporation. Upon termination of his or her employment in the corporation, the holder of this share must transfer the share back to the corporation at redemption terms determined in accordance with the By-laws."

Since these membership shares are non-transferable and have no market value, the By-laws (Article III) create another structure to carry the capital value due back to the members. This structure is the internal capital account system described in the next section.

ARTICLE III: Internal Capital Accounts

These annotations of Article III refer to the "full version" of Article III (the version which appears in the Model By-laws). A simpler (but less powerful) version of Article III can be obtained by deleting selected portions as indicated by the remarks enclosed in square brackets in the body of Article III. The simplified version differs in that it deletes the following "advanced" features:

- (1) the startup losses account which allows the amortization of startup losses over an extended time period, and
- (2) the by-law authorization to use "qualified" written notices of allocation of patronage dividends in addition to the simpler "non-qualified" written notices of allocation.

Hence the simplified version of Article III avoids some of the complication of the full version, but it also sacrifices some of the refinements and flexibility of the advanced features described below.

Article III is the heart of the capital structure created by the ICA Model By-laws. It establishes the system of internal capital accounts. These accounts do not exist in a conventional corporation where the shares are themselves marketable pieces of property with a certain market value. Since the membership shares in a cooperative are not marketable and thus have no market value, a new capital structure is created, the internal capital accounts, to keep track of the capital eventually due back to each member.

SECTION 1 specifies that each member has an individual capital account, and there is one collective account that belongs to the cooperative as a whole, not to any individual members. A cooperative might also have a startup losses account which is a contra-account or offset account to the collective account. Thus the debit balance in the startup losses account will subtract from the credit balance in the collective account. The sum of the individual capital accounts and the collective account minus the startup losses account (if any) equals the net worth (or equity or net book value)

of the cooperative. The net worth is the value of the assets on the accounting books after the value of the debts or liabilities have been subtracted away. This is illustrated in the following cooperative balance sheet.

B A L A N C E S H E E T	
ASSETS:	LIABILITIES:
Cash	Accounts Payable
Accounts Receivable	Wages Payable
Inventories	Current Notes Payable
Other Current Assets	Other Current Liab.
Plant and Equipment	Long Term Debt
Land	
	EQUITY = INTERNAL CAPITAL ACCOUNTS:
	Individual capital accounts
	Collective account
	Less: Startup losses account
<u>TOTAL ASSETS</u>	<u>TOTAL LIABILITES AND EQUITY</u>

As an example, if a cooperative had assets totaling \$100,000 and debts totaling \$60,000, then the net worth would be the remaining \$40,000. Then there would be a total of \$40,000 in the internal capital accounts. For example, the individual capital accounts might have a total (credit) balance of \$30,000, the collective account could have a (credit) balance of \$20,000, and the startup losses account a (debit) balance of \$10,000, since $\$30,000 + \$20,000 - \$10,000 = \$40,000$.

It is a common confusion to envision "money in an internal account" in the same sense that there might be money in a safe. But a member's individual capital account only records the amount of money that is ultimately to be paid back to the member. That amount of money is not 'sitting' in the account. An amount of cash in a safe would be an asset account on the left-hand side (LHS) of the balance sheet, whereas the internal capital accounts are equity accounts on the right-hand side (RHS) of the balance sheet. Thus a member's individual capital account represents his or her share of the corporation's net worth — not a 'pile of cash' set aside with the member's name on it. [For more details, see the paper "Internal Capital Accounts: Theory and Practice" available from the ICA]

SECTION 1.A explains the structure of a member's individual capital account. The account could be divided into a short-term portion and a

long-term portion (even though, for the sake of simplicity, this long-term/short-term language was not used in the By-laws themselves). The short-term portion (or "rollover" portion) represents the amount (e.g., patronage dividends) the cooperative will attempt to pay out to the member after a fixed time period whether or not the person is still working in the cooperative. The long-term portion of the member's account (e.g., membership fee and accumulated interest) is not paid out until the member terminates membership or retires, and then it is to be paid out over an extended (e.g., five year) period.

The balance in a member's account increases as the member pays in the membership fee, as interest accrues on the account, and as the cooperative retains part of the profits for the year (called "retained patronage dividends"). The accrued interest is the part of the co-op's income which goes to the member in proportion to the member's capital as represented by the member's individual capital account. The patronage dividend is the member's share of the income allocated in proportion to the member's labor, since "patronage" is defined as labor (measured by hours or wages) in a worker cooperative.

The balance in an individual account decreases if the cooperative makes a loss for the year or if a portion of the account was paid out to the member. An individual capital account is different from a savings account in a bank (even though it accrues interest). In particular, the money cannot be withdrawn from an internal account upon demand by the accountholder. The cooperative is not in the banking business. The purpose is to use the money to help produce other goods and services, so the money is not available to be withdrawn or paid out at the option of individual members. The payout conditions are discussed below.

SECTION 1.B explains how additions and subtractions are made to the collective account. Each year a portion of the profits or losses are added to or subtracted from the collective account. This is a form of self-insurance. If the co-op tried to put all its profits in the individual accounts, then given the uncertainties of business it would probably not be able to pay out the individual accounts. By only putting a portion in the individual accounts with the remainder in the collective account, the co-op is helping to insure that it will actually be able to eventually pay off the

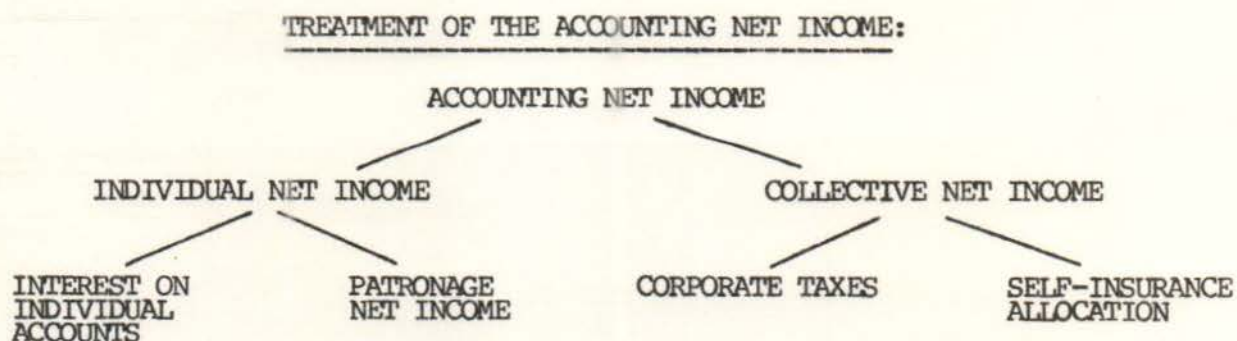
individual accounts. Hence the amount, out of each year's earnings, put into the collective account is called the "self-insurance allocation." Gifts or grants to the cooperative would typically be allocated to the collective account.

Although the Model By-laws do not contain this provision, a certain portion (e.g., 20%) of each membership fee could be made non-returnable and put into the collective account. This would help cover the implicit costs of training a new member, and it should discourage a rapid turnover of membership.

SECTION 1.C explains the additions and subtractions from the startup losses account. Any new business incurs one-time "startup costs," such as the costs to get organized, develop new products, establish the firm's reputation, and penetrate markets. If these startup losses were simply subtracted from the founders' individual accounts, then those accounts would be wiped out. After a few years, when the startup costs start to pay off, a new member could come in to share in the profits without sharing a portion of the startup losses. Hence the full version of the By-laws uses a special startup losses account which spreads the startup losses over a five year period. In this way, the burden of startup losses does not fall entirely on the founders. Anyone coming in the cooperative within five years of the initial years when the co-op incurred startup losses would share in a certain percentage of those losses [as explained in SECTION 2.B(2)(a) and 2.B(2)(b)]. A different number of years could, of course, be used by adjusting the percentages accordingly.

SECTION 2 explains the accounting treatment of the net income or profit at the end of each fiscal year. An audit of a company's accounting books determines if the balance sheets and income statements have been prepared in accordance with the Generally Accepted Accounting Principles (GAAP). The profit or net income determined according to GAAP is called the "accounting net income." The tax authorities will allow the use of some non-GAAP techniques (e.g., Accelerated Cost Recovery System of depreciation). Hence there might be a tax-basis net income different from the accounting net income. Cooperatives usually base the patronage dividends and other internal account calculations on the accounting net income, even though the taxes might be based on a different tax-basis net income.

The accounting net income, positive or negative, is split 50-50 into two parts: the individual net income and the collective net income (a different percentage could be used). Interest accrues on the individual capital accounts at a rate determined by the bylaws. That interest income to the individual capital accounts is subtracted from the individual net income to yield the patronage net income. (The phrase "patronage net income" is not used in the By-laws; it is simply the individual net income minus the interest on the individual capital accounts.) Except for a special treatment of losses during the startup period, the individual net income, positive or negative, is allocated between the individual capital accounts in proportion to the members' labor patronage (as measured by hours or pay, as specified in the By-laws). The applicable Federal corporate income tax, which could be calculated on a different tax-basis net income, is subtracted from the collective net income, and the remainder is the self-insurance allocation to the collective account. The division of the accounting net income into all these parts is illustrated by the following tree diagram.



Federal tax laws and regulations place some restrictions on what can be declared as a (positive) patronage dividend. Patronage dividends to members may not be declared on non-member patronage (e.g., work performed by prospective members during their trial period), and the total patronage dividends may not exceed the tax-basis net income. These restrictions could be spelled-out as follows. The restriction due to non-member patronage means in the event that for a fiscal year, the ratio of the patronage net income over the accounting net income exceeds the members' patronage over the total patronage, then the collective part of the accounting net income shall be increased until the first ratio is equal to or less than the

second ratio.

As an example, suppose that the accounting net income was \$1,000 and that the interest on the individual capital accounts was \$200. Then the individual net income was 50% of \$1,000 or \$500, and the patronage net income was $\$500 - \$200 = \$300$. The ratio of the patronage net income to the accounting net income was $300/1000$ or $3/10$. No adjustment would be necessary if the ratio of the members' patronage to total patronage was $3/10$ or greater. If the members had only accounted for $2/10$ or $1/5$ of the patronage (an unusual circumstance), then the collective net income should be increased from \$500 to \$600 so the individual net income would be reduced to \$400. Then the adjusted patronage net income would be $\$400 - \$200 = \$200$ so the ratio of patronage net income to accounting net income would also be $200/1000$ or $1/5$.

The restriction due to tax-basis net income means in the event that the patronage net income is positive and exceeds the entire tax-basis net income, then the collective part of the accounting net income shall be increased until the patronage net income is equal to or less than the tax-basis net income. In the previous numerical example where the patronage net income was \$300, suppose that the tax-basis net income was only \$200 while the accounting net income was \$1,000 (an unusual circumstance). Then the collective net income should be increased to \$600 so the patronage net income would also be reduced to \$200 ($= \$1,000 - \$600 - \200).

SECTION 2.A specifies the rate of interest for the individual capital accounts. This interest rate should be comparable to the interest received in a savings account or a credit union (e.g., 6%). The accrual of interest on the individual capital accounts is partial compensation to the members for the use of the money which was retained in the cooperative rather than distributed and invested in an interest-bearing savings account. An internal capital account is, however, not entirely comparable to a savings account in a local bank. The internal account is less liquid (cannot be withdrawn at will) and more risky, but it contributes to creating and maintaining a job for the member. In addition to a member's internal capital account, it is possible for a member to make a subordinate loan to the cooperative at a higher interest rate.

When positive patronage dividends are declared and credited to the members' accounts, these credits are externally represented by written notices of allocation of patronage dividends. Since the face amount of the written notice is just an external representation of the amount internally credited to a member's account, the written notice is, in effect, interest bearing (since the account is interest bearing). There is a tax break associated with paying out the patronage dividends. Hence, the By-laws have the face amounts of the patronage dividends (not the accrued interest) being paid out to the members prior to termination (see SECTION 3.B). The accrued interest normally remains in each member's account, and is paid out after termination or retirement (see SECTION 3.C). If the Board deems it advisable, some of the accumulating interest could be paid out prior to termination or retirement. An example is discussed in the appendix to the ICA publication "Internal Capital Accounts: Theory and Practice."

SECTION 2.B gives the two standard definitions of "labor patronage": (1) according to the hours of work or (2) according to the dollar amount of gross wages. One could imagine other hybrid definitions of labor patronage, but only the two standard definitions based on hours or pay have legal precedence. Hence the ICA recommends sticking with one or the other of the standard definitions. The pay definition is the easiest to administer since labor patronage is then given directly by the W-2 Form.

