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SHOULD THE EARNINGS OF CO-OPERATIVE  
ASSOCIATIONS BE MADE SUBJECT TO THE  
FEDERAL INCOME TAX?

by

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A Thesis submitted in partial fulfillment  
of the requirements for the  
Degree of

MASTER OF ARTS

in the

DEPARTMENT OF ECONOMICS, POLITICAL SCIENCE  
AND SOCIOLOGY

at the  
University of British Columbia

August, 1947

PREFACE

I should like to express my grateful acknowledgements to Mr. Arthur Wirick of the Co-operative Union of British Columbia for his kind assistance in the interpretation of the present income tax law as applied to co-operatives; to Mr. George Dolsen of the British Columbia Co-operative Wholesale Society for his permitting me to use the files of the Society; to the many who answered my letters of enquiry and supplied me with information; to Dr. R. M. Clark under whom this thesis was written and who provided much helpful advice and criticism; and to Mrs. H. Foster who typed this thesis.

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Introduction.

- I        The Essentials of a Co-operative.
- II       Co-operative Development in Canada.
- III      The Business Methods of Co-operatives and the  
          Relation of Tax Discrimination to Co-operative  
          Plant Values.
- IV       The Canadian History of the Taxation of  
          Co-operatives and the Growth of the Controversy  
          Over the Application of the Income War Tax Act  
          to Co-operative Associations.
- V        The Particular Application of the Canadian Income  
          War Tax Act to Co-operative Associations before  
          the 1946 Amendments.
- VI       The Report of the 1919 British Royal Commission on  
          Income Tax, and the Report of the 1932 British  
          Parliamentary Committee Inquiring into the  
          Position of Co-operative Societies in Relation  
          to the Income Tax.
- VII      The Report of the Canadian Royal Commission of  
          Co-operatives.
- VIII     The Present Tax Status of Co-operatives in Canada  
          as Compared with their Position in Great  
          Britain and Foreign Countries.
- IX       An Analysis of the Arguments put Forward by Co-  
          operatives and Their Competitors Regarding the  
          Subjection of the Earnings of Co-operative  
          Organizations to Income Tax.
- X        Conclusions.

This thesis attempts to give an equitable and just answer to the problem of subjecting the earnings of co-operative associations to the federal income tax. The first three chapters discuss the nature of a co-operative per se, the development of the co-operative movement in Canada, the financial and business methods of Canadian co-operatives and the effect which the accumulation of tax-free reserves had had upon co-operative plant values. Chapters IV and V trace the Canadian history of the controversy over co-operative income taxation, and explain the particular application of the Income War Tax Act to co-operative associations before the 1946 amendments. The next two chapters examine the recommendations of three government bodies - two in Great Britain and one in Canada - which have wrestled with the question of subjecting co-operative earnings to income taxation. Chapter VIII explains the present Canadian tax law as it applies to co-operatives and compares it to the laws found in Great Britain and certain foreign countries. Chapter IX consists of an examination of the chief arguments advanced by both the advocates of co-operative income taxation and the defenders of co-operatives from such taxation.

It will be noted that the problem is dealt with statistically, historically and theoretically. Such a three sided attack is necessary if just conclusions are to be set forth.

## INTRODUCTION

During the War an intensive controversy arose in Canada over the status of co-operative organizations in regard to the Federal War Income Tax Act. While this controversy has been of recent origin in our country, it has been a moot question for many years in other lands. It is likely that the dispute came to a head in Canada because of the heavy wartime taxes levied on private business, and because of ambiguities in Section 4(p) of the Income War Tax Act. Any individual or group of individuals, who were felt by other individuals or groups, to be unfairly exempt from income tax naturally were the recipients of severe criticism from those in the country suffering the most from taxation. Co-operatives found themselves in the position of being considered unfairly exempt from income taxation.

In the following pages an attempt is made to give a comprehensive picture of the various aspects of the Canadian co-operative movement having a bearing on the question of the subjection of the earnings of co-operative organizations to federal income tax. In order to do this an effort has been made at the start to indicate the essential nature of a co-operative, and to show the various ways in which it differs from a joint stock company. Once this has been done, it is necessary that a picture be presented of the over-all co-operative development in Canada. No sensible

approach to the problem can be taken unless the peculiar sectional development of the Canadian movement is fully understood. The fruit associations of British Columbia, the Prairie Wheat Pools and the purchasing associations of Nova Scotia all form a part of a regional scheme. It is also important that co-operative development be examined relative to the development of other forms of business organization. Too many people have noted only the absolute increase in the volume of co-operative trade. They either have not taken the trouble, or have not wished to take the trouble to compare increases in co-operative trade with increases in the national income, and with increases in the trade of other private business organizations.

Chapter III is devoted to an examination of the business methods of various co-operative organizations, both of the marketing and of the purchasing type. An examination is made of the effect of tax discrimination upon the growth of co-operative plant values. This concerns itself principally with the increase in plant values during the War as compared with prewar growth figures. In this way some indication is gained of the effect of tax free reserves upon capital expansion.

To understand the co-operative tax problem it is necessary to know something of the history of the Canadian controversy. Chapter IV, as well as presenting the controversy in

in chronological form, attempts to show how and why it arose. Unfortunately it is extremely difficult to obtain reliable information on this aspect of the work. The particular application of the Income War Tax Act to Canadian co-operatives shows amazing vacillation and may probably be attributed in large measure to the ambiguity inherent in that part of the Act applicable to co-operative societies.

The foregoing enables a reasonably complete picture of the co-operative movement in Canada, and of its relation to the income tax. Once this has been concluded it is possible to turn to various studies made by impartial groups appointed by governments. These groups have concerned themselves with an investigation of the tax status of co-operatives. The findings of a British Royal Commission and of a British Parliamentary Committee are presented. A notable feature of their respective reports is the disagreement observed in the first as compared with the unanimity found in the second. The British situation is of interest because at the time of the appointment of the Commission in 1919, English co-operatives were experiencing somewhat the same growth as may be noted in the Canadian movement at the present time. However, in examining the British solution to the problem, two or three things should be kept in mind. The movement in the United Kingdom has been primarily a consumers' movement, and as such

its members have not suffered the extreme price fluctuations of the primary producers who comprise the bulk of the membership in Canadian societies. Secondly, it must be remembered that the financial methods of British associations differ considerably from the Canadian. The former finance mainly by the sale of additional shares, and through loans and deposits from members; the latter have come more and more to finance through the retention of patronage dividends as in the case of consumers' associations, and the withholding of part of the gross proceeds from the sale of a member's product as in the case of marketing associations.

No better source for information on the Canadian co-operative movement can be found than the Report of the Royal Commission on Co-operatives.<sup>1</sup> A Canadian Royal Commission was appointed in 1944 to look into the whole question of the exemption of co-operative organizations from federal income tax under Section 4(p) of the Income War Tax Act. The five man Commission held hearings from Vancouver to Halifax, and later visited the United Kingdom and the United States. This body presented its report in 1945 and the conclusions of this study are outlined and commented upon.

The Canadian Government incorporated many of the recommendations found in the Report of the Royal Commission on Co-operatives. As a result, old Section 4(p) of the Act was

1. Ottawa, King's Printer, 1945.



repealed, and a new Section 4(p) substituted. The great surprise of this new legislation was the provision for a tax on 3 per cent of the capital employed. This special tax was levied inspite of the fact that the Commission unanimously rejected consideration of a special tax as being outside the scope of the body's inquiry.<sup>1</sup> An attempt is made to analyze the reasons for this special tax on co-operatives, and to discover its application under varying circumstances. In order to find out if any relatively uniform pattern exists in co-operative taxation, a study has been included of the tax laws in various European countries and in the United States with reference to their particular application to co-operatives.

Finally, it is essential that an analysis be made of the arguments advanced by both the spokesmen of co-operatives and of their competitors with regard to the taxation of co-operatives. This centers around the theoretical justification for the exemption of co-operatives from income tax on the one hand, and for the subjection of co-operatives to income tax on the other. This is important in helping us to reach fair and equitable basis on which co-operatives may be made subject to income tax.

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1. R. C. C., p. 38

CHAPTER I

THE ESSENTIALS OF A CO-OPERATIVE

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In order to examine the validity of the exemption of co-operative organizations from the corporate income tax, it is first necessary that the essential features of the co-operative form of organization be made clear. This chapter aims to set out those features in order that a clear distinction be drawn between a bona fide co-operative organization and a joint stock company.

As Ivan V. Emelianoff's Economic Theory of Co-operation points out, to do this the nature of co-operatives must be satisfactorily explained in the light of all the forms which they have taken throughout the world. In order to meet this demand, a basis other than the widely publicized "Rochdale Principles" must be found. While generally accepted in England and on this Continent, the "Rochdale Principles" are not essential to the co-operative form of organization.

In the Economic Theory of Co-operation Mr. Emelianoff appears to have satisfactorily explained the nature of co-operation. In reality, he points out a co-operative association is an aggregate of economic units, either of the pro-

ducing or of the consuming type. Only farmers, fishermen, householders and the like - units which perform an economic function in their own right - can be members of a co-operative. The membership of any co-operative association is definitely limited to the number of possible buyers or sellers in the field where the association is operating. On the other hand, a joint stock company is a fusion of economic fractions. The entrepreneurial risks are borne by a body of shareholders, and individual shareholders may simply be regarded as fractions of the entrepreneurial whole. A co-operative is termed an aggregate because the members of the association retain their individual identity. Shares in a co-operative are identified with individuals. Shareholders must be admitted to membership, and transfers of shares must be approved by the association. Essentially, a co-operative organization is an agency through which a group of economic units coordinate certain of their economic activities. A joint stock company is termed a fusion of economic fractions because its stockholders are not necessarily economic units in their own right. For example, a shareholder in an elevator line organized as a joint stock company, does not have to be a wheat farmer. On the other hand, shareholders in a wheat pool must be wheat farmers. The medium through which individual shareholders of a joint stock company find expression is the

general meeting of the company. Their opinion is expressed by voting. They vote in proportion to the number of shares which each owns. Shareholding in a joint stock company is not under supervision either by the company, or the directors which means that shares are easily transferable and may be held by anyone. Every fraction functions as the whole and so is strictly subordinated to the whole. Essentially, a joint stock company is an organization in which an individual invests his money in order to obtain a profit.

#### PROPORTIONALITY

The financial operations peculiar to a co-operative are based upon the individuality of the members. The maintenance of individual identity is achieved by means of the principle of proportionality.

Where possible, members finance co-operative associations in proportion to the volume of business which each expects to do through the association. If a member of a consumers co-operative buys through the association one per cent of the goods handled by the association, it is commonly considered in co-operative circles that he should have been required to contribute one per cent of the capital required by the co-operative. However, in certain circumstances, it may be impossible to anticipate the amount of business which each member may do. In such cases individuality is main-

tained by a provision for the payment of a dividend on capital stock. In Canada, the maximum for such a payment varies between five and eight per cent. Where a member has advanced less capital to the association than is warranted by the volume of his transactions, he is actually using a part of the services provided by the advances contributed by other members. Where a member has advanced more than is warranted by the volume of his transactions, then other members are making use of his contributions in order to carry on their transactions. A dividend on stock actually represents some consideration paid by those members who underestimated their volume of transactions, and therefore their advances, to members who overestimated their volume of transactions and therefore their advances. The members of the association who correctly anticipated their volume of transactions, and therefore contributed a proper proportion of the capital, are neither the payees nor the recipients of such a consideration. Dividends on stock eliminate any maladjustments among the members of the association which might have arisen because of lack of proportionality between money advanced and volume of transactions carried on through the association.<sup>1</sup>

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1. This is true either if the members did the same volume of sales each year, or, if individual capital contributions changed each year in the same ratio as transactions.

Any surplus which might exist is distributed as a patronage dividend, or credited as allocated reserves, to each member in proportion to the volume of business done by him through the association, instead of in proportion to the amount of capital subscribed by each member as is true in a joint stock company. With regard to member business, a large part of the surplus of an association arises on account of this member business through underpayments, as in the case of marketing associations, or overcharges, as in the case of a purchasing association. Once declared, a patronage dividend could be likened to an "account receivable" on the books of the member and an "account payable" on the books of the association.

#### THE ROCHDALE PRINCIPLES

In spite of the fact that a co-operative is an aggregate of economic units and the one vital principle of its operations is proportionality, the "Rochdale Principles" are often accepted as the criteria of a true co-operative organization. These principles are:

1. Goods to be sold at market prices,
2. Cash transactions only,
3. The number of shares owned by any one person is limited,
4. Dividends on stock may not exceed the prevailing rate of interest,
5. Distribution of patronage dividends in proportion to the volume of business done by each member through the association,
6. Provision for democratic control -- one member, one vote.

Only the provision for democratic control requires comment. There is usually homogeneity of membership in co-operative organizations -- in fact, laws governing the organization of credit unions demand homogeneity of membership. Provincial laws applying to credit unions require that members have a common occupational bond or that they reside in the same general district or neighborhood. However, where co-operatives have a heterogeneous membership, it would seem to be more in accord with our governing principle of proportionality if voting were in accord with the volume of business transacted through the association. This would be especially applicable where there were wide deviations between members in the use which they made of the association. All provincial legislation in Canada though, asserts that a necessary prerequisite of a co-operative association is that each member of that association shall have only one vote.



CHAPTER II

CO-OPERATIVE DEVELOPMENT IN CANADA

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With the exception of the farmers' wheat pools and the Antigonish movement, Canadian co-operatives have apparently seldom been considered an important part of Canadian economic life. On the whole the growth of the co-operative movement in Canada has been slow, but a more rapid growth has been discernible during the past few years.

Those who turned first to co-operation were the ones who were hardest hit by price fluctuations -- the primary producers. Farmers found they had to buy their farm and household supplies at prices that were high relative to those received for their produce. In an effort to overcome this disadvantage many turned to co-operative marketing of their farm products. This placed the emphasis of co-operative development upon producer rather than consumer co-operatives.

The first consumer co-operatives in Canada were organized during the latter part of the nineteenth century but none was successful.<sup>2</sup> The only exception was the British-Canadian Co-operative Society Limited, of Sidney Mines, Nova Scotia.

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1. This chapter aims only at giving a sketchy picture of co-operative development in various fields in Canada. A comprehensive picture has not been attempted.
  2. Stewart, Rosemary G., THE PLACE OF THE CO-OPERATIVE MOVEMENT IN THE CANADIAN ECONOMY, B.A. Thesis, University of British Columbia.

This association followed Rochdale principles to the letter<sup>1</sup> and in 1943 had a volume of sales amounting to \$1,500,000.

Agricultural co-operation had its beginnings in the pioneer settlements. However, the commercial agriculture of recent years changed the form of group activity although the co-operative principles remained. In such a commercial agricultural economy the disadvantages of the unorganized farmer gave emphasis to the development of producers' co-operation. Table I indicates how marketing co-operatives have continued to dominate the Canadian co-operative scene.

TABLE I - MARKETING OF PRODUCE AND PURCHASES OF SUPPLIES AND MERCHANDISE AS PERCENTAGES OF THE BUSINESS OF CANADIAN CO-OPERATIVES, Years ending July 31st.

| Year    | Marketing of Produce | Purchases of Supplies <sup>2</sup> |
|---------|----------------------|------------------------------------|
| 1932-33 | 93                   | 7                                  |
| 1933-34 | 95                   | 5                                  |
| 1934-35 | 94                   | 6                                  |
| 1935-36 | 92                   | 8                                  |
| 1936-37 | 91                   | 9                                  |
| 1937-38 | 87                   | 13                                 |
| 1938-39 | 90                   | 10                                 |
| 1939-40 | 91                   | 9                                  |
| 1940-41 | 89                   | 11                                 |
| 1941-42 | 85                   | 15                                 |
| 1942-43 | 86                   | 14                                 |
| 1943-44 | 89                   | 11                                 |

2. This percentage includes figures for consumers' co-operatives.

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Source: Report of the Royal Commission on Co-operatives, 1945, p.79.

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1. Stewart, Rosemary G., Ibid p.27.

### CONSUMER CO-OPERATION

Early attempts at consumers' co-operation appear to have failed due to the inability of both members and management to understand the principles of co-operation and to develop co-operative federations with the economies of bulk purchases. When members felt they were not receiving the economies that they thought they should, many were disappointed and disloyal to the association. In addition, the inability to obtain sound, efficient management had a depressing effect on growth. Unsound financial structure was also a major factor in many failures. A great many associations lacked sufficient working capital to carry on the day to day operations of the business. According to a pamphlet entitled "Co-operative Purchasing Associations in the Province of Saskatchewan, 1914-1938", 1091 co-operative purchasing associations were incorporated in Saskatchewan during that period. By December 31st, 1934, 531 of these associations had dissolved. 23 per cent of these dissolutions represented associations which had never been commercially active. Of the actual failures, 21.5 per cent were caused by mismanagement arising from over-extended credit, poor accounting and insufficiently qualified officials. Lack of interest accounted for 17.1 per cent of the dissolutions.<sup>1</sup>

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1. Regina: Department of Agriculture, 1941.

In large centres and in more thickly populated areas, the competition of the chain store proved to be too much for the younger and financially weaker co-operatives. Thus, consumer co-operatives have grown most rapidly in the rural areas where chain stores have not penetrated and where a more or less homogeneous population has provided a loyal membership. Table II indicates this rural predominance.

TABLE II - CO-OPERATIVE RETAIL STORES IN CANADA, 1941.

|  | <u>Number</u> | <u>Amount</u>       | <u>Sales</u><br><u>Per Cent</u><br><u>of Total</u> |
|--|---------------|---------------------|--|
|  |               | \$                  |  |
| General Merchandise Stores             | 27            | 3,195,800           | 16.1   |
| Country General Stores                 | 248           | 8,823,200           | 44.5   |
| Grocery Stores (without<br>fresh meat) | 69            | 1,840,600           | 9.3  |
| Combination Stores                     | 53            | 3,370,600           | 17.0   |
| Restaurants                            | 5             | 130,200             | 0.6  |
| Filling Stations                       | 5             | 145,800             | 0.7  |
| Farmers' Supply Stores                 | 17            | 1,048,200           | 5.3  |
| Other Retail Stores                    | 21            | 1,284,600           | 6.5  |
| <b>Total</b>                           | <b>445</b>    | <b>\$19,839,000</b> | <b>100.0</b>                                       |

Source: Eighth Census of Canada, 1941, Vol. X, p.26.

Since 1926 and more especially since the depression and during the war years there has been an increase in consumer retail distribution. The turnover has been in such consumer goods as groceries and dry goods, while in the West farm supplies provide a large proportion of the stock. A general idea of the increase which has taken place over the period from 1930 to 1941 and of the position which co-operatives occupy in relation to the total retail trade is given in Table III (next page).

TABLE III - A COMPARISON OF THE NUMBER AND SALES OF CO-OPERATIVE RETAIL STORES  
IN CANADA for the Years 1930 and 1941.

|                   | No.<br>of Stores<br>1930 | Amount<br>of<br>Sales<br>1930<br>(000) | Per Cent<br>of Total<br>Retail<br>Trade<br>1930 | No.<br>of Stores<br>1941 | Amount<br>of<br>Sales<br>1941<br>(000) | Per Cent<br>of Total<br>Retail<br>Trade<br>1941 |
|-------------------|--------------------------|--|---|--------------------------|--|---|
|                   |                          | \$                                     |   |                          | \$                                     |   |
| Canada            | 282                      | 15,647.9                               | 0.6   | 445                      | 19,839.0                               | 0.6   |
| Prince Edward Is. | 0                        | 0                                      | 0   | 5                        | 59.0                                   | 0.4   |
| Nova Scotia       | 17                       | 2,103.7                                | 2.1   | 72                       | 3,434.9                                | 2.1   |
| New Brunswick     | 15                       | 890.7                                  | 1.0   | 18                       | 665.7                                  | 0.7   |
| Quebec            | 13                       | 1,303.5                                | 0.2   | 78                       | 3,248.7                                | 0.4   |
| Ontario           | 71                       | 4,809.1                                | 0.4   | 81                       | 4,478.9                                | 0.3   |
| Manitoba          | 28                       | 689.3                                  | 0.4   | 35                       | 936.4                                  | 0.4   |
| Saskatchewan      | 61                       | 2,991.8                                | 1.6   | 70                       | 2,974.4                                | 1.6   |
| Alberta           | 31                       | 1,288.9                                | 0.7   | 53                       | 2,169.9                                | 1.0   |
| British Columbia  | 46                       | 2,301.4                                | 0.9   | 33                       | 1,881.1                                | 0.6   |

Source: Report of the Royal Commission on Co-operatives, 1945, p.107.

## CREDIT UNIONS

The credit union movement developed in the province of Quebec and the first credit union was organized there in 1900. The movement made little progress outside of the province until the depressed conditions encountered in the thirties, and the belief that credit unions provided a useful method of encouraging people in low income groups to build up savings and provide themselves with a source of credit at low interest rates, tended to spread the movement throughout Canada. Table IV gives some idea of the rapid rate of growth experienced in the last few years; Table V shows that the ratio for 1943 of rural to urban credit unions varies greatly between the provinces; Table VI gives the position of the credit union movement in Canada in 1945.

TABLE IV - STATISTICAL SUMMARY OF THE DEVELOPMENT OF CREDIT UNIONS IN CANADA from 1900 to 1945

| Year | Credit Unions<br>No. | Members<br>No. | Assets      |
|------|----------------------|----------------|-------------|
| 1900 | 1                    | .....          | 26.         |
| 1915 | 91                   | 23,614         | 2,027,728   |
| 1920 | 113                  | 31,752         | 6,306,965   |
| 1925 | 122                  | 33,279         | 8,261,515   |
| 1930 | 194                  | 45,767         | 11,178,810  |
| 1935 | 277                  | 52,045         | 10,173,997  |
| 1936 | 331                  | 62,068         | 11,115,800  |
| 1937 | 441                  | 77,177         | 13,769,468  |
| 1938 | 645                  | 111,012        | 16,835,672  |
| 1939 | 844                  | 151,554        | 20,680,594  |
| 1940 | 1,167                | 201,137        | 25,069,685  |
| 1941 | 1,314                | 238,463        | 31,230,813  |
| 1942 | 1,486                | 295,984        | 43,971,925  |
| 1943 | 1,780                | 374,069        | 69,219,654  |
| 1944 | 2,051                | 478,841        | 92,574,440  |
| 1945 | 2,219                | 590,794        | 145,890,889 |

Source: Report of the Royal Commission on Co-operatives, 1945, p.241. Saskatchewan, Dept. of Co-operation and Co-operative Development, Annual Report, 1946, p.87.

