ENERGY TAX CREDITS

HEARING

BEFORE THE

SUBCOMMITTEE ON

ENERGY AND AGRICULTURAL TAXATION

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

S. 1819 and S. 2151

MARCH 30, 1982

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CONTENTS

ADMINISTRATION WITNESS

ENERGY TAX CREDIT

TUESDAY, MARCH 30, 1982

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2221, Dirksen Senate Office Building, Hon. Malcolm Wallop (chairman of the subcommittee) presiding.

Present: Senator Wallop.

[The committee press release announcing this hearing; the bills S. 1819, S. 2151; the description of these bills by the Joint Committee on Taxation; and the opening statement of Senator Wallop follow:]

Press Release No. 82-112
(Revised)

P R E S S   R E L E A S E

FOR IMMEDIATE RELEASE
March 24, 1982

UNITED STATES SENATE
COMMITTEE ON FINANCE
Subcommittee on Energy
and Agricultural Taxation
2227 Dirksen Senate
Office Building

FINANCE SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION ADDS
S. 2151 TO MARCH 30, 1982 HEARING

Senator Malcolm Wallop, Chairman of the Subcommittee on Energy and Agricultural Taxation of the Committee on Finance, announced today that the Subcommittee will consider S. 2151 at the previously announced hearing on Tuesday, March 30, 1982.

S. 2151 would make modification to chlor alkali electrolytic cells eligible for a 10-percent energy tax credit.

The hearing will begin at 9:30 a.m. in Room 2221 of the Dirksen Senate Office Building.

Requests to testify.--Witnesses who desire to testify on S. 2151 must submit written requests to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, to be received no later than noon on Friday, March 26, 1982. Witnesses will be notified as soon as practicable thereafter whether it has been possible to schedule them to present oral testimony. If for some reason a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of the personal appearance. In such a case, a witness should notify the Committee as soon as possible of his inability to appear.

P.R. #82-112
(Revised)

II

97TH CONGRESS
1ST SESSION

S. 1819

To amend the Internal Revenue Code of 1954 with respect to the taxation of crude oil purchasing cooperatives.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 5 (legislative day, NOVEMBER 2), 1981

Mr. WALLOP (for himself, Mr. SYMMS, Mr. LONG, Mr. BOREN, Mr. MATSUNAGA, Mr. JOHNSTON, and Mr. BENTSEN) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 with respect to the taxation of crude oil purchasing cooperatives.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. CRUDE OIL PURCHASING COOPERATIVES.

(a) IN GENERAL.—Part IV of subchapter F of chapter 1 of the Internal Revenue Code of 1954 (relating to farmers' cooperatives) is amended by adding at the end thereof the following new section:

"SEC. 522. EXEMPTION OF CRUDE OIL PURCHASING COOPERATIVES FROM TAX.

"(a) EXEMPTION FROM TAX.—A crude oil purchasing cooperative shall be exempt from taxation under this subtitle except as otherwise provided in part I of subchapter T (relating to tax treatment of cooperatives), and shall be considered an organization exempt from income taxes for purposes of any law that refers to organizations exempt from income taxes, notwithstanding the application of such part.

"(b) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

"(1) CRUDE OIL PURCHASING COOPERATIVES.— The term 'crude oil purchasing cooperative' means an association—

"(A) all of the members of which (determined at the close of the taxable year of such association) are independent refiners or subchapter T cooperatives, and

"(B) which is organized and operated on a cooperative basis for the purpose of—

"(i) purchasing crude oil and reselling it to members, nonmember independent refiners, and nonmember subchapter T cooperatives and turning back to them the proceeds of such resales, less necessary expenses thereof, "(ii) purchasing supplies and equipment for the use of members, nonmember independent refiners, and nonmember subchapter T cooperatives and turning over such supplies and equipment to them at actual cost, plus necessary expenses thereof,

"(iii) trading crude oil (not including the transportation of such oil in connection with such trading),

"(iv) storing of crude oil, and

"(v) insuring risks associated with any of the activities described in clauses (i) through (iv).