SECTION 2.B(1) deals with the patronage net income (= individual net income minus interest on the individual accounts) when that income is positive. It is declared as a patronage dividend. Assuming that the co-op wants to retain a maximum amount of the patronage dividend, the principal choice is to issue non-qualified or qualified written notices of allocation for the retained patronage dividends as defined in Subchapter T of the Internal Revenue Code (see the paper, "Internal Capital Accounts: Theory and Practice," for more details). Smaller co-ops may wish to simplify the By-laws by deleting the provisions allowing for issuing "qualified" written notices of allocation. Transactions concerning patronage dividends on income earned during a fiscal year must be completed during the "payment period" — which is eight and one half months following the end of the fiscal year.

Patronage dividends in the form of "qualified" written notices are deductible by the corporation from its taxable income. However, such qualified written notices must be declared by the member as taxable personal income for the year in which the patronage dividends were declared, i.e., the year after the fiscal year when the income was earned by the corporation. The corporation must, within the payment period, pay at least 20% of the qualified dividend (the amount of the qualified written notices plus cash) in cash to the member, presumably to enable the member to pay the personal tax. If any member's marginal tax rate on income from the cooperative is above 20%, then the cooperative should consider paying out more than 20% to that member. The tax laws also require that the members consent to include the face amount of any qualified written notices plus the cash received in their reported taxable income. SECTION 2.B(1)(c) in the full version of Article III gives a form of by-law consent. A similar clause should be included in the membership agreement, a sample of which appears in the Appendix. Note there is a "grace year": the corporation deducts the qualified dividend for one year, and the member recognizes the taxable income for the following year.

A "non-qualified" written notice is any written notice of allocation of patronage dividends which fails to satisfy any one of the qualification conditions described above. Non-qualified written notices require no personal tax payment by the recipient in the year of allocation, but also offer no current corporate deduction for the patronage dividends. Hence income allocated with non-qualified written notices is taxable 'upfront' at the corporate level. In a later year, when such notices are paid out in cash to the members, the members pay personal tax and the cooperative deducts the amount of the cash payout.

If the marginal tax bracket for the co-op is below 20%, then the co-op would pay out less cash by using non-qualified written notices of allocation. Co-ops in a higher tax bracket might prefer to use the qualified written notices of allocation in addition to the non-qualified notices.

SECTION 2.B(1)(a) permits the payment of patronage dividends in combinations of cash, qualified written notices, or non-qualified written notices of allocation, and requires delivery of the written notices and cash

to the member within eight and a half months after the fiscal year ends (as required by Subchapter T of the tax code). Here again is the grace year. The co-op has eight and a half months to pay out any qualified patronage dividends (cash patronage dividends, cash redemption of non-qualified written notices, or qualified written notices), but the member must file the personal tax returns by April 15th. Hence the individual is allowed to postpone reporting the qualified dividends as income until the next April 15th. The intervening year is the grace year.

Without express approval by the Board, written notices are non-transferable. SECTION 2.B(1)(b) assures that the amounts of the written notices are credited to the individual capital accounts. The income retained by the cooperative, and externally evidenced by the written notices, can be used for any and all corporate purposes. (See the previous remarks about not envisioning the internal capital accounts as cash or other assets.)

SECTION 2.B(2) deals with negative patronage allocations. There are two ways to treat losses, the normal treatment and the special treatment during the startup years (if the startup losses account is used). In the normal treatment, the negative patronage net income is treated just like a negative 'patronage dividend.' Thus each member's share of the loss is subtracted from the balance in the member's account in proportion to their labor patronage. That is "where the buck stops." One of the purposes of the membership fee is to serve as a deposit, like a damage deposit made when one rents an apartment. It provides an initial positive balance in a new member's account, a balance from which losses can be subtracted. If the membership fee 'cushion' is eaten away by repeated losses, then the cooperative might consider the self-assessment of a second membership fee to replenish that buffer.

Some people question whether it is fair to allocate losses to the members in proportion to patronage (symmetrically with profits). Doesn't this penalize those who work the most (i.e., have the most labor patronage)? Wouldn't it be more fair to divide losses equally between the members? But an 'equal' split of losses between members would constitute very unequal treatment if the members are working quite different amounts of time. When a co-op is having losses, very likely some of the members will be suffering

temporary lay-offs. The bulk of income paid out to members as wages will go to those members who are not laid off. Hence it would seem that the fair and equal treatment would be to allocate the most losses to those who worked the most hours and thus got the most income. It would seem unfair to allocate the laid-off members an 'equal' share of the losses when they didn't get an equal share of the income-producing work.

SECTION 2.B(2) covers the allocation of losses to the individual capital accounts, but it does not specify exactly which portions of an account should be debited first. One useful method is that a member's patronage share of the losses is first subtracted from the long-term part of his or her account (i.e., membership fee and accumulated interest), and then, when that is exhausted, from short-term part of the account (written notices of allocation). Within the short-term part of an account, the losses should be applied first to the oldest written notices on a first-in-first-out or FIFO basis. By not subtracting losses from the previous positive patronage dividends until that is necessary, the co-op reaps the maximal tax advantage from the patronage dividends. That is, if and when money is later paid out to members, a maximum amount of it will be the redemption of non-qualified or qualified patronage dividends. If the original patronage dividends were non-qualified, the payout is deductible at the corporate level. If the original patronage dividends were qualified, the payout is tax-free at the individual level. The payout of an amount in an internal account representing accumulated interest is probably not deductible at the corporate level and is not tax-free at the individual level. However, an early payout of accumulated interest might be advisable on grounds of financial planning. See the example discussed in the appendix of the ICA publication "Internal Capital Accounts: Theory and Practice."

SECTION 2.B(2) (b) and (c) deal with accounting for startup losses if the startup losses account is used. In the first years of operation before the co-op makes a positive accounting net income ("the startup period"), only 20% of the (negative) patronage net income is subtracted from the accounts of the current members. The remainder is put into the startup losses account. Since 1/5th of the negative patronage income was individually allocated immediately, 1/4th of the remaining 4/5ths is individually allocated in each of the next four years. Thus over the next four years, one quarter of those startup losses 'seep out' of that special

account into the individual accounts of the people who are members during those years. Thus new members who join within five years after an early year of losses will share in the startup losses. Hence the startup losses are spread over a five year period, a one year direct allocation and a four year delayed allocation through the startup losses account. That is called the "amortization" of the startup losses. A different number of years could, of course, be chosen.

The startup loss allocations (the initial 20% and the annual loss allocations from the startup losses account) are distributed between the individual accounts in accordance with patronage. It might be noted that it is possible for an account to have a positive patronage allocation from current profits and a negative patronage allocation from past startup losses — both in the same year. In that case, the positive patronage dividends should be evidenced by newly issued written notices of allocation represented in the short-term part of the account, and the negative patronage allocations should be applied (if possible) to the long-term part of the account.

SECTION 2.B(3) describes the accounting statement which should be issued to each member after the year-end changes in his or her individual capital account. If positive patronage dividends are declared, the member will receive a (non-qualified or qualified) written notice of allocation. If old written notices are redeemed, the members holding these notices will receive the cash. The accounting statement should list these transactions as well as any other changes in the member's account (e.g., accrued interest and current losses or old startup losses subtracted from the account).

SECTION 2.C describes the fifty percent (50%) of the accounting net income that is called the "collective net income" — which could be positive or negative. Any applicable Federal corporate income tax is subtracted from that collective net income, and the remainder (which could be negative) is the "self-insurance allocation" to the collective account.

SECTION 2.C(1) describes the tax benefit for cooperatives under Subchapter T of the Internal Revenue Code. A co-op may deduct from taxable income any patronage dividends paid in cash, qualified written notices, or

other property (excluding non-qualified written notices), as well as any cash paid out in redemption of non-qualified written notices of allocation. Otherwise, Federal corporate income tax is computed as in a conventional corporation.

In any corporation, considerable complications might be involved in the computation of corporate income taxes. The tax law allows one to use a tax-basis net income different from the accounting net income based on GAAP. For instance, certain accelerated depreciation methods (e.g., Accelerated Cost Recovery System) are tax-acceptable but not GAAP-acceptable. The tax calculations can be performed independently of the patronage allocations to the individual capital accounts. The resulting amount of corporate income tax is subtracted from the collective net income, and that difference, the self-insurance allocation, is allocated to the collective account in accordance with SECTION 2.C(2).

SECTION 3 deals with the capital paid into or paid out from the internal capital accounts. There are three ways amounts are credited to a member's account: the membership fee, accumulated interest, and retained patronage dividends. The co-op tries to redeem the retained patronage dividends five years after the patronage dividends are retained. The membership fee and the accumulated interest are in the long-term portion which remains in the account, as a cushion against possible losses, until the member terminates or retires. Then the remaining balance is paid out over a period of years as the legal consideration for the returned membership share.

SECTION 3.A gives the treatment of the capital paid in as the membership fee.

SECTION 3.B describes how the patronage dividends in the short-term part of a member's account are treated as a revolving or rollover fund. Each member's portion of the retained patronage dividends is credited to the member's account. It is a dated entry due to be paid out five years later. But any losses assigned to the short-term part of a member's account will subtract from those amounts due to be next paid out. To be finally redeemed or paid out in cash, each member's patronage dividends for a given year must 'run the gauntlet' — must survive the five-year period of exposure to

possible losses. If the patronage dividends survive the gauntlet and if allowed by the cooperative's financial agreements, then the patronage dividends are paid out in cash. The co-op should plan the level of wages to be paid out during the fiscal year, so, with no unpleasant surprises, the co-op will be able to redeem the five-year-old written notices. However, if unforeseen circumstances result in insufficient profits, then the redemptions may be postponed by the Board of Directors. Moreover, lenders may require restrictive covenants in the financing agreements of the cooperative. The bracketed language in SECTIONS 3.B and 3.C gives By-law recognition for such subordination agreements.

SECTION 3.C describes the distribution triggered by a member's termination or retirement from the cooperative. The written notices in the short-term part of the member's account are scheduled, whether the member terminates or not, to be redeemed within a certain period of years. Termination brings no changes in the status of those written notices of allocation. The terminating member's membership share is automatically transferred back to the cooperative. The legal consideration for the returned share is the long-term balance in the member's account which represents the surviving accumulated interest and membership fee. That long-term balance is paid out to the departing member in some combination of cash and subordinated notes as determined by the Board of Directors. If the long-term balance in the member's account is zero or negative, the membership share is forfeited back to the corporation for no legal consideration.

SECTION 3.D gives the treatment of the collective account if the cooperative is liquidated or dissolved. If a co-op is liquidated or dissolved, there is unlikely to be anything left after normal debts and (if possible) the individual accounts are paid off. In any case, the collective account was contributed by all the past members so it would be unfair for the current members to try to 'raid' and appropriate it. In the unlikely event of any positive residual assets, the By-laws allow the co-op to, in effect, reconstruct the individual capital accounts as if there had been no collective account in the past. The resulting additional distribution is obtained if the co-op uses the By-law language allowing the cooperative to distribute any residual amounts to all past and present members in proportion to their patronage. Alternative language is provided for a *payout of any positive residual assets to charity.*

payout of any positive residual assets to charity. Such an alternative is typical in a non-profit corporation but is unusual in a conventional business corporation. Members should choose the alternative appropriate for their cooperative.

ARTICLE IV: Membership Meetings

Most state corporation laws require at least one annual meeting of shareholders. In a worker cooperative, the members hold the basic rights and responsibilities of shareholders. In practice, members of a worker cooperative are likely to play a more active role than shareholders in a conventional corporation.

The annual meeting (SECTION 1) gives members at least the minimum opportunity to elect the Board of Directors. In addition, the annual meeting provides an opportunity for membership review, discussion, and ratification of important corporate policies and plans. The blank spaces in this section should be filled in with such language as "the third Tuesday in January at 7:00 o'clock P.M."

Ordinarily, the Board and/or officers determine the agenda for annual membership meetings, but 10% of the members can ensure consideration of issues other than those presented by the directors and officers. The date and location of the annual meeting is fixed in the By-laws to achieve regularity and, in many states, to comply with the law. For the sake of flexibility, however, SECTION 1 permits a special meeting in place of the scheduled annual meeting.

In many cooperatives, especially smaller ones, meaningful membership input requires more than just one meeting a year. Thus, SECTION 2 permits more frequent "regular" membership meetings, held at a regular time and place determined by the President or by the members. In addition SECTION 3 permits special meetings to be called at any time and for any lawful purpose. Power to call such a meeting rests with the Board, the President, or 10% of the members. But, in the ordinary course of business, especially in large cooperatives, the elected Board can act on most corporate matters between occasional membership meetings.