TABLE V - THE NUMBER OF CREDIT UNIONS IN THE DIFFERENT PROVINCES TOGETHER WITH AN ESTIMATE OF THE NUMBER SERVING RURAL AS COMPARED WITH URBAN RESIDENTS, 1943

| PROVINCE             | Total<br>No. | Urban<br>No. | Rural<br>No. |
|----------------------|--------------|--------------|--------------|
| Prince Edward Island | 47           | 5            | 42           |
| Nova Scotia          | 204          | 80           | 124          |
| New Brunswick        | 145          | 48           | 97           |
| Quebec               | 775          | 131          | 644          |
| Ontario              | 163          | 141          | 22           |
| Manitoba             | 80           | 20           | 60           |
| Saskatchewan         | 128          | 35           | 93           |
| Alberta              | 129          | 59           | 70           |
| British Columbia     | 109          | 67           | 42           |
| Canada               | 1,780        | 586          | 1,194        |

Source: Report of the Royal Commission on Co-operatives, 1945, p.241.



TABLE VI

STATISTICAL SUMMARY OF CREDIT UNIONS IN CANADA, 1945

| Province.      | Credit<br>Unions<br>Chartered | Credit<br>Unions<br>Report-<br>ing | Members | Assets                   | Shares    | Deposits    | Loans<br>to<br>Members<br>1945 | Total Loans<br>since<br>Inception |
|----------------|-------------------------------|------------------------------------|---------|--------------------------|-----------|-------------|--------------------------------|-----------------------------------|
|                | No.                           | No.                                | No.     | \$                       | \$        | \$          | \$                             | \$                                |
| Prince Ed. Is. | 52                            | 52                                 | 8,239   | 457,202                  | 323,187   | 111,958     | 250,218                        | 1,081,715                         |
| Nova Scotia    | 218                           | 218                                | 33,645  | 2,567,055                | 2,315,909 | 70,250      | 1,723,097                      | 9,764,292                         |
| New Brunswick  | 155                           | 148                                | 32,168  | 2,614,561                | 2,340,024 | 126,929     | 1,345,698                      | 6,074,410                         |
| Quebec:        |                               |                                    |         |                          |           |             |                                |                                   |
| Desjardins     | 908                           | 908                                | 371,211 | 119,089,459 <sup>1</sup> | 7,367,379 | 107,213,042 | 25,000,000 <sup>2</sup>        | 209,735,698 <sup>3</sup>          |
| Que. League    | 15                            | 9                                  | 2,624   | 552,822                  | 114,330   | 186,414     | 173,999                        | 781,782                           |
| Montreal Fed.  | 9                             | 9                                  | 11,486  | 5,362,558                | 467,324   | 4,648,976   | 1,116,797                      | 1,116,797                         |
| Ontario        | 266                           | 248                                | 53,728  | 6,893,683                | 2,894,638 | 3,324,558   | 4,658,071                      | 24,644,455                        |
| Manitoba       | 100                           | 97                                 | 16,616  | 1,419,972                | 563,740   | 721,784     | 1,303,575                      | 3,331,833                         |
| Saskatchewan   | 172                           | 172                                | 25,563  | 3,715,813                | 2,012,441 | 1,303,599   | 2,488,964                      | 6,060,609                         |
| Alberta        | 179                           | 169                                | 18,128  | 1,512,583                | 1,271,912 | 280,137     | 1,549,792                      | 4,109,037                         |
| Br. Columbia   | 145                           | 145                                | 17,386  | 1,705,181                | 1,433,914 | 147,646     | 1,595,426                      | 3,667,006                         |

Canada, 1945 2,219 2,175 590,794 145,890,889 20,960,798 118,135,293 41,205,637<sup>4</sup> 270,367,628

Canada, 1944 2,051 1,993 478,841 92,574,440 13,011,976 75,694,723 53,008,826<sup>5</sup> 228,922,559

1. Assets, shares and deposits of "Caisses regionales" not included.

2. Estimated loans to members only not including investment loans.

3. Includes approximately \$52,250,000 investment loans since 1926.

4. Does not include investment loans. 5. Includes \$20,006,340 investment loans by Quebec Desjardins in 1944.

Source: Saskatchewan, Department of Co-operation and Co-operative Development,  
Annual Report, 1946, p.87.

AGRICULTURAL CO-OPERATION

Canadian co-operatives have always had more to do with the sale of farm produce than with the purchase or sale of any other type of commodity. In the West, co-operation started with the organization of the Grain Growers Grain Company in 1906. Since that time the amount of agricultural co-operation has steadily grown until between 1933 and 1944 the dollar value of products marketed through co-operative channels fluctuated between 19.5 per cent and 27.9 per cent of the total cash income from the sale of farm products. This is indicated in Table VII. Table VIII indicates the large percentage which grain and seed makes up of the total value of commodities marketed through co-operative associations.

TABLE VII - DOLLAR VALUE OF CO-OPERATIVE MARKETING AS A PERCENTAGE OF CASH INCOME FROM THE SALE OF FARM PRODUCTS FOR ALL CANADA

| Year | All Products | All Products        |
|------|--------------|---------------------|
|      |              | Less Grain and Seed |
| 1933 | 26.9         | 13.3                |
| 1934 | 26.6         | 9.8                 |
| 1935 | 23.0         | 11.7                |
| 1936 | 25.0         | 11.3                |
| 1937 | 24.3         | 10.7                |
| 1938 | 20.2         | 11.1                |
| 1939 | 25.0         | 13.4                |
| 1940 | 27.9         | 14.6                |
| 1941 | 23.5         | 12.2                |
| 1942 | 19.5         | 13.8                |
| 1943 | 21.0         | 15.1                |
| 1944 | 26.2         | 16.2                |

Source: Report Royal Commission on Co-operatives, 1945, p.99

TABLE VIII - GRAIN AND SEED AS A PERCENTAGE OF TOTAL PRODUCE  
MARKETINGS OF CANADIAN CO-OPERATIVES, 1933-1944

| <u>Year</u> | <u>Percentage</u> |
|-------------|-------------------|
| 1933        | 69.0              |
| 1934        | 73.5              |
| 1935        | 66.4              |
| 1936        | 67.4              |
| 1937        | 69.6              |
| 1938        | 60.1              |
| 1939        | 61.5              |
| 1940        | 66.3              |
| 1941        | 63.7              |
| 1942        | 40.6              |
| 1943        | 45.5              |
| 1944        | 57.6              |

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Source: Report Royal Commission on Co-operatives, 1945, p.86.

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Table IX shows the value of products marketed through co-operatives by provinces. The table reveals the large percentage of the total carried on in the Prairie Provinces. This may be attributed to the major position occupied by grain and seed with regard to the whole.

Table X shows the value of commodities marketed by co-operative associations in Canada by commodities. With the exception of grain, seed and fur there has been a steady growth in co-operative marketing activities for the other products. This increase has been notable in every province. Of the commodities indicated, wool is handled on a national basis through the Canadian Co-operative Wool Growers Limited. Other commodities are handled either provincially or regionally.

TABLE IX - VALUE OF PRODUCE MARKETED BY CO-OPERATIVE ORGANIZATIONS IN CANADA,  
1933 - 1944, By Provinces  
(Thousands of Dollars)

| Crop Year<br>Ending In | Canada  | Maritimes | Quebec | Ontario | Manitoba | Saskatchewan | Alberta | British<br>Columbia |
|------------------------|---------|-----------|--------|---------|----------|--------------|---------|---------------------|
| 1933                   | 106,804 | 2,755     | 6,066  | 9,190   | 6,731    | 32,890       | 25,229  | 6,173               |
| 1934                   | 128,909 | 2,746     | 6,175  | 9,206   | 8,902    | 50,677       | 27,395  | 6,939               |
| 1935                   | 117,784 | 2,673     | 8,211  | 11,446  | 8,402    | 45,982       | 20,730  | 7,253               |
| 1936                   | 144,963 | 3,580     | 11,883 | 12,922  | 7,701    | 49,660       | 32,305  | 8,145               |
| 1937                   | 157,031 | 3,472     | 9,502  | 14,646  | 11,172   | 61,571       | 26,763  | 7,887               |
| 1938                   | 134,492 | 4,085     | 11,160 | 16,655  | 19,131   | 21,107       | 33,293  | 8,063               |
| 1939                   | 180,747 | 4,972     | 10,561 | 33,014  | 15,793   | 48,408       | 36,039  | 8,383               |
| 1940                   | 214,293 | 4,340     | 13,885 | 32,513  | 16,175   | 79,024       | 34,537  | 8,649               |
| 1941                   | 215,030 | 4,082     | 18,529 | 28,726  | 20,226   | 70,216       | 37,514  | 8,123               |
| 1942                   | 214,763 | 6,112     | 27,949 | 44,284  | 26,811   | 44,611       | 32,999  | 12,960              |
| 1943                   | 295,499 | 8,189     | 27,949 | 46,047  | 32,075   | 86,082       | 45,944  | 16,925              |
| 1944                   | 459,537 | 10,038    | 32,968 | 51,364  | 61,014   | 159,444      | 78,489  | 19,546              |

Source: Report Royal Commission on Co-operatives, 1945, p.114.

TABLE X - VALUE OF COMMODITIES MARKETING BY CO-OPERATIVE ORGANIZATIONS IN CANADA  
BY COMMODITIES For Years 1933-1944  
(Thousands of Dollars)

| Year | Total<br>Produce<br>(2) | Dairy<br>Products<br>(1) | Fruit<br>and<br>Veget-<br>ables<br>(2) | Grain<br>&<br>Seed<br>(2) | Livestock<br>(1) | Poultry<br>(1) | Honey<br>(2) | Maple<br>Sugar<br>(1) | Tobacco<br>(1) | Wool<br>(1) | Fur<br>(2) |
|------|-------------------------|--------------------------|--|---------------------------|------------------|----------------|--------------|-----------------------|----------------|-------------|------------|
| 1933 | 106,804                 | 12,372                   | 6,002                                  | 73,771                    | 10,066           | 1,809          | 367          | 287                   | 263            | 747         | --         |
| 1934 | 128,909                 | 14,277                   | 6,783                                  | 94,796                    | 17,565           | 2,409          | 238          | 293                   | 6,858          | --          | --         |
| 1935 | 117,784                 | 18,474                   | 7,264                                  | 81,284                    | 18,777           | 2,458          | 594          | 453                   | 9,202          | 758         | --         |
| 1936 | 144,963                 | 16,329                   | 8,603                                  | 97,693                    | 15,371           | 3,283          | 211          | 456                   | 7,693          | 879         | 1,454      |
| 1937 | 157,031                 | 19,004                   | 8,193                                  | 109,355                   | 18,913           | 3,146          | 272          | 668                   | 15,452         | 649         | 1,823      |
| 1938 | 134,492                 | 19,412                   | 8,278                                  | 80,889                    | 16,169           | 4,297          | 203          | 685                   | 17,171         | 615         | 1,639      |
| 1939 | 180,747                 | 18,580                   | 9,125                                  | 111,117                   | 18,775           | 3,130          | 245          | 502                   | 17,758         | 844         | 1,654      |
| 1940 | 214,293                 | 23,637                   | 10,135                                 | 141,981                   | 25,383           | 4,493          | 571          | 839                   | 10,113         | 1,193       | 678        |
| 1941 | 215,030                 | 38,650                   | 9,355                                  | 137,116                   | 40,419           | 7,192          | 710          | 1,138                 | 19,937         | 1,367       | 528        |
| 1942 | 214,763                 | 43,607                   | 15,432                                 | 87,014                    | 62,840           | 10,924         | 727          | 1,138                 | 18,957         | 1,989       | 705        |
| 1943 | 295,499                 | 52,664                   | 19,505                                 | 134,240                   | 82,230           | 15,315         | 530          | 972                   | 18,081         | 1,794       | 761        |
| 1944 | 459,357                 | --                       | 21,093                                 | 264,201                   | --               | --             | 647          | --                    | ---            | ---         | 1,025      |

Source: Report of Royal Commission on Co-operatives, 1945, p.115

(1) Calendar year.

(2) Crop year.

Table XI shows the extent and variety of co-operation in Canada.

TABLE XI - PRODUCTS MARKETED, MERCHANDISE AND SUPPLIES HANDLED BY CO-OPERATIVE BUSINESS ORGANIZATIONS IN CANADA, Crop Year Ended July 31, 1944

|   | <u>Associations</u><br>No. | <u>Value of Sales</u><br>\$ |
|---|----------------------------|-----------------------------|
| Marketing:                              |                            |                             |
| Dairy Products                          | 545                        | 52,664,433                  |
| Fruits & Vegetables                     | 162                        | 21,092,565                  |
| Grain and Seed                          | 96                         | 264,200,667                 |
| Live Stock                              | 250                        | 82,492,637                  |
| Eggs & Poultry                          | 201                        | 15,315,437                  |
| Honey                                   | 5                          | 647,368                     |
| Maple Products                          | 2                          | 972,050                     |
| Tobacco                                 | 7                          | 18,080,820                  |
| Wool                                    | 10                         | 1,794,000                   |
| Fur                                     | 3                          | 1,025,402                   |
| Lumber and wood                         | 11                         | 154,935                     |
| Miscellaneous                           | 21                         | 1,358,484                   |
| Total, Marketing                        | 949                        | 459,798,798                 |
| Merchandising:                          |                            |                             |
| Food Products                           | 331                        | 14,822,120                  |
| Clothing and home furnishings           | 213                        | 2,478,991                   |
| Petroleum products and auto accessories | 561                        | 11,256,372                  |
| Feed, fertilizer or spray material      | 803                        | 25,472,160                  |
| Machinery and equipment                 | 347                        | 811,760                     |
| Coal, wood, building material           | 446                        | 4,312,091                   |
| Miscellaneous                           | 676                        | 6,355,277                   |
| Total, Merchandising                    | 1,271                      | 65,508,771                  |
| Grand Total                             | 1,792                      | 525,307,569                 |

Source: Marketing Service, Economics Division,  
Department of Agriculture, "Co-operation in Canada"  
1944, p.6.

FISHERMEN'S CO-OPERATIVES

This type of co-operative is of fairly recent origin. The first was established in 1924<sup>1</sup> on the Atlantic Coast at Tiginish, Prince Edward Island. Their development has been more rapid and more advanced on the Eastern coast than in British Columbia.

Fishermen's co-operatives are engaged in other activities besides the marketing and processing of fish. On both coasts the fishermen pool their purchases of fishing gear and nets through their marketing associations. Many groups operate co-operative stores which supply the members with household necessities.

By 1942 there was a total of 67 associations with a membership of 4,826 doing an annual volume of sales amounting to \$2,628,380.<sup>2</sup> In 1943-44 a substantial increase was shown in membership and sales, there being 68 associations with an estimated membership of 7,193 doing an annual volume of business of \$5,055,109.<sup>3</sup>

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1. Co-operation in Canada, 1942, p.6
  2. Loc cit.
  3. Co-operation in Canada, 1944, p.3

MUTUAL AND CO-OPERATIVE INSURANCE

Mutual and co-operative insurance has been used by farmers for 75 years to protect their property against fire.<sup>1</sup> Table XII shows that there are roughly 400 such companies in Canada. These companies are of special importance in Ontario and Quebec. In farmers' mutuals, a premium note is given by the insured. He may be required to pay a definite portion of this in cash in advance, or he may be assessed from time to time to provide cash against losses and management expenses. Other mutual fire insurance groups also specializing to a considerable extent in farm risks have a large membership in contrast with local farm mutuals. These include "cash mutuals" which commenced operations on the premium note basis, but are now operating on a cash premium basis as well.

Mutuals operating on both the cash premium and premium note plan are of special importance in Ontario and Western Canada, insuring a large number of farmers. Table XII also reveals the 1943 figures for mutual insurance in Canada. While Quebec has had by far the largest number of companies, Ontario has the largest volume of business.

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1. Department of Agriculture, Economics Division,  
Marketing Service, "Co-operation in Canada, 1942"



TABLE XII - FARMERS' MUTUAL FIRE INSURANCE COMPANIES IN CANADA, 1943

| Province         | Companies<br>No. | Unassessed<br>Premium<br>Note<br>Residue | Net<br>Admitted<br>Assets | Total<br>Liabilities | Net Amount<br>Insurance<br>at Risk | Net Losses<br>Paid 1943 |
|------------------|------------------|--|---------------------------|----------------------|------------------------------------|-------------------------|
|                  |                  | \$                                       | \$                        | \$                   | \$                                 | \$                      |
| Prince Edward I. | 1                | ---                                      | 195,133 <sup>1</sup>      | 3,158                | 14,672,600                         | 17,990                  |
| Nova Scotia      | 5                | 64,114                                   | 467,577                   | 110,033              | 20,797,435                         | 24,037                  |
| New Brunswick    | 5                | 107,320                                  | 56,696                    | 30,334               | 6,126,962                          | 9,181                   |
| Quebec:          |                  |  |                           |                      |                                    |                         |
| County           | 9                | 1,533,142                                | 71,611                    | 28,358               | 24,661,585                         | 45,616                  |
| Municipality     | 77               | --                                       | 108,361                   | 11,221               | 26,251,457                         | 30,089                  |
| Parish           | 234              | 6,082,093                                | 337,508                   | 42,160               | 130,596,709                        | 200,119                 |
| Ontario          | 67               | 15,535,561                               | 6,650,343                 | 1,295,160            | 636,545,069                        | 972,770                 |
| Saskatchewan     | 5 <sup>2</sup>   | 172,080                                  | 997,424                   | 364,877              | 33,379,752                         | 35,420                  |
| British Columbia | 1                | 113,749                                  | 71,938                    | 21,402               | 6,315,281                          | 5,449                   |
| Dominion         | 2                | 1,840,500                                | 5,572,559                 | 2,479,137            | 454,716,271                        | 1,204,262               |
| Total            | 406              | 25,468,559                               | 14,529,150                | 4,385,840            | 1,354,063,121                      | 2,544,933               |

1. Includes unassessed premium note residue.

2. Includes one company which does business in four Western Provinces.

Source: Department of Agriculture, Economics Division, Marketing Service,  
"Co-operation in Canada, 1944", p.9.

TOTAL CO-OPERATIVE BUSINESS AND MEMBERSHIP

As was pointed out before, co-operatives have developed at a steady and rapid pace since the first years of the depression. Table XIII indicates the expansion in numbers, members and volume of business from 1932 through 1945. With the exception of 1943 there has been no move toward the amalgamation of existing societies. This is indicative of the preponderantly rural nature of the Canadian co-operative movement. The Table shows a significant increase in the number of shareholders and in the business per member. Some of the increase in volume of business may be attributed to a higher price level but much can also be attributed to the increasing services and wider range of goods made available by consumers' and farmers' supply co-operatives. We should also realize that the national ~~income~~ <sup>income</sup> increase has virtually tripled over the period. Increasing co-operative education has also been a contributing factor. It is apparent that both co-operative sales of farm products and co-operative purchase of supplies have greatly increased. However, by far the greater relative increase is in the latter. Of interest is the fact that a very high percentage of the patrons are also members of co-operatives.

TABLE XIII - SUMMARY OF ANNUAL STATEMENTS OF NUMBERS, MEMBERSHIP AND BUSINESS OF  
OF CO-OPERATIVE BUSINESS ORGANIZATIONS IN CANADA,  
1932 to 1945

| Year | Associations<br>No. | Places of<br>Business<br>No. | Share-<br>holders<br>or<br>Members<br>No. | Patrons<br>No. | Sales of<br>Supplies<br>\$ | Total Business<br>Including other<br>Revenue<br>\$ |
|------|---------------------|------------------------------|---|----------------|----------------------------|--|
| 1932 | 795                 | 3,501                        | 379,687                                   | 417,000        | 10,665,503                 | 145,303,954  |
| 1933 | 686                 | 3,057                        | 342,369                                   | 376,000        | 8,779,115                  | 115,849,894  |
| 1934 | 690                 | 3,223                        | 345,024                                   | 379,740        | 7,389,034                  | 136,411,483  |
| 1935 | 697                 | 3,301                        | 341,020                                   | 378,730        | 7,991,755                  | 126,064,891  |
| 1936 | 781                 | 3,186                        | 366,885                                   | 406,321        | 12,788,192                 | 158,165,565  |
| 1937 | 1,024               | 3,987                        | 396,918                                   | 451,231        | 16,363,966                 | 173,927,117  |
| 1938 | 1,217               | 4,125                        | 435,529                                   | 462,937        | 20,091,893                 | 155,080,435  |
| 1939 | 1,332               | 3,791                        | 445,742                                   | 486,589        | 20,400,008                 | 201,659,984  |
| 1940 | 1,151               | 3,657                        | 450,453                                   | 462,296        | 21,129,822                 | 236,322,466  |
| 1941 | 1,395               | 4,005                        | 451,685                                   | 507,223        | 25,895,374                 | 242,158,305  |
| 1942 | 1,722               | 4,291                        | 561,314                                   | 620,034        | 42,327,447                 | 257,090,427  |
| 1943 | 1,650               | 4,406                        | 585,826                                   | 608,680        | 55,689,141                 | 352,785,598  |
| 1944 | 1,792               | 4,534                        | 690,967                                   | 719,080        | 65,508,771                 | 527,855,540  |
| 1945 | 1,824               | --                           | 739,604                                   | --             | 81,360,855                 | 585,650,066  |

Source: Department of Agriculture, Economic Division, Marketing Service,  
"Co-operation in Canada, 1944", p.4.

Department of Co-operation and Co-operative Developments, Annual Report, 1946,  
p.84.

Table XIV shows the financial condition of the movement in Canada from 1932 to 1944. For purposes of comparison the excess of assets over general liabilities has been taken. A noticeable decrease in members' equity is shown while there has been a six-fold increase in general liabilities over the period, which may in large measure be explained by the increasingly popular method of financing through loan capital advanced by the members. A comparison of the value of the reserves and surplus reveals a decrease from \$97.00 per member in 1932 to \$82.00 per member in 1944. This drop is partially the result of the large number of new associations which have been incorporated. Their surplus and reserve accounts would, in most cases be quite small or even negligible.