"(2) ORGANIZATIONS HAVING CAPITAL STOCK.—An association having capital stock which is otherwise described in paragraph (1) shall be treated as a crude oil purchasing cooperative if—

"(A) the dividend rate of such stock is fixed at a rate which does not exceed the legal rate of interest in the State in which such association is incorporated on the value of the consideration for which the stock was issued, and

"(B) substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by independent refiners and subchapter T cooperatives who purchase crude oil, supplies, or equipment through the association.

"(3) ORGANIZATIONS DOING BUSINESS IN FEDERATED FORM.—An association which—

"(A) is doing business in federated form on the basis of geographic regions, qualities of crude oil, or on any other reasonable basis, and

"(B) is otherwise described in paragraph (1),

shall be treated as a crude oil purchasing cooperative.

"(4) TRANSACTIONS WITH NONMEMBERS.—An association which—

"(A) purchases—

"(i) crude oil for nonmembers in an amount the value of which does not exceed the value of the crude oil purchased for members, or

"(ii) supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the purchases made for members, and

"(B) is otherwise described in paragraph (1), shall be treated as a crude oil purchasing cooperative, if the value of all purchases for persons (other than members, nonmember independent refiners, or nonmember subchapter T cooperatives) does not exceed 25 percent of the value of all its purchases.

"(5) OTHER ACTIVITIES.—For the purpose of determining whether an association is operated for the purposes set forth in paragraph (1)—

"(A) the trading and transportation of crude oil,

"(B) the insurance of risks associated with such trading and transportation, or

"(C) any other activity incidental to the purposes described in paragraph (1) or designed to increase the efficiency of the association in carrying out any activity described in paragraph (1),

shall be treated as an activity described in paragraph (1).

"(c) OTHER DEFINITIONS.—For purposes of this section—

"(1) CRUDE OIL.—The term 'crude oil' has the meaning given such term in section 4996(b)(1).

"(2) INDEPENDENT REFINER.—The term 'independent refiner' means a refiner who, for any calendar quarter ending after June 30, 1973, obtained, directly or indirectly, more than 70 percent of his refinery input of domestic crude oil (or 70 percent of his refinery input of domestic and imported crude oil) from producers who do not control, are not controlled by, and are not under common control with, such refiner.

"(3) NECESSARY EXPENSES.—The term 'necessary expenses' means, with respect to an activity described in clause (i) or (ii) of subsection (b)(1)(B), the greater of—

"(A) 15 percent of the costs allocable to such activity, or

"(B) the amount demonstrated by the taxpayer to the satisfaction of the Secretary as properly allocable to the costs of such activity.

"(4) SUBCHAPTER T COOPERATIVE.—The term 'subchapter T cooperative' means an organization exempt from taxation under section 521 or 522 or a corporation described in section 1381(a)(2).".

(b) CONFORMING AMENDMENTS.—

(1) SUBCHAPTER T AMENDMENTS.—

(A) Paragraph (1) of section 1381(a) of such Code (relating to organizations to which part I of subchapter T applies) is amended by striking out "section 521 (relating to exemption of farmers' cooperatives from tax), and" and inserting in lieu thereof "part IV of subchapter F (relating to cooperatives), and".

(B) Subsection (b) of section 1381 of such Code (relating to tax on certain farmers' cooperatives) is amended by striking out "Farmers'" in the caption of such subsection.

(C) Paragraph (2) of section 1385(a) of such Code (relating to amounts includible in patron's gross income) is amended by striking out "farmers".

(2) OTHER CONFORMING AMENDMENTS.—

(A) Paragraph (1) of section 116(b) of such Code (relating to certain dividends excluded), as in effect for taxable years beginning after December 31, 1981, is amended by inserting before the semicolon at the end thereof the following: ", or section 522 (relating to crude oil purchasing cooperatives)".

(B) Subsection (a) of section 246 of such Code (relating to deduction not allowed for dividends from certain corporations) is amended by striking out "or section 521 (relating to farmers' cooperative associations)" and inserting in lieu thereof ", section 521 (relating to farmers' cooperative associations), or section 522 (relating to crude oil purchasing cooperatives)".