To enable a member to exercise his or her voting rights, he or she must receive one-week advance notice of the time, place, and purpose of annual or special meetings (SECTION 4). Such notice may be given in person at the workplace, and might (for instance) be included with distribution of

paychecks. To facilitate notice by mail, each member has a duty to notify the corporation of his or her current mailing address. The member's ability to provide a written waiver of the notice requirement can simplify the process in cases where notice is unnecessary. Notice is not required for each regular meeting, provided that members are notified of the establishment of a regular time and place of regular membership meetings. A majority of members must attend a membership meeting (SECTION 5) to achieve a quorum and take valid membership votes.

The basic cooperative principle of one-member/one-vote appears in SECTION 6. This applies at least to the addition, election, or removal of directors, as well as other matters requiring membership voting. State corporate laws often require shareholder (here, member) voting on major corporate changes such as merger, dissolution, sale of substantial corporate assets, or amending the Articles of Organization. In addition, these By-laws give members voting rights to amend the By-laws, to adopt operating rules, and (if so provided by membership or Board resolution) to approve major contractual commitments. (Compare Article VI, section 6.) Precise division of responsibility between the management, the Board, and the members should be defined in operating rules and policy resolutions — consistent, of course, with the legal responsibilities of the Board under state law. For a practical guide to division of responsibility and power, see the ICA publication, Saglio and Hackman, "The Design of Governance Systems for Small Worker Cooperatives."

Many corporations permit proxy voting — i.e., delegation of an absent shareholder's voting rights to another shareholder present at a meeting. A proxy can be directed (specifying how to vote) or undirected (giving the proxy holder discretion in voting the proxy.) SECTION 6 prohibits proxy voting in a worker cooperative in order to encourage active participation by the full membership. Moreover, certain external restrictions on proxy voting may exist, in cooperative statutes or in financing eligibility criteria (e.g., of the National Consumer Co-op Bank.)

For practical reasons, especially if the members live far from one another and achieving a quorum would be difficult, you might add an exception to SECTION 6 allowing for directed proxy voting. If you permit such proxy voting, then change SECTION 7 to provide for action by a majority

of the members present "or represented by proxy," and change the quorum provision (SECTION 5) to require a majority of the members "in person or represented by proxy." In addition, you might add the following language to the end of SECTION 6 to permit directed proxy voting:

"...; except that members may vote by absentee ballot (which may also be referred to as a "directed proxy") in the election of directors or in membership resolutions expressly and entirely stated in the written notice of the meeting. Such absentee ballots must be signed by the absent member, dated not more than four (4) weeks before the meeting for which they are authorized, and clearly marked as to the member's vote. Absentee ballots shall be filed with the Clerk (or Temporary Clerk of the meeting) prior to the beginning of the meeting."

Ordinarily, a membership meeting with a quorum can take action on the basis of a majority vote of members present (SECTION 7). Exceptions might be prescribed in the Articles or the state corporation law, e.g., requiring 2/3 vote for certain amendments of the Articles involving major corporate changes. The Board designates which officer or other person will reside at meetings of the members. Finally, for practical reasons, membership action can be taken by unanimous written consent (SECTION 8), even without a meeting.

ARTICLE V: The Board of Directors

In most corporations, the Board of Directors has primary responsibility for managing the affairs of the corporation. This usually involves selecting and monitoring management personnel. Many worker cooperatives, especially smaller ones, reserve policy decisions to the members, through the By-laws and operating rules. Under these By-laws (SECTION 1) and many corporation laws, however, major responsibility remains with the Board of Directors. Members exercise ultimate control through the power to elect and remove directors. As a practical matter, the Board is the representative body that meets regularly to develop policy and oversee management. Analogous to a parliamentary political system where the elected parliament selects the prime minister, the elected Board in a worker cooperative selects the President as the chief executive officer. SECTION 1 expressly

authorizes the Board to issue stock — without such a provision (in some states), such a power would rest with the shareholders. Check your local law.

Whatever division of responsibility you choose, the Board of Directors retains certain legal responsibilities. For instance, directors can be held personally liable for the corporation's failure to pay Federal tax. The general "fiduciary duty" of directors requires them to act responsibly and honestly with persons outside and inside the corporation, and forbids them from seeking personal gain at the expense of the corporation. Consult with a local lawyer to establish the legal parameters for Board of Director responsibility.

The number of directors (SECTION 2) is chosen initially by the incorporators (the corporation organizers) and thereafter by the members. The number should be odd (to avoid tie votes), small enough to comprise a working group, and within the boundaries defined by state law. (For instance, Massachusetts requires a minimum of three directors in corporations with three or more shareholders.) SECTION 2 reinforces the basic membership right to elect directors, and SECTION 4 enables the members to enlarge the Board. Vacancies (SECTION 3) may be filled by Board vote or membership vote. The term of office for directors is usually one year, although SECTION 5 ensures that directors can resign before one year or remain beyond one year until they are replaced. Thus, if an annual election is delayed, the Board will remain intact and operational. Absent contractual agreement or Board resolution, terminated directors have no right to compensation. SECTION 2 permits non-member directors. This enables the cooperative to have outside expertise or a link with other institutions on the Board.

The members' right to remove directors (SECTION 6) is the analogue to their right to elect directors. The right is unlimited, insofar as the members can remove a director for any reason at all, i.e., "without cause." The Board, on the other hand, can remove a director only "for cause" — i.e., if the director acted dishonestly, irresponsibly, or inconsistent with the best interests of the corporation. Thus, without cause, the Board cannot undercut the membership selection of directors. A director removed for cause has minimum due process rights — i.e., reasonable notice and an

opportunity for a hearing.

The Board of Directors should meet regularly (SECTION 7) in order to be responsible in overseeing management, developing policy, and responding to problems. Monthly meetings are common for a "working board," although opportunity for special meetings might decrease the need for such frequent regular meetings. Notice (SECTION 8) is essential, since directors must pay close attention to their legal and operational responsibilities. A majority of directors constitutes a quorum (SECTION 9), and a majority of directors present ordinarily can take action (SECTION 10).

Board power to take action by unanimous consent (SECTION 11), absent a meeting, is important for practical reasons; so is delegation of certain powers to Board committees (SECTION 12).

ARTICLE VI: Officers

These By-laws (SECTION 1), like many state laws, require the Board to select a President, a Treasurer, and a Clerk as officers. The Board must elect a Chairperson, and may create and fill other officer positions at its discretion. The choice of officers is important since, in most cases, the officers are responsible for managing the day-to-day business of the corporation. They administer the policies developed by the Board and the members.

We suggest that the officers also be members (SECTION 2), since they will be working for the firm. The Chairperson, as the presiding officer of the Board, should be selected from among the directors. The other officers need not be directors (unless required by state law). One person can hold more than one office, which might prove practical in smaller operations.

The term of office of the officers is determined by the Board (SECTION 3). An officer may resign in writing in accordance with this section. But, absent a contractual agreement or Board resolution, a terminated officer has no right to compensation as an officer. If such officer is also terminated as a member, however, his or her membership rights (due process and share redemption under Articles II and III) remain effective.

The Board can remove any officer for any reason, as long as the officer is given notice and a chance for a hearing before the Board (SECTION 4.) The Board, of course, can choose persons to fill any vacant offices until their next annual selection of officers (SECTION 5.)

The primary responsibility of the Chairperson is to preside at Board meetings (SECTION 6), although the Board may choose to assign additional responsibilities to the Chairperson.

The President is the chief executive officer (SECTION 7) — presumably, a fulltime role of managing the business of the corporation. Although subject to Board supervision and removal, the President must be given adequate discretion for managing the day-to-day operation of the corporation.

SECTION 7 also gives the President power to enter binding contracts on behalf of the corporation. This power may be altered or limited by Board or member resolution, or by amending these By-laws. Cautious business practice suggests that such power to enter contracts be limited to one or a few individuals. Beware, however, that state law often gives any officer legal authority to enter contracts for the corporation. A contract can be binding on the corporation if the party with whom an officer contracts believes the officer has the necessary authority — i.e., if the officer has apparent authority. And, the other party might be able to get out from under a contractual obligation if signed by a corporate officer without actual authority. Thus, a corporation should be clear and consistent about signing authority, and should always choose responsible officers.

The Treasurer (SECTION 8) is responsible for the finances of the corporation. This involves administration, custody, and record-keeping in all financial concerns. Check-signing authority may be delegated, but the Treasurer and Board retain legal responsibility for money matters. As an additional protection, some corporations require the Treasurer to co-sign checks over a certain amount. In performance of its supervisory role, and to protect the corporation from any mishandling of funds by the Treasurer, the Board may require the Treasurer to give a bond for faithful performance of his or her duty. Bonding is usually arranged with an insurance company.

The Clerk (SECTION 9) is the primary record-keeper of the corporation. Such records, at a minimum, should include: (1) a membership list and stock transfer information, (2) minutes of all meetings of members and directors (notes taken by the Clerk or a designated substitute) and (3) other corporate documents, such as Articles of Organization, By-laws, and corporate filings. The Clerk may also serve as resident agent of the corporation. (See notes to Article I.) In many states, the term Secretary is used instead of Clerk.

ARTICLE VII: Indemnification and Insurance

Indemnification (SECTION 1) is a protection that many corporations provide for directors and officers. To indemnify a person means to secure against loss or damage, and to compensate that person for such a loss. This provision gives individual directors and officers a guarantee that the corporation will cover any expenses or losses incurred by virtue of their positions as directors or officers. This right to indemnification applies only to the responsible execution of a director's or officer's duties. Thus, the corporation need not compensate a person for damages resulting from actions that the person took (or failed to take) if he or she was aware that such actions were not in the best interests of the corporation. The specific exceptions to indemnification, listed in this Article, defer to the law or to a court's decision for determining whether an exception applies.

Indemnification is an important provision in attracting people to serve as a director or an officer. It can also be very costly to the corporation if the indemnification rights are triggered. Therefore, a corporation might obtain insurance, authorized by SECTION 2, to cover indemnification. "Director and Officer Liability Insurance" can be purchased from an insurance company.

ARTICLE VIII: Amendments

As the basic laws of a democratic organization, these By-laws may be amended by a vote of a majority of the members (SECTION 1). Along with the power to elect or remove directors, this power to amend the By-laws is among the most important membership rights to control the corporation. The formalities of membership meeting with notice should be followed in the amendment process.

For practical reasons, the directors also have the power to amend the By-laws (SECTION 2). This power, however, is carefully limited in order to keep ultimate control of By-law amendments in the members. Thus, the provisos in SECTION 2 prohibit the Board from: (1) changing any provisions that currently give members the right to take action, or (2) changing this amendment procedure or the procedure for removal of directors. Moreover, any amendment by the Board can subsequently be amended by the members. And members must receive timely notice of any amendment by the directors.

ARTICLE IX: Operating Rules

This provision allows and suggests the adoption of Operating Rules, to provide a more detailed "governance system" within the framework of these By-laws. Operating Rules can specify important day-to-day operating procedures and rights, including (but not limited to): personnel policies, a grievance procedure, and decision-making mechanisms. For more guidance on developing a governance system that might be embodied in Operating Rules, see the ICA publication "The Design of Governance Systems for Small Worker Cooperatives."

APPENDIX

BY-LAW CHECKLIST

After reviewing An Introduction to the ICA Model By-laws for a Worker Cooperative, you can begin the process of adapting the Model By-laws to your cooperative. Following is a checklist of some key choices to be made in that process.

Each item refers to the relevant section of the By-laws. Each choice should be made in light of the explanations in the appropriate portion of the "Annotations to the By-laws" in the Introduction paper. The checklist lists blanks to be filled in, and clauses enclosed in square brackets ([...]) to be chosen or deleted, on the Model By-laws form. The list also includes items which you might choose to change. In the latter items, "default value" or "default" is used to note the term that will remain in the By-laws if you make no change.

Articles of Organization

(section references are to the appropriate section of "A Brief Guide to the Articles of Organization" in the Introduction paper.)

- ___ 1. Name of Corporation: section 1 (and, By-laws I.1.).
- ___ 2. Corporate purposes: section 2.
- ___ 3. Authorized stock: section 3.
- ___ 4. Stock transfer restrictions: section 5 (and By-laws II.4.).
- ___ 5. Other lawful provisions: section 6.
- ___ 6. Other details: section 7 (several items duplicated in By-laws).

By-laws

(Section references are to the appropriate section of the Model By-laws.)