#### PROVINCIAL PATTERN

There remains the problem of showing the position of co-operative associations by provinces. This is done in Tables XV and XVI, which reveal the difference in co-operative growth in each province. If a comparison were made of the varied types of co-operatives, the sectional development would be still more apparent. The differences in rates of development of the various types has naturally been accentuated by the fact that there is no Dominion co-operative legislation, each province having its own.

TABLE XIV - SUMMARY OF THE ANNUAL BALANCE SHEETS AND FINANCIAL CONDITION OF CO-OPERATIVE  
BUSINESS ORGANIZATIONS IN CANADA,  
1932 to 1944

| Year | Total<br>Assets | Value<br>of<br>Plant | General<br>Liabilities | Paid-up<br>Share<br>Capital | Reserves<br>and<br>Surplus | Working<br>Capital <sup>1</sup> | Net Worth in<br>Per Cent of<br>Total Assets |
|------|-----------------|----------------------|------------------------|-----------------------------|----------------------------|---------------------------------|---|
|      | \$              | \$                   | \$                     | \$                          | \$                         | \$                              | %   |
| 1932 | 70,226,288      | 45,607,366           | 22,072,331             | 8,570,488                   | 37,805,137                 | 2,546,691                       | 66.0  |
| 1933 | 90,003,261      | 42,520,970           | 43,005,593             | 8,224,016                   | 38,773,652                 | 4,476,698                       | 52.2  |
| 1934 | 104,350,702     | 40,432,859           | 56,046,004             | 8,722,451                   | 39,590,050                 | 7,871,839                       | 46.3  |
| 1935 | 105,183,565     | 38,850,488           | 55,306,671             | 8,933,425                   | 40,943,469                 | 11,026,406                      | 47.4  |
| 1936 | 85,751,901      | 35,289,468           | 34,665,210             | 8,954,135                   | 42,132,556                 | 15,797,223                      | 59.6  |
| 1937 | 87,938,453      | 36,338,952           | 36,685,625             | 9,265,747                   | 41,987,081                 | 14,913,876                      | 58.3  |
| 1938 | 83,140,697      | 36,569,984           | 33,423,607             | 9,265,391                   | 40,451,699                 | 13,147,106                      | 59.8  |
| 1939 | 86,240,783      | 37,751,641           | 32,973,321             | 9,685,537                   | 43,581,925                 | 15,515,821                      | 61.8  |
| 1940 | 102,685,109     | 38,265,055           | 48,424,694             | 10,155,221                  | 44,105,194                 | 15,995,360                      | 52.8  |
| 1941 | 145,658,904     | 38,567,084           | 92,222,947             | 10,503,077                  | 42,932,880                 | 14,868,873                      | 36.7  |
| 1942 | 128,004,893     | 37,597,916           | 69,964,822             | 12,220,249                  | 45,819,822                 | 20,442,155                      | 45.3  |
| 1943 | 186,634,839     | 36,866,861           | 124,264,085            | 13,091,948                  | 49,278,806                 | 25,503,893                      | 33.4  |
| 1944 | 203,047,911     | 40,664,827           | 130,556,373            | 15,608,150                  | 56,883,388                 | 31,826,711                      | 35.7  |

1. Working capital, as used in this Table, is the excess of assets less value of plant over general liabilities.

Source: Department of Agriculture, Economics Division, Marketing Service, "Co-operation in Canada, 1944", p.5.

TABLE XV - CO-OPERATIVE BUSINESS ORGANIZATIONS BY PROVINCES, Crop Year Ended July 31, 1945

| Province         | Associations | Shareholders<br>or Members | Sales of<br>Products | Sales of<br>Merchandise | Total Business<br>Including other<br>Income |
|------------------|--------------|----------------------------|----------------------|-------------------------|---|
|                  | No.          | No.                        | \$                   | \$                      | \$  |
| Prince Edward I. | 25           | 12,327                     | 3,437,530            | 725,443                 | 4,221,860                                   |
| Nova Scotia      | 83           | 16,242                     | 5,094,063            | 6,407,610               | 11,577,710                                  |
| New Brunswick    | 41           | 8,043                      | 3,565,474            | 2,780,242               | 6,507,790                                   |
| Quebec           | 589          | 61,713                     | 42,034,827           | 20,737,714              | 62,275,269                                  |
| Ontario          | 256          | 57,715                     | 64,929,622           | 13,464,131              | 77,507,707                                  |
| Manitoba         | 95           | 116,043                    | 42,180,099           | 5,586,186               | 47,927,942                                  |
| Saskatchewan     | 496          | 237,842                    | 174,346,888          | 16,449,785              | 191,164,395                                 |
| Alberta          | 146          | 149,196                    | 91,067,024           | 7,764,575               | 99,080,370                                  |
| British Columbia | 87           | 28,675                     | 28,573,519           | 5,788,269               | 35,626,053                                  |
| Inter-Provincial | 6            | 52,008                     | 45,252,581           | 2,156,900               | 47,426,851                                  |
| Total            | 1,824        | 739,604                    | 500,481,627          | 81,360,855              | 585,650,066                                 |

Source: Saskatchewan: Department of Co-operation and Co-operative Development,  
Annual Report, 1946, p.84.

TABLE XVI - FINANCIAL STRUCTURE OF CO-OPERATIVE BUSINESS ORGANIZATIONS BY PROVINCES,  
Crop Year Ended July 31, 1944.

| Province         | Total<br>Assets | Value of<br>Plant | General<br>Liabilities | Paid-up<br>Share Capital | Reserve<br>and Surplus |
|------------------|-----------------|-------------------|------------------------|--------------------------|------------------------|
|                  | \$              | \$                | \$                     | \$                       | \$                     |
| Prince Edward I. | 337,612         | 91,003            | 156,667                | 52,170                   | 128,775                |
| Nova Scotia      | 2,688,757       | 1,039,034         | 1,002,656              | 918,816                  | 767,285                |
| New Brunswick    | 871,693         | 303,354           | 443,856                | 181,456                  | 246,381                |
| Quebec           | 16,392,729      | 7,896,714         | 6,991,640              | 3,091,311                | 6,309,778              |
| Ontario          | 7,996,148       | 3,118,001         | 3,359,374              | 1,646,885                | 2,989,889              |
| Manitoba         | 12,647,242      | 2,665,086         | 8,419,453              | 539,789                  | 3,688,000              |
| Saskatchewan     | 92,193,558      | 12,492,140        | 61,223,062             | 2,703,818                | 28,266,678             |
| Alberta          | 31,649,554      | 4,715,170         | 21,356,887             | 750,962                  | 9,541,705              |
| British Columbia | 10,742,867      | 2,661,987         | 6,341,847              | 2,464,837                | 1,936,183              |
| Inter-Provincial | 27,527,751      | 5,692,338         | 21,260,931             | 3,258,106                | 3,008,714              |
| Total            | 203,047,911     | 40,664,827        | 130,556,373            | 15,608,150               | 56,883,388             |

Source: Department of Agriculture, Economics Division, Marketing Service,  
"Co-operation in Canada, 1944", p.8.

### RELATIVE GROWTH

In order not to create a misleading impression about the growth of co-operatives in Canada during the past two decades, and especially since the war, it is necessary to examine co-operative growth in relation to the growth of other forms of business enterprise. An attempt has been made to give a picture of the development of co-operatives in the absolute sense. However, relative growth is even more important and this has been recognized in the "Report of the Royal Commission on Co-operatives".<sup>1</sup> Unfortunately, comparable data for non-co-operative agencies is not available. With regard to marketing co-operatives, the Commission has used as a basis of comparison, cash income from the sale of farm products. This is sound because farm cash income figures closely approximate the value of all marketings, co-operative and non-co-operative, done at the same selling level as co-operative marketing.

### ALL FARM PRODUCE

Table XVII compares indices of dollar turnover of co-operative marketing agencies with indices of cash income from the sale of farm produce. The years from 1935 to 1939 inclusive are used as the base period in order that undue weight

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1. Ottawa: King's Printer, 1945.



be not given to any extreme year. The Table would seem to indicate that despite great absolute growth, co-operative marketing was actually performing a smaller proportion of total marketings than it was in the late 1930's.

TABLE XVII - INDICES OF DOLLAR VOLUME OF PRODUCE MARKETED  
BY CO-OPERATIVES COMPARED WITH INDICES  
OF CASH INCOME FROM SALE OF FARM PRODUCE  
FOR ALL CANADA  
(1935-1939 = 100)

| Year | Produce Marketed | Cash Income |
|------|------------------|-------------|
| 1933 | 72.6             | 63.5        |
| 1934 | 87.6             | 77.7        |
| 1935 | 80.1             | 81.9        |
| 1936 | 98.6             | 92.6        |
| 1937 | 106.8            | 103.4       |
| 1938 | 91.4             | 106.4       |
| 1939 | 122.9            | 115.7       |
| 1940 | 145.7            | 122.7       |
| 1941 | 146.2            | 146.4       |
| 1942 | 145.6            | 176.3       |
| 1943 | 200.4            | 224.6       |
| 1944 | 311.4            | 280.5       |

Source: Report of Royal Commission on Co-operatives,  
1945, p.83.

Table XVIII shows the average annual percentage rates of growth of co-operative marketing and of cash income from the sale of farm products. The indication is that the rate of growth is less for co-operative marketing than for cash income, but in Tables XVII and XVIII the co-operative marketing figure is heavily weighted by grain and seed figures.

Marketing co-operatives have apparently more than held their own in Quebec, Ontario and Manitoba, while cash income has grown at a faster pace in Saskatchewan, Alberta and British Columbia. In the Maritimes both have grown at the same rate. One cannot help noting the definite sectional differences.

TABLE XVIII - AVERAGE ANNUAL RATES OF GROWTH OF CO-OPERATIVE FARM PRODUCE MARKETINGS AND OF CASH INCOME FROM THE SALE OF FARM PRODUCE BY REGIONS  
1933 - 1943

| <u>Province or Region</u> | <u>Produce Marketed</u> | <u>Cash Income</u> |
|---------------------------|-------------------------|--------------------|
| Canada                    | 9.3                     | 11.5               |
| Maritimes                 | 10.3                    | 10.5               |
| Quebec                    | 16.2                    | 14.6               |
| Ontario                   | 16.9                    | 10.9               |
| Manitoba                  | 16.3                    | 13.5               |
| Saskatchewan              | 5.9                     | 11.8               |
| Alberta                   | 5.6                     | 9.3                |
| British Columbia          | 7.6                     | 10.0               |

Source: Report of the Royal Commission on Co-operatives, 1945, p.86.

#### GRAIN AND SEED

The data in the Royal Commission Report is rather ambiguous. The dollar value of co-operative grain and seed marketing as a percentage of cash income from grain and seed marketing has shown a decrease during the years 1940 to 1944. From 1935 to 1939 the co-operative share averaged about 52 per cent, while from 1940 to 1944 it declined to an average of 48 per

cent. Differences may in part be explained by differences in handling charges made by the pools and the private elevator companies, for the pools claim they anticipate the private companies in any price cuts made. However, handling charges are generally the same, and on the whole the conclusion of the Royal Commission may be accepted, that co-operatives handling grain and seed have neither increased nor decreased their share of the grain handling business.<sup>1</sup> Manitoba, Quebec and British Columbia, however, do show a definite increase in the proportion of grain and seed marketed through co-operative channels. The latter has shown a particular increase during the war years. Ontario, like the Prairie Provinces, shows neither an increase nor a decrease.

#### ALL FARM PRODUCE EXCLUDING GRAIN AND SEED

A relatively steady upward trend is evident in co-operative marketing since 1935.<sup>2</sup> In that year the co-operative share was 11.7 per cent and in 1944 it had risen to 16.2 per cent. No unusual increase appears during the war years.

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1. R.C.C., p.95.

2. R.C.C., p.99.

### DAIRY PRODUCTS

The proportion of co-operative marketing has shown a decided increase during the war. The 1935 to 1939 average was 11.5 per cent, while the 1940 to 1943 average was 15.4<sup>1</sup> per cent. This increase is apparent in every province or region, except British Columbia, where the increase has been much less substantial, and the Maritimes where there has been a continuance of a steady growth beginning in the depression.

### FRUITS, VEGETABLES AND POTATOES

No increase of the co-operative proportion is indicated.<sup>2</sup> The 1935 to 1939 average was 19.3 per cent and the 1940 to 1944 average was 20.6 per cent. In Quebec and British Columbia the co-operative proportion has remained about the same. Ontario shows a co-operative increase between 1936 and 1939 with a slight decrease from the 1939 figure during the war years. A war-time increase is apparent in the Maritimes.

### LIVESTOCK

The co-operative proportion increased from a 1935 to 1939 average of 9.8 per cent to a 1940 to 1943 average of 14.5 per cent.<sup>3</sup> A substantial war-time increase occurred in Saskatchewan, Manitoba, Alberta and British Columbia. The proportion

1. R.C.C., p.102.

2. R.C.C., p.103.

3. R.C.C., p.104.

remained relatively constant in Ontario and Quebec, and fell in the Maritimes.

#### POULTRY AND EGGS

The figures show a co-operative increase from a 1935 to 1939 average of 7.2 per cent to a 1940 to 1943 average of 10.7 per cent.<sup>1</sup> A definite war-time increase is evident in British Columbia, while figures for the other provinces are rather inconclusive.

#### CO-OPERATIVE PURCHASING

In Canada, co-operative purchasing is relatively unimportant. The Royal Commission has presented little data on its growth. Table III has shown that in both 1930 and 1941 co-operative retail stores accounted for only .06 per cent of total Canadian retail trade.

Table XVIV compares co-operative purchasing with general retail trade and with country general store sales. A rapid war-time growth in co-operative purchasing is indicated. However, some reservations should be kept in mind. The 1941 census showed that less than 50 per cent of co-operative purchasing was done through consumers' co-operative retail stores.<sup>2</sup> In rural areas, moreover, a large proportion of

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1. R.C.C., p.97,104.      2. R.C.C., p.108.

of co-operative merchandising is wholesale rather than retail.<sup>1</sup> Further, the past co-operative purchasing growth may partly be explained by increases in sales of feeds and fertilizers during the war.<sup>2</sup> The latter make up a large proportion of the co-operative purchasing business. With these considerations in mind, the Table indicates that the increase in co-operative purchasing is not a war-time development, but something which has been taking place at a steady rate since 1933.

TABLE XVIV- INDICES OF CO-OPERATIVE PURCHASING AND OF  
RETAIL TRADE AND COUNTRY GENERAL STORE  
SALES: CANADA (1935-39 = 100)

| Year | Co-operative<br>Purchasing | Country General<br>Stores | Retail<br>Trade |
|------|----------------------------|---------------------------|-----------------|
| 1933 | 40.3                       | --                        | 73.4            |
| 1934 | 44.0                       | --                        | 82.1            |
| 1935 | 70.4                       | --                        | 87.1            |
| 1936 | 90.1                       | --                        | 94.7            |
| 1937 | 110.7                      | 105.4                     | 107.2           |
| 1938 | 112.4                      | 103.2                     | 104.5           |
| 1939 | 116.4                      | 100.7                     | 106.6           |
| 1940 | 142.6                      | 106.7                     | 121.2           |
| 1941 | 204.1                      | 116.2                     | 141.4           |
| 1942 | 265.7                      | 132.9                     | 149.3           |
| 1943 | 317.9                      | 148.0                     | 154.3           |

Source: Report of the Royal Commission on Co-operatives, 1945, pp.108,109.

The Royal Commission Report contains figures for the Province of Saskatchewan, which during the war years did the largest co-operative purchasing business in the Dominion.

1. R.C.C., p.108.

2. Ibid pp.110-111.

The material shows that this has not been an increase attributable to war-time conditions, but rather that such a development had been taking place throughout the depression. War-time expansion would in large measure appear to be a continuation of this growth.

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## CHAPTER III

### THE BUSINESS METHODS OF CO-OPERATIVES AND THE RELATION OF TAX DISCRIMINATION ON CO-OPERATIVE PLANT VALUES



### CHAPTER III

#### THE BUSINESS METHODS OF CO-OPERATIVES AND THE RELATION OF TAX DISCRIMINATION ON CO-OPERATIVE PLANT VALUES

The problem of discussing the business methods of co-operatives is complicated by the fact that there is no special Dominion legislation affecting the co-operative movement. Although, there is no specific enabling legislation, Part I or Part II of the Companies Act is available. However, this is an unsatisfactory vehicle for co-operative incorporation, since no reference to the co-operative form of organization is contained therein.

Every province has legislation dealing with co-operative associations but in certain cases great variations exist. Laws enabling the formation of co-operative credit associations are found in every province; laws governing agricultural co-operative associations are evident in all provinces; laws providing for co-operative societies for the production and distribution of commodities are found in every province except Ontario and New Brunswick.

The three uniform features of the legislation applying to co-operative business organizations appear to be:

(a) the provisions that each member shall have one vote regardless of the number of shares that he may own,

(b) the provisions that surplus less reserves shall be distributed among the members in proportion to patronage,

(c) the fact that a co-operative association is held to be a body corporate.

Since co-operative associations are regarded as body corporates, they possess the same advantages and face most of the same problems as any joint stock company or publicly owned business. Any co-operative has the problems of initial financing, of finding working capital to carry on day to day operations, of providing for reserves, of distributing surplus, and of providing for capital investment out of earnings.

#### MARKETING CO-OPERATIVES

The best source of material on the business methods and financial operations of marketing co-operatives in Canada, is the Canadian Royal Commission Report. The Commission obtained evidence from co-operative associations engaged in the grain trade, in the dairy industry, livestock marketing, in processing and handling fruits and vegetables, and from the Canadian Co-operative Wool Growers, Limited. One cannot help but note the variety in methods and operations.

Some marketing co-operatives handle the products of their members on consignment, others purchase the products outright. Generally, co-operative associations handling grain and seed

make an outright purchase of a member's product. The Alberta, Saskatchewan and Manitoba Pools finance their operations by internal methods -- out of current operations. The Saskatchewan and Alberta Pools deduct 2¢ per bushel for an elevator reserve, and 1 per cent of gross sales for a commercial reserve.<sup>1</sup> Table XIX shows the sources of capital funds for the Saskatchewan Pool and its subsidiaries, and is indicative of internal financing. In Manitoba, local associations constitute the membership of the Manitoba Pool. Locals have a separate corporate existence, and operate on a contract basis with the Pool.<sup>2</sup> Financial difficulties have forced the Manitoba Pool to make somewhat different financial arrangements. There, up to 50 per cent of the net surplus of each local has to be placed in a special reserve to repay chartered bank loans guaranteed by the Government, and up to 25 per cent in a working capital reserve.<sup>3</sup> In Alberta and Saskatchewan, certificates representing the members' equity in commercial and elevator reserves have been issued. Interest has been paid on these certificates when financial conditions permitted. Both Pools use a form of revolving fund. Part of the patronage rebate is withheld, and used to buy up the commercial and elevator reserve certificates of those who are no longer active in the association. By this means active

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1. R.C.C., pp. 142, 145.

2. Ibid, p. 146.

3. Ibid, p. 148.

TABLE XIX - SASKATCHEWAN CO-OPERATIVE PRODUCERS LIMITED, MODERN PRESS LIMITED,  
SASKATCHEWAN CO-OPERATIVE LIVESTOCK PRODUCERS LIMITED, SASKATCHEWAN POOL  
ELEVATORS LIMITED AND SASKATCHEWAN POOL TERMINALS LIMITED: SOURCE OF  
CAPITAL FUNDS, As At July 31, 1946

| Source of Capital Funds  | Capital | Commercial<br>Reserve | Elevator<br>Deductions | Livestock<br>Pool Equity<br>Account.<br>Old<br>Membership | (Table<br>Continued<br>Below) |
|--------------------------|---------|-----------------------|------------------------|---|-------------------------------|
| Stock Subscriptions      | 129,412 | --                    | --                     | --  |                               |
| Deductions from Pool     | --      | 6,567,851             | 12,188,060             | --  |                               |
| Payments                 |         |                       |                        |   |                               |
| Retained from Operations | --      | --                    | --                     | 184,843   |                               |
| Province of Saskatchewan |         |                       |                        |   |                               |
| Loan                     | --      | --                    | --                     | --  |                               |
| Total Capital Receipts   | 129,412 | 6,567,851             | 12,188,060             | 184,843   |                               |

|  |                     |                      |   |                                 |            |
|--|---------------------|----------------------|---|---------------------------------|------------|
| TABLE CONTINUED:   | Reserve<br>Accounts | Undivided<br>Surplus | Excess Charges<br>Refund, Seasons<br>43-4; 44-5; 45-6 | Deferred<br>Loans<br>Outstand'g | Total      |
| Stock Subscriptions  | --                  | --                   | --  | --                              | 129,412    |
| Deductions from Pool   | --                  | --                   | --  | --                              | 18,755,911 |
| Payments   |                     |                      |   |                                 |            |
| Retained from Operations   | 4,710,179           | 1,230,093            | 8,484,758   | --                              | 14,609,872 |
| Province of Saskatchewan   |                     |                      |   |                                 |            |
| Loan   | --                  | --                   | --  | 4,733,979                       | 4,733,979  |
| Total Capital Receipts   | 4,710,179           | 1,230,093            | 8,484,758   | 4,733,979                       | 38,229,174 |
| Source: Saskatchewan Co-operative Producers Ltd., Annual Report, 1946, p.52. |                     |                      |   |                                 |            |

membership is maintained, and reserve certificates are held roughly in accord with patronage. In reality, certificates are not redeemed, but merely perpetually transferred in the direction of more active members.<sup>1</sup> All three Pools have paid patronage dividends in cash to the members when financial conditions have permitted.