(C) Sections 48(a)(4), 52(c), 1245(b)(3), 1250(d)(3), 3121(a)(16), and 3306(c)(10) of such Code (relating to certain tax-free transactions) are each amended by inserting "or 522" after "section 521".

(D) Paragraph (2) of section 4421 of such Code (relating to definition of wages) is amended by striking out "sections 501 and 521" and inserting in lieu thereof "section 501, 521, or 522".

(c) CLERICAL AMENDMENTS.—

(1) The section analysis for part IV of subchapter F of chapter 1 of such Code is amended by adding at the end thereof the following new item:

"Sec. 522. Exemption of crude oil purchasing cooperatives from tax.".

(2) The caption for part IV of subchapter F of chapter 1 of such Code is amended by striking out "FARMERS'".

(3) The part analysis for subchapter F of chapter 1 of such Code is amended by striking out "Farmers'" in the item relating to part IV.

SEC. 2. EFFECTIVE DATE.

The amendments made by this Act shall apply with respect to taxable years beginning after the date of enactment of this Act.

II

97TH CONGRESS
2D SESSION

S. 2151

To amend the Internal Revenue Code of 1954 to include modifications to chlor-alkali electrolytic cells in credit for investment in certain depreciable property.

IN THE SENATE OF THE UNITED STATES

MARCH 2 (legislative day, FEBRUARY 22), 1982

Mr. ROBERT C. BYRD introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to include modifications to chlor-alkali electrolytic cells in credit for investment in certain depreciable property.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (5) of section 48(l) of the Internal Revenue Code of 1954 (defining specially defined energy property) is amended—

(1) by striking out "or" at the end of subparagraph (L),

(2) by redesignating subparagraph (M) as subparagraph (N) and by inserting after subparagraph (L) the following new subparagraph:

"(M) modifications to chlor-alkali electrolytic cells, or", and

(3) by striking out "(M)" in the second sentence and inserting in lieu thereof "(N)".

(b) The table contained in clause (i) of section 46(a)(2)(C) of the Internal Revenue Code of 1954 (relating to amount of credit) is amended by adding at the end thereof the following new subsection:

"VII. CHLOR-ALKALI ELECTROLYTIC CELLS.—Property described in section 48(l)(5)(M).	10 percent	Jan. 1, 1981	Dec. 31, 1986.".

94-802 0 - 82 - 2

DESCRIPTION OF S. 1819

RELATING TO

TAX TREATMENT OF CRUDE OIL PURCHASING COOPERATIVES

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

OF THE

SENATE COMMITTEE ON FINANCE

ON

MARCH 30, 1982

PREPARED BY THE STAFF
OF THE
JOINT COMMITTEE ON TAXATION

MARCH 29, 1982

JCX-3-82

INTRODUCTION

The Senate Finance Subcommittee on Energy and Agricultural Taxation has scheduled a hearing on S. 1819 (introduced by Senators Wallop, Symms, Long, Boren, Matsunaga, Johnston, and Bentsen) on March 30, 1982. This pamphlet has been prepared by the staff of the Joint Committee on Taxation in connection with this hearing.

The first part of this document is a summary of the bill. The second part is a description of the bill, including present law, issue, explanation of the bill, and effective date.

I. SUMMARY OF THE BILL

Under present law, cooperatives generally are treated as conduit entities for Federal income tax purposes. Amounts derived from transactions with patrons (i.e., persons doing business with the cooperative) which are distributed or allocated currently to patrons are not taxable to the cooperative. In other respects, cooperatives generally are taxed as corporations. Thus, income distributed to members (i.e., the persons who share in the cooperative's profits and are entitled to participate in the management of the cooperative) derived from transactions with nonmembers is not deductible and is taxed both to the cooperative and to the members.

