

Book 5: RULES & REGULATIONS

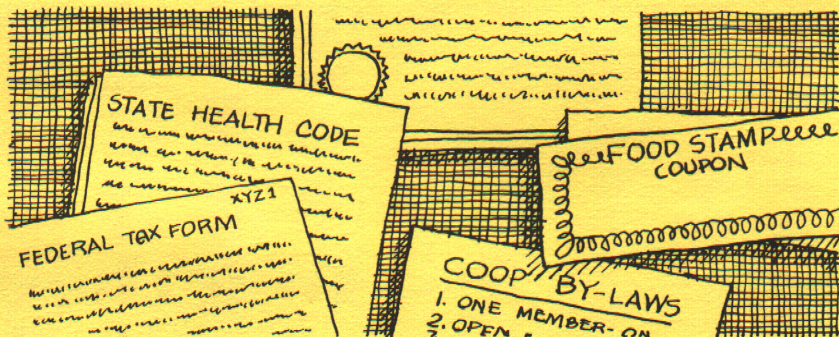
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Together For a Change

A Series on Food Cooperatives



V: Rules and Regulations



BY DIANE HALL¹, ELIZABETH SCOTT² and CHRISTOPHER STEELE³

WHEN STARTING a food cooperative, you should know about the basic legal requirements and organizing tools which will get you off to a good start.

Just which laws apply to your organization will depend on whether it is a member-only co-op or is open to the public and how much business is done per year. Since most preorder cooperatives are small, member-only volunteer groups, there will be relatively few regulations. If, however, the group wants to expand to include non-members or increase size significantly, the organization should be set up to avoid problems in the future. In this case there are many more regulations to follow.

Bylaws

All groups, regardless of size or whether they are member-only, should write a set of bylaws. Their purpose is to form an organizational structure. The bylaws will be the last word on how the group operates.

An important aspect of the bylaws in any cooperative should be the six cooperative principles* these are:

1. open membership
2. one member, one vote
3. limited return on investment
4. profits rebated to members
5. education of members
6. cooperation

¹ Michigan Federation of Food Cooperatives

² MSU Dept. of Agricultural Economics

³ National Consumer Cooperative Bank

* See Cooperative Extension Bulletin E-1503.

By incorporating these principles in your bylaws, they become part of the organization's structure and are therefore able to protect the individual members and the co-op as a whole.

Other things often included are:

1. name of the co-op
2. the purpose of the co-op
3. qualifications for membership in the co-op
4. size of the co-op
5. general membership meetings, (This should include the month in which annual meetings are to be held, how to call special meetings, and how many members must be present in order to conduct business.)
6. board of directors (Cooperatives often have a smaller group responsible for seeing that the co-op is meeting the goals and objectives of the members. Include here rules for elections, term of office and responsibilities of the board.)

Name of the Co-op

The co-op may want to register its name with the "Doing Business As" department of the nearest county clerk's office. Usually there is a small fee, and the registration term lasts several years.

The reason for this is to avoid having more than one group with the same name. When the co-op applies, the registrar will tell you if you have selected a name currently being used by another group. Once a group is registered, it can prevent other organizations from using the same name.

If the co-op is planning to purchase from one of the cooperative warehouses, it should contact them about the proposed name for the same reasons.

Health Codes

If your cooperative is member-only, that is, not serving the general public, it is not required to undergo inspection by the State Department of Agriculture or the Department of Weight and Measures. This, however, should not preclude good sanitary practices by the members who are involved in breakdown and repackaging during distribution.

Good sanitary practices include:

1. Using stainless steel equipment instead of more porous wood utensils.
2. Cleaning all food contact surfaces (cutting boards, counter tops, and utensils) before their use and washing with a sanitizing solution between uses for other foods.