The United Grain Growers, Limited, have financed by both direct and internal means. Until recently, elevator facilities were acquired through the retention of surplus earnings.<sup>2</sup> However, from 1925 to 1929, dividend certificates on a patronage basis were issued and later redeemed. Since 1940-1941, the Company has sold preferred shares with a par value of \$20.00, providing for a 5 per cent dividend. These shares are sold to the general public and classified as Class "A" Preferred. Class "B" shares are the voting shares with a par value of \$5.00 and sale of these is limited to farmers and lessees or owners of land. These shares carry the right to participate in patronage dividends.<sup>3</sup>

The vast majority of dairy co-operatives purchase the producers' product outright. In evidence before the Commission, only one co-operative claimed to handle its members products on consignment.<sup>4</sup> Operations have been financed by both internal and direct means, although the former greatly predominates. Certain co-operatives withhold some of the

1. R.C.C., p.143 and 146. 2. Ibid, p.141. 3. Ibid, p.141

4. Ibid, p.157.

surplus for use as working capital. Others finance by means of a "revolving door fund". Under a five year "revolving door plan", for example, surplus withheld to the credit of a member in the year 1937 would be repayable to that member in 1942, surplus withheld in 1938 would be repayable in 1943 and so on. Here there is a commitment on the part of the association to repay the funds of which they have made use. These associations have also used retained surplus to finance plant expansion. Other co-operative dairy associations have sold additional bonds, shares, or preferred stock in order to buy up plants or to build new ones.<sup>1</sup> It must be kept in mind that several dairy co-operatives have received government assistance in the form of guarantees. Such assistance has enabled expansion of plant facilities. This assistance was particularly in evidence during the 1930's in Alberta.

Livestock marketing co-operatives also show variation in method of operation. There is generally a marketing contract between the association and the member. In Alberta, shippers are members of local associations.<sup>2</sup> The liquidity of the local association is insured either by the deduction of a large handling charge, or by the use of reserves set aside out of proceeds. The shipper receives an initial price and a pro-rata payment if any surplus arises. The locals are

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1. R.C.C., pp.149-158.      2. Ibid, pp.159-160.  
3. Ibid, pp 160-161.

affiliated in a central selling organization. The central organization returns the proceeds to the members after deducting operating costs and \$1.00 per car for a commercial reserve. The fund procured from membership fees and from reserve deductions is on a three year revolving basis. Funds for an educational reserve and an operating reserve are also deducted. Member associations receive equity certificates showing their participation in these reserves. In Saskatchewan and Manitoba, <sup>1</sup> shippers are members of province wide organizations. The Saskatchewan body is a subsidiary of the Saskatchewan Co-operative Producers. In neither province is marketing contract in existence. When surplus is distributed it must be on a patronage basis. The Manitoba and Saskatchewan organizations are members of a central selling agency -- Canadian Livestock Co-operative (Western). Local co-operatives or individuals may consign livestock to the body as selling agent. After certain handling deductions, there is an initial return direct to the producer. Surplus is returned on a pro rata basis to the member co-operatives, 90 per cent being in <sup>2</sup> cash and 10 per cent on an eleven year "revolving fund basis".

In the Maritimes, Maritime Co-operative Services is a <sup>3</sup> federation of 100 local associations with 10,000 members. There is a contract requiring that a member confine his marketing and purchasing (if possible) to the local concerned. Each

1. R.C.C. pp.160-161. 2. Ibid, p.161. 3. Ibid, p.162.

local must hold at least one of the 4,000 shares of capital stock. Shares have a par value of \$25.00. Interest not exceeding 6 per cent is paid on shares. Since 1944 the capital structure plan has provided for the setting aside of 5 per cent of the surplus each year as an unallocated reserve until it reaches 20 per cent of the paid up capital; the provision for other reserves deemed necessary by the shareholders; provision for the payment of the remainder of surplus to shareholders only.

The Prince Edward Island Marketing Board is a federation of local shipping associations.<sup>2</sup> Each member is bound by a contract to consign his livestock through the local association. There is a  $1\frac{1}{2}$  per cent commission on all livestock shipped, a charge of \$1.00 per shipment to cover transportation costs, and  $\frac{1}{4}$  per cent of surplus is set aside as a condemnation fund.<sup>3</sup> The Board estimates prices with great care and very little surplus is left over. As a result no patronage dividend payment is made.<sup>4</sup> It should be pointed out that in Prince Edward Island and the Maritimes, it appears that government grants have provided both an initial source of funds and working capital.

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1. R.C.C. p.163. 2. Ibid, p.164. 3. Ibid, p.164  
4. Ibid, p.164.



The co-operative marketing of fruits and vegetables is a large proportion of total marketings in British Columbia. The Associated Growers in the Okanagan Valley have a three party marketing agreement between the grower, the local and the central sales agency.<sup>1</sup> The central sales agency handles members' produce on consignment. There is a commercial reserve set up through the deduction of 1 per cent from the gross selling price allocated to the locals. Returns are pooled, and all locals receive the same amount per box for a similar product. Excess handling charges, if any, are rebated on a pro-rata basis through the locals. However, a small surplus account is held back.<sup>2</sup> Local associations are financed mainly by deductions for which growers receive shares.<sup>3</sup> These revolve on a three to five year basis. In locals working capital is obtained through a per box deduction for which redeemable stock certificates may or may not be issued. Excess handling and packing charges are rebated on a pro-rata basis. The Pacific Co-operative Union, not affiliated with the Associated Growers, ~~revalues~~<sup>4</sup> its \$10.00 shares every five years. Shippers' products are handled on consignment and a contract is in force. Returns from like grades of product are pooled and rebated on a pro-rata basis.

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1. R.C.C. p.168.

2. Ibid, p.169

3. Ibid, p.170

4. Ibid, p.170

In Ontario, fruit and vegetable marketing schemes have been tried on a regional basis as well as through the United Farmers Co-operative.<sup>1</sup> Of the regional associations mentioned, variations in operating methods are apparent. One is a buying and selling agency for four local associations who sign a contract.<sup>2</sup> There is a membership fee, and annually not more than 20 per cent of the surplus can be put into a reserve fund.<sup>3</sup> Another association is divided into sales units.<sup>4</sup> One per cent of gross sales may be set aside out of surplus annually as a reserve fund for that year. The remainder may be distributed on a pro-rata patronage basis. Operating costs are covered by a deduction from each sales unit not to exceed  $\frac{1}{4}$  per cent of the sales units total gross sales. Each unit deducts a brokerage fee of  $\frac{1}{4}$  cent per pound. A third association has non-revolving share capital.<sup>5</sup> Members sign a marketing contract. Dividends are paid on a pro-rata basis and in cash, and the remainder of the surplus is placed in a four or five year revolving fund. A fourth association has interest bearing shares with a par value of \$100.00. Under an agreement, members leave surpluses with the association to provide increased storage capacity.<sup>6</sup> These Ontario examples are indicative of the tremendous variation found in the business methods and financial operations of marketing associations.

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1. R.C.C., p.171. 2. Ibid, p.171. 3. Ibid, p.171.  
4. Ibid, p.171. 5. Ibid, p.171. 6. Ibid, p.171.

In Nova Scotia, the United Fruit Company is the central selling agency for the locals.<sup>1</sup> Operating expenses are met by deductions of several cents a barrel. Capital consists of \$100.00 shares with interest dependent upon conditions. Advances are made to growers through the season, and the company must pay back all surplus. The company owns processing plants, and recently members have permitted the company to retain \$50,000. for a cold storage plant. Assistance for warehouses has been received by locals from the Nova Scotia Government Mortgage Company. "The dividend paid is only a rough approximation to payment on a patronage basis".<sup>2</sup>

Co-operative wool marketing is carried on by the Canadian Co-operative Wool Growers, Limited, which is incorporated federally.<sup>3</sup> Marketing is carried on either through a small number of local associations or by some 12,000 individual farmers. Local associations are incorporated provincially, and meet expenses by a per pound levy on wool, and by earnings derived from the sale of supplies in areas not served by other associations. There is no contract membership in the central body. The capital of the central association consists of \$10.00 shares. Local associations may purchase

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1. R.C.C., p.172, 2. Ibid, p.173, 3. Ibid, p.177.

an unlimited number, but individual members are limited to fifty shares each. In practice the shares return a 4 to 6 per cent dividend, although the limit is 8 per cent. During the clipping season, the association borrows \$500,000 from the banks.<sup>1</sup> Two-thirds of the estimated wool price is advanced to growers or associations at marketing time. After 80 per cent of the clip has been marketed a final payment is made. Any surplus after reserves have been deducted is rebated on a poundage basis at the end of the year. The following reserves have been set up:

- (1) A contingency reserve which is the property of the association, but which the by-laws provide shall be distributed on a pro-rata basis to current year shippers upon dissolution of the association.
- (2) A general reserve which is the property of the members, distributed upon dissolution to current year's shippers on a pro-rata basis.
- (3) A growers reserve which is essentially a revolving fund used by the association as working capital.<sup>2</sup>

The co-operative shows no desire to make a member's equity in the association proportional to the volume of produce which he markets through the association.

#### PURCHASING CO-OPERATIVES

The Royal Commission Report has detailed information on co-operative purchasing only for the province of Saskatchewan. This information is valuable because in 1944 Saskatchewan

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1. R.C.C. p.177.

2. R. C.C. p.178.

purchasing and consumers' co-operatives enjoyed the largest volume of total sales of any province.

In 1929 many of the co-operative purchasing associations in the Province federated to form the Saskatchewan Co-operative Wholesale Society Limited.<sup>1</sup> The Wholesale Society was to supply its members with both farm supplies and consumers' goods. In 1935 a consumers' co-operative refinery was organized in Regina by many of the co-operative oil purchasing associations throughout the Province. 1944 saw this latter body amalgamate with the Co-operative Wholesale Society<sup>2</sup> under the name of Saskatchewan Federated Co-operatives, Limited. The Federated Co-operatives finance principally by means of the "revolving door fund".

The basis of subscribing for capital stock in local associations varies with the by-laws of those associations.<sup>2</sup> In the great majority of cases an initial payment may be made towards owning stock when taking out membership in the association. The balance is paid up mainly through the application of patronage dividends. A large number of local associations have provision for "revolving door funds" which have become popular, since their advantages have been illustrated by the successful operation of the Consumers Co-operative Refineries. Other local associations obtain capital by loans from members and by deferring payment of patronage dividends.

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1. R.C.C. p. 181.

2. Ibid, p.181.

Table XX shows the financial results of all co-operative associations engaged in a retail business in Saskatchewan during the years 1935-36 to 1945-46. The increase in both numbers of associations and members is evident. Members' equity has increased 6000 per cent since 1935-36, and over 550 per cent since 1939-40. Equity per member has declined from \$83 in 1935-36 to \$56 in 1945-46. Volume of sales increased from \$3,000,000 in 1935-36 to \$18,500,000 in 1945-46.<sup>1</sup>

Table XXI shows the financial results of co-operative wholesaling and manufacturing organizations in Saskatchewan. The Table is heavily weighted by figures for the Saskatchewan Federated Co-operatives. While total business has greatly increased, it should be remembered that virtually 100 per cent of the products sold by the Saskatchewan Federated Co-operatives are sold either to member associations or to other unaffiliated local co-operative associations. Sales of the Federated Co-operatives are duplicated in Table XX. However, local societies are buying an increasingly large percentage of their goods from the Federated Co-operatives, Limited.

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1. Table XX.

TABLE XX - FINANCIAL RESULTS OF ALL CO-OPERATIVE ASSOCIATIONS ENGAGED IN A  
RETAIL BUSINESS

| Year    | No.<br>Report'g    | No.<br>Membrs.         | Sales       | Total<br>Assets          | Liabilities<br>to Public | Liab.<br>to Members | Paid<br>Up<br>Capital   | Net<br>Reserves          | Members'<br>Equity |
|---------|--------------------|------------------------|-------------|--------------------------|--------------------------|---------------------|-------------------------|--------------------------|--------------------|
| 1935-6  | 194                | 12,690                 | \$3,000,000 | \$1,341,704              | \$288,695                | \$ --               | \$ --                   | \$ --                    | \$ 193,334         |
| 1938-9  | 306                | 23,182                 | 3,937,209   | 1,564,717                | 403,152                  | --                  | 624,571                 | 536,994                  | 1,161,565          |
| 1939-40 | 327                | 28,590                 | 4,681,510   | 1,888,397                | 642,054                  | --                  | 632,208                 | 614,135                  | 1,246,343          |
| 1940-1  | 453                | 42,535                 | 7,068,226   | 2,582,910                | 777,547                  | --                  | 863,252                 | 942,111                  | 1,805,363          |
| 1941-2  | 483                | 50,881                 | 8,576,518   | 3,215,392                | 726,626                  | --                  | 917,605                 | 1,571,161                | 2,488,766          |
| 1942-3  | 489                | 57,948                 | 11,225,288  | 3,775,739                | 724,923                  | --                  | 954,902                 | 2,095,914                | 3,050,816          |
| 1943-4  | 486                | 66,340                 | 13,078,226  | 4,491,150                | 903,961                  | --                  | 971,849                 | 2,615,340                | 3,587,189          |
| 1944-5  | 483                | 76,714                 | 16,549,383  | 5,593,834                | 1,420,936                | --                  | 981,512                 | 3,191,386                | 4,172,898          |
| 1945-6  | 519 <sup>(1)</sup> | 121,545 <sup>(1)</sup> | 18,588,411  | 7,854,112 <sup>(1)</sup> | 1,020,765 <sup>(2)</sup> | 3,125,937           | 1654,840 <sup>(1)</sup> | 2,052,570 <sup>(4)</sup> | 6,833,347          |

1. 1945-46 figures include 16 co-operative implement associations with total assets amounting to \$481,061 and 28,239 members.
3. This 1945-46 figure includes allocated deferred patronage dividend of \$1,975,451 shown in previous years as reserves (4) and loans from members of 1,150,486 shown in previous years as liability to the public (2).

Source: Royal Commission Report on Co-operatives, p.187-188 and  
Saskatchewan: Department of Co-operation and Co-operative Development, Annual  
Report, 1945-46.

TABLE XXI - FINANCIAL RESULTS OF CO-OPERATIVE WHOLESALING  
AND MANUFACTURING ORGANIZATIONS

| Year    | No. Report-<br>ing | Places of<br>Bus. | Member<br>Assoc-<br>iations | Fixed<br>Assets | Total<br>Assets | Liabil-<br>ities to<br>Public | Liabilities<br>to<br>Members | Paid-up<br>Capital | Reserves | Members<br>Equity | Commodities<br>Sold or<br>Marketed | Other<br>Income | Total<br>Business |
|---------|--------------------|-------------------|-----------------------------|-----------------|-----------------|-------------------------------|------------------------------|--------------------|----------|-------------------|------------------------------------|-----------------|-------------------|
|         |                    |                   |                             | \$              | \$              | \$                            | \$                           | \$                 | \$       | \$                | \$                                 | \$              | \$                |
| 1938-39 | 2                  | 2                 | 539                         | 165,870         | 528,633         | 225,164                       | 5,413                        | 156,800            | 141,256  | 303,469           | 1,664,473                          | 14,859          | 1,679,332         |
| 1939-40 | 2                  | 4                 | 780                         | 295,825         | 949,155         | 456,519                       | 54,616                       | 242,565            | 195,455  | 492,636           | 2,508,592                          | 13,643          | 2,522,235         |
| 1940-41 | 2                  | 4                 | 623                         | 723,292         | 1,428,602       | 640,346                       | 120,095                      | 367,862            | 300,299  | 788,256           | 3,857,635                          | 30,420          | 3,888,055         |
| 1941-42 | 2                  | 4                 | 626                         | 825,565         | 1,988,920       | 878,172                       | 224,215                      | 512,122            | 374,411  | 1,110,748         | 4,814,243                          | 36,529          | 4,850,772         |
| 1942-43 | 2                  | 4                 | 664                         | 856,333         | 2,456,324       | 973,038                       | 349,276                      | 633,838            | 500,172  | 1,483,286         | 6,104,564                          | 51,348          | 6,155,912         |
| 1943-44 | 2                  | 4                 | 696                         | 835,827         | 3,018,610       | 1,239,438                     | 624,625                      | 669,925            | 484,622  | 1,779,172         | 7,076,952                          | 54,759          | 7,131,711         |
| 1944-45 | 1                  | 5                 | 461                         | 777,089         | 3,218,015       | 1,613,848                     | 604,372                      | 437,871            | 561,924  | 1,604,167         | 6,838,629                          | 26,018          | 6,864,647         |
| 1945-46 | 1                  | 7                 | 499                         | 1,203,889       | 3,939,675       | 2,291,438                     | 1,369,374                    | 53,536             | 225,327  | 1,648,237         | 7,141,551                          | 154,534         | 7,296,085         |

1. Decrease in membership due to amalgamation of two co-operative federations.

2. Business for 7 months period only.

Source: Saskatchewan: Department of Co-operation and  
Co-operative Development, Annual Report, 1945-46.



The Royal Commission Report also has selected 40<sup>1</sup> purchasing associations in the Province for separate analysis. Table XXII is very significant. It shows the total earnings available for allocation and the large percentage of the total earnings which has been retained by the associations. Of these earnings which have been retained, in the four year period 1936 to 1939, 74 per cent remained unallocated, in the 1940 to 1943 period 69 per cent remained unallocated, and throughout the entire eight year period 70 per cent remained unallocated. Thus, these forty associations did not repay to their members 70 per cent of the operating earnings which they retained over the eight year period 1935 to 1943. However, since we do not know the method of selecting these forty purchasing associations, and since they are all in the one Province of Saskatchewan, it is necessary to be cautious in drawing conclusions from the Table.

#### PLANT VALUES

Unfortunately no figures are available for the plant values of those joint stock companies in direct competition with co-operatives. The only available basis for comparing companies and co-operatives is to compare their working capital. The net increase in co-operative working capital was \$4,500,000 from 1935 to 1939 and \$10,000,000 from 1939

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1. R.C.C. p.182.

TABLE XXII - A STATEMENT SUMMARIZING CHANGES IN MEMBERS' EQUITY IN THE FORTY SELECTED PURCHASING ASSOCIATIONS IN SASKATCHEWAN, During the Eight Fiscal Years, 1936' to 1943

|  | Four Years<br>1936 - 1939<br>\$ | Four Years<br>1940 - 1943<br>\$ | Eight Years<br>1936 - 1943<br>\$ |
|--|---------------------------------|---------------------------------|----------------------------------|
| Sales  | 5,521,192                       | 9,863,372                       | 15,384,564                       |
| Less Cost of<br>Sales & Operating<br>Expenses  | <u>5,328,539</u>                | <u>9,344,973</u>                | <u>14,673,612</u>                |
| Operating Earn'gs  | 192,653                         | 518,399                         | 710,952                          |
| Add Other Income   | <u>141,762</u>                  | <u>262,758</u>                  | <u>404,620</u>                   |
| Earnings Available<br>for Allocation   | 334,415                         | 781,157                         | 1,115,572                        |
| Deduct Earnings<br>Allocated to<br>Patrons   | <u>203,335</u>                  | <u>467,463</u>                  | <u>670,798</u>                   |
| Earnings Unallocated   | <u>131,080</u>                  | <u>313,694</u>                  | <u>444,774</u>                   |
| Allocated Earnings<br>as above   | 203,335                         | 467,463                         | 670,798                          |
| Deduct Patronage Dividends paid and interest paid on<br>Capital (less increase in paid-up capital) | <u>156,117</u>                  | <u>326,760</u>                  | <u>482,877</u>                   |
| Allocated Earnings<br>Retained   | <u>47,218</u>                   | <u>140,703</u>                  | <u>187,921</u>                   |
| Total Earnings Retained<br>(Allocated & unallocated)<br>representing increased<br>equity:          | <u>178,298</u>                  | <u>454,397</u>                  | <u>632,695</u>                   |

Source: Report of Royal Commission on Co-operatives, p.190.

to 1943.<sup>1</sup> For corporations, the net increase was \$41,000,000 from 1935 to 1939, and \$144,000,000 from 1939 to 1943.<sup>2</sup> These figures seem to show that corporations have accumulated larger reserves during the war than co-operatives. However, we must remember that these figures include corporations engaged in war work. There were allowed to set aside generous untaxed depreciation reserves which are included in these working capital figures. If we had statistics for the companies competing with co-operatives, our results would probably be quite different. Presumably corporations engaged in normal peacetime occupations were not allowed to set aside such large depreciation allowances.

The principal competitive advantage arising from tax exemption received by co-operatives would appear to be the use of tax free reserves in order to buy up competitors or to build additional plant and equipment.

The Royal Commission Report mentions two cases of expansion by purchase. Retention of surplus has played an important part in purchases in 1944 by the Northern Alberta Dairy Pool of a creamery at Bonnyville, and eighteen drivers and creameries formerly owned by Burns and Company.<sup>3</sup> In B.C., the Fraser Valley Milk Producers Association purchased the remaining half of the associated dairies' stock that it did not already own.<sup>4</sup> As for purchasing associations, 59

1. Canada, Department of Trade and Commerce, Dominion Bureau of Statistics, CANADA YEAR BOOK, 1945, Ottawa, King's Printer, p.624. 2. Ibid pp.624 and 1030

3. R.C.C., p.155 4. Ibid, p.151.

retail stores in the province of Saskatchewan were converted<sup>1</sup> from private to co-operative ownership.

Of interest would be figures of the increases in the number of co-operatives and in co-operative plant values. These would be particularly valuable if total plant value figures were broken down into plant value figures for the various products marketed through co-operative channels. This break-down is available up to 1941, but unfortunately after that, the figures for plant values of Canadian marketing co-operatives are not segregated from the plant values of all business co-operatives.

Table XXIII shows the plant values of Canadian co-operatives by provinces. The figures from 1942 on include all Canadian business co-operatives but Quebec figures do not include statistics for urban co-operative retail stores for 1942. Table XXIV presents plant value figures for the years 1935 to 1941 for marketing co-operatives in various fields. Table XXV indicates the increase in co-operative associations engaged in marketing various products. Unfortunately these figures are not available on a provincial basis.

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1. R.C.C. p.111.