- ___ 1. Name of corporation: Article I, section 1 (and Articles).
- ___ 2. Corporation address: Article I, section 2 (and Articles).
- ___ 3. Fiscal year: Article I, section 3 (and Articles).
- ___ 4. Membership trial period: Article II, section 2.
- ___ 5. Option to restrict membership to state residents: see Annotations to Article II, section 2.
- ___ 6. Membership fee and payment terms: Article II, section 3, and Article III, section 3.A. (Board decision.)
- ___ 7. Percentage split of net earnings between the collective net income and the individual net income: Article III, sections 2 and 2.C -- default value is 50/50 split.

- ___ 8. Interest rate on individual capital accounts: Article III, section 2.A.
- ___ 9. Definition of patronage: Article III, section 2.B — default is patronage measured according to hours worked.
- ___ 10. Option to use startup losses account and the amortization schedule for startup losses: Article III, sections 1.C and 2.B(2)(b) — default value is 5-year amortization. [Startup losses account not used in simplified Article III.]
- ___ 11. Option to have a percentage of membership fee non-refundable and credited to the collective account — such a provision is not included in the Model By-Laws, and would require appropriate changes in Article III, sections 1.A, 1.B and 3.A.
- ___ 12. Redemption period for written notices of allocation: Article III, section 3.B — default value is 5 years.
- ___ 13. Written notice subordination clause: Article III, sections 3.B and 3.C.
- ___ 14. Liquidation distributions: Article III, section 3.D — default provision is distribution of residual assets upon liquidation to all past and present members in proportion to patronage.
- ___ 15. Annual meeting date: Article IV, section 1 (and Articles).
- ___ 16. Proxy voting prohibited or limited: Article IV, section 6 — default is prohibition on proxy voting.
- ___ 17. Outside directors permitted or not: Article V, section 2 — default is non-member directors permitted.
- ___ 18. Governance system (e.g., division of powers, grievance procedure): Article IX, section 1, and Operating Rules — must be adopted by Board and/or members.

COOPERATIVE MEMBERSHIP AGREEMENT

1. The undersigned applicant for membership (hereinafter referred to as "Applicant") hereby applies for and accepts Membership in the _____ (hereinafter referred to as the "Cooperative"); incorporated and doing business under the laws of the State of _____. The Applicant hereby assents to, approves and ratifies the By-laws of the Cooperative, together with all amendments thereto, if any, which are attached to this Membership Agreement (hereinafter referred to as the "Agreement"). Receipt of a copy of such By-laws is hereby expressly acknowledged.
2. The Applicant hereby agrees pay the membership fee of _____ in accordance with the terms determined by the Board of Directors, and the Cooperative to issue a membership share to the Applicant. The Applicant agrees not to sell, assign any interest in, or otherwise transfer his or her membership share during the period of membership in the Cooperative. The Applicant hereby agrees that upon the voluntary or involuntary termination of work and membership in the Cooperative, he or she will transfer his or her membership share back to the corporation for the legal consideration, if any, determined in accordance with Article III of the By-laws.
3. The Applicant further approves and agrees to observe and be bound by the Operating Rules of the Cooperative as they may now or hereafter be in force and effect.
4. Conditioned upon the approval of this Agreement by the Cooperative, the Applicant hereby agrees to contribute his or her labor to the business of the Cooperative, and the Cooperative hereby agrees to utilize the services of the Applicant in its business and to confer upon the Applicant the rights of membership including, but not limited to, voting rights and labor compensation rights.
5. The obligations of both parties under the terms of this Agreement are subject to the right of the Applicant to withdraw said contribution of labor, to terminate Membership, and to terminate this Agreement; provided, however, that all conditions and restrictions on such right as are contained in the Cooperative's By-laws, in the Operating Rules, and in this Agreement are fully complied with.
6. The Applicant specifically agrees to satisfy any Federal income tax obligation which may arise pursuant to Article III of the Cooperative's By-laws. Specifically, the Applicant agrees to include in his or her taxable personal income the stated dollar amount of any qualified written notices of allocation received by him or her, and to pay the tax thereon.

Date _____

(Signature of Applicant for Membership)

Membership Agreement ratified by _____

(Signature of President of Cooperative)

SAMPLE FORM:

WRITTEN NOTICE OF ALLOCATION OF PATRONAGE DIVIDEND

Issued to: _____
(Name of Member)

Issued by: _____
(Name of Corporation)

Date: _____

This is your written notice of allocation issued in accordance with Subchapter T of the Internal Revenue Code and Article III of the By-laws of this Corporation.

This written notice represents a patronage dividend for the _____ fiscal year in the amount of \$_____ based upon your labor patronage, defined as the total hours worked [or, "gross wages earned," if appropriate] in this Corporation during the fiscal year.

[For "non-qualified written notices of allocation," use the following paragraph]:

This is a non-qualified written notice of allocation as defined in section 1388(d) of the Internal Revenue Code. The amount of this non-qualified written notice of allocation has been credited to your individual capital account, and will be redeemed in five (5) years or at a later date as determined by the Board of Directors at its discretion. At that redemption time, you must report the redeemed amount to the Internal Revenue Service as taxable income on your personal income tax form.

[For "qualified written notices of allocation," replace the preceding paragraph with the following paragraph]:

This is a qualified written notice of allocation as defined in section 1388(c) of the Internal Revenue Code. The amount of this qualified written notice of allocation has been credited to your individual capital account, and will be redeemed in five (5) years or at a later date as determined by the Board of Directors at its discretion. You will also receive a cash patronage dividend accompanying this written notice of allocation. In accordance with section 1385 of the Internal Revenue Code, you must report the full amount of this qualified written notice and the cash patronage dividend to the Internal Revenue Service as taxable income on your personal income tax form.

Signature of President or Treasurer

TAXATION OF WORKER COOPERATIVES

A worker cooperative, like any business, faces a battery of Federal and state taxes. Careful tax planning can minimize this burden, through special tax benefits for cooperatives as well as tax breaks available to any corporate enterprise. This article presents a brief introduction to the primary cooperative tax advantage: Subchapter T of the Federal Internal Revenue Code.

Ordinarily, corporate earnings are subject to double taxation. The corporation pays corporate income tax on its taxable income and individual shareholders pay personal income tax on their share of corporate earnings distributed as dividends. Subchapter T enables a cooperative to avoid this double taxation, by legally avoiding the corporate level tax.

Subchapter T works as follows. The worker cooperative deducts from corporate taxable income any earnings allocated to members on the basis of work performed (called "patronage," often measured by hours worked). These allocations or "patronage dividends" may be in the form of cash distributions. Alternatively, patronage dividends may be in the form of written obligations ("written notices of allocation") credited to members' individual capital accounts. Thus, Subchapter T can provide a dual benefit. The cooperative can avoid double taxation *and*, at the same time, retain and reinvest a portion of the earnings allocated to members. Such allocations, of course, would be in addition to ordinary cash wages.

There are two different ways to use Subchapter T, each with different cash-flow implications depending on the particular tax brackets of the cooperative and the members. Patronage dividends in the form of "qualified" written notices are currently deductible by the corporation. However, the member must pay personal tax currently on any allocations, and the corporation must pay at least 20% of the dividend in cash to the member immediately, presumably to enable the member to pay the personal tax. Alternatively, "non-qualified" written notices require no

up-front personal tax payment, but also offer no current corporate deduction for the patronage dividend. In a later year, when the written notice is paid out in cash to the member, the member pays personal tax, and the cooperative deducts the amount of the cash pay-out. The choice between qualified and non-qualified written notices requires careful attention to Subchapter T provisions and to a cash-flow analysis.

The benefits of Subchapter T are available, in the words of the Tax Code, to "any corporation operating on a cooperative basis." Unfortunately, the IRS and the courts have produced no precise definition of "operating on a cooperative basis." Nonetheless, IRS rulings and court cases tend to cite certain criteria for use of Subchapter T. Two criteria appear to be most important: (1) a worker cooperative must allocate earnings on the basis of patronage, as opposed to relative capital investment; and (2) the cooperative must be democratically controlled by the members. Clearly, some variation from these criteria will not necessarily preclude use of Subchapter T — courts have allowed non-cooperative elements within corporations using Subchapter T. But, the tax benefit becomes less certain as one strays away from patronage allocations and democratic structure. A note of caution: consult with your lawyer before relying on Subchapter T.

Two other important points are established by case law. First, Subchapter T is expressly available to worker cooperatives, although it originated as a tax break for agricultural cooperatives. Second, the particular state-level incorporation statute is not controlling for Federal tax purposes. For instance, if an enterprise is incorporated as a business corporation but operates in substance on a cooperative basis, it can still qualify under Subchapter T.

The mechanics of using Subchapter T are simple. No prior election or approval is required. A corporation that is operating on a cooperative basis simply files the appropriate IRS forms (1099-PATR and 1096) when paying taxes.

The potential for creative tax planning by a worker cooperative extends far beyond Subchapter T. This article merely scratches the surface. For more

information on cooperative taxation, consult with your lawyer or accountant, or contact the Industrial Cooperative Association. ■

1984

Department of the Treasury
Internal Revenue Service

Instructions for Form 1096

(Annual Summary and Transmittal of U.S. Information Returns) and Forms 1099-ASC, 1099-B, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, and 5498

(Section references are to the Internal Revenue Code, unless otherwise noted.)

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Highlights

Backup Withholding

Beginning January 1, 1984, certain interest, dividends, and other payments are subject to backup withholding at a 20% rate. For payments to which backup withholding applies, see the *Specific Instructions* for each form.

Payments are subject to backup withholding if:

- (1) The payee fails to furnish his or her taxpayer identification number (TIN) to you, or for accounts opened or instruments acquired after 1983 the payee fails to certify, under penalties of perjury, that the TIN provided is correct, OR
- (2) We notify you that the payee furnished an incorrect TIN, OR
- (3) You are notified that the payee is subject to backup withholding (under section 3406(a)(1)(C)), OR
- (4) For accounts opened or instruments acquired after December 31, 1983, the payee fails to certify to you, under penalties of perjury, that he or she is not subject to backup withholding under (3) above.

(1) through (4) above apply to payments of interest, dividends, and patronage dividends (except certain "window payments" of interest). "Window payments" of interest are subject to backup withholding only if the payee fails to furnish his or her TIN. Other payments are subject to backup withholding only if (1) or (2) above apply, except that payments reportable under Code sections 6041, 6041A(a), and 6050A do not require the payee to certify the correctness of the TIN.

Some payees are exempt from backup withholding. For a list of types of exempt payees and other information, please see **Form W-9, Payer's Request for Taxpayer Identification Number**.

Generally, the period for which the 20% should be withheld is:

Failure to Furnish TIN in the Manner Required.—Withhold on payments made until the TIN is furnished in the manner required, unless the payee has applied for a TIN. The payee may certify to this on Form W-9 by noting "applied for" in the TIN block and by signing the form. This form then becomes an "awaiting-TIN certificate." If the TIN is not received and certified in the manner required in 60 days, begin withholding. (For accounts established before January 1, 1984, you must treat a payee as if a TIN has been applied for until January 16, 1984. You must withhold if no TIN or awaiting-TIN certificate is received by that date.)

Receipt of Notification from IRS That Payee's TIN Is Incorrect.—Unless you receive a new TIN from the payee, start withholding on payments made on the 31st day after you receive notification from IRS and continue withholding on payments made thereafter. Stop withholding when another TIN is furnished in the manner required. **Note:** *IRS will furnish an additional copy of the notice to you and you are required to promptly furnish such notice to the payee. If the payee furnishes you with another TIN, you are required to promptly notify IRS of the new TIN.*

Receipt of Notification That Payee Is Subject to Backup Withholding.—Start withholding on payments made on the 31st day after you receive notification from IRS and continue withholding on payments made thereafter. IRS will notify you in writing when to stop withholding, or the payee may furnish to you a written certification from IRS stating when withholding is to stop. In most cases, the stop date will be January 1 of the year following the year of the notice. **Note:** *You must notify the payee when withholding under this procedure starts.*

Payee Failure of Certification Under (4) Above.—Withhold until certification has been provided.

For exceptions to these general timing rules, see section 3406(e).

Reporting and Payment of Backup Withholding.—Backup withholding amounts will be reported on **Form 941, Employer's Quarterly Federal Tax Return**, (or **Form 941-E, Quarterly Return of Withheld Federal Income Tax**). For tax deposit purposes, payers can either combine backup withholding with other taxes reported on **Form 941** (or **Form 941-E**), or they can treat backup withholding as a separate tax and deposit it separately. The separately

deposited taxes are accounted for on **Schedule A (Form 941)**, to be filed as an attachment to **Form 941** (or **Form 941-E**). For more detailed information, see the instructions for **Form 941** (or **Form 941-E**).