3. Washing hands before and during food distribution. (This is particularly important if a member handles one type of food and then another.)
4. Using plastic gloves, hair nets, scarfs, and aprons. (Although not mandatory they do enhance the sanitary aspects of distribution. It should be noted, however, that anyone with long hair should pin it back before handling food.)
5. Anyone with a sore throat, head cold or any other type of illness should not handle food.
6. Smoking or eating food during distribution should be discouraged and always followed by hand washing.
7. Paper or plastic bags should never be reused to package bulk foods.

Any food cooperative which is open to the general public should contact the State Department of Agriculture for regulations and information on inspection practices. You should also contact local governments regarding any local ordinances.

Food Stamps

If your co-op wishes to allow members to use food stamps to purchase goods, you must apply for a permit from the U.S. Department of Agriculture (USDA). In this relatively simple process, the co-op must fill out an application and pay a \$1 fee. The USDA will then give you a number which is used when depositing the stamps. The procedure for deposit is similar to that of depositing checks and is accepted by most banks. Remember that you may allow members to use food stamps only for nontaxable, edible food items.

Incorporation

Most cooperative stores are incorporated; most preorder cooperatives are not. Incorporation offers few benefits when a group of households are cooperating by purchasing food together, distributing it immediately, carrying little or no inventory, dealing in cash and have little investment in fixed assets, as in a member only preorder group. Incorporation, however, is advisable for larger, more complex business organizations, including cooperative stores or preorder co-ops doing more than \$40,000 worth of business per year. The advantage of incorporation is the provision for limited liability. If the co-op comes upon hard times, its creditors can lay claim only to the assets of the cooperative. They cannot hold individual co-op members liable for the organization's debts.

A second plus for incorporation is that it assures the public that your organization is registered with the Corporation and Securities Bureau of the Michigan Department of Commerce and has met the minimum stan-

dards of business organization. The cooperative has a legal name, a purpose, an authorized level and form of capitalization, a legal address, and a board of directors with certain legal responsibilities for the management of the business. This combination of limited liability and minimum standards is very important when the cooperative seeks investment capital to sustain its operations and grow.

In Michigan, a cooperative can incorporate as a profit cooperative or a nonprofit cooperative. These terms should not be taken literally. The primary difference between profit and nonprofit is in the earnings distribution requirements and the level of return to the organization's paid-in capital.* If the cooperative decides to incorporate, it should contact a lawyer for guidance.

Sales Tax

Michigan has a state sales tax on all nonfood items. Many food cooperatives are interested in purchasing paper products and other nonfood items usually purchased at retail supermarkets. These items are subject to sales tax.

In understanding the state sales tax, it is important to understand that the tax is always paid by the last person to buy the item, that is, the person who will use it. Whoever sells the product to the consumer (or user) must collect the sales tax and send it to the State Treasury. In order to do so, they must have a sales tax license.

A member-only preorder cooperative that does not resell any items it buys only for its members' own use is not required to have a license but will pay the tax directly to the supplier (who needs to have the license).

On the other hand, a cooperative which does resell to nonmembers (such as a store which carries inventory) needs to have a sales tax license. These groups should request an application from the Michigan Department of Treasury. There is a \$1 fee and a \$50.00 deposit. This group is then responsible for collecting the sales tax on all purchases of nonfood items and filing quarterly with the Treasury.

Taxes

Most preorder food cooperatives will not be required to file tax forms either on the federal or state levels. The reason is that most groups are not incorporated, do not pay volunteers, have relatively low sales volume and do not generate retained earning (net profit).

* For a further explanation see *Cooperative Food Buying Manual*, M.S.U. Extension Service, by Ron Cotterill and Elizabeth Scott, Dept. of Agricultural Economics. Staff paper No. 81-59.

Withholding—As stated above, because most preorder co-ops utilize volunteer rather than paid staff they are not required to withhold employee income taxes. Problems may, however, arise if the co-op gives a discount to members who work. This is easily avoided by having a mandatory work requirement for all members. If the co-op prefers to give working members discounts, it is still not liable for the recordkeeping or filing as long as the cumulative amount of the discount does not exceed \$1,500 per member per year. Under these circumstances, members are responsible for keeping track of their discounts themselves and should consider them income on their income tax forms.