An exception to this treatment is accorded to certain farm cooperatives (referred to as "exempt farmers' cooperatives"). Exempt farmers' cooperatives are cooperatives of farmers, fruit growers, or similar producers which are organized (1) to market the products of producers and to turn back the proceeds less necessary operating expenses or (2) to purchase supplies and equipment for patrons at a price equal to actual cost plus necessary expenses. In addition to the deductions allowed to regular cooperatives for amounts returned to patrons, exempt farmers' cooperatives are allowed deductions for earnings distributed to members on capital stock and to patrons on income derived from transactions with the United States Government or from nonpatronage sources. However, the volume of purchase transactions that an exempt farmers' cooperative can have with nonmembers is restricted to (1) an unlimited amount with the United States Government plus (2) an amount with other nonmembers equal to 15 percent of the value of all purchases.

The bill would provide special rules for the taxation of "crude oil purchasing cooperatives." A crude oil purchasing cooperative would be a cooperative formed for the purpose of-- (1) purchasing and selling crude oil to a "qualified group" consisting of members, nonmember independent refiners, and nonmember cooperatives; (2) purchasing supplies and equipment for the use of the qualified group at cost plus necessary expenses; (3) trading crude oil; (4) storing crude oil; (5) insuring against risks involved with any of these activities; and (6) any activity incidental to the foregoing purposes. The members of a crude oil purchasing cooperative must be independent refiners (defined as refiners where 70 percent of its crude oil purchases in any calendar quarter since June 30, 1973, are from unrelated sources) or other cooperatives.

Under the bill crude oil purchasing cooperatives would be accorded tax treatment similar to exempt farmers' cooperatives. Thus, a crude oil purchasing cooperative would be allowed a deduction for distributions to its members on capital stock and to patrons on income derived from transactions with the United States Government or from nonpatronage sources. Under the bill, the volume of purchase transactions that the crude oil purchasing cooperatives could have with nonmembers would be restricted to (1) an unlimited amount with the United States Government, all nonmember cooperatives, and nonmember independent refineries plus (2) an amount with other nonmembers equal to 25 percent of all of its purchases. Under the bill, "necessary expenses" would be automatically deemed to be 15 percent of purchase costs. The bill would also allow crude oil purchasing cooperatives to operate in federated form.

The bill would apply with respect to taxable years beginning after the date of enactment.

II. DESCRIPTION OF THE BILL

A. Present law

Overview

The Internal Revenue Code provides special rules for the taxation of cooperatives (secs. 1381-1388).1/ For Federal income tax purposes, cooperatives are taxed as conduits in that they are not taxed on amounts derived from transactions with patrons to the extent that such amounts are returned to the patrons. This conduit treatment is granted on the basis that the cooperative is acting as the agent of the patron and, thus, the "patronage earnings" are not income of the cooperative.

Generally, conduit treatment is not accorded to distributions of income to members of a cooperative derived from transactions involving nonmembers since such income cannot be viewed as derived by the cooperative in its capacity as an agent. An exception to this treatment is accorded to so-called "exempt farmers' cooperatives." Exempt farmers' cooperatives are cooperatives created for farmers, fruit growers, livestock growers, dairymen, etc., for the purpose of (1) marketing the products of such persons and (2) purchasing supplies and equipment for such persons. Exempt farmers' cooperatives are entitled to a deduction for distributions to members of income derived from transactions with nonmembers. However, the volume of business that an exempt farmers' cooperative can engage in with nonmembers is restricted to (1) an unlimited amount with the United States Government plus (2) an amount with other nonmembers equal to 15 percent of the total value of its purchases.

Rules Applicable to the Taxation of Regular Cooperatives

Applicability.--The special tax treatment provided cooperatives (secs. 1381-1388) applies to any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of amount of the business done with or for such patron.

1/ A cooperative is a business entity created by persons in an attempt to use the increased purchasing power, marketing power, and efficiency associated with the use of a larger economic entity to generate savings for such persons. A "patron" is the person who produces or consumes the cooperative's products or services. A "member" is the person who shares in earnings not returned to patrons and is entitled to participate in the management of the cooperative.

In a cooperative arrangement, the benefits attributable to any purchasing and marketing economies generally accrue to the benefit of the cooperative's patrons in proportion to the business done with the cooperative (referred to as "patronage") during the year. However, some cooperatives are organized so that earnings from business with certain groups is not returned to those groups but is distributed to the cooperative's members.