TABLE XXIII PLANT VALUE OF CANADIAN CO-OPERATIVES FROM 1935 to 1944  
(Thousands of Dollars)

| Year | Inter<br>Prov_<br>incial | Marl-<br>times | Quebec | % Ontario | Manitoba | Sask-<br>atche-<br>wan | Alberta | British<br>Columbia | Total  |
|------|--------------------------|----------------|--------|-----------|----------|------------------------|---------|---------------------|--------|
| 1935 | 6,868                    | 788            | 1,779  | 1,394     | 2,268    | 17,333                 | 7,129   | 1,290               | 38,850 |
| 1936 | 6,181                    | 804            | 2,085  | 1,252     | 1,964    | 15,533                 | 6,043   | 1,427               | 35,289 |
| 1937 | 6,262                    | 768            | 2,203  | 1,298     | 2,282    | 16,097                 | 6,017   | 1,473               | 36,339 |
| 1938 | 6,626                    | 821            | 3,054  | 1,370     | 2,483    | 16,191                 | 5,725   | 1,308               | 36,570 |
| 1939 | 6,320                    | 830            | 2,386  | 1,598     | 2,903    | 16,167                 | 5,950   | 1,632               | 37,786 |
| 1940 | 6,224                    | 801            | 3,224  | 1,470     | 3,046    | 15,379                 | 6,298   | 1,824               | 38,265 |
| 1941 | 6,688                    | 804            | 3,790  | 1,446     | 3,142    | 14,920                 | 5,941   | 1,836               | 38,567 |
| 1942 | 5,837                    | 1,170          | 4,424  | 1         | 2,245    | 4,806                  | 13,787  | 5,325               | 37,598 |
| 1943 | 6,002                    | 1,552          | 4,606  | 2,357     | 2,757    | 13,032                 | 4,943   | 2,021               | 37,273 |
| 1944 | 5,692                    | 1,434          | 7,897  | 3,118     | 2,655    | 12,492                 | 4,715   | 2,661               | 40,665 |

1. Does not include statistics for urban co-operative retail stores.

Source: Canada Year Books 1937 - 1946.

TABLE XXIV PLANT VALUE OF CANADIAN MARKETING CO-OPERATIVES 1935 to 1941

(Thousands of Dollars)

| <u>Year</u> | <u>Dairying</u> | <u>Fruits and<br/>Vegetables</u> | <u>Grain and<br/>Seed</u> | <u>Livestock</u> | <u>Poultry<br/>and eggs</u> |
|-------------|-----------------|----------------------------------|---------------------------|------------------|-----------------------------|
| 1935        | 2,070           | 1,755                            | 32,343                    | 616              | 94                          |
| 1936        | 2,184           | 1,711                            | 28,412                    | 328              | 96                          |
| 1937        | 2,308           | 1,808                            | 29,007                    | 560              | 115                         |
| 1938        | 2,397           | 1,861                            | 29,474                    | 563              | 110                         |
| 1939        | 2,674           | 2,329                            | 29,608                    | 538              | 120                         |
| 1940        | 3,164           | 2,627                            | 29,007                    | 521              | 148                         |
| 1941        | 3,601           | 2,472                            | 28,748                    | 370              | 136                         |

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Source: Canada Year Books 1937-1942.

TABLE XXV      NUMBER OF MARKETING ASSOCIATIONS ENGAGED IN MARKETING VARIOUS PRODUCTS  
FROM 1935 to 1944

| Year | Dairying | Fruits and<br>Vegetables | Grain and<br>Seed | Livestock | Poultry<br>and Eggs |
|------|----------|--------------------------|-------------------|-----------|---------------------|
| 1935 | 115      | 104                      | 30                | 53        | 24                  |
| 1936 | 136      | 107                      | 30                | 59        | 31                  |
| 1937 | 146      | 98                       | 35                | 115       | 57                  |
| 1938 | 166      | 94                       | 36                | 177       | 61                  |
| 1939 | 197      | 100                      | 32                | 180       | 87                  |
| 1940 | 279      | 113                      | 32                | 92        | 66                  |
| 1941 | 386      | 117                      | 47                | 53        | 79                  |
| 1942 | 443      | 193                      | 114               | 321       | 199                 |
| 1943 | 446      | 161                      | 105               | 225       | 194                 |
| 1944 | 545      | 162                      | 96                | 250       | 201                 |

Source: Canada Year Books 1937-1946.

What must be sought from these tables is a relationship between plant values and the co-operative growth indicated in the previous chapter. Table XXIII has limited value. In spite of the fact that the greatest relative co-operative<sup>1</sup> gains were scored in Manitoba during the war, the Table shows that plant values actually declined there. This may be attributed to the high percentage of total Manitoba co-operative business that is in grain and seed. Elevators are a high percentage of total plant value and changes in plant values of other Manitoba co-operatives would be hidden in total plant figures for the Province. Purchasing is a large per-<sup>2</sup>centage of total co-operative business in the Maritimes, and statistics for the region would therefore be largely unreliable if applied to marketing associations alone. The importance of grain and seed in Saskatchewan and Alberta prevents the Table from being much use in those Provinces. However, for Quebec, Ontario and British Columbia the figures could be significant. Clear marketing co-operative gains were scored in Ontario and Quebec, while British Columbia co-operatives held their own. Meantime from the outbreak of the War to 1944 plant values trebled in Quebec, doubled in Ontario, and rose by over 60 per cent in British Columbia. Quebec showed gains in the co-operative marketing of poultry and eggs,

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1. R.C.C., p.85

2. Ibid, p.79



livestock, grain and seeds and dairy products; Ontario showed gains in dairy products, fruits and vegetables, and poultry and eggs; British Columbia showed an increase in poultry and eggs, livestock, grain and seeds, fruits and vegetables and dairy products. In 1940 the ratio of plant value to total sales of dairy products was \$1 to \$7.60; for fruits and vegetables it was \$1 to \$4; for grain and seeds it was \$1 to \$5; for livestock it was \$1 to \$50; for poultry and eggs it was \$1 to \$30.<sup>1</sup> Grain and seed, fruits and vegetables and dairy products all require a heavy fixed investment. Taking all this into consideration we may infer that the relative wartime growth of co-operatives in British Columbia, Quebec and Ontario may have arisen partly from the use of tax free surpluses to buy or construct capital equipment.

Plant figures arranged according to produce are interesting. Regarding poultry and livestock, the figures show a slow irregular increase in the case of poultry, and a decline in the case of livestock. On the other hand, co-operative marketings in both made great gains during the war relative<sup>2</sup> to the competitors of co-operatives. In 1941 co-operative livestock marketings were 229.6 per cent of the 1935-1939 average; cash income from the sale of livestock was only 193.4 per cent of the 1935-1939 average. 1941 figures for

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1. Table XXIII and Royal Commission Report, p.115

2. R.C.C., pp 96 and 97.

poultry were 220.4 per cent of the 1935-1939 average, while cash income averaged 149.3 per cent for the same five year period. Further, as the war continued, marketings through co-operative channels of poultry and livestock rapidly increased, and so did the number of co-operative associations in those fields. Absence of plant increases in the early war years and increases in the number of associations later in the war, force us to the conclusion that use of tax-free reserves to extend plant and equipment had little or nothing to do with the relative growth during the war of poultry and livestock co-operatives.

Of the other figures, the dairying is the most interesting. The plant value figures for 1941 show a \$930,000 increase over 1939 figures. On the other hand 1939 figures show an increase of only \$365,000 over 1937<sup>1</sup>. In 1941 co-operative dairy marketings were 210.5 per cent of the 1935-1939 average, while cash income from the sale of dairy products was only 149.3 per cent of the 1935-39 average. As pointed out previously, the ratio of fixed assets to sales is quite high in dairying. These facts would appear to indicate the use of tax free reserves to extend plant and equipment. However, consideration must also be given to

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1. Table XXI

the rapid numerical increase in associations from 1939 to 1944. The importance of this numerical increase is largely nullified by the fact that the structural organization of many dairy co-operatives is such that many local associations<sup>1</sup> are members of some centralized organization. For example, dairy or creamery purchases by a central organization may result in the incorporation of local associations. Our conclusion with regard to reserves of dairying co-operatives, though somewhat modified, would still appear to apply.

The figures show no significant relative increase or decrease in the plant values of fruit and vegetables or grain and seed co-operatives during the war years.

CHAPTER IV

THE HISTORY OF THE TAXATION OF CO-OPERATIVES AND  
THE GROWTH OF THE CONTROVERSY OVER THE APPLICATION  
OF THE  
INCOME WAR TAX ACT TO CO-OPERATIVE ASSOCIATIONS

CHAPTER IV  
THE HISTORY OF THE TAXATION OF CO-OPERATIVES  
AND  
THE GROWTH OF THE CONTROVERSY OVER THE APPLICATION  
OF THE  
INCOME WAR TAX ACT TO CO-OPERATIVE ASSOCIATIONS

The Income War Tax Act was first passed in 1917. There was no direct reference to co-operative associations in the Act, but it did contain the following exempting clause:

"The incomes of mutual corporations not having a capital represented by shares, no part of the income of which inures to the profit of any member thereof." 1

In reply to a question in the House from Sir Herbert Ames, Sir Thomas White, then Minister of Finance, indicated that the paragraph was intended to exempt co-operatives.<sup>2</sup>

However, the phrasing of this paragraph was extremely vague, and in 1919 a dispute arose over the exemption of co-operatives. In The Budget, (the organ of the Alberta Wheat Pool), of September 6, 1941, George Keen, who was at the time Secretary of the Co-operative Union of Canada, declared:

"In 1919 I had a voluminous discussion in writing with Mr. Law, the then Solicitor of the Income Tax Division at Ottawa, on the question of the liability of co-operatives for income taxation. Eventually he accepted my argument that the above mentioned savings could not legally be taxable as income or profit. The Commissioner of Income Tax at the time, a layman, however, overruled his lawyer on a legal question, and declared that the net surplus, after deducting patronage dividends as discounts, was taxable."

1. Statutes of Canada, 1917,
2. Canada, Parliament, House of Commons, Official Report of Debates, Aug. 2, 1917, p.4101. (Hereinafter referred to as Hansard).

Inspite of this decision made in 1919, no action was taken with respect to co-operatives until five years later in 1924. In that year the Income Tax Commissioners assessed the Fraser Valley Milk Producers on their net surplus after deducting payment of patronage dividends, and also on dividends or interest paid to the shareholders on paid-up capital.<sup>1</sup> The assessment covered the fiscal year ending December 31, 1923. An appeal was made to the Commissioner, and nothing more was heard by the Association until 1928 when it was assessed retroactively for the years 1924 to 1928. The Fraser Valley Milk Producers appealed their 1923 assessment before the Exchequer Court in 1928<sup>2</sup> and the Supreme Court of Canada in 1929.<sup>3</sup> Both appeals were dismissed.

In handing down its decision the Exchequer Court held that the Association must in fact be considered as a commercial company, and that dividends paid by it to its shareholders, as interest on capital, were profits or gains, liable to assessment as income. The Court disagreed with the contention of the Association that it was an agent or a factor, and that the dividends paid by it to shareholders were disbursements in the hands of the company as trust moneys. In its decision several English cases were referred to. Of particular interest and importance is the reference to the Case of

1. Most of the material in the following paragraphs is taken from the Brief of the Fraser Valley Milk Producers, and the Submission of the Saskatchewan Co-operative Producers, Ltd.
2. Fraser Valley Milk Producers Assn. vs. Minister of National Revenue, 1928, Ex. C.R., 215.
3. Fraser Valley Milk Producers Assn. vs. Minister of National Revenue, 1929, S.C.R., 435.

the Commissioners of Inland Revenue vs The Sparkford Vale Co-operative Society, Limited. The British courts held that since this Society dealt in milk, its profits arose from selling to the public and not from buying from its members, and as a result of this it was not entitled to exemption from British income tax. In the Fraser Valley Milk Producers Association decision, Judge Audette, who presided, wrote:

"It is a very commendable action for the producers of milk to combine and form an association, a company, with the object of reducing the costs of collection and distribution, thereby realizing better and larger profits or dividends; but that does not entitle such association or company to discriminate as against the public, the taxpayers, and place it in a position whereby it would become exempt from paying the income tax. The company has been able by combination to secure an advantage measured in money which it could not have enjoyed but for such combination." 1

In the middle twenties, the Saskatchewan Wheat Pool was also being assessed for taxes. In 1926, 1927, 1928 and 1929 the Pool paid taxes levied on its undistributed surplus and on its interest payments. 2 In 1926 it was also assessed on its commercial and elevator reserve deductions. The Pool appealed the latter assessment and in 1930 won an Exchequer Court decision. 3 In the opinion of the Court these deductions were held to be loans or advances under contract for the purpose of carrying on business. In addition it was pointed out that these deductions were from the price paid for the wheat

1. Fraser Valley Milk Producers Assn. vs. Minister of National Revenue, 1928, Ex. C.R., 217.
2. Submission of Saskatchewan Co-operative Producers, p.18
3. Minister of National Revenue vs. Saskatchewan Co-operative Producers, Limited, 1930, Ex. C.R., 402.

and were repayable to the grower, who voluntarily permitted such deductions. Commercial and elevator reserves were not regarded as profit or gain to the association. The presiding judge went on to state:

"No one can be held to make a profit or a gain by dealing with himself only; two parties are needed, and under the pool scheme, the associations being the agent of the farmer, they are one and the same." <sup>1</sup>

In passing, it is interesting to note that in these two important cases that it was the co-operative that sold its products directly to the consumer that lost its appeal. The association which was held to be purely a marketing agency, won its appeal from assessment. But we should keep in mind that in dispute on the one hand were dividend payments on capital stock, while the other case revolved around the tax position of allocated reserves.

The adverse decision of the courts in the Fraser Valley Milk Producers case gave rise to co-operative pressure for an amendment in the Income War Tax Act, lest the decision establish a precedent for the taxing of co-operatives' dividend payments on paid-up capital. The then Minister of Finance, Mr. Dunning, was interviewed by representatives of co-operatives from coast to coast, <sup>2</sup> and as a result Section 4 of the Act was amended to provide for the exemption of:

"The income of farmers', dairymen's, livestockmen's, fruit growers', poultrymen's, fishermen's and other

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1. Ibid, p.408

2. Hansard, May 24, 1930, p.2509.



like co-operative companies and associations whether with or without share capital, organized and operated on a co-operative basis." 1

It was further provided in the amendment that in order to qualify for exemption 80 per cent of the value of produce, supplies or equipment marketed or purchased had to be done with the members of the association.

Apparently the only voice raised in objection to the amendment was that of the Honourable R. B. Hanson. He first stated that he could see no need for the legislation since the principle of exemption had already been established by the court decision favourable to the Saskatchewan Wheat Pool.<sup>2</sup> However, Mr. Dunning pointed out that this decision did not bear specific relationship to the nature of the organization,<sup>3</sup> but rather to certain specific facts involved. Mr. Hanson then went on to state that while he did not object to the principle of exemption as applied to bona fide co-operative associations, he felt that there was strong feeling about the exemption of certain provincially owned businesses, and he continued:

"I have no doubt that to a lesser degree there is the same feeling with respect to co-operative companies." 4

As far as can be ascertained, Mr. Hanson was the first member of Parliament to ever question the tax exempt status of co-operatives.

1. Statutes of Canada, 1930, An Act to Amend the Income War Tax Act, p.231.
2. Hanserd, May 24, 1930, P.2508.
3. Ibid, p.2508.
4. Ibid, p.2508.

After some research in the field, I could only find one in the 1930's occasion/on which the taxation of co-operative earnings was mentioned. Mr. R. S. Law, president of the United Grain Growers brought up the matter before the Turgeon Grain Inquiry Commission in 1937. He mentioned that the wheat pools were<sup>1</sup> not subject to federal income tax.

In 1939 the War broke out bringing with it a war induced prosperity to most sectors of the economy. To pay for war expenditures taxes increased sharply with the introduction of the Excess Profits Tax in 1940. The Submission of the Saskatchewan Co-operative Producers in 1945 to the Royal Commission on Co-operatives declared that:

"following a widespread and well organized campaign directed against the Pool organizations (presumably by competitors of co-operatives) the question of the liability of the (Saskatchewan) Pool for payment of income tax was again introduced by the Department of National Revenue in 1940".<sup>2</sup>

In 1941 agitation from business interests became apparent. The Brief of the North West Line Elevators Association claims that in January, 1941, Pool Insurance Company, the inter-provincial subsidiary of the Pools providing insurance services was assessed and filed notice of appeal. In May of the same year, for the first time in eleven years, the income tax status of co-operatives was raised in the House of Commons. On May 15, Mr. R. B. Hanson inquired whether the income tax

1. Alberta Wheat Pool, A History of the Events Leading to the Taxation of Co-operatives, Calgary, 1946, p.3.
2. Ibid, p.18

status of those "quasi-co-operatives", the "pools and grain growers of the West" had been looked into. Mr. Ilsley replied that the matter was being investigated, but that no decision had been reached.<sup>1</sup> In September, the official organ of the Alberta Wheat Pool, The Budget, mentioned an attack on the tax position of the wheat pools appearing in the Financial Post. However, throughout 1941, Canadian Business, the organ of the Canadian Chamber of Commerce, made no mention of the tax exempt status of co-operatives.

In 1942, increased agitation from private sources and additional Federal Government action were apparent. According to the Brief of the Alberta Wheat Pool, the decision of the Pools in 1941 to recommence patronage dividend payments may have been in part responsible for the increased agitation.<sup>2</sup> From February to April, Canadian Business ran a series of three articles on co-operatives under the heading "Co-ops: a threat or a promise?"<sup>3</sup> These articles were written by L. L. Knott. The first article discussed the growth of the Canadian co-operative movement. The second article presented arguments for and against the co-operative movement. The third article reached the conclusion that co-operatives were a threat to other forms of private enterprise, and it offered

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1. Hansard, p.2836

2. Op. Cit. p.33

3. Vol. 15, Feb. 1942, p.30ff; March, p.24ff; April, p.26ff.

suggestions for combatting them. The author urged an improvement in wages, conditions and prices offered by businessmen. In an accompanying news item in the February issue entitled "How Co-ops Escape Taxes"<sup>1</sup>, the tax exemption received its first mention. In July, 1942, the Wheat Pools cut their handling charges by half a cent - a reduction of some 14 per cent - and on July 21 the question of their tax status was again before the House.<sup>2</sup> Ralph Maybank, a Winnipeg member, asked the present status of the Wheat Pools in regard to income tax payment. The Honourable Colin Gibson, Minister of National Revenue, replied that a decision had been rendered by the Department of Justice. He went on:

".....I do not know that there is any particular secret in the fact that we are going ahead assessing the various pools, and possibly the question will come before the courts whether they are or are not co-operatives." <sup>3</sup>

Later in the year the Saskatchewan Pool was assessed for the fiscal year 1939-40. The Revenue Department, in making the assessment, claimed that the Pool was no longer acting as selling agent for members' grain, since that function had been assumed by the Canadian Wheat Board. The assessment was appealed, and at the time of the Royal Commission hearings,<sup>4</sup> was still before the Revenue Department.

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1. Ibid, p.34

2. Hansard, p.4490-1.

3. Ibid.

4. Submission of the Saskatchewan Co-operative Producers,  
p.18

In 1943, the Government took further action. This might be partly attributed to the fact that very few farmers were paying income tax. According to the Brief of Professor MacDougall before the Royal Commission, only 24,000 farmers paid income tax in 1943 and their total payments amounted to only \$7,000,000.<sup>1</sup> Additional evidence of this may be obtained in the Financial Post of March 17, 1945.<sup>2</sup> This paper stated that in 1943 farmers comprised only 1 per cent of all income taxpayers and their payments represented only 1.4 per cent of total personal income tax collections. On February 15, Saskatchewan Pool Elevators were notified that in the opinion of the Justice Department even patronage dividends were a taxable profit.<sup>3</sup> From February 16 to March 29 an intermittent House of Commons debate on the question of co-operative taxation took place. Only two speakers expressed approval of the action taken by the government. In April, The Budget reported that the Saskatchewan Legislature had passed an unanimous resolution favouring the exemption of co-operatives, and the Premier of Manitoba had made a statement opposing the subjection of co-operatives to federal income tax.<sup>4</sup> At this time the Commissioner of Income Tax wrote to the Co-operative Union of Canada saying, in effect, that many accusations had

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1. Page 30.20

2. Page 1.1

3. Submission of the Saskatchewan Co-operative Producers, p.19

4. April 10, 1943.

been made in the press and by competitive interests that co-operative associations were receiving more lenient tax treatment than was justified by existing law, and this was resulting in discrimination against other taxpayers.<sup>1</sup> In the middle of April, 1943, Saskatchewan Pool Elevators were advised by the Income Tax Commissioner that co-operatives paying dividends on paid-up share capital could not qualify for exemption under the Statutes; in June the Saskatchewan Pool and all its subsidiaries were assessed jointly for the fiscal year 1939-1940.<sup>2</sup>

In 1944 agitation increased as a result of absolute co-operative growth, increasing tax burdens on competitors of co-operatives and confusion over interpretation of Section 4(p). At the end of December, 1943, the Canadian Chamber of Commerce had called for the taxation of all business, whether publicly, privately or co-operatively owned.<sup>3</sup> May and July editorials in Canadian Business called for the same thing. More important for our purposes, however, was the formation of the Income Tax Payers Association by two lawyers, G.S. Thorvaldson K. C., M.L.A., and Herbert Adamson, both of Winnipeg. Some of the objects of the Income Tax Payers Association were stated to be:

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1. The Budget, April 10, 1943.
  2. Submission of the Saskatchewan Co-operative Producers, p. 19
  3. Canadian Business, December, 1943

- "-To secure equitable distribution of the income tax burden.
- To secure the redress of inequalities in the incidence of the income tax.
- To afford income tax payers an opportunity of acting unitedly in making representations to the proper authorities to secure relief from inequalities in income tax law or administration; and to give publicity to such inequalities to obtain redress thereof." 3

In spite of the fact that no specific mention was made of co-operatives, this organization appears to have devoted a very large share of its efforts to having the tax exempt status of co-operatives repealed. In October and November the organization printed speeches made by its two founders at various luncheon meetings held throughout Canada. These pamphlets, though well written, showed an unmistakable bias against co-operatives.

In July, The Retail Merchants Association of Canada<sup>1</sup> issued some literature on the co-operative movement. Over half of the booklet was devoted to the tax position of co-operatives in Canada and other countries. In his concluding paragraph, the author states:

"It would now seem that the question to be determined is as to whether the Canadian Retail Federation, upon its own initiative or by collaboration with other interested parties, should make representations to the appropriate authorities upon the question of equity in taxation which seems the only valid approach which could be made and which has an important precedent to support it in the action that has been taken in Great Britain."