Penalties.—The following penalties generally apply to payers for failure to supply identification numbers and for failure to file information returns or to furnish statements. A penalty of \$50 applies to:

- Each failure to furnish the recipient's TIN on information returns.
- Each failure to report the recipient's correct TIN on information returns for payments of interest and dividends.
- Each failure to timely furnish statements to payees.
- Each failure to timely file information returns.

The penalties relating to information returns for interest and dividend payments apply unless it is shown the payer exercised due diligence in attempting to satisfy the requirements for such TIN, statement, or return. In addition, the penalties relating to payments of interest and dividends are self-assessed. IRS will announce filing requirements and other details on these self-assessed penalties. The penalties on payments other than interest and dividends apply unless it can be shown that the failures were due to reasonable cause and not willful neglect. Any payer who fails to include his or her TIN in any return, statement, or document is subject to a \$5 penalty for each such failure. For exceptions, limitations, and other information, see sections 6652, 6676, and 6678.

Any person required to provide reports on individual retirement accounts or annuities on **Form 5498**, but fails to do so, is subject to a penalty of \$10 for each failure unless it is shown that the failure is due to reasonable cause.

The following instructions relate to due diligence for purposes of obtaining and reporting a payee's correct TIN. Due diligence imposes a higher standard of conduct than previously required under application of the reasonable cause defense. In general, to satisfy due diligence with respect to dividend and interest accounts established or instruments acquired after 1983, you must have a TIN provided by the payee under penalties of perjury. For pre-1984 dividend and interest accounts, you will have exercised due diligence if you made the mailing or mailings required by A-5 and A-6 of section 35a.9999-1 of the Temporary Employment Tax Regulations. For a more detailed discussion of the application of due diligence, see section 35a.9999-1 of the Temporary Employment Tax Regulations, *Questions and answers concerning the due diligence requirement and the certification requirements in connection with backup withholding and other related issues*. For determining whether a brokerage account (and instruments contained therein) is treated as a pre-1984 or a post-1983 account, see A-41 of section 35a.9999-1 and A-20 of section 35a.9999-3 of the Temporary Employment Tax Regulations. Also, for penalties relating to brokers of readily tradable instruments, see the discussion below.

Special Rules for Readily Tradable Instruments and Retail Brokers.—There are special certification rules for readily tradable instruments and retail brokers. A readily tradable instrument is one which is part of an issue any part of which is traded on an established securities market or regularly quoted by brokers or dealers. Generally, a retail broker must obtain the TIN, certified under penalties of perjury, of any purchaser taking delivery of a readily tradable instrument and must provide it to the payer of any interest or dividend with respect to the readily tradable instrument. The payer may rely on the TIN received from the broker and will not be subject to a penalty if the TIN is an incorrect one. On the other hand, if the payer does not receive a TIN from the broker, the payer is subject to the penalty for failure to include a TIN on any return or statement unless the payer exercises due diligence. For a definition of due diligence in this situation, see A-51 of section 35a.9999-3 of the Temporary Employment Tax Regulations.

Backup withholding for a payee's failure to certify that he or she is not subject to backup withholding because of underreporting of interest and dividends applies to payments on readily tradable instruments if, and only if, the payee fails to provide the payer with such certification, under penalties of perjury, AND:

- (1) The payer is notified by the broker with the transfer instructions for the acquisition that the payee did not provide such certification, or that the broker was notified by the IRS before the acquisition that the payee is subject to backup withholding, OR
- (2) The readily tradable instrument was acquired directly from the payer, OR
- (3) Such instrument is held by the payer or broker as nominee for the payee.

A penalty of \$500 for each failure will be imposed on any broker who willfully fails to notify a payer as described in (1) above. The certification rule in (1) above, with respect to readily tradable instruments, does not apply to an instrument acquired through a brokerage account if the account was established before January 1, 1984, and, during 1983, the broker bought or sold readily tradable instruments for the payee or acted as a nominee for the payee through such account.

Magnetic Media Reporting

We encourage filing all information returns on magnetic tape, diskette, or disk pack. Revenue Procedures for Magnetic Media Reporting are available at Internal Revenue Service Centers and district offices. Different types of payments such as interest, dividends, and rents may be reported on the same tape or disk submission. Payers have found magnetic media reporting to be economical, efficient, and more flexible for integrating the reporting required under the Internal Revenue Code with their reporting to other government agencies.

Any person who is required to file information returns because of payments of dividends, patronage dividends, or interest to more than 50 payees for any calendar year after 1983, must file the returns with the IRS on magnetic media. This requirement shall not apply to any person for any period if such person establishes

that this requirement would result in undue hardship. Request for relief because of undue hardship should be sent to the service center for your area.

Regulations section 1.6045-1(l) requires brokers and barter exchanges to use magnetic media in reporting Form 1099-B data to the IRS. New brokers and barter exchanges may request an undue hardship exception by filing an application with their service center by the end of the second month following the month in which they became a broker or barter exchange.

Form 4419, Application for Magnetic Media Reporting of Information Returns, must be filed with the Magnetic Media Coordinator at the service center where the returns will be filed, prior to submitting returns on magnetic media. IRS will provide a written reply to the applicant and further instructions at the time of approval.

Payers who file information returns on magnetic tape, diskette, and disk pack should be sure that duplicate returns are not filed on paper returns.

Paper Document Reporting

Payers filing returns on paper forms must use a separate transmittal, **Form 1096**, for each different type of form. If you have one type Form 1099 with and without TIN's, you may submit them on one Form 1096 if they are bundled separately and the number without TIN's is shown in Box 4. **Transmit nominee/middleman Forms 1099 with a separate Form 1096.**

Note: For 1984, all Forms 1099, 5498, and 1096 should be machine prepared and have been designed in a machine-scannable format. If you order these forms from a private printer, be sure the forms meet IRS specifications for machine-scannable format. **DO NOT CUT AND SEPARATE forms that are three to a page.**

In the payer/broker or trustee/issuer entity area on the Forms 1099 and 5498, there are double-spaced areas shaded off for entry of payer/broker or trustee/issuer name, street address, city, state, ZIP code, and Federal identifying number. Your information should be entered in the appropriate area. If your information cannot be entered completely because there is not enough space, continue the data in the brown shaded area.

In the recipient entity area on these forms there are double-spaced areas shaded off for entry of recipient name, street address, city, state, and ZIP code. The recipient information should be entered in the appropriate area. If this information cannot be entered completely because there is not enough space, continue the data in the brown shaded area.

Recipient's Account Number.—It may be to your benefit to include the recipient's account number on paper documents, in addition to the recipient's name and taxpayer identification number, if your system of records uses the account number rather than the recipient's name, social security number, or employer identification number for identification purposes. If you furnish the account number, IRS will include it in future notices to you about backup withholding. To provide the account number, use the last line in the recipient entity (brown shaded) area of the form.

General Instructions

A. Who Must File.—See the instructions applicable to specific forms.

Nominee/Middleman Returns.—Anyone receiving amounts that actually belong to another person should file a Form 1099 showing the actual owner as the recipient and the nominee as the payer.

B. When to File.—File Form 1096 with the accompanying Forms 1099 and 5498 by February 28, 1985. Brokers may file Form 1096 and Form 1099-B anytime after the reporting period they elect to adopt (month, quarter, or year), but not later than February 28, 1985. See General Instruction H about providing Forms 1099 and 5498 to recipients.

C. Where to File.

If your legal residence, principal place of business, office, or agency is located in

Use the following Internal Revenue Service Center address

New Jersey, New York City and counties of Nassau, Rockland, Suffolk, and Westchester	1040 Waverly Avenue Holtville, NY 11799
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	310 Lowell Street Andover, MA 01810
Delaware, District of Columbia, Maryland, Pennsylvania	11601 Roosevelt Boulevard Philadelphia, PA 19154
Alabama, Florida, Georgia, Mississippi, South Carolina	4800 Buford Highway Chamblee, GA 30341
Michigan, Ohio	201 West Second Street Covington, KY 41019
Arkansas, Kansas, Louisiana, New Mexico, Oklahoma, Texas	3651 S. Interregional Highway Austin, TX 78740
Alaska, Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	1160 W. 1200 South Street Ogden, UT 84404
Illinois, Iowa, Missouri, Wisconsin	2306 E. Bannister Road Kansas City, MO 64131
California, Hawaii	5045 E. Butler Avenue Fresno, CA 93727
Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia	3131 Democrat Road Memphis, TN 38110

If you have no legal residence or principal place of business in any Internal Revenue district, file with the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, PA 19154.

If you pay nontaxable dividends to your shareholders (other than actual distributions of S corporations out of previously taxed income), complete and file **Form 5452, Corporate Report of Nontaxable Dividends**, by February 28, 1985, with the **Director, Corporation Tax Division, Attn: CC:C:C:1:1, Internal Revenue Service, Washington, DC 20224.**

D. Calendar Year Basis.—Forms 1099 and 5498 are used to report amounts paid, credited or contributed during the calendar year.

Numbers.—Taxpayer identification numbers are used to associate and verify amounts reported to the IRS with corresponding amounts on tax returns. Therefore, it is important that you furnish correct social security or employer identification numbers for recipients on the forms, magnetic tape, diskette, or disk pack sent to IRS. (There is a penalty for reporting an incorrect TIN. See "Penalties" under Highlights on page 1.)

The taxpayer identification number for individual recipients, including sole proprietors, is the social security number (000-00-0000). For other recipients, it is the employer identification number (00-0000000).

When listing an identification number, please separate the nine digits as shown above, to distinguish the type of number being reported. See Form W-9 for further information.

Show the full name and address in the section provided on the return. When payments have been made to more than one individual recipient, show as the ONLY name on the first line the name of the recipient whose identification number is on the return. Show only the name of one of the remaining individual recipients in the brown shaded area after the first line.

F. Payer Names and Identification Numbers.—The taxpayer identification number for payers, including sole proprietors and nominee/middlemen, is the Federal employer identification number and should be shown on the returns they prepare. However, sole proprietors and nominee/middlemen who are not otherwise required to have an employer identification number should use their social security number. The payer name and taxpayer identification number should be consistent with the name and taxpayer identification number used on the payer's income tax or other tax return filed. The name of the payer's paying agent or service bureau must NOT be used in lieu of the name of the payer.

G. Shipping and Mailing.—Payers who file on paper forms and who use more than one type of form should group returns of the same type and prepare separate transmittals for each group. For example, if you pay both interest and dividends, file Forms 1099-INT with one Form 1096 and Forms 1099-DIV with a second Form 1096.

If you are sending many forms, you may send them in conveniently sized packages. On each package write your name and identification number, number the packages consecutively, and place Form 1096 in package number one. At the top of Form 1096 show the number of packages. Postal regulations require forms and packages to be sent by first class mail.

H. Statements to Recipients.—For payments of dividends or interest (reported on Forms 1099-DIV, 1099-PATR, 1099-INT, or 1099-OID) made in 1984 and subsequent years, you are required to furnish an official Form 1099 to a payee either in a separate mailing or in person. These forms may not be combined or mailed with other information furnished to the recipient. You may use substitute Forms 1099 if they are substantially similar to the official forms and only if you comply with all

revenue procedures relating to substitute Forms 1099 in effect at the time. Copy B (For Recipient) of the substitute forms must contain the statement that "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty will be imposed on you if this income is taxable and the IRS determines that it has not been reported."

Statements to recipients for Forms 1099-B, 1099-G, 1099-MISC, 1099-R, or 5498 need not be a copy of the paper form filed with the Service. It is important that income items be properly classified for Federal tax purposes on the statement you give to recipients. The message that "This information is being furnished to the Internal Revenue Service" must appear on the statements. You may combine the statements with other reports or financial or commercial notices, or expand them to include other information of interest to the recipient. Also, be sure that all copies of the forms are legible and provide the recipient with any instructions that appear on the back of the recipient's copy of the official Internal Revenue Service form so that the information may properly be used by the recipient in meeting his or her tax obligations.

For more information about paper substitutes, see Publication 1179, Specifications for Paper Substitutes for Forms 1099, 5498, and W-2G.

You should generally provide Form 1099 and Form 5498 information between December 31, 1984, and January 31, 1985. However, you may issue them earlier in some situations, as provided by the regulations. For example, you may choose to furnish Form 1099-INT to the recipient on redemptions of Series E, EE, H, or HH bonds, etc., at the time of redemption. Cooperatives may furnish Forms 1099-PATR with the final dividend payment regardless of the date. Brokers and barter exchanges may furnish Form 1099-B anytime but not later than January 31, 1985.