However, this special treatment does not apply to (1) organizations which are exempt from tax, (2) mutual savings banks, building and loan associations, and cooperative banks, (3) insurance companies, or (4) certain organizations engaged in furnishing electric energy or telephone service to persons in rural areas (sec. 1381).

Taxation of the cooperative.--The taxable income of a cooperative is determined in the same manner as a corporation, except that the gross income of a cooperative is determined without regard to (i.e., after reduction or exclusion of) amounts paid within the current taxable year or within the first eight and one-half months of the succeeding taxable year, in cash or other property (as a "patronage dividend," as a "per-unit retain allocation, or as a redemption of "nonqualified written notice of allocation" or "nonqualified per-unit retain certificates") or in certain types of qualified script (called "qualified written notices of allocation," or "qualified per-unit retain allocations").

Rules Applicable to the Taxation of Exempt Farmers' Cooperatives

In addition to the deductions and exclusions allowed to regular cooperatives, exempt farmers' cooperatives are entitled to deductions for (1) dividends on its capital stock and (2) amounts paid (or redemptions of nonqualified written notices of allocation) on a patronage basis to patrons from earnings derived from transactions with the United States or from nonpatronage resources.

Exempt farmers' cooperatives are associations of farmers organized on a cooperative basis for the purpose of (1) marketing products of members or other patrons and returning any proceeds therefrom (less necessary expenses) or (2) purchasing supplies and equipment for the use of members or other persons and turning such items over to the patrons at actual cost plus necessary expenses. Any capital stock of an exempt farmers' cooperative must not bear a dividend rate of the greater of the State's legal interest rate or 8 percent and generally must be owned by persons who patronize the cooperative.

Exempt farmers' cooperatives are limited in the amount of transactions that they can have with nonmembers. With respect to marketing transactions, the value of products marketed for nonmembers (other than the United States Government) cannot exceed the value of products marketed for members. With respect to purchase transactions, the value of supplies and equipment sold to nonmembers (other than the United States Government) cannot exceed the lesser of (1) the value of supplies and equipment sold to members or (2) 15 percent of the value of all of its purchases.

Taxation of Patrons.

The provisions dealing with the taxation of patrons of both regular cooperatives and exempt farmers' cooperatives generally mirror the provisions dealing with amounts excludable or deductible from the gross income of a cooperative. Thus, a patron must include in income--

(1) any patronage dividend paid in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation) received during the taxable year.

(2) the amount of any per-unit retain allocation paid in qualified per-unit retain certificates and received during the taxable year; and

(3) in the case of an exempt farmers' cooperative, any nonpatronage distribution (amounts earned with respect to nonpatronage transactions and business done with the United States or any of its agencies).

Amounts which would otherwise be gross income to a patron as a patronage dividend or redemption of a nonqualified written notice of allocation received as a patronage dividend, are excludable from gross income to the extent such amount is properly used to reduce the basis of property or is attributable to personal, living, or family items.

Because patronage dividends, per-unit retain allocations, etc., are deductible if paid within eight and one-half months after the close of the taxable year of the cooperative but such items are not includible in the patrons' income until the taxable year of payment, a deferral of tax on such items is possible under present law. This deferral period can be lengthened by use of fiscal years and operating on a federated basis.

B. Issues

The principal issue is whether cooperatives formed by independent refiners and cooperatives for the purpose of purchasing crude oil, equipment and supplies should be allowed deductions for distributions on a nonpatronage basis of earnings derived from transactions with the United States Government or from nonpatronage sources and, if so, what should be the restrictions on the volume of business done with nonmembers. A subsidiary issue is whether such cooperatives should be permitted to operate in federated form.

C. Explanation of the bill

In general.--The bill would provide rules for the tax treatment of "crude oil purchasing cooperatives" which are similar to the rules presently provided for exempt farmers' cooperatives. Thus, a crude oil purchasing cooperative would be allowed a deduction for distributions to its members on capital stock and to patrons on a patronage basis on income derived from transactions with the United States Government and from nonpatronage sources. In order to qualify for this treatment, the cooperative must meet certain restrictions regarding its membership and capital stock, the purposes for which it is organized and operated, and the amount of transactions that it can have with nonmembers.