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1. Hougham, Geo. S., Survey of the Development of the Co-operative Movement in Canada, Toronto, 1944.

In the same month a delegation from the Co-operative Union of Canada met with the Minister of Finance and proposals were submitted by the Minister which the Union felt unable to accept.<sup>1</sup>

Meantime in May, the Government had retained Mr. Pitblado, a lawyer employed by the Winnipeg Grain Exchange and various grain companies in the past, to present the Government's case in the pending court action.<sup>2</sup> Then in September came an announcement by the Saskatchewan and Manitoba Pools, that retroactive to August 1, handling charges would be reduced from 3¢ to 1¢ a bushel on all grains. The Alberta Wheat Pool followed suit on October 7 to become effective October 10.<sup>3</sup> The significance of this is that the Pools apparently were trying to show that patronage dividends arose from an over-charge and that, in reality, co-operatives did operate at cost. It appears to have been a threat that, if they were made subject to taxation, they would cut charges to a minimum in order to avoid paying taxes. On October 21, news came that Exchequer Court hearings on the case of the Wheat Pools were to commence.<sup>4</sup> However, on October 23rd, the hearings were cancelled when Finance Minister Ilesley announced that a Royal Commission was being appointed to look into the whole question of tax exemption of co-operatives.

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1. The Canada Year Book, 1946, p.619.

2. The Budget, May 6, 1944.

3. Brief of the North-West Line Elevators, p.27.

4. The Budget



That is the history of the Canadian controversy up to the time of the appointment of the Royal Commission. In examining this history, several things stand out. First, the agitation for co-operative taxation has centred around the three Wheat Pools. This might be expected, for they are the largest and most powerful co-operative organizations in Canada. Secondly, this agitation arose more particularly at budget time and came from the private line elevator companies who were hit hardest by co-operative business. Thirdly, the chief grievances have been the growth of co-operative business and the exemption of co-operative concerns from the high wartime taxes. For example, the Income Tax Payers Association has regarded this tax exemption as a "weapon" which is used by co-operatives:

1. To take business away from its private competitors through price advantages.
2. By pyramiding earnings as capital and building up reserves for future expansion. 1
3. To buy out private competitors' businesses.

Fourthly, criticism of co-operative tax exemption appears to have come largely from western private grain dealers and from eastern business interests. The question started with the grain dealers and was taken up by the Financial Post of Toronto and Canadian Business of Montreal. Criticism of co-operative exemption has come in Parliament mainly from the

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1. Thorvaldson, G.S., How to Avoid Paying Income Taxes, Winnipeg, 1944, p.9.

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eastern Canadian members. Finally, as we shall now see, ambiguities in Section 4(p) led to confusion over the precise status of co-operatives in regard to the federal income tax.

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CHAPTER V

THE PARTICULAR APPLICATION OF  
THE CANADIAN INCOME WAR TAX ACT TO  
CO-OPERATIVE ASSOCIATIONS  
BEFORE THE 1946 AMENDMENTS

## CHAPTER V

### THE PARTICULAR APPLICATION OF THE CANADIAN INCOME WAR TAX ACT TO CO OPERATIVE ASSOCIATIONS BEFORE THE 1946 AMENDMENT

The Section in the Income War Tax Act dealing with income tax exemptions is Section 4. In 1930, Section 4 was amended to include subsection (p). Section 4(p), dealing with the exemption of co-operatives, read as follows:

"(p) The income of farmers', dairymen's, livestockmen's fruit growers', poultrymen's, fishermen's and other like co-operative companies and associations, whether with or without share capital, organized and operated on a co-operative basis, which organizations

(a) market the products of the members or shareholders of such co-operative organizations under an obligation to pay them the proceeds from the sales on the basis of quantity and quality, less necessary expenses and reserves;

(b) purchase supplies and equipment for the use of such members under an obligation to turn such supplies and equipment over to them at cost, plus necessary expenses and reserves.

Such companies and associations may market the produce of, or purchase supplies and equipment for non-members of the company or association provided the value thereof does not exceed twenty per centum of the value of the produce, supplies or equipment marketed or purchased for the members or shareholders.

This exemption shall extend to companies and associations owned or controlled by such co-operative companies and associations and organized for the purpose of financing their operations." 1

Upon careful reading, it is obvious that definite ambiguities exist in the section. First, there is the word "like" in line 2. It is not clear whether "like" refers to the words "organ-

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1. Statutes of Canada, 1930, Chapter 24, An Act to Amend the Income War Tax Act, p.231.

ized and operated", that is, to companies and associations organized on a co-operative basis, or, whether it is used to refer to co-operative companies and associations which are akin to those listed at the beginning of Section 4(p). Secondly, difficulty arises in the interpretation of the word "co-operative" (line 3), which is nowhere defined in the Act. Thirdly, there is no definition of the term "market the products" (line 6). Obviously using this phrase as a basis, Senator J.W. DeB.Farris, who represented a group of independent Vancouver milk producers, declared that co-operatives which process or manufacture produce received from members are merely "alleged" co-operatives.<sup>1</sup> One may easily interpret the phrase in such a way. Fourthly, the word "obligation" (line 8) has an uncertain meaning. It could be interpreted either as a legal obligation, or as a gentleman's agreement.

This ambiguity of language has had an apparently profound effect upon the particular application of the tax. As far as purchasing co-operatives are concerned, the administration of the tax has varied greatly between provinces. In an interview on July 11, 1947, Mr. George Dolsen, Treasurer of the British Columbia Co-operative Wholesale Society, informed me that the tax had been far from uniformly administered throughout Canada. He indicated that in his opinion it had been most leniently administered from the co-operative point

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1. Vancouver Sun, January 17, 1945.

of view, in the Prairie Provinces. On October 1, 1946, Mr. R. J. McMaster wrote to the National Secretary of the Co-operative Union of Canada in part:

"If we can force the Dominion Government to make rulings (on the income tax) at the top level of the department which are applicable throughout the country we will avoid the situation which previously existed under 4(p) of different rulings applying in different political atmospheres and thereby we should all be able to benefit by the weakest link in the Government's chain". 1

Thus, it would appear that the subjection of co-operative purchasing associations to income tax depended upon the relative strength of the co-operative movement in the particular province in question.

Mention has already been made of the application of the income tax to marketing co-operatives, and in particular to the Wheat Pools. Generally, all marketing co-operatives incorporated under provincial or federal law were exempt from taxation during the thirties. In 1940 and the years following a more urgent need for revenue was felt, and the Pools appeared to be a large, untapped source. Yet, the Act was not uniformly administered even with respect to marketing co-operatives, for the Ontario Farm Union Brief to the Royal Commission reported that "under the existing law most Ontario co-operatives pay even the income and excess profits taxes". 2 Representatives for the Oxford

1. Mr. R. J. McMaster is the Solicitor of the British Columbia Co-operative Wholesale Society.
2. Toronto Star, February 13, 1945.

Farmers' Co-operative Produce Company, Limited and for Ilderton, Middlesex Farmers' Co-operative, both of Ontario, reported that they paid income tax on retained surpluses.<sup>1</sup> It is not clear for how long a period these statements refer to. The ambiguity of the Act has been manifested also in the way in which the government has handled the assessment of the Wheat Pools. Judging by their actions, they first decided that the Saskatchewan Pool should be assessed because it was no longer acting as a marketing agent for its members. Then the Pool was informed that a co-operative paying dividends on share capital could not come within the statutory exemption. In this the Revenue Department may have been influenced by the Exchequer Court decision of 1929 in the case of the Fraser Valley Milk Producers. Finally, the Pool was told that even patronage dividends were to be regarded as taxable income. On the other hand, the Alberta Pool was never assessed until 1944,<sup>2</sup> and this inspite of the fact that the operating methods of the two organizations are very similar.

Surveying all the available facts, it would appear that there was no such thing as a uniform application of the Income War Tax Act to co-operative associations before the 1946 amendments.

1. Toronto Globe and Mail, February 14, 1945.
2. Submission of the Alberta Wheat Pool, p. 36(a).

CHAPTER VI

THE REPORT OF THE 1919 BRITISH ROYAL COMMISSION  
ON INCOME TAX  
AND THE REPORT OF THE  
1932 BRITISH PARLIAMENTARY COMMITTEE  
INQUIRING INTO THE POSITION OF  
CO-OPERATIVE SOCIETIES IN RELATION  
TO THE INCOME TAX



## CHAPTER VI

### THE REPORT OF THE 1919 BRITISH ROYAL COMMISSION ON INCOME TAX AND THE REPORT OF THE 1932 BRITISH PARLIAMENTARY COMMITTEE INQUIRING INTO THE POSITION OF CO-OPERATIVE SOCIETIES IN RELATION TO THE INCOME TAX

Before discussing British history of the taxation of co-operatives it would be well to point out that British co-operatives are financed in a different manner than those in Canada. British co-operative associations finance largely through the sale of additional shares to members, through loan capital from members, and by deposits from members, rather than by the retention of undistributed earnings.

The history of the income tax question in Great Britain goes back to the year 1867, when co-operatives were required to pay a tax on patronage dividends. However, the amount collected in taxes was not worth the effort, and as a result in 1876<sup>1</sup> co-operatives received exemption. From that time until the present day arguments have raged pro and con over the tax issue.

In 1919 a Royal Commission was appointed to survey the whole income tax field. The subject of co-operative taxation was dealt with in its report. The Commissioners agreed unanimously that dividends on purchases were not distributed profits, but rebates on the purchase price and therefore not

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1. R.C.C., p.216.

subject to tax. However, this was the only point of agreement. A majority report, signed by eleven of the twenty-two members, recommended that any part of the net proceeds of a society which was not returned to the members in patronage dividends should be subject to income tax. Income from<sup>1</sup> investments was also held to be taxable.

Seven members of the Commission presented a minority report which stated in part:

"In our opinion, the proceeds of mutual trade are not profits in any sense of the groups of individuals among whom the trade is carried on. They are no more profits than the payments to a club by its members are profits... The majority report ... implies that the question whether or not the receipts of a co-operative constitute a profit depends not on the origin of those receipts but on the use to which they are put. This test is not employed as regards any other class of receipts, and we cannot agree that it can properly be applied with regard to this particular class of receipts." 2

Two other members of the Commission agreed that receipts from mutual trading were not taxable profits, whether distributed or put to reserve, but they recommended that as more and more trade in relation to the whole was conducted through co-operative channels, the Government should devise some other<sup>3</sup> special form of taxation to apply to them. The final two members of the Commission felt that the "mutuality" characteristic had pretty well disappeared, and could be disregarded

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1. Carr-Saunders, Florence, Peers, Consumers' Co-operation in Great Britain, London, Allen and Unwin, 1938, p.465.
  2. From the Report of the Royal Commission on the Income Tax 1910 as quoted in Consumers' Co-operation in Great Britain p.466
  3. Consumers' Co-operation in Great Britain, p.466

for purposes of taxation. They believed surplus arising from mutual trading should be chargeable to income tax, but for practical purposes a distinction was urged between surplus distributed to the members and undistributed reserves. To make for efficient tax collecting, they suggested exemption of patronage dividends, but agreed a tax should be levied on the reserves of co-operative organizations.<sup>1</sup> In spite of the fact that the Commission apparently had made a thorough study of co-operative tax exemption from every angle, nothing was done by the Government to implement any of the recommendations. This may be explainable by the obvious disagreement among the Commissioners. It might be well to add that the majority report recommended that agricultural co-operatives be treated in exactly the same way as the purchasing societies.<sup>2</sup>

In the elections of 1931, although the Conservatives received a sizeable majority, they formed a National Government with Ramsay MacDonald as Prime Minister. Neville Chamberlain, a man regarded by co-operatives as unfriendly, was given the post of Chancellor of the Exchequer.<sup>3</sup> The appointment of the Raeburn Committee in 1932 for the purpose of inquiring into the income tax status of co-operatives is explainable only because of the large area of disagreement found among the members of the 1919 Royal Commission. From available

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1. Loc. cit.

2. R.C.C., p.216

3. Co-operative Wholesale Society, People's Year Book, 1934, p.65.

information it appears that non-co-operative traders had been pressing for the implementation of the majority Report since 1920. This pressure may be attributed to two factors. First, the income tax rates were high. After 1915 income tax rates increased sharply. Before the 1914-18 War the standard rate on undistributed surplus was 1s.2d. in the pound. The rate was raised by one-third in 1914 and doubled in the fiscal year 1915-16. Since the first War, except for a period during Mr. Churchill's Chancellorship, it has never been below 4s.2d.<sup>1</sup> The second reason was probably the considerable growth of co-operative membership and sales. In order to examine the fears of non-co-operative traders in this connection, statistics are necessary. Table XXVI shows co-operative retail distributive societies in England, and numbers of members of retail societies. It appears that sales roughly doubled from 1897 to 1915 and from 1915 to 1933.<sup>2</sup> However, these figures must be considered in the light of changes in total retail sales during the period, and for this purpose we shall use national income figures which are a reasonably good measure for showing these changes. From 1894 - 1903 the average national income has been estimated at £1,666,000,000; at £2,339,000,000 in 1913 and at £3,962,000,000 in 1933.<sup>3</sup> Although co-operatives show striking relative gains

1. U.K. Hicks, The Finance of the British Government 1920-36, London, Oxford Press, 1938, p.234.
2. Table XXVI
3. Colin Clark, National Income and Outlay, London, MacMillan, 1938, pp. 232 and 88.

in the period from 1897 to 1915, the effect of the increase in national income between 1913 and 1933 is to indicate very little relative increase in co-operative trade.

The Raeburn Committee was a Parliamentary committee consisting of three members. Commenting on the report of the committee, the Rt. Hon. A. V. Alexander stated in 1934 that the committee was anything but impartial, for it included in its membership "a director of companies which had regularly boycotted co-operative societies with regard to supplies, and who was also the president of an Institute of Accountants which had given evidence against co-operative societies before the Royal Commission on Income Tax in 1919"<sup>1</sup>. In spite of this alleged bias, the Committee presented a Report which was virtually the same as that of the majority of the 1919 Royal Commission.

The Report of the Committee was presented to Parliament in February, 1933. The Committee obtained evidence from some fifteen bodies. Apart from the specific exemption of the Income Tax Act, the Committee acknowledged that the courts had declared that the part of the surplus of a co-operative association arising from trade with members should not be subject to tax.<sup>2</sup> However, the following was rather interestingly added:

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1. Co-operative Wholesale Society, People's Year Book, 1934, p. 65
  2. Report of the Committee appointed to Inquire into the Present Position of Co-operative Societies in Relation to Income Tax, London, 1933, p. 4. (Hereinafter called Raeburn Committee)

TABLE XXVI - THE GROWTH OF THE BRITISH CO-OPERATIVE  
RETAIL MOVEMENT

| <u>Year</u> | <u>Members</u> | <u>Trade</u><br><u>£</u> |
|-------------|----------------|--------------------------|
| 1891        | 1,044,675      | 30,599,401               |
| 1893        | 1,169,094      | 31,925,896               |
| 1895        | 1,274,994      | 33,900,674               |
| 1897        | 1,465,538      | 40,128,559               |
| 1899        | 1,613,461      | 45,047,446               |
| 1901        | 1,793,167      | 52,761,171               |
| 1903        | 1,987,423      | 57,512,887               |
| 1905        | 2,153,015      | 61,086,991               |
| 1907        | 2,323,376      | 68,109,376               |
| 1909        | 2,469,396      | 70,423,359               |
| 1911        | 2,640,429      | 74,812,469               |
| 1913        | 2,878,296      | 83,607,043               |
| 1915        | 3,264,811      | 102,557,779              |
| 1917        | 3,788,490      | 142,003,612              |
| 1919        | 4,131,477      | 198,930,437              |
| 1921        | 4,548,557      | 218,780,384              |
| 1923        | 4,569,256      | 165,490,038              |
| 1925        | 4,910,983      | 183,584,049              |
| 1927        | 5,579,038      | 199,924,938              |
| 1929        | 6,168,994      | 216,967,099              |
| 1931        | 6,590,020      | 207,888,385              |
| 1933        | 6,917,138      | 197,257,009              |
| 1935        | 7,483,976      | 220,429,517              |
| 1937        | 8,084,990      | 251,393,047              |
| 1939        | 8,643,233      | 272,293,748              |
| 1941        | 8,773,255      | 302,246,329              |
| 1943        | 9,082,218      | 331,574,123              |
| 1945        | 9,401,927      | 360,999,519              |

Source: Co-operative Wholesale Society,  
People's Year Book, 1947, p.160.

"On the other hand it has been urged that this conclusion is not to be inferred from the decisions in question. The arguments on either side have been very fully stated to us and it is clear that the point is by no means free from doubt and could be finally settled only by a court of law." 1

The Committee went on to recommend that co-operative societies should be subject to income tax in respect of all trading, whether with members or non-members after making allowances for trade expenses, wear and tear of plant and equipment, and necessary repairs and renewals; patronage dividends were to be regarded as a trade expense.<sup>2</sup> However, it was also recommended that co-operatives be freed of the duty of collecting the tax on share and loan interest at the source, that is, the interest would be chargeable in the hands of the individual rather than in the hands of the co-operative association.<sup>3</sup> In reality, what was suggested was the taxation of reserves. The decision was made mainly on legal grounds, for the Committee stated that although associations initially took the form of "mutual" trading societies, such was no longer the case, for co-operatives were held to be legal entities<sup>4</sup> apart from their members.

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1. Raeburn Committee, p.4.
  2. Ibid, p.9.
  3. Ibid, p.10.
  4. Ibid, p.8.

"...a separate legal entity -- the Society -- is interposed between the income or surplus and the members, and in our opinion the existence of that entity cannot, as we have already stated, be ignored, any more than the existence of an entity separate from the shareholders in the case of an incorporated company. Income tax at the full rate has to be paid on the undistributed profits of a company irrespective of the individual liabilities of the shareholders, and there must be many companies in which a considerable body of the shareholders are not individually liable at that rate." 1

The Committee is probably correct in its statement that many shareholders of private companies would not be liable to pay income tax at the rate paid by companies on undistributed surplus. However, the Report as a whole is not entirely logical, for as The Economist pointed out:

"It is one thing to subscribe to a company in order to build up and share in the surplus of its trading; it is another thing to subscribe to a society to obtain commodities cheaper than elsewhere by virtue of a deferred rebate; and if a deferred rebate be further deferred, why should this latter be taxable and not the former." 2

The recommendations of the Raeburn Committee were not acceptable to the representatives of the co-operative movement. Attempts of the representatives of the co-operatives and Mr. Chamberlain to work out a compromise agreement were unsuccessful, and subsequently the Government implemented the Raeburn recommendations.

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1. Raeburn Committee, p.9

2. March 4, 1933, p.458.



CHAPTER VII

THE REPORT OF THE CANADIAN ROYAL COMMISSION  
ON CO-OPERATIVES

## CHAPTER VII

### THE REPORT OF THE CANADIAN ROYAL COMMISSION ON CO-OPERATIVES

The history leading up to the appointment of a Royal Commission has already been discussed. On November 16, 1944, a Commission was named to inquire into:

- "(a) the present position of co-operatives in the matter of the application thereto of the Income War Tax Act and the Excess Profits Tax Act, 1940 and
- (b) the organization and business methods and operations of said co-operatives as well as any other matters relevant to the question of the application of income and profits tax measures thereto, and
- (c) the comparative position in relation to taxation under the said Acts of persons engaged in any line of business in direct competition with co-operatives."<sup>1</sup>

The Commission was directed to report all facts which would be relevant in determining an equitable basis for the applica-<sup>2</sup>tion of these two tax Acts to co-operative associations.

The Commission consisted of five members under the chairmanship of Mr. Justice McDougall of Quebec.

The report of the Commission deals with virtually every aspect of Canadian co-operatives and contains much valuable statistical material. In examining the tax status of co-operatives under Section 4(p), the Commissioners made no distinction between co-operatives and joint stock companies. One of the reasons for this is that no one was able to furnish the Commission, nor was the Commission able to find, a suit-

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1. R.C.C., p.9

2. Ibid, p.9.

able definition for a co-operative.<sup>1</sup> As was pointed out elsewhere, co-operative associations organized under Provincial co-operative statutes exhibited such a variety of forms and operating methods that no all-inclusive definition could be found. Having regard to the premise of close similarities of organization between co-operative and joint stock companies, and keeping in mind the desirability of equity in any taxation suggestions brought forth, the Commission made several important recommendations. In making these recommendations, it was held that the operations of a co-operative result in income to the co-operative and its members. The Commission attempts to distinguish between that portion of the surplus which is retained permanently by the co-operative, as compared with that portion which is paid to, or claimable by, the customers of the co-operative.<sup>2</sup>

The Report holds that interest on a loan to, or another investment in a co-operative association, provided that the loan or investment is withdrawable by the member, on condition that reasonable notice be given by him to the association, and provided that the loan or investment has a fixed date of maturity, should be deductible as an expense of the association and taxed as income of the member when he receives it.<sup>3</sup> Interest on a loan or investment is clearly

1. Co-operative Union of Saskatchewan, Notes on Royal Commission Recommendations, Regina, 1945, p.1

2. R.C.C., p.41

3. R.C.C., p.41.

distinguished from "interest" or dividends on share capital, declared by the co-operative association at the end of its financial year. The Report holds that a payment of this nature is analogous to the distribution of profits on the basis of investment as in a joint stock company. This would be particularly true in the case of an association paying dividends on shares and not financed in proportion to the volume of business which each member does through the association. The fact that the rate of dividend may be fixed was held to be irrelevant. Such amounts are not considered deductible as an expense of the association unless the principal upon which they are paid has a definite maturity date, and is withdrawable by the member upon reasonable<sup>1</sup> notice. They are also considered taxable in the hands of those who receive them.

Understandably, contributions made in the form of share capital, loan capital, or membership fees, are not regarded as income of the association, but rather as equities in the association. In the case of marketing associations, deductions from the gross proceeds of the sale of a member's product which are applied to further the member's equity in the association are held to be advances to the co-operative and not income. Deductions made to cover operating expenses<sup>2</sup> are ~~con~~sidered as deductible for income tax purposes.