I. Returns Filed with IRS.—If you use paper forms, report payments on the appropriate form, as explained in the Specific Instructions below. Do NOT report payments to employees, such as Christmas bonuses or reimbursements for travel or car expenses, on forms of the 1099 series. Report these on Form W-2, Wage and Tax Statement.

See the revenue procedures on specifications for private printing of information documents. If proposed privately printed forms do not meet the specifications in the procedures, you may request special consideration by submitting your proposed forms to the Internal Revenue Service, Washington, DC 20224 (Attention: D:R:I:).

The regulations call for a signed affidavit on the transmittal document. This requirement is fulfilled by signing the Form 1096 on the bottom after the declaration of compliance. A separate affidavit is not necessary.

Under certain conditions, a transmitter, service bureau, paying agent, or disbursing agent may sign the affidavit on behalf of the

payer. The transmitter, service bureau, paying agent, or disbursing agent must meet all of the following conditions:

- (1) Have the authority to sign the affidavit under an agency agreement (oral, written, or implied) that is valid under state law.
- (2) Have the responsibility (oral, written, or implied) conferred on it by the payer to request the taxpayer identification numbers of recipients reported on magnetic media or paper documents.
- (3) Sign the affidavit and add the caption "For (Name of payer)."

Signing of the affidavit by an authorized agent on behalf of the payer does not relieve the payer of the responsibility for filing a correct, complete, and timely Form 1096 or Form 4804, Transmittal of Information Returns Reported on Magnetic Media, and attachments. It also does not relieve the payer of any penalties for not complying with those requirements.

Forms 1099, 5498, or other statements to recipients issued by a service bureau or agent should show the same payer's, broker's, trustee's, or issuer's name as shown on the information return filed with the Service.

J. Corrected Returns.—To insure proper matching of information documents to corresponding amounts on tax returns, please pay careful attention to the following instructions:

(1) Form 1096.—If you are transmitting corrected Forms 1099 or 5498, use a separate Form 1096 and mark over the "X" in the box at the top left corner of this form. Also, do not include original Forms 1099 or 5498 with your corrected transmittal.

(2) Forms 1099 and 5498.—On corrected returns, mark over the "X" in the box appearing in the top left corner of the form and mark over the "X" in the box at the top left corner of Form 1096. For paper forms correcting data previously submitted on magnetic tape, diskette, or disk pack, print "CORRECTED RETURN—MAGNETIC MEDIA" on the bottom of the transmittal Form 1096 and mark over the "X" in the box at the upper left corner of the Forms 1099 and 5498. Be sure to complete all the required data boxes on the corrected return since it supersedes the information previously reported. Also, statements issued to recipients should be identified as "CORRECTED."

If a completed Form 1099 or 5498 is incorrect and you want to void it, mark over the "X" in the VOID box appearing in the top left portion of the form. DO NOT CUT the forms that are three to a page.

K. Other Information Returns.—The income information you report on the following returns must not be repeated on the returns discussed in the Specific Instructions:

- (1) Returns filed with Form W-3.
 - (a) Form W-2 reporting wages and other employee compensation.
 - (b) Form W-2P reporting annuities, pensions, retirement pay, and IRA payments.

(2) Returns filed with Form W-3G.

- (a) Form W-2G reporting gambling winnings.
 - (b) Form 1099-R reporting total distributions from retirement or profit-sharing plans or from IRA's, etc.
- (3) Forms 1042S, 1000, and 1001 reporting income.
 - (4) Form 2439 reporting undistributed long-term capital gains of a regulated investment company.
 - (5) Schedule K-1 of Form 1065 reporting distributive shares to members of a partnership.
 - (6) Schedule K-1 of Form 1041 reporting distributions to beneficiaries of trusts or estates.
 - (7) Schedule K-1 of Form 1120S reporting distributive shares to shareholders of S corporations.
 - (8) Schedule K of Form 1120-DISC reporting actual and constructive DISC distributions to shareholders.

L. Forfeiture of Interest on Time Deposits.—For more detailed instructions for determining the amount of forfeiture deductible by the depositor (Forms 1099-INT and 1099-OID) see Revenue Rulings 75-20, 1975-1 C.B. 29 and 75-21, 1975-1 C.B. 367, available at IRS offices.

M. Exempt-Interest Dividends.—An exempt-interest dividend from a regulated investment company retains its tax-exempt status and is not reported on Form 1099-DIV or 1099-INT.

N. Payments to Corporations.—Reporting generally is not required for payments to corporations unless the payment is for medical payments, unless you withheld Federal income tax or foreign tax, or unless the payment is from a barter exchange. For example, reporting is not required for payments of architectural fees to corporations.

O. Earnings on an IRA, SEP, or DEC.—Any income with respect to an IRA, SEP or DEC, such as interest or dividends, should not be reported on Forms 1099 except when a designated distribution is made. However, distributions should be reported on Form 1099-R or Form W-2P.

Specific Instructions

If a distribution includes noncash property, show the fair market value of the property at the time of payment.

Although you generally need not report payments smaller than the minimum described for each form, you may prefer, for economy and your own convenience, to file Copies A for all payments. IRS encourages this.

Form 1099-ASC

All-Savers Certificates should have matured by December 31, 1983. If you paid \$10 or more in interest on these certificates for 1983 to a person in 1984, please use the 1983 version of Form 1099-ASC and change the year to 1984. Give Copy B to the recipient.

Form 1099-B

If you are a broker or barter exchange, file Form 1099-B, Statement for Recipients of Proceeds from Broker and Barter Exchange Transactions, for each person (a) for whom the broker has sold (including short sales) stock, bonds, commodities, regulated futures contracts, forward contracts, debt instruments, etc., or (b) who exchanged property or services through the barter exchange.

The term "broker" means a person that, in the ordinary course of a trade or business, stands ready to effect sales to be made by others.

The term "barter exchange" means any person with members or clients that contract either with each other or with such person to trade or barter property or services either directly or through such person. The term does not include arrangements that provide solely for the informal exchange of similar services on a noncommercial basis.

If the proceeds of a sale are paid in convertible foreign currency, the amount to be reported must be converted into U.S. dollars. You may use the exchange rate on the sales date or the exchange rate on the last business day of the reporting period in which the sale occurs.

Brokers must report each transaction (other than regulated futures contracts) on a separate Form 1099-B. Transactions involving regulated futures contracts are to be reported on an aggregate basis.

Barter exchanges must report each transaction involving noncorporate members or clients of a barter exchange on a separate Form 1099-B. Transactions involving corporate members or clients of a barter exchange must be reported on an aggregate basis.

No return is required for:

- (1) Sales by exempt recipients. (Common examples include corporations, charitable organizations, individual retirement plans, the United States, a state and political subdivisions. See A-29 of section 35a.9999-1 and A-21 of section 35a.9999-2 of the Temporary Employment Tax Regulations.)
- (2) Sales initiated by dealers in securities and financial institutions.
- (3) Sales by certain custodians and trustees (Regulations section 1.6045-1(c)(3)(iii)).
- (4) Sales at issue price of interests in certain regulated investment companies (see Regulations section 1.6045-1(c)(3)(iv)).
- (5) Obligor payments on:
 - (a) Nontransferable obligations, such as savings bonds.
 - (b) Obligations for which gross proceeds are reported on other Forms 1099, such as stripped coupons issued prior to July 1, 1982.
 - (c) Retirement of short-term obligations with original issue discount.
- (6) Callable demand obligations that have no premium or discount.

(7) Sales of foreign currency, unless under a forward or regulated futures contract that permits or requires delivery of foreign currency.

- (8) Sales of fractional shares of stock if gross proceeds are less than \$20.
- (9) Retirements of book-entry or registered form obligations if no interim transfers have occurred.
- (10) Exchanges by barter exchanges with less than 100 transactions during the calendar year.
- (11) Exempt foreign persons.

Report in:

Box 1(a).—The date of the sale or exchange. Enter the trade date or the settlement date. If you use the settlement date, enter a capital "S" before the date. For aggregate reporting, no entry is required.

Box 1(b).—For transactional reporting by brokers, the CUSIP (Committee on Uniform Security Identification Procedures) number of the obligation.

Box 2.—The gross proceeds from any disposition of securities (including short sales), commodities, or forward contracts. To determine gross proceeds, you may take into account commissions and option premiums if this treatment is consistent with your books. Do not include amounts shown in Boxes 6 through 9. Any accrued interest on obligations sold between payment dates should not be included in this box. Instead, report this accrued interest on Form 1099-INT. A loss from a closing transaction on a forward contract must be shown as a negative amount by enclosing it in parentheses.

Box 3.—Gross amounts received by a member or client of a barter exchange for goods or services. This includes cash received, property or services received, a credit on your books, or scrip issued.

Box 4.—Amounts for backup withholding. For example, persons who have not furnished their taxpayer identification number to you in the manner required are subject to withholding at a 20% rate on certain amounts required to be reported on this form.

Box 5.—A brief description of the disposition item, e.g., 100 shares of XYZ Corp. stock, etc. For regulated futures contracts and forward contracts, enter "RFC" or other appropriate description and the amount subject to backup withholding, if any, under A-23 of section 35a.9999-3 of the Temporary Employment Tax Regulations. **Note:** The amount withheld in these situations is to be included in Box 4.

For bartering transactions, show the service or product transaction as recorded in your books or records that gave rise to the barter credit or scrip.

Box 6.—The profit or (loss) realized by the customer on closed regulated futures contracts.

Box 7.—The unrealized profit or (loss) on open regulated futures contracts at the end of the prior year.

Box 8.—The unrealized profit or (loss) on open regulated futures contracts as of December 31, 1984.

Box 9.—The aggregate profit or (loss) for the year from regulated futures contracts.

Form 1099-DIV

File Form 1099-DIV, Statement for Recipients of Dividends and Distributions, for each person (a) to whom you have paid gross dividends and other distributions on stock (Box 1) of \$10 or more, (b) for whom you have withheld and paid foreign tax on dividends and other distributions on stock, if the recipient can claim credit for the tax on his or her income tax return, or (c) for whom you have withheld any Federal income tax under the backup withholding rules regardless of the amount of the payment.

Give a copy to each recipient. See regulations under section 6042 for a definition of dividends.

Note: Certain distributions commonly referred to as "dividends" are actually interest and are to be reported on Form 1099-INT. These include interest, so-called "dividends," on deposit or on share accounts in cooperative banks, credit unions, domestic building and loan associations, domestic and Federal savings and loan associations, and mutual savings banks.

Report In:

Box 1.—Gross dividends and other distributions on stock. The total of amounts in Boxes 2, 3, 5, and 6 should equal this amount. Do not include in Box 1 amounts reported in Boxes 9 or 10.

Box 2.—Dividends qualifying for the dividend exclusion on Forms 1040 or 1040A.

Box 3.—Dividends not qualifying for the dividend exclusion. (Do not include amounts shown in Boxes 5 and 6.)

Box 4.—Amounts for backup withholding. For example, persons who have not furnished their taxpayer identification number to you in the manner required are subject to withholding at a 20% rate on certain dividend payments reported on this form.

Box 5.—Capital gain distributions.

Box 6.—Nontaxable distributions, if determinable. (File Form 5452 for dividends paid from other than earnings and profits.)

Box 7.—Foreign tax withheld and paid on dividends and other distributions on stock. Report this amount in U.S. dollars.

Box 8.—The name of the foreign country or U.S. possession for which the withheld tax applies.

Note: Boxes 9 and 10 only apply to corporations in partial or complete liquidation.

Box 9.—Cash distributed as part of a liquidation. Do not include this amount in Box 1.

Box 10.—Noncash distributions made as part of a liquidation. Show the fair market value as of the date of distribution. Do not include this amount in Box 1.

Dividends on Restricted Stock.—Property transferred to an employee in connection with the performance of services is not taxable until it has become substantially vested. Until such property becomes substantially vested, the transferor is regarded as the owner and any income from the property received by the

employee constitutes additional compensation and is includible in the employee's gross income. In addition, the employee should be provided a Form W-2, Wage and Tax Statement, showing the amount of the additional compensation and any tax withheld. (See Rev. Proc. 80-11, 1980-1 C.B. 616.)