Membership and capital stock--In order for a cooperative to be a crude oil purchasing cooperative, all of its members would have to be either (1) "independent refiners" or (2) nonmember crude oil purchasing cooperatives, regular cooperatives, or exempt farmers' cooperatives (collectively called "subchapter T cooperatives"). An "independent refiner" would be defined as any refiner who for any single calendar quarter after June 30, 1973, obtained more than 70 percent of its refinery input of domestic crude oil or domestic plus imported crude oil from unrelated producers.

Any capital stock of a crude oil purchasing cooperative generally must be owned by persons who patronize the cooperative and cannot have a dividend rate which exceeds the greater of the legal interest rate in the State of incorporation or 8 percent.

Qualifying purposes.--A crude oil purchasing cooperative would have to be organized and operated for the following purposes: (1) purchasing and reselling crude oil to a "qualified group" consisting of members, nonmember independent refiners, and nonmember subchapter T cooperatives at cost plus necessary expenses; (2) purchasing supplies and equipment for the use of the qualified group at cost plus necessary expenses; (3) trading crude oil; (4) storing crude oil; and (5) insuring all of the above activities. In addition, the trading and transportation of crude oil, the insurance of risks associated with trading and transportation of crude oil, and any other activities incidental to any qualifying purposes or designed to increase the efficiency of the cooperative in carrying out any qualifying purposes also would be treated as a qualifying purpose.

The bill would provide a "safe harbor" rule under which "necessary costs" would be deemed to be the greater of 15 percent of an activity's cost or an amount shown to the Secretary of the Treasury as being properly allocable to that activity.

Limitations on transactions with nonmembers.--The bill would impose the following restrictions on the volume of transactions with nonmembers: (1) the value of crude oil purchased for nonmembers could not exceed the value of crude oil purchased for members; (2) the value of supplies and equipment purchased for nonmembers could not exceed the value of purchases for members; and (3) the value of all purchases for nonmembers could not exceed an unlimited amount for nonmember independent refiners and nonmember subchapter T cooperatives plus an amount equal to 25 percent of the value of all its purchases.

Operation in federated form.--The bill would permit a cooperative to be a crude oil purchasing cooperative where it is doing business on a federated form on the basis of geography, regions, qualities of crude oil, or any other reasonable basis.

D. Effective date

The bill would apply to taxable years beginning after the date of enactment.

DESCRIPTION OF S. 2151

RELATING TO

ENERGY INVESTMENT TAX CREDIT FOR CHLOR-ALKALI ELECTROLYTIC CELLS

SCHEDULED FOR A HEARING
BEFORE THE
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION
OF THE
SENATE COMMITTEE ON FINANCE
ON
MARCH 30, 1982

PREPARED BY THE STAFF
OF THE
JOINT COMMITTEE ON TAXATION

MARCH 29, 1982
JCX-4-82

INTRODUCTION

The Subcommittee on Energy and Agricultural Taxation of the Senate Finance Committee has scheduled a hearing on S. 2151 on March 30, 1982. The bill (introduced by Senator Robert Byrd) would add modifications to chlor-alkali electrolytic cells to the list of equipment that would qualify as specially defined energy property eligible for the 10-percent energy investment tax credit.

This document, prepared by the staff of the Joint Committee on Taxation in connection with the March 30 Subcommittee hearing, provides a description of S. 2151. The first part is a summary of the bill, and part two is a description of the provisions of the bill, including present law, issues, and effective date.

I. SUMMARY

Under present law, property that qualifies as specially defined energy property is eligible for a 10-percent energy investment tax credit. Qualifying property includes "modifications to alumina electrolytic cells." The Secretary of the Treasury has discretionary administrative authority to add items to the list of qualified property that meet certain statutory requirements. This provision for an energy credit expires after December 31, 1982.

S. 2151 would add "modifications to chlor-alkali electrolytic cells" to the list of specially defined energy property, and the bill would be effective to cover expenditures from January 1, 1981, through December 31, 1986.