Federal tax—Only incorporated cooperatives are required to file **corporate** income tax statements.

If your co-op is incorporated, it must and should file such a statement even if it loses money or breaks even. Losses can be carried forward to offset income in future years. In order to file, the co-op must first acquire an employer identification number. This is obtained upon request from the Internal Revenue Service (IRS) and is needed even if your co-op does not have employees. The IRS uses this number for its records in much the same way as it uses an individual's social security number.

Any co-op that intends to file federal tax forms must have a bookkeeping system with an income/expense statement and a simple balance sheet.

Single business tax—Single business tax reporting is required of any co-op in Michigan with sales above \$40,000 annually. Again, if incorporated, the co-op should file regardless of sales volume. Forms for filing are available from the State Department of Treasury.

Fair-Share Capital

A cooperative is owned by all its members. This ownership is made real by the fair-share investment which each member holds in the cooperative. In a preorder co-op this amount is usually small since the co-op doesn't own a lot of things. If the co-op owns a refrigerator or scales or a truck, then the cost of those items should be shared among the members. The co-op may also wish to maintain a reserve of money against possible losses due to spoilage or towards replacement of equipment.

Cooperatives also sometimes maintain a buying deposit with their wholesale supplier. This is true of cooperatives which belong to the Michigan Federation of Food Cooperatives (MFOFC). The MFOFC is partially capitalized by deposits from member cooperatives equal to 110% of the co-op's average monthly purchase. Other cooperative suppliers also utilize similar capitalization programs; among those serving

Michigan are Frontier Herbs in Iowa and Intra-Community Cooperative (ICC) and Common Health in Wisconsin.

Examples of how to keep records of this can be found in Cooperative Extension Bulletin E-1504, *Keeping Track*.

Capital Needs

Most preorder food co-ops have limited capital needs, that is, the amount of money they need to raise to buy equipment. For most groups, equipment needs may be only a scale and a few utensils and sometimes some large containers. Others may also feel the need to have a refrigerator. These capital needs can be raised in one of two ways. The first is by adding it to the markup. In order to figure this markup amount, you need to know two figures. The first is the amount of money needed to purchase equipment. The second is your expected purchases for the next year. As an example, total equipment needed costs \$480 and monthly purchases from suppliers is \$2000.00, multiplied by 12 months = \$24,000 yearly. To find the markup, divide capital needs by purchases:

$$\frac{\text{capital needs}}{\text{year of purchases}} = \frac{480}{24,000} = .02 = 2\% \text{ markup}$$

This amount would be added to the amount of markup needed to cover expenses.

The other method is to divide the amount needed to buy capital by the total number of members. Again, we will use \$480.00 and say the co-op has 40 members. In this case:

$$\frac{\text{capital needs}}{\text{No. of members}} = \frac{480.00}{40} = 12 = \$12.00 \text{ per member}$$

To raise this money the co-op would ask each member to pay a \$12.00 membership fee. The second method is generally preferred for two reasons. The first is that a co-op can generally raise the money needed faster than with the markup method which would take a full year. The second reason is that if this membership fee is refundable when the member leaves the co-op, the co-op once again would not have to worry about tax obligations.

Covering expenses with the markup. To figure out how much the groceries should be marked up, first list all expenses, add them together

and then divide by the average or expected monthly purchase. As an example:

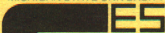
Expenses:	packaging materials	10.00
	driver expenses	15.00
	newsletter	<u>10.00</u>
	total	\$35.00

$$\frac{\text{Expenses}}{\text{purchase amount}} = \frac{35}{2,000} = .0175 = 1.75\%$$

For ease of multiplying by members and to insure an adequate markup, the number 1.75% should be rounded up to 2.0%.

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