However, property transferred to an employee in connection with the performance of services is treated as substantially vested if the employee elects to include in gross income, for the year the property is received, the excess (if any) of its fair market value (determined without regard to any restrictions other than one that will never lapse) over the amount (if any) paid for the property, as compensation for services. If elected, the employee is regarded as the owner of restricted stock and any dividends paid are not additional compensation to the employee but retain their character as dividends. In this case, a Form 1099-DIV, should be issued to the employee showing the amount of the dividends. (See Rev. Proc. 83-38, 1983-1 C.B. 773 and Rev. Rul. 83-22, 1983-1 C.B. 17.)

S Corporations.

Box 1.—Report as dividends on Form 1099-DIV only distributions made during 1984 out of accumulated earnings and profits (retained earnings). (See section 1368 for more information.)

Form 1099-G

File Form 1099-G, Statement for Recipients of Certain Government Payments, if you have made payments as a unit of a Federal, state, or local government.

Report In:

Box 1.—Payments of \$10 or more in unemployment compensation including Railroad Retirement Board payments for unemployment.

Box 2.—Refunds, credits, or offsets of state or local income tax of \$10 or more you made to recipients. If recipients deducted the tax paid to a state or local government on their Federal income tax returns, any refunds, credits, etc., may be taxable to them. However, if you can ascertain that the taxes paid were not deducted on the recipient's Federal income tax return, you are not required to include amounts in this box.

Refunds, credits, or offsets attributable to an income tax that applies exclusively to income from a trade or business and is not a tax of a general application should be identified by a capital "X" after the amount.

Box 3.—No entry is required in Box 3 if the refund, credit, etc., is for the 1983 tax year. If it is for any other tax year, enter the year of the refund, credit, etc., in this box. Also, if the refunds, credits, etc., are for more than one tax year, report the amount for each year on a separate Form 1099-G.

Box 4.—Amounts for backup withholding. For example, persons who have not furnished their taxpayer identification number to you become subject to withholding at a 20% rate on payments required to be reported in Boxes 6 or 7 on this form.

Box 5.—Any amount in excess of \$600 that was owed to the Federal Government and that has been declared uncollectible as a result of:

- (1) a defaulted obligation, not in dispute;
- (2) Federal statute expiration for collection of debt; or
- (3) formal compromise agreement.

If an amount less than the amount owed is accepted as payment in full, enter the difference between the amount of the debt and the settlement amount in Box 5. The discharge or forgiveness of indebtedness is taxable income to the person originally liable for that amount.

Do not include any obligation discharged in a Title 11 bankruptcy case, for a debtor known to be insolvent or a qualified business indebtedness.

Box 6.—Amounts of taxable grants of \$600 or more given to recipients during the year. A Federal grant is ordinarily taxable unless stated otherwise in the legislation authorizing the grant.

Box 7.—U.S.D.A. agricultural subsidy payments made to recipients during the year. Since the Department of Agriculture reports these payments on magnetic media, this box will ordinarily be used by persons receiving subsidy payments (including payments-in-kind (PIK) converted to cash) as nominees for another person. Nominees file Form 1099-G to report the actual owner of the payments.

Form 1099-INT

File Form 1099-INT, Statement for Recipients of Interest Income, for each person (a) to whom you paid amounts reportable in Box 1 of at least \$10 (except for the \$600 limit described in the instructions below in Box 1), (b) for whom you withheld and paid foreign tax on interest if the recipient can claim credit for the tax on his or her income tax return, or (c) for each person from whom you withheld any Federal income tax under the backup withholding rules regardless of the amount of the payment. Give a copy to each recipient. If you have furnished Forms 1099-INT to a recipient for amounts received during the year on a transactional basis, for example, window transactions, do not include these same amounts in a 1099-INT furnished to the same recipient for other payments during the year.

Only report interest payments made in the course of your trade or business (including Federal, state, and local governmental agencies and activities deemed nonprofit) or for which you were a nominee/middleman or from which you withheld Federal income tax or foreign tax.

Note: Do not report tax-exempt or tax-deferred interest, such as interest on municipal bonds or interest that is earned but not distributed from an individual retirement arrangement (IRA).

Report In:

Box 1.—Amounts, whether or not designated as interest, that are paid or credited to any person's account by savings and loan associations, mutual savings banks not having capital stock represented by shares, building and loan associations, cooperative banks, homestead associations,

credit unions, or similar organizations. Include interest on bank deposits, indebtedness (including bonds, debentures, notes and certificates) issued in registered form or of a type offered to the public, or from which you withheld Federal income tax or foreign tax. Also include payments of interest made in the course of your trade or business not meeting these criteria if they total \$600 or more for any person.

Also show original issue discount on short-term obligations of one year or less and interest on all bearer certificates of deposit.

Box 2.—Amounts of interest reported on Form 1099-INT in any year which were later forfeited due to premature withdrawal of time deposits, and are deductible by the recipient from gross income. The forfeiture may include principal. The amount in Box 1 should not be reduced by the forfeiture.

Box 3.—Amounts for backup withholding. For example, persons who have not furnished their taxpayer identification number to you in the manner required become subject to withholding at a 20% rate on payments required to be reported in Box 1 (which may be reduced by the amount reported in Box 2) on this form.

Box 4.—Foreign tax withheld and paid on interest (applicable only to taxes eligible for the recipient's foreign tax credit). Report this amount and the amounts in Boxes 1, 2, 3, and 4 in U.S. dollars.

Box 5.—The name of the foreign country or U.S. possession for which the withheld tax applies.

Do not include in Box 1 interest on tax-free covenant bonds, which is reportable on Form 1042S.

Form 1099-MISC

File Form 1099-MISC, Statement for Recipients of Miscellaneous Income, for each person, other than corporations (Box 6 items must be reported to corporations), to whom you have paid at least \$600 (unless a different amount is indicated below) in rents, royalties, and other payments reportable on the form, or from whom you have withheld any Federal income tax under the backup withholding rules regardless of the amount of the payment. Give a copy to each recipient. Only report payments made in the course of your trade or business (including Federal, state, or local governmental agencies and activities deemed nonprofit) or for which you were a nominee/middleman or from which you withheld Federal income tax or foreign tax.

Report in:

Box 1.—Amounts paid to recipients for all types of rents, such as real estate rentals paid for office space, machine rentals (for example, hiring a bulldozer to level your parking lot), and pasture rentals (for example, farmers paying for the use of grazing land). If the machine rental is a part of a contract that includes both the use of the machine and the operator, the rental should be prorated between the rent of the machine (reported in Box 1) and the operator's charge (reported as nonemployee compensation in Box 7).

Box 2.—Gross royalty payments before reduction for severance and other taxes which may have been withheld and paid. Do not include surface royalties. They should be reported in Box 1.

Box 3.—Prizes and awards that are not for services rendered. Prizes or awards for services rendered by employees should be reported on Form W-2. Prizes and awards for services rendered by nonemployees (an award for the top commission salesperson) are reported in Box 7.

Box 4.—Amounts for backup withholding. For example, persons who have not furnished their taxpayer identification number to you become subject to withholding at a 20% rate on payments required to be reported in Boxes 1, 2 (net of severance taxes), 3, 5 (to the extent paid in cash), 6, and 7 on this form.

Box 5.—The share of all proceeds from the sale of a catch or the fair market value of a distribution in-kind to each crewmember of fishing boats with normally fewer than 10 crewmembers.

Box 6.—Payments by medical and health care insurers to each physician or other supplier or provider of services (list the corporation as the recipient rather than the individual providing the services) under health, accident, and sickness insurance programs. (See Rev. Rul. 69-595, 1969-2 C.B. 242, and Rev. Rul. 70-608, 1970-2 C.B. 286.)

The exemption for issuing Form 1099-MISC to a corporation does not apply to corporations that provide medical or health care services.

Box 7.—Nonemployee compensation. Include fees, commissions, prizes, awards, or other forms of compensation for services rendered for your trade or business by an individual who is not your employee. Also include expenses incurred for the use of an entertainment facility that you treat as compensation to a nonemployee.

Note: In order to qualify for relief under section 530 of the Revenue Act of 1978 as extended by Pub. L. 97-248, employers may file Form 1099-MISC. Additional requirements for relief are discussed in Publication 15, *Employer's Tax Guide*.

Box 8.—Report sales by you of \$5,000 or more of consumer products to a person on a buy-sell, deposit-commission, or other basis for resale by simply checking the box in Box 8. No dollar amount is needed.

The report required to be given to the recipient for these direct sales need not be made on the official form. It may be in the form of a letter showing this information along with commissions, prizes, awards, etc.

Also see Magnetic Media Reporting on page 2 of these instructions.

Form 1099-OID

File Form 1099-OID, Statement for Recipients of Original Issue Discount, if you are any of the following: (1) an issuer with any bond outstanding or other evidence of indebtedness in registered or bearer form issued with original issue discount; (2) an issuer of certificates of deposit made, purchased, or renewed after December 31, 1970, if there is original issue discount of at least \$10 and the term of the obligation or deposit is more than one year; or (3) a financial institution having other deposit arrangements, such as time deposits or bonus-savings plans having a term in excess of one year provided the payment of interest is deferred until maturity.

Issuers that do not use actual dates of ownership by holders in computing the discount are permitted to prepare a Form 1099-OID only for each person who is a holder of record of the obligations on the semiannual record date, if any, used by the corporation or its agent for the payment of stated interest, or if there is no such date, on June 30, and December 31. On each Form 1099-OID, you should treat each holder as holding the obligation on every day it was outstanding during the calendar year. However, for time deposits and face-amount certificates use the actual date of deposit to compute original issue discount.

Also, file Form 1099-OID in any case in which you are required to deduct and withhold taxes (including backup withholding) even if the amount of the OID is less than \$10. Give a copy to each recipient. Original issue discount on obligations with a term of one year or less should be reported on Form 1099-INT.

"Original issue discount" means the difference between the stated redemption price at maturity and the issue price. A discount of less than one-fourth of 1% of the stated redemption price at maturity, multiplied by the number of full years from the date of issue to maturity, is considered to be zero.

Ordinarily, you will file only one Form 1099-OID for the depositor or holder of a particular obligation for the calendar year. If a person holds more than one discount obligation, issue separate Forms 1099-OID for each obligation. However, if a person holds more than one certificate of the same issue for the same period of time during the calendar year, and if Form 1099-OID amounts are proportional, you may treat all such certificates as one discount obligation and file a single Form 1099-OID.

For time deposits and face-amount certificates, use the actual date of deposit and compute original issue discount on a straight line, monthly prorated basis for obligations issued before July 2, 1982, and on a daily prorated basis for obligations issued after July 1, 1982.

Publication 1212, List of Original Issue Discount Obligations, contains information on outstanding publicly traded discount obligations.

long-term obligations issued in 1984 should attach a statement to Form 1096. The statement should show for all obligations issued in 1984 (and any obligations not included in last year's statement) to which original issue discount applies:

- (1) The name of the issuer,
- (2) The issue date,
- (3) The maturity date,
- (4) The coupon or annual stated interest rate,
- (5) The issue price as a percentage of principal amount, and
- (6) The CUSIP number.

This information will enable the IRS to update Publication 1212.

Report in:

Box 1.—The total original issue discount for the year that is reportable on the obligation covered by this return.

Box 2.—The regular interest paid on this obligation during this year. This is the stated periodic interest paid without regard to any original issue discount. Interest reported here must not be reported on Form 1099-INT.

Box 3.—Any interest forfeited by the holder of the obligation because of an early redemption. Amounts in Boxes 1 and 2 should not be reduced by the forfeiture. It must be reported as interest paid or credited and ALSO as interest forfeited.

Box 4.—Amounts for backup withholding. For example, persons who have not furnished their taxpayer identification number to you in the manner required become subject to withholding at a 20% rate on amounts required to be reported in Boxes 1 and 2 (which may be reduced by the amount reported in Box 3) if there are payments made during the year on these obligations.

Box 5.—The abbreviation for the stock exchange, the abbreviation for the issuer used by the stock exchange, the coupon rate, and the year of maturity (e.g., NYSE XYZ 12½ 87).

Form 1099-PATR

File Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives, for each person to whom the cooperative has paid at least \$10 in patronage dividends and other distributions described in section 6044(b), or from whom you withheld any Federal income tax under the backup withholding rules regardless of the amount of the payment. Give a copy to each recipient. A cooperative determined to be primarily engaged in the retail sale of goods

living, or family use of the members, may ask for and receive exemption from certain IRS reporting requirements. See Regulations section 1.6044-4(b) for information about how to apply for this exemption.

Report dividends paid on cooperatives' capital stock on Form 1099-DIV.

Report in:

Box 1.—The total patronage dividends paid in cash (qualified or "consent" checks), qualified written notices of allocation (face amount), and other property.