II. DESCRIPTION OF THE BILL

Energy Investment Tax Credit For Chlor-alkali Electrolytic Cell

A. Present Law

An energy investment tax credit of 10 percent is allowed for investment in specially defined energy property (sec. 48(ℓ)(5). Such property includes equipment used for heat transfer or heat conservation purposes, an automatic energy control system, a combustible gas recovery system, and modifications to alumina electrolytic cells. In addition, the Secretary of the Treasury has the authority to add items to the list which have as their principal purpose reducing the amount of energy consumed, and which are installed in connection with an existing commercial or industrial facility.

The Secretary, however, may not specify an item for the list unless the item meets several minimum energy conservation and efficiency standards (sec. 44C(c)(9)). For this purpose, the Secretary would have to determine that the new equipment would reduce oil or natural gas consumption by a sufficient amount to justify resulting revenue losses, and would not increase use of items environmentally hazardous or a threat to public health or safety, and production or use of the equipment would not also receive any other Federal subsidy. The Secretary has not yet exercised the administrative discretion provided to him in this section.

Under present law, section 48(ℓ)(5) will terminate on December 31, 1982. For property which is part of a project with a 2 year or longer normal construction period, the termination date is December 31, 1990, if all relevant engineering studies have been completed, and all required Federal, State or local environmental and construction permits have been applied for, before January 1, 1983. In addition, before January 1, 1986, the taxpayer must enter into binding contracts for at least 50 percent of the cost of equipment specially designed for the project.

B. Issues

(1) Should the list of specially defined energy property be expanded to include chlor-alkali electrolytic cells?

(2) Should the expiration date for this single item of specially defined energy property be December 31, 1986, which is 4 years after the December 31, 1982, expiration date for section 48(*l*)(5)?

C. Explanation of the Bill

S. 2151 would add "modifications to chlor-alkali electrolytic cells" to the list of equipment that would qualify as specially defined energy property eligible for the 10-percent energy investment tax credit. Although section 48(*l*)(5) will terminate under present law after December 31, 1982, the allowance of the energy credit for these modifications under the bill would be retroactive to January 1, 1981, and extended forward through December 31, 1986.

The chlor-alkali industry uses a brine solution in a bipolar electrolytic cell process to produce chlorine gas and caustic soda. This industry consumes two percent of all electricity used in the United States. The modifications involve redesign of the use of electricity in the electrolytic process, a modification that closely adheres in function to the modifications to alumina electrolytic cells, which qualify presently as specially defined energy property. The planned modifications would reduce electricity consumption by as much as 20 percent--according to the proponents--but the modifications would not increase the productive capacity of the cells and do not constitute periodic replacements of existing cell components, which can continue in use for several more years without change or replacement.

Firms in the industry have filed with the Secretary the material needed for a determination as a qualified addition to the list of specially defined energy property. No action has been taken on the application.

D. Effective Date

The amendment to section 48(ℓ)(5) would be retroactive for expenditures from January 1, 1981, and would continue in effect through December 31, 1986.

Senator WALLOP. Good morning, ladies and gentlemen.

I am amazed to find myself here on time this morning because when I went out to my garage, I found that I had left the lights on in the car all night, and it was mostly dead this morning, but we got it going anyway.

The purpose of this morning's hearing is to receive testimony on two bills. S. 2151, which was introduced by Senator Robert Byrd, would add "modifications to chlor-alkali electrolytic cells" to the list of specially defined property for purposes of the 10 percent energy tax credit.

S. 1819, which I introduced with Senators Symms, Long, Boren, Matsunaga, Johnston, and Bentsen, would provide special rules for the taxation of "crude oil purchasing cooperatives."

Before we proceed to hear from Mr. Glickman, who will offer the Treasury Department's view on these two measures, I would like to make a few comments regarding the "crude oil purchasing cooperatives" bill.

It is almost 1 year ago to the date that I held hearings in this subcommittee concerning problems confronting the domestic refining industry. One inescapable conclusion that came from that hearing was that the problem of crude oil access experienced by independent refiners was attributable to their relatively small size. During the course of the hearing we discussed the idea of "crude oil purchasing cooperatives" as a possible alternative to help independents cope with that problem.