1. R.C.C. p.42.

2. Ibid, p.42.

One of the main findings in the Commission Report was that any sum paid in cash or credited to a member or patron of a co-operative in such a way that he can withdraw them upon some reasonable notice, subject, however, to the authority of the directors to protect the co-operative against sudden or excessive withdrawals, could not be considered as income of the association, and could not therefore be considered as taxable in its hands.

Patronage dividends paid in cash or credited towards payments for shares or other investments are thought of as the income of the member, or customer and taxable in his hands.<sup>1</sup> These payments are clearly the income of their recipients for, taking the example of a primary producer who markets his produce through a co-operative, he receives an initial payment at the market price and then later receives a patronage rebate, and this rebate is an increase in the total amount received for his produce and therefore an increase in his income. But patronage dividends on consumers' goods were held to be simply a reduction in the price of the good rather than income.<sup>2</sup>

To preserve equality of treatment, the Report states that where joint stock companies, partnerships or individual enterprises hold forth the prospect to customers of distributing earnings in proportion to patronage, patronage payments should be allowable as a deduction when arriving at taxable income.

1. R.C.C. p.42. 2. Ibid, p.42.

The Report concludes that the remaining surplus of the co-operative association which is retained by the association, either as undistributed surplus or as unallocated reserves, or as allocated reserves which are credited to the members, but in such a way that they are not withdrawable by the member upon some reasonable notice "should not be allowed as a deductible expense of the association when earned", and constitute taxable income.<sup>1</sup> This is quite justifiable, for undistributed surplus and reserves which are unallocated are, for all practical purposes, the property of the association per se. In many cases such earnings are not withdrawable except at the sole discretion of the Board of Directors. However, the Report recommends that undistributed surplus or reserves be allowed as a deductible expense of the association in any year in which they might be returned to the members.

The Report holds that in the distribution of patronage dividends if the dividends distributed to non-members are to be allowed as a deductible expense of the association, they must be paid at the same rate, on the same types or classes of goods, to both members and non-members. If there is no discrimination,<sup>2</sup> amounts paid to non-members are not held to be taxable.

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1. R.C.C. p.44

2. Ibid, p.45.

Recognition is also given to a major weakness of co-operative organizations -- their inability to attract investment capital. In view of this, the Report suggests that co-operative organizations, other than federations of co-operatives, should receive exemption from taxation for the first three years of their operations.<sup>1</sup> This is a salient point which unfortunately was not taken into consideration by any British body investigating the income tax status of co-operative societies, although we should keep in mind the fact that British co-operatives are financed largely through the sale of additional shares to each member, through loan capital and by deposits, rather than by retention of patronage dividends. The use of deferred dividends as working capital appears to be the outcome of circumstances<sup>2</sup> peculiar to Canadian agricultural conditions.

In brief, the recommendations of the Royal Commission provided for the repeal of Section 4(p) of the Income War Tax Act, and the taxation of co-operatives on virtually the same basis as private companies. But certain basic differences between joint stock companies and co-operatives were recognized in that patronage dividends were treated as trade expenses, providing certain conditions existed. To be deductible it was held that patronage dividends had to be paid

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1. R.C.C. p.45

2. Ibid, p.215.

in cash, or an equivalent, within six months after the annual meeting of the association, or that such dividends were credited to the customer within the same period and "exigible<sup>1</sup> by him on giving such notice as may be deemed reasonable". It also was required that the association had to hold forth the prospect of the payment of patronage dividends, and that there be no discrimination in the rate of dividend paid on the same type of item as between members and non-members. Deductions from the gross sale proceeds of a farmer's product were held to be deductible as an expense provided that they were used to purchase shares, or were credited to him and exigible by him upon reasonable notice. On the other hand, patronage dividends and deductions credited to the customer, and used for capital purposes on the so-called "revolving door" plan, but not payable except at the sole discretion of the directors are held to be taxable in the period credited to customers. Nevertheless, the Report holds them to be exempt in the period in which they are paid out. Interest on loan capital, or any form of investment in the association having a fixed date of maturity, or being withdrawable on reasonable notice, and provided that the interest is at a fixed rate and payable by the association annually can be regarded as deductible for tax purposes. The Report recommends

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1. R.C.C. p.68.



that newly formed associations be exempt from income tax the first three years of their operations, and that service type co-operatives be given a blanket exemption. Services co-operatives would include associations organized for the purpose of distributing electric power, operating rural telephone lines, providing hospital services and the like.

Three Commissioners had reservations to make.<sup>1</sup>

Mr. B. N. Arnason, dealing with the provision that reasonable notice be given before any member might withdraw amounts credited to him, suggests that "what constitutes reasonable notice must have reference to conditions that prevail in Canada".<sup>2</sup> Here, he would appear to have in mind the largely agricultural basis of the Canadian co-operative movement.

Mr. Arnason points out that the Report seeks to distinguish between that part of surplus retained by a co-operative association for itself, and that part which members may claim, upon reasonable notice, as their own. But there is a third case which may be added, and which is mentioned by Mr. Arnason, though ignored in the recommendations of the Report. This third case is where there is an irrevocable obligation providing that deductions from the gross proceeds of the sale of a member's produce, or patronage dividends, shall be deferred for a definite period only. Commissioner Arnason feels that payments of this nature cannot be con-

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1. R.C.C., pp 67-72.

2. Ibid, p.68.

sidered as income of the association, for they are deferred for a definite period under a definite obligation to pay. The irrevocable obligation to the member is clearly established. This is an intermediate case between capital which can be withdrawn upon reasonable notice, and capital which is, for all practical purposes, the property of the association per se. He urges that such payments be considered as deductible<sup>1</sup> in computing taxable income for the association. In my opinion, Mr. Arnason's point is well taken, if only on the grounds that the obligation has been established and is irrevocable.

Another point raised by Commissioner Arnason takes cognizance of the weak position of co-operatives in relation to the raising of capital. He suggests that co-operatives be permitted to put aside certain limited tax-free reserves<sup>2</sup> in order to protect the equity of members.

Mr. J. M. Nadeau likewise recommends that certain tax-free reserves be put aside in order to maintain the members' equity.<sup>3</sup>

On the other hand, Mr. J. J. Vaughan felt that the amount of taxation which would be imposed on co-operatives should the Government accept the recommendations of the Report would not remove existing inequalities. He suggests that either a new special tax be levied on co-operatives, or alternatively,

1. R.C.C., pp.68-69.      2. Ibid, p.69.      3. Ibid, p.70.

the removal by the Government of part of the taxation now<sup>1</sup> imposed on joint stock companies.

By and large, with the exception of the provision that the rate of patronage refund was to be the same for both members and non-member customers, the Report is quite favorably disposed to the co-operative point of view. Co-operative spokesmen state that this is one of the most dangerous and administratively difficult provisions of the recommendations. They go on to add:

"From a consumer point of view this involves an exhausting bookkeeping and administrative problem. A record of the name, etc. of every purchaser of goods whether for five cents or \$100.00 worth must be kept as well as a record of his purchases. The problem of producers' co-operatives in this respect is much simpler, but if they have firm contracts to supply they will require to beware. Further take note that such provision will surely discourage many persons from becoming members and advancing capital, particularly in consumer organizations. Why risk capital if you can get the same patronage dividends without?" 2

Such a criticism would appear to place an emphasis on capital previously disclaimed by many co-operative members. Judging by the above, patronage dividends would seem just as much a return on capital as a rebate or trade expense.

However, contentions of co-operatives with regard to the nature of patronage dividends, and the inherent weakness of the co-operative method -- lack of attractibility for investment capital -- were recognized. The latter was ignored in

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1. R.C.C. p.72.

2. McMaster, R.J., and Dolsen, George, Memorandum of Comments Re Report of the Royal Commission on Taxation of Co-operatives, Vancouver, January, 1946, unpublished, p.5.

in the British Parliamentary Committee Report, and it may be assumed that the Royal Commission took into consideration the nature of Canadian co-operative development and its relative position in Canada's economy. Further, contentions of private business organizations that co-operatives be made subject to the Income War Tax Act and the Excess Profits Tax Act on a retroactive basis were unanimously rejected. Undoubtedly provision for retroactive assessment would work an undue hardship on co-operatives, who, in good faith had believed themselves to be exempt under Section 4(p).

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CHAPTER VIII

THE PRESENT TAX STATUS OF CO-OPERATIVES IN CANADA  
AS COMPARED WITH THEIR POSITION IN GREAT BRITAIN AND  
FOREIGN COUNTRIES

## CHAPTER VIII

### THE PRESENT TAX STATUS OF CO-OPERATIVES IN CANADA AS COMPARED WITH THEIR POSITION IN GREAT BRITAIN AND FOREIGN COUNTRIES.

At the 1946 Session of the Canadian Parliament, the exemption previously accorded co-operative companies and associations was rescinded effective December 31, 1946. Commencing with the 1947 taxation year, all co-operatives became subject to tax if they had a taxable income.

Section 4(p) as amended provides for exemption from income tax during the first three taxation years of co-operatives which comply with certain requirements. The co-operative (a) must have commenced business after January 1, 1947,

(b) be incorporated under provincial co-operative legislation,

(c) hold forth the prospect that payments will be made to members and non-members in proportion to patronage,

(d) provide that each member shall have only one vote,

(e) have as members individuals only,

(f) provide that dividends on shares shall not exceed 5 per cent per annum,

(g) do at least 80 per cent of its business with members,

(h) provide that no member hold more than 5 per cent of the shares issued, or capital subscribed,

(i) must not be a continuation of a previous business in which a large number of members of the association had a substantial interest. 1

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1. Statutes of Canada, 1946, Chapter 55, pp.290-291

With regard to co-operatives operating before January 1, 1947, the new law puts these associations in the same class as other businesses for tax purposes. However, the law as applied to co-operatives centers around the now famous 3 per cent provision.<sup>1</sup> To appraise the fairness of the law it is essential that this provision be understood. The 3 per cent provision was introduced partly for administrative reasons. The Government appears to have feared that had co-operatives been taxed only on net increases in reserves, co-operatives would then have adopted a policy of paying out in patronage dividends a large percentage of what was formerly put to reserves. If co-operatives followed this policy, nothing would have been done to relieve existing inequities. The 3 per cent provision insures that co-operatives pay on a sum amounting to at least 3 per cent of their employed capital. It would seem that the Government holds that capital in any organization -- co-operatives included -- earns a return. It feels that a normal return on capital employed -- to be computed in accordance with the First Schedule to the Excess Profits Tax Act, 1940 -- in any co-operative organization is 3 per cent. With the idea of administrative convenience in mind, the Government's position appears to be that the income of a marketing co-operative is made up of income from

1. The material explaining present tax status of co-operatives and the 3 per cent provision, is found in Preliminary Explanatory Brochure re The Income War Tax Act, issued by the Department of National Revenue to assist co-operative associations subject to tax under the Act as amended.

investments, underpayments to members and customers, and a sum equivalent to 3 per cent of the capital employed by the business; the income of a purchasing association is made up of income from investments, overcharges to the members and customers, and a sum equivalent to 3 per cent of capital employed by the association. The 3 per cent of capital employed might be termed a floor. The Act provides that earnings over and above 3 per cent of the capital employed, when paid in proportion to patronage, may be deducted from taxable income. Before patronage payments are considered as deductible, the prospect that such payments were to be made must have been held forth to member and non-member customers, and allocation and payment must have been made within the taxation year, or within twelve months thereafter. Patronage refunds are allowed as deductions from taxable income if paid in cash, or credited to the customer on his written authority authorizing the association to retain the money on loan or to apply the same on purchase of shares, or by the payment of moneys for the purchase of certificates of indebtedness or stock or shares of the association. Refunds may be made to members alone, or to members and non-members, at either similar or varying rates. However, the amount of refunds to members which may be exempt from taxation must all have been obtained from member business. Thus, if a co-operative



does 75 per cent of its business with members, it can pay out any or all of its surplus to members, but a maximum of 75 per cent of the surplus will be allowed as a deduction in computing taxable income. The other 25 per cent to be considered as deductible would have to be paid out on a patronage basis to non-members.

If part of an organization's surplus is allocated to members or patrons, but kept by the co-operative for financing, it is taxable. But, if in some later years it is paid out as originally allocated, it is allowed as a deduction in computing taxable income in the years in which it is paid out. Hence, this applies to the "revolving door" fund method of financing. By this provision, if a "revolving door" fund is built up to \$50,000. and kept there, tax has to be paid on the \$50,000, but because the amounts paid out in later years are deductible from taxable income, the \$50,000 is only taxed once, and it is not taxed again each time it is turned over. It should be pointed out that the fact that tax exemption can be claimed for patronage refunds to members only to the amount of the surplus accumulated through members' business does not mean that only this amount can be paid to members in patronage refunds. Subject to taxes, the whole of a co-operative's surplus may be paid to members, regardless of the non-member patronage.

Only under one circumstance may deductions be made below 3 per cent of the capital employed. There may be deducted the amount of interest paid on borrowed moneys other than moneys borrowed from a bank or from a credit union.

So far it has been indicated that the 3 per cent provision is, in effect, a means of setting a minimum taxable income. The above mentioned circumstance is, of course, an exception. But what of the co-operative association that has annual earnings which are less than 3 per cent of the capital employed? In this case NOTHING is allowed as a deduction from net earnings, except interest on borrowed moneys other than moneys borrowed from banks or credit unions. The Government's logic here is rather difficult to interpret. One might say that they feel that if an association is not making a return of at least 3 per cent on employed capital, either the association is being inefficiently managed, or that none of the earnings can be considered as an overcharge or underpayment to the members. The latter appears to be the more correct explanation for the Government in applying the tax seems to regard the earnings of such an association as a return on capital and therefore taxable.

The Income War Tax Act as applied to co-operatives not making earnings equal to 3 per cent of the capital employed is, in my opinion, grossly unfair. In reality the new tax

provisions hit small co-operatives the hardest, even allowing for the three year tax exemption period. It must also be remembered that the exemption applies only to co-operatives incorporated after January 1, 1947. The larger co-operative organizations probably have little difficulty making a return of 3 per cent on employed capital. In addition they are the ones most able to hire efficient management and an efficient labour force. Because their earnings are over 3 per cent, they are eligible to deduct patronage dividends from net earnings when computing taxable income. In many cases smaller co-operatives, and in particular small purchasing societies probably do not have earnings equal to, or greater than 3 per cent of capital employed. Further, they are least able to hire an efficient manager and an able labour force. They are unable to offer a good manager a salary which would be commensurate with his abilities.

Unfortunately, the tax weighs most heavily on purchasing associations, who in 1943-44 did only 11 per cent of the total business of all Canadian co-operatives.<sup>1</sup> Those associations which do not make a return of 3 per cent on capital employed, must pay tax at the full rate on their earnings, and patronage dividends are not considered to be deductible in computing the tax. It is quite probable that purchasing associations as a whole do not earn as high a return as market-

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1. R.C.C. , p.79.

ing associations, and it is also likely that many purchasing associations do not earn a 3 per cent return. Marketing co-operatives, who did the remaining 89 per cent <sup>1</sup> appear to have a relative advantage under the Act.

It would be interesting and helpful to compare the present tax status of co-operatives in Canada with their position in other countries. Also, it would be worth noting whether the tax treatment of co-operatives shows variety or uniformity as between countries.

The British Parliament in 1933 accepted the recommendations of the Parliamentary Committee of Inquiry. As a result co-operative societies are taxed on exactly the same basis as private companies under Schedules A, B, C, and D. That is, a co-operative must pay tax on the annual value of property owned, rents from property owned and let to tenants, profits from the occupation of land, interest on government stocks, trading profits, deposit interest and other interest received in full without deduction of tax, dividends and interest on investments and income from foreign securities or foreign <sup>2</sup> possessions. However, the Finance Act of 1933 provides for <sup>3</sup> the treatment of patronage dividends as trade expenses. The same rate of tax as is levied on private competitors is <sup>4</sup> paid on earnings set aside annually as reserves. Interest

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1. R.C.C., p.79.
  2. Raeburn Committee, p.6.
  3. Report of the Inquiry on Co-operative Enterprise in Europe, Washington D.C., Government Printing Office, 1937, p.74.
  4. R.C.C. p.218.

on loan and share capital is taxable as part of the income of the recipient, while the co-operative is permitted to deduct from its income tax the tax normally payable on share<sup>1</sup> and loan interest. This is the case because many of the recipients of loan and share interest are not in the taxable income brackets. The Canadian Royal Commission regards the British experience as a satisfactory compromise, even if it is not entirely logical. While the British experience is of great use, it is imperative to keep in mind that the British movement is largely a consumer movement and therefore different from the situation found in Canada.

In France, co-operatives must pay the same taxes as their private competitors.<sup>2</sup> Workers' productive societies, however, get a 25 per cent reduction in taxes on their gains.<sup>3</sup> All societies whose volume of transactions exceeds a certain figure<sup>4</sup> must pay a special volume of business tax.

A Dutch law passed in 1917 makes co-operatives just as liable to taxation on patronage dividends as a corporation is liable on stock dividends. In spite of arguments advanced by co-operative supporters, Government taxation officials have claimed that members by getting a dividend receive a

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1. R.C.C. p.218.

2. Co-operative Enterprise in Europe, p.74.

3. Co-operative Enterprise in Europe, p.74

4. Co-operative Wholesale Society, People's Year Book, 1934, p.78.

profit at the expense of non-members who are not paid a dividend. Secondly, they say the dividend is paid on all purchases and does not correspond with the surplus on each individual article. Thirdly, it is argued that the actual amount of the dividend depends upon the results of the year's trading operations.<sup>1</sup> It might be concluded that in Holland absolutely no distinction is made between profits in a joint stock company and patronage dividends in a co-operative.

In Belgium, co-operatives pay the same taxes as other private business organizations. Patronage dividends are<sup>2</sup> allowed as deductions in computing net taxable income.

Danish co-operative associations are exempt from income tax provided that they trade only with members. Such associations may remain exempt by applying a patronage refund due to a non-member towards his membership in the organization. Societies that sell to non-members, or market the produce of non-members are taxed on the same basis as other private businesses. A tax is also levied on annual accumulated<sup>3</sup> surplus.

In Norway, co-operatives pay tax on a presumed income of the property they occupy. The tax has to be paid whether<sup>4</sup> their activity results in a surplus or not. This appears

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1. People's Year Book, 1934, p.73

2. Ibid, pp. 70-72.

3. Co-operative Enterprise in Europe, p.75.

4. People's Year Book, 1934, p.85.

to bear a slight resemblance to Canada's 3 per cent provision. Full tax is paid on the income derived from sale to non-members, but no tax is paid on income derived from members.<sup>1</sup>

The tax status of co-operatives in Sweden is rather peculiar. Patronage dividends are not regarded as profits and therefore not taxed. Neither are they taxed in the hands of the individual. However, associations pay tax on dividends on share capital and on surplus allocated to reserves. This tax is on the same basis as that paid by natural persons or foreign companies -- the tax is graduated. Domestic joint stock companies pay at a lower rate than co-operatives.<sup>2</sup> The latter has had the effect of forcing the Swedish Co-operative Wholesale Society to organize many of its factories on a joint stock company basis in order to take advantage of the lower tax rate.<sup>3</sup>

Czechoslovakian co-operatives are exempt from profit and capital taxes. Purchasing co-operatives dealing only with members or making only inadvertent sales to non-members pay a tax of two-tenths of 1 per cent on their paid-up capital. Non-co-operative business organizations pay a tax of 8 per cent on their profits. An association that has both members and non-members as regular customers pays the 8 per cent profits tax. A transaction tax is levied on all business whether privately or co-operatively owned. However, co-operative wholesalers

1. Co-operative Enterprise in Europe, p.75.
2. Ibid, p.75.
3. The People's Year Book, 1934, p.74-75

do not pay this transaction tax since the Government feels that it will be paid by the retail societies that they<sup>1</sup> serve.

Finnish co-operative distributive societies pay a municipal tax on half of their surplus which arises from their business transactions.<sup>2</sup> Domestic societies promoting productive efforts in primary industries, or supplying members with commodities are allowed to deduct, for purposes of national tax, half of their net earnings in calculating taxable income. However, to be eligible for such deduction, a co-operative association must pay no more than a 6 per cent dividend on shares, and non-member customers must have the right to<sup>3</sup> become members.

In pre-Hitlerian Austria, co-operatives who dealt only with members paid a tax of 12 per cent on their entire surplus. Those who also traded with non-members paid a tax of 25 per cent on their entire surplus. In contrast, private traders paid tax on profits at progressive rates varying<sup>4</sup> from 1 per cent to only  $7\frac{1}{2}$  per cent.

In Switzerland, co-operatives generally pay tax on their capital assets and on earnings transferred to reserve.<sup>5</sup>

In the United States, with regard to federal income tax, urban consumers' co-operatives are allowed to deduct patron-

1. Co-operative Enterprise in Europe, p.75
2. The People's Year Book, 1934, p.104
3. Co-operative Enterprise in Europe, p.75
4. The People's Year Book, 1934, pp.106-107
5. Ibid, p.90.



age refunds in computing taxable income. Farmers' marketing and supply organizations are treated in a similar way. On the whole, earnings transferred to reserves, and interest or dividends paid on share capital constitute taxable income. Consumers' associations organized and operated by farmers receive complete exemption because such associations are composed of farmers. By and large, state corporation income tax rules are like the federal in their treatment of co-operatives.<sup>1</sup>

From the foregoing information, it appears that the tax status of co-operatives in Great Britain and foreign countries offers no uniform pattern with which to contrast the Canadian law. Roughly, it seems that the majority of countries examined treat the patronage dividend as a deduction from taxable income, and assess co-operatives on earnings transferred to reserves. Several countries give special treatment to agricultural co-operative societies. It is interesting that Czechoslovakie and Norway tax co-operatives on a basis somewhat similar to the 3 per cent provision.

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1. R. C. C. pp.228-229.

CHAPTER IX

AN ANALYSIS OF THE ARGUMENTS PUT FORWARD BY

CO-OPERATIVES AND THEIR COMPETITORS

REGARDING

THE SUBJECTION OF THE EARNINGS

OF CO-OPERATIVE ORGANIZATIONS TO INCOME TAX

## CHAPTER IX

### AN ANALYSIS OF THE ARGUMENTS PUT FORWARD BY CO-OPERATIVES AND THEIR COMPETITORS REGARDING THE SUBJECTION OF THE EARNINGS OF CO-OPERATIVE ORGANIZATIONS TO INCOME TAX

This chapter consists of a critical examination of the various main arguments put forward by spokesmen of co-operative organizations and their competitors in advocating their respective solutions to the problem of the tax status of co-operatives.