Box 2.—The total nonpatronage distributions paid in cash (qualified or "consent" checks), qualified written notices of allocation (face amount), and other property. This box is applicable only to farmers' cooperatives qualifying under section 521.

Box 3.—The total per-unit retain allocations paid in cash, qualified per-unit retain certificates (face amount), and other property.

Box 4.—Amounts for backup withholding. For example, persons who have not furnished their taxpayer identification number to you in the manner required become subject to withholding at a 20% rate on payments required to be reported in Boxes 1, 2, 3, and 5 to the extent such payments are in cash or qualified check. See A-10 of section 35a. 9999-3 of the Temporary Employment Tax Regulations for more information on distributions by cooperatives.

Box 5.—All redemptions of nonqualified written notices of allocation issued as patronage dividends, nonqualified written notices of allocation issued as nonpatronage allocations (applicable only to farmers' cooperatives qualifying under section 521), and nonqualified per-unit retain certificates, issued with respect to marketing.

Pass-through Credits.—Report in the appropriate boxes the patron's share of unused credits that the cooperative is passing through to this patron:

- Box 6.**—Investment credit.
- Box 7.**—Energy investment credit.
- Box 8.**—Jobs credit.

Form 1099-R

Because Form 1099-R, Statement for Recipients of Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, etc., is transmitted to IRS using Form W-3G, Transmittal of Certain Information Returns, instructions for Form 1099-R are contained in Form W-3G.

Form 5498

File Form 5498, Individual Retirement Arrangement Information, with the IRS on or before February 28, 1985, for each person from whom you received contributions during 1984 to an individual retirement arrangement (IRA) or a simplified employee pension (SEP). Also file for each person from whom you received qualified deductible voluntary employee contributions (DEC's) to a plan maintained by an employer.

Report the contributions received during 1984 without regard to whether the participant designated them for 1983 or 1984.

Report in:

Box 1.—Regular contributions to an IRA, SEP, or DEC during 1984.

Box 2.—Rollover contributions made to an IRA, SEP, or DEC received by you during 1984.

For reporting purposes, contributions and rollovers do not include direct transfers between trustees (or issuers) that involve no payment or distribution of funds to the participant.

Trustees and issuers of IRA's and SEP's must provide participants with the following information:

- (1) The amount of regular contributions during the calendar year,
- (2) The amount of contributions designated as a rollover,
- (3) In the case of an endowment contract, the amount of the premium paid allocable to the cost of life insurance,
- (4) The name and address of the trustee (or insurer), and
- (5) The value of the participant's account at the end of the year.

Furnish this information to the participant on or before January 31 of the following calendar year. If you wish, you may use Form 5498 to furnish this information to participants. We have provided several blank boxes on Form 5498 for this purpose.

Forms 5498 that show the amount of DEC's the employee made for the calendar year should be furnished to the employee by January 31.

Distributions from IRA's, SEP's, and DEC's will continue to be reported on Forms 1099-R or W-2P.

Guide to Information Returns

You can use the chart below as a quick reference guide to information returns. For details about forms of the 1099 series, please see the separate Instructions for Form 1096.

(See Form W-3G for Form 1099-R instructions.) Do not use the 1099 series to report payments you made to employees; report these on Form W-2 or W-2P. See the

separate Instructions for Forms W-2 and W-2P for details "Other compensation" to be reported on Form W-2 is described in sections 6 and 16 of Circular E.

FORM NUMBER	TITLE	KINDS OF PAYMENTS TO REPORT (Paid by You in the Course of Your Business)	AMOUNTS TO REPORT (Total for Year)	DUE DATE	
				TO IRS	TO RECIPIENT
1099-B	Statement for Recipients of Proceeds from Broker and Barter Exchange Transactions	Sales or redemptions of securities, futures transactions, commodities, bartering exchange transactions.	All amounts	February 28	January 31
1099-DIV	Statement for Recipients of Dividends and Distributions	Distributions, such as dividends, capital gains, or nontaxable distributions, that were paid on stock and distributions in liquidation of \$600 or more.	\$10 or more	February 28	January 31
1099-G	Statement for Recipients of Certain Government Payments	Unemployment compensation, state and local income tax refunds, agricultural payments, taxable grants, and discharge of indebtedness.	\$10 for unemployment and tax refunds; \$600 for all others	February 28	January 31
1099-INT	Statement for Recipients of Interest Income	Interest payments, including interest on bearer certificates of deposit, other than original issue discount and interest on All-Savers Certificate.	\$10 or more	February 28	January 31
1099-MISC	Statement for Recipients of Miscellaneous Income (Also, use this form to report the occurrence of direct sales of \$5,000 or more of consumer goods for resale.)	Rent or royalty payments, payments not made in the course of the recipient's business. Example: prizes and awards, such as winnings on TV or radio shows.	\$600 or more	February 28	January 31
		Payments to crewmembers by owners or operators of fishing boats. Report payments of proceeds from sale of fish.	All payments	February 28	January 31
		Payments to a physician, physicians' corporation or other supplier of health and medical services. Issued mainly by medical assistance programs or health and accident insurance plans.	\$600 or more	February 28	January 31
		Payments for services performed for a trade or business by people not treated as its employees. Examples: fees to subcontractors or directors and expenses incurred for use of an entertainment facility treated as compensation to a nonemployee.	\$600 or more	February 28	January 31
1099-OID	Statement for Recipients of Original Issue Discount	Original issue discount. (Defined in Form 1096 instructions.)	\$10 or more	February 28	January 31
1099-PATR	Statement for Recipients (Patrons) of Taxable Distributions Received from Cooperatives	Distributions from cooperatives to their patrons.	\$10 or more	February 28	January 31
1099-R	Statement for Recipients of Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, etc.	Distributions from retirement or profit-sharing plans or from individual retirement arrangements (IRA's). Use Form 1099-R only if the distribution closed the payee's account.	IRA's: all distributions Others: \$600 or more	February 28	January 31
5498	Individual Retirement Arrangement Information	Contributions (including rollover contributions) to an individual retirement arrangement (IRA), simplified employee pension (SEP), or a plan that accepts qualified deductible voluntary employee contributions (DEC's).	All amounts	February 28	January 31
W-2	Wage and Tax Statement	Wages, tips, other compensation, withheld income and FICA taxes, and advance earned income credit (EIC) payments. Include bonuses, vacation allowances, severance pay, moving expense payments, some kinds of travel allowances and third-party payments of sick pay.	See separate instructions	TO SSA	TO RECIPIENT
				Last day of February	January 31
W-2P	Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments	Retirement payments other than total distributions. If you are the trustee or custodian, include the current insurance premiums you paid.	See separate instructions	Last day of February	January 31

Annual Summary and Transmittal of U.S. Information Returns

OMB No. 1545-0108

1984

Type or machine print PAYER'S name

Street address

City, State and ZIP code

Enter in Box 1 or 2 below the identifying number you used as the payer on the attached information returns. Do not fill in both Boxes 1 and 2.

1 Employer identification number

2 Social security number

3 Total number of documents

4 Number without taxpayer ID numbers

Regular 1099's and 5498's

Nominee/Middleman 1099's

1099 ASC 84	1099 B 79	1099 DIV 91	1099 G 86	1099 INT 92	1099 MISC 95	1099 OID 96	1099 PATR 97	5498 28	1099 ASC 84	1099 B 79	1099 DIV 91	1099 G 86	1099 INT 92	1099 MISC 95	1099 OID 96	1099 PATR 97
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Under penalties of perjury, I declare that I have examined this return, including accompanying documents and to the best of my knowledge and belief, they are true, correct, and complete. In the case of documents without recipients' identifying numbers I have complied with the requirements of the law in attempting to secure such numbers from the recipients.

Signature _____ Title _____ Date _____

Please return this entire page to the Internal Revenue Service.

Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Notice to Payers

Purpose of this Form.—Use this form to transmit Forms 1099 and 5498 to the Internal Revenue Service. However, use Form W-3G to transmit Form 1099-R.

Enter your name, address, and taxpayer identifying number (TIN) in the spaces provided on the form. Individuals not in a trade or business should enter their social security number in box 2; sole proprietors and all others should enter their employer identification number in box 1. However, sole proprietors who are not required to have an employer identification number should enter their social security number in box 2.

Do not submit more than one type of Form 1099 or submit Forms 5498 and Forms 1099 with the same Form 1096.

In box 3, enter the number of documents attached to Form 1096 and check the appropriate box to indicate the type of Form 1099 (or 5498) you are transmitting.

If you are transmitting Forms 1099 as a nominee or middleman for payments you received on behalf of another person, check the appropriate box on the lower right half of this form. If you are required to file both regular Forms 1099 or 5498 and Forms 1099 as a middleman or nominee, use a separate Form 1096 for each category.

If you have one type of Form 1099 (or 5498) that includes forms with TIN's of recipients and others with no TIN's, you may submit them with one Form 1096 if they are bundled separately. Show the total number of documents being transmitted in box 3. Also, show the number of forms without TIN's in box 4.

For more information about where and when to file, etc., see the separate instructions for Form 1096.

If you are filing a Form 1096 for corrected information returns mark over the "X" in the box at the top left corner of this form.

Type or machine print PAYER'S name Street address City, State, and ZIP code Federal identifying number	1 Patronage dividends 3 Per-unit retain allocations 5 Redemption of nonqualified notices and retain allocations	2 Nonpatronage distributions 4 Federal income tax withheld 6 Investment credit	OMB No 1545-0118 1984 Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives For Paperwork Reduction Act Notice and instructions for completing this form, see Instructions for Form 1096. Copy A For Internal Revenue Service Center
Type or machine print RECIPIENT'S name (first, middle, last) Street address City, State, and ZIP code	Recipient's identifying number 8 Jobs credit	7 Energy investment credit	

Form 1099-PATR

Do NOT Cut or Separate Forms on This Page

Department of the Treasury - Internal Revenue Service

☐ 9797 ☐ VOID

For Official Use Only

Type or machine print PAYER'S name Street address City, State, and ZIP code Federal identifying number	1 Patronage dividends 3 Per-unit retain allocations 5 Redemption of nonqualified notices and retain allocations	2 Nonpatronage distributions 4 Federal income tax withheld 6 Investment credit	OMB No 1545-0118 1984 Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives For Paperwork Reduction Act Notice and instructions for completing this form, see Instructions for Form 1096. Copy A For Internal Revenue Service Center
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Form 1099-PATR

Department of the Treasury - Internal Revenue Service

OMB No 1545-0118

1984

Statement for
Recipients (Patrons) of
Taxable
Distributions
Received
From
Cooperatives

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty will be imposed on you if this patronage dividend income is taxable and the IRS determines that it has not been reported.

Copy B
For Recipient

PAYER'S name, address, ZIP code, and Federal identifying number.	1 Patronage dividends	2 Nonpatronage distributions
	3 Per-unit retain allocations	4 Federal income tax withheld
	5 Redemption of nonqualified notices and retain allocations	6 Investment credit
RECIPIENT'S name, address, and ZIP code.	Recipient's identifying number	7 Energy investment credit
	8 Jobs credit	

Form 1099-PATR

Department of the Treasury - Internal Revenue Service

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Department of the Treasury - Internal Revenue Service

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Form 1099-PATR

Department of the Treasury - Internal Revenue Service

Instructions to Recipient

Any amount listed in Box 4 represents backup withholding. For example, persons not furnishing their taxpayer identifying number to the payer become subject to backup withholding at a 20% rate on certain payments shown on the form. See **Form W-9, Payer's Request for Taxpayer Identification Number**, for information on backup withholding and the furnishing of your taxpayer identifying number to the payer. You may take a credit on your income tax return for the tax withheld.

Amounts shown in Boxes 6, 7, and 8 represent unused credits that are being passed through to you by the

cooperative. Take these credits on your income tax return as follows:

Box 6 amounts - On Form 3468 on the cooperative credit line.

Box 7 amounts - On Schedule B (Form 3468) on the cooperative credit line.

Box 8 amounts - On Form 5884 on the flow-through jobs credit line.

☆ U.S. GOVERNMENT PRINTING OFFICE: 1983-390-163 E.I. 11-1897126

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	3 Per-unit retain allocations	4 Federal income tax withheld	
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RECIPIENT'S name, address, and ZIP code.	Recipient's identifying number	7 Energy investment credit	For Paperwork Reduction Act Notice and instructions for completing this form, see Instructions for Form 1096.
	8 Jobs credit		
			Copy C For Payer

Form 1099-PATR

Department of the Treasury - Internal Revenue Service

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