Advocates of co-operatives have stated, as their principal argument for exemption, that co-operatives are non-profit organizations and that their aim is to operate at cost. They claim that their motto is service and not profit. However, they also admit that all of the earnings of a co-operative society are not savings. First, they admit that that portion of net surplus arising from non-member business, which is not distributed to non-members at the same rate as to members, is properly taxable as profit of the association. To this may be added several things. A portion of the interest paid on share capital is income. This is true in the case of associations which are not financed proportionally to volume of sales carried on by individual members through the association, and which pay interest or dividends on share capital. For example, a member who puts up 4 per cent of the capital of an association and does a volume of trans-

actions which would warrant him putting up only 3 per cent of the capital, clearly receives income amounting to one-quarter of that member's interest receipts. Such an amount is obviously a return on capital. The other three-quarters of his receipts were in fact contributed to himself.

Certain allocated reserves may also be regarded as profit. Some reserves are held by an association in such a way that members, even though they may die or move away from the community, find it impossible to obtain their portion of the reserves except at the sole discretion of the Board of Directors or of the Association. Such reserve holdings clearly must be deemed to be profit of the Association.

To the foregoing must be added moneys received from rentals of the property, investments in Government bonds, and in private bonds. Manufacturing and processing activities by a co-operative, which receives its raw materials for such activities from sources other than members, result in income or profit to the association.

Thus, with some assurance we can say that income from non-member business, certain portions of interest or dividend paid on share capital, certain reserves and income from investments, rentals and earnings derived from some manufacturing and processing activities and certain retail distribution

may be regarded as profits of associations organized on a co-operative basis. What we must now decide in analysing this argument is whether patronage dividends, themselves, are savings, or profits, or whether they contain an element of both.

Co-operatives maintain that patronage dividends are merely an overcharge or underpayment by an association to its members. Co-operatives, they say, are groups of people who have joined together that they might supply themselves with services. Any surpluses which co-operatives may accumulate are the savings of the members and not the profits of the association. A patronage dividend is regarded as a final settlement between an association and its members, and the net result is the same as if the selling price less necessary expenses had been originally paid to the producers, or the cost price less necessary expenses had been originally charged to the consumers. Some private businessmen argue that the whole of the net proceeds of a co-operative is profit and attributable to the taking of risks, the use of capital, the employment of labour, managerial skill and the pooling of marketing and purchasing operations. The co-operative argument is very well put forth by Professor Pigou when he writes:

"Those who contend that even that part of the proceeds of mutual trade which is returned to members as dividends on purchases constitutes a profit are up

against the awkward fact that co-operative societies have the power, if they choose, instead of selling to their members at market price and returning to them a dividend on purchases, to sell to them at prices reduced by an amount nearly equivalent to the "divis" and to pay no "divis". The existence of this power not only makes plain the fact that, from the point of view of the revenue, taxation of "divis" would be a futile proceeding, but it also puts in a clear light the essential nature of those "divis". They are, in essence, not a profit in the ordinary sense of that term, but a refund made from an overcharge." 1

It will be observed that Professor Pigou stresses the idea of mutuality -- he speaks of "mutual trade". It is argued by advocates of the taxation of co-operatives that mutuality is no longer existent, for the association is a legal entity and members trade through the association so that the idea of clubbing together has been lost. It is also said that true mutual trading would entail members supplying themselves with only one product and not many. What is posed here is a problem in joint costs. A dividend on one product is not simply a return on an overcharge, or an underpayment, on that one product, but it is dependent upon the aggregate excess of prices paid for all things over the costs of, or receipts from all things. However, Professor Pigou replies:

"But this fact is not really relevant. The aggregate sum distributed to members is still a refund and not a profit". 2

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1. Essays in Applied Economics, London, King and Son, 1923, pp. 142-143.
  2. Ibid, p.142.

On the other hand, Professor D. H. MacGregor has refuted the claim that the dividend is an overcharge.

"Suppose it was said that five men contribute £10 each for a tour the expenses of which come to only £40; is the £10 which is returned a profit? If what is implied is mere purse bearing by one member of the party, who cannot effect the costs of a predetermined journey, the answer would be no. But, if by having £50 in hand, he is able to risk adventures which turn out fortunately, so that the whole cost is then only £40, it is not so clear; there has been a larger real income than in the former case. The full contribution was necessary to the enterprise and its result." 1

Professor MacGregor is correct here, for it is apparent that part of the surplus of a co-operative society must be due to capital, risk and other factors previously mentioned. We should also realize when we say that the association can make real profits out of non-members, we not only mean non-member buyers and sellers, but also labour which does not participate in dividends. This is particularly true in the case of an association employing a large labour force.

However, we must not say that the surplus of a co-operative is due entirely to the same factors as the surplus of any private company. As the Canadian Royal Commission Report points out, a co-operative organization is at least morally obligated to make a refund to members in proportion to patron-<sup>2</sup>age. In other words, one of the chief reasons for joining and patronizing such an association is the prospect of receiving

1. Taxation of Co-operative Dividends, Economic Journal, 1933, Vol. 43, p.47.
2. R.C.C. pp 33-34.

a rebate pro-rata to purchases, or pro-rata to products marketed through the organization. With this in mind, we may consider part of the patronage dividend to be a legitimate trade expense. A member of a co-operative expects a patronage refund.

In analysing the argument of co-operatives that they are non-profit organizations and their surplus arises from an overcharge or underpayment, we must conclude that their net surplus over costs at the end of a fiscal period arises partly from an overcharge, as in the case of a purchasing association, or underpayment, as in the case of a marketing association, and partly from the taking of risk, managerial efficiency, the employment of capital and pooling of resources.

Spokesmen for joint stock companies have argued that the co-operative payment -- the patronage dividend -- is analogous to the distribution of profits in a joint stock company. But before this could be true, patronage dividends must arise in the same way, and also be distributed in the same manner. We have already seen how the patronage dividend arises; we must now examine its distribution. The profits of a joint stock company are distributed in proportion to the number of shares held by each stockholder of the company. It is true that a patronage dividend is not distributed in this manner, but it is also true that the rebate is made to the owners of a



co-operative -- those who have capital holdings. We can even assert that where in an organization members' equity is kept exactly proportional to patronage, the refund may be distributed either on the basis of patronage, or on the basis of capital holdings. In addition, where an individual deals through an association, yet has not purchased in cash or deductions a share in the association, in many cases he does not receive a rebate of any kind.<sup>1</sup> A pamphlet of the British Columbia Co-operative Wholesale Society urges member societies to pay patronage refunds to member societies only. By so doing, it is argued that non-members will be stimulated to join by the prospect of refunds.<sup>2</sup> In reality, a member of a co-operative organization is both customer and investor. A patronage refund is partly rebate, partly profit.

It is interesting to ask why a co-operative association should pay patronage dividends to only one group of its patrons. That is, why should the Saskatchewan Co-operative Creameries, for example, pay a patronage refund to milk producers only? Why should the savings made by the Creameries go to the producer of milk -- rather than the consumer of milk? Only one logical conclusion may be inferred. The patronage rebate is paid to the producer of milk because he has put up the capital, hired the management and borne the risk. But, as was pointed out in the case of the Fraser

1. For further proof of this see page 105
2. Suggested Policies for Consumer Co-operatives with Reference to New Tax Legislation, Vancouver, 1947.

Valley Milk Producers vs. The Minister of National Revenue,<sup>1</sup>  
not all of the surplus belongs to the producer. On the contrary, much may be attributed to the consumers of milk. If one-third of a supposed surplus of two cents a quart is actually saving, then the other two-thirds is actually a profit arising from trade with the consumers of milk. This two-thirds might be paid to the consumers but for the fact that the producers have contributed the capital. Of course, in many instances there would be barriers in the way of such a distribution of surplus to the consumers. Many marketing associations do not deal directly with the consumers. Actually they function as one middleman in a chain of middlemen. In these cases an attempt to distribute a dividend to the ultimate consumer would be ridiculous.

We may apply the same analysis to a purchasing co-operative. There is no reason why consumers should receive a rebate anymore than producers, except that the former contribute the capital. Also, of course, it would be impossible for a purchasing association to trace back through lines of middlemen in order to rebate a producer. These answers to our questions verify the nature of the patronage dividend.

Another argument advanced by proponents of co-operative income taxation was that co-operative growth could be largely explained by the use of tax-free reserves for capital expan-

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1. 1928, Ex. C.R. 215.

sion. In our approach, it is again necessary to emphasize that, while co-operative growth appears huge in the absolute sense, the situation is entirely different if we examine co-operative growth on a relative basis. This has already been done in the latter part of Chapter II, and the conclusion reached was that relative to the marketings of other private business organizations, an increase was shown during the War years in the co-operative marketing of poultry and eggs, dairy products and live-stock, and in co-operative retail trade. In Chapter III, an examination of tax discrimination on the growth of co-operative plant values was undertaken, and from available evidence, it was apparent that the use of tax-free reserves for capital expansion was noticeable only in dairy co-operatives. It must be admitted that figures for the last War year and for the post-war period are unavailable. Private businessmen have expressed particular fear over the use of these reserves in the post-war period. Any discussion of the effect of reserves on co-operative expansion in the post-war period unfortunately would be mere speculation.

An argument of co-operative spokesmen that deserves comment is their claim that co-operative organizations should be exempt from income taxation because membership in co-operatives comes from the lower income groups. But this is completely unsubstantiated by facts. No material has ever been

assembled in Canada to indicate in what income groups co-operative membership is found. The Danish situation might be worth noting. According to figures in the Danish Year Book, the great majority of members of co-operative agricultural societies in that country own relatively large farms. This might very well appear to indicate that Danish agricultural co-operatives are largely supported by middle class income groups. Figures for purchasing societies also indicate that strong membership support comes from the same general income groups.<sup>1</sup>

The final major argument advanced by co-operative spokesmen was that they should receive special consideration on the ground that they are in the public interest. As the Royal Commission Report pointed out, co-operatives in rural areas<sup>2</sup> provide excellent training grounds for young people. Often, co-operatives in these areas are one of the organizations where young adults may be given an opportunity to show their abilities and to discharge the responsibilities of administrative positions. Other forms of private business organizations do not offer some of these same opportunities to rural dwellers. Many individual co-operative organizations render commendable services. The Saskatchewan Wheat Pool selects "junior co-operators" who supervise a wheat variety testing programme

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1. 1937, pp.75-83.

2. R.C.C., p.30.

throughout the Province.<sup>1</sup> Results are helpful in reflecting every condition of soil and moisture that occurs in the different areas. The programme is also of educational value to the young people making and supervising the tests. The Pool also makes grants to the University of Saskatchewan for the maintenance of junior grain and seed clubs throughout the Province.<sup>2</sup> The Pool provides a circulating library of non-fiction books, travelling libraries, facilities for the organization of study groups by itself and co-operation with the Canadian Association for Adult Education and lends practical support to educational farm radio programmes.<sup>3</sup> The Fraser Valley Milk Producers claim that through its magazine it has disseminated information on methods of improving milk production, and has helped farmers eradicate the warble fly.<sup>4</sup>

Powerfully supporting this argument is the experienced recorded at Massett in the Queen Charlotte Islands. In the 1930's the business affording employment to the people, a fish and clam cannery, closed down. As a result unemployment was rife until the organization of a co-operative in 1942. The lease of the canning company to the clam beaches was bought up, the cannery equipment was repaired, and the clam

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1. Saskatchewan Co-operative Producers, Annual Report, 1946, pp. 27-28.
  2. Ibid, pp. 28-29.
  3. Submission of the Saskatchewan Co-operative Producers, p.22
  4. Brief of the Fraser Valley Milk Producers, pp.18-19

and salmon packing business revived. In the two years previous to the hearings of the Royal Commission, this association had become the virtual means of livelihood for the 700 persons living in Massett, and had appreciably raised their standard<sup>1</sup> of living through the distribution of \$150,000 in wages.

In 1935, the Royal Commission on Price Spreads urged the establishment of co-operatives to check monopolistic practices:

"It is our opinion that further development of consumers' co-operatives in Canada would be of general benefit, introducing a restraining influence on the practices of other merchandising organizations and assisting in consumer education, which we feel is most necessary." 2

While it is consumers' co-operatives that are referred to, we may find examples of marketing co-operatives which have acted as restraining influences on private corporations. The Wheat Pools claim partial credit for the elimination of unfair practices in the grain trade.<sup>3</sup> The Pools also claim credit for the reduction in handling charges on grain from a total<sup>4</sup> of 6¢ in 1924 to 3¢ in 1943.

An eastern example of the benefits derived from the co-operative form of organization is indicated by the experiences at Harbour Boucher in the Maritimes. In that community, fishermen belonging to a co-operative cannery averaged 19¢ for

1. Brief of The Massett Co-operative Association, Massett, B.C.

2. Report of the Royal Commission on Price Spreads, Ottawa, King's Printer, 1935, p.220.

3. Submission of the Saskatchewan Co-operative Producers, p.4,14.

4. Submission of the Alberta Wheat Pool, p.36a

live lobster for the whole season, and 12¢ for canned lobster, while across the Bay independent fishermen were receiving 9¢<sup>1</sup> fresh and 6¢ canned.

Actually economic benefits of this type, and the social benefits mentioned earlier are of great value to the nation as a whole. The movement may help to relieve a feeling of exploitation and frustration amongst peoples of depressed regions and areas. Dr. M. M. Coady of St. Francis Xavier University, Nova Scotia, claims that co-operatives would actually prevent Canada from embracing some form of fascism or totalitarian socialism, although the danger of dictatorship in complete socialization is very questionable. He feels that co-operation is the last complete democratic obstacle in the way of statism. He urges businessmen to encourage co-operatives simply as a means of saving themselves. Co-operatives give a sense of ownership, and what is necessary, he says, is just enough co-operative business "to destroy proletarianism", whether in the city or in the country. He argues that co-operatives are a sort of economic breakwater, for they reduce reliance upon the state and teach people to depend more upon<sup>2</sup> their own initiative.

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1. Dr. Coady as a witness before the Special Committee on Reconstruction and Re-establishment, as quoted in "Some Information on the Co-operative Movement in the Maritime Provinces", I.L.O. Co-operative Information, No. 7/8, 1943.
  2. The Social Significance of the Co-operative Movement  
Brief of the Extension Department of St. Francis Xavier University, p.24.

Internationally, the important role that co-operatives can play has been recognized by the United Nations Conference on Food and Agriculture in 1943. The Conference urged:

- "(1) That, in order to make it possible for people to help themselves in lowering costs of production and costs of distribution and marketing:
- (a) All countries study the possibilities of the further establishment of producer and consumer co-operative societies in order to render necessary production, purchasing, finance and other services;
  - (b) Each nation examine its laws, regulations and institutions to determine if legal or institutional obstacles to co-operative development exist, in order to make desirable adjustments..." 1

From available evidence, it is apparent that co-operatives generally serve the public interest even if it is only in the limited case of a rebate to purchasers or consumers. However, it is an entirely different question to give encouragement or assistance to co-operative groups by giving them a blanket tax exemption. As the Report of the Royal Commission correctly comments, it is likely that any advantages gained by encouragements of this nature would play into the hands of those associations which need encouragement least -- the large, well-established bodies.<sup>2</sup> Blanket exemption in my opinion leads to inequity within the co-operative movement itself, for the larger associations would receive a benefit at the expense of

1. "United Nations Conference on Food and Agriculture, text of the final Act", in International Conciliation, Documents for the Year 1943, N.Y., Carnegie Endowment for International Peace, Division of Intercourse and Education, 1943, p.496.
2. R.C.C. p.31.



other smaller groups, who might benefit more from some other type of assistance.

In considering the benefits derived from co-operatives, we must not forget that many joint stock companies render services of equal or in some cases of even greater benefit to the public as a whole. Also, if co-operatives are performing the valuable and useful services which they now claim to be, then they have little need of exemption. If they are able to provide these services then co-operatives are well qualified to stand on their own feet and they require no special consideration.

Finally, we must remember that any type of subsidy which takes the form of privilege in taxation is a concealed subsidy. Since co-operatives have enjoyed subsidization in Canada through a tax exempt status in the past, it has been impossible to ascertain the amount of the subsidy which they received each year through this instrument of tax exemption. If we feel that co-operatives are sufficiently in the public interest to warrant Government subsidization, then it would be better if they were given a direct subsidy each year. In that way we would know exactly how much the co-operative movement was being subsidized each year, and as a result we would be in a better position to assess the benefits received from the co-operative movement as against the cost of the subsidization of the movement.

## CONCLUSIONS

## CONCLUSIONS

The question of the subjection of the earnings of co-operative associations to federal income tax has been discussed and examined from both a statistical and a theoretical point of view. We are now able to draw certain conclusions. Probably our conclusions will satisfy neither the outspoken advocate of co-operative taxation, nor the ardent defender of the movement from such taxation. However, these suggestions are submitted in the belief that they offer a just and equitable basis upon which co-operatives may be taxed.

Before giving voice to these recommendations it is necessary to segregate and underline the most salient of the facts already presented. Our discussion began with an outline of co-operative development in Canada, in which co-operative growth relative to that of other forms of private organizations, more particularly during the War period, when taxes were high, was emphasized. In examining these figures for co-operative growth, several facts stood out. First, was the regional pattern of co-operative development. It is impossible to understand the Canadian movement unless one is aware of its regional pattern. Secondly, figures showed that while co-operatives registered gains over their competitors in the marketings of certain products, this was not always the case.

Large co-operative gains over competitors were shown in the marketing of dairy products, livestock, and poultry and eggs. On a regional basis larger co-operative marketings of dairy products were shown in every Province. The same is true of poultry and eggs, with the exception of the Maritime region, Saskatchewan and Alberta. Co-operative marketings of livestock showed relative gains over the marketings of competitors in all regions except the Maritimes and Ontario. On the other hand, the marketings of grain and seed, and fruit and vegetables through co-operative channels showed neither a significant relative increase nor decrease over the marketings of competitors during the War. Thirdly, it is not correct to attribute the relative increase in the co-operative marketings of livestock, and poultry and eggs to advantages which might have been obtained by the use of tax-free reserves for capital expansion. Our statistics showed that the use of tax-free reserves to expand plant facilities could have been the case only in co-operative dairy associations. In dairy associations, the ratio of plant values to sales is high. Also, dairy associations showed large relative gains over the marketings of their competitors, and secondly, they showed a significant increase in plant values during the first years of the War. As for poultry and livestock associ-

ations, their very low ratio of plant values to sales, large increases in numbers of associations, and lack of any significant increases in plant values during the early War years rules out the possibility that they obtained their increases in marketings at the expense of their competitors through the use of tax-free reserves. However, it is admitted that poultry and livestock co-operatives might have benefitted from tax privileges by being able to pay out higher refunds than would otherwise have been possible.

In examining the financial operations and business methods of co-operatives, one cannot escape the fact that Canadian co-operatives finance in the main by the retention of patronage dividends, or by deductions from the gross proceeds of the sale of members' products. Commenting upon the financial difficulties suffered by the Manitoba Wheat Pool in the period following 1928, the Report of the Royal Commission states:

"The experience of the elevator company with regard to working capital serves to illustrate the difficulties of financing some co-operatives and suggests a strong reliance on capital supplied internally." 1

It has been pointed out before that the retention of patronage dividends as the main means of financing appears to be a purely Canadian development. Since this is the case, it must

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1. R.C.C. p.148.

be explainable only in terms of Canadian agriculture. The primary producers -- the group hardest hit by price fluctuations -- constitute by far the largest percentage of the members of Canadian co-operatives. This fact, in itself, is a logical explanation for internal financing. The method is made necessary by conditions prevailing amongst agricultural co-operatives where the volume of transactions may fluctuate sharply from year to year, and where the ratio of plant values to sales is high.<sup>1</sup> The necessity for internal financing in Canadian co-operative associations must be recognized in any conclusions that may be advanced. In my opinion, co-operative business setbacks or failures have very serious consequences and therefore it is essential that no tax law should seriously affect their method of internal financing.

The present Canadian income tax law with respect to co-operatives, and foreign tax laws dealing with co-operatives have been explained. The 3 per cent provision in the present Canadian legislation appears unsatisfactory but can be conveniently administered. An arbitrary 3 per cent provision is anything but equitable. Foreign and British tax laws seem to suggest only a precedent for the exemption of patronage dividends and the subjection of net increases in reserves to taxation.

It might be argued that the British law with respect to co-operatives could be applied suitably to the Canadian situation. The ratio of plant values to sales is high in dairy, fruit and vegetable and grain and seed co-operatives.

tion. However, such a suggestion does not take into consideration certain basic differences, notably in membership, stage of development, and financial and business methods.

The nature of patronage dividends has been discussed, and we reached the conclusion that these refunds are partly rebate and partly profit. The only logical grounds on which these dividends can be exempted from income tax is that it is impossible to determine what percentage of the whole is profit. To fix a certain percentage, and to call it profit and the remainder a rebate, is most unfair and inequitable.

There can be no doubt that co-operatives did enjoy advantages over their private competitors during the period of high wartime taxation. However, this advantage will be greatly reduced in the future by the abolition of the Excess Profits Tax Act.

In stating my conclusions, I agree wholeheartedly with the Report of the Royal Commission that the operations of a co-operative result in income to the associations and their members. With this, and the other salient points already discussed, in mind, I therefore recommend:

(1) That co-operatives be taxed on the same basis as joint stock companies, but that the following should be considered as deductible in computing taxable income:

(a) Patronage dividends, or deductions from the gross proceeds of the sale of a member's product, paid in

cash or in kind within twelve months after the annual meeting of the association, or applied toward the fulfilling of an obligation to purchase shares or other investment in the association.

(b) Patronage dividends, or deductions from the gross proceeds of the sale of a member's product, deferred for a definite period only and where the payment is set at a stipulated date in the future, so that the association is under an irrevocable obligation to make the payment.

(2) That patronage dividend payments to member and non-member customers should be at the same rate on the same classes, grades or types of commodities. If rebates to non-members are less than those paid to members on the same classes, grades or types of commodities, then income tax at the full rate should be paid on the earnings resulting from non-member business.



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