At that time, the Treasury Department did not voice outright opposition to the idea of purchasing co-ops, but instead stated that it was their opinion that the same objective could be achieved through the formation of a subchapter T cooperative. Further research after those hearings made it clear that subchapter T did not offer the flexibility that was necessary to make a crude oil purchasing cooperative a workable or reasonable alternative.

Thereafter, I joined with six of my colleagues in the introduction of S. 1819, which provides specific statutory for the tax-exempt treatment of crude oil purchasing cooperatives.

And while the term "tax-exempt" is in large part a misnomer, the basic structure, which is almost exactly the same as that presently offered for farmer cooperatives, provides the flexibility and manageability that is necessary if these organizations are to have a chance to succeed.

Last December, we asked the Treasury Department to consider this legislation for inclusion in the miscellaneous tax bill. Treasury's response then, and that which is expected today, is not all that different from that of a year ago. Now, instead of subchapter T being sufficient, we will hear that the same thing can be accomplished with a very complicated partnership agreement.

There are a number of factors which indicate that the partnership structure is not adequate. First, the idea of limited partnership has been tried. Complications arising out of the difficulties of making timely decisions and making credit arrangements on short notice because of the partnership structure, spelled the eventual dissolution of that partnership.

Second, an exempt cooperative must, by law, treat members and nonmembers alike. This is clearly not the case with partnerships, organizations which would be perceived as competition, rather than an organization that could be of help to the collective body of independent refiners.

This legislation is quite modest. There is, in all likelihood, no revenue loss caused by the bill. What it does do is offer the independent refining industry the chance to do something for themselves.

It is my sincere hope that it won't be the Treasury Department's continued position that a very complicated, and most likely totally unworkable beast in the form of a partnership agreement, will suffice as an adequate alternative to a straightforward legislative proposal which will add but two pages to the Internal Revenue Code.

We should proceed with the attitude that our purpose in government is to help people help themselves, and not seek to place further obstacles in the road of an industry that wants nothing more than to be competitive in the open market.

With that statement, we will now call upon Mr. Glickman.

STATEMENT OF DAVID G. GLICKMAN, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. Glickman. Thank you, Mr. Chairman.

I am pleased to appear before you today to present the Treasury Department's views on S. 1819, a bill to amend the Internal Revenue Code with respect to the taxation of crude oil purchasing cooperatives.

Under the bill, crude oil purchasing cooperatives would be treated in a manner similar to that accorded exempt farmers' cooperatives under section 521 of the code. Consequently, unlike so-called "subchapter T" cooperatives, which are taxable on all nonpatronage business, crude oil purchasing cooperatives would be able to claim deductions against income for amounts paid to patrons from nonpatronage sources, including income from business done with the United States and its agencies.

Treasury opposes enactment of S. 1819, and I will cite the reasons for that position in my statement.

We were recently advised that this committee is also considering S. 2151, a bill to amend the code to add an additional item to the list of specially defined energy property.

We have not had sufficient time to study the bill and comment on its provisions. However, we would be pleased to forward our comments for the record, if the chairman would permit us to do so.

Senator WALLOP. Certainly that would be very agreeable.

[Statement was subsequently furnished:]

TREASURY DEPARTMENT'S COMMENTS WITH RESPECT TO S. 2151

S. 2151 would amend section 48(l)(5) of the Internal Revenue Code to add a new item to the list of specially defined energy property eligible for the 10 percent energy investment tax credit. The credit would be extended to modifications of chlor-alkali electrolytic cells. The bill would also amend section 46(a)(2)(C) of the Code to make the credit available retroactively for such property, beginning on January 1, 1981 and extending through December 31, 1982. Under present law all specially defined energy property investment tax credits terminate on December 31, 1982.

The Treasury Department strongly opposes enactment of S. 2151 for the following reasons:

(1) In general, energy tax subsidies are no longer justified. At the time the energy tax incentives were enacted, price controls were in effect on both crude oil and natural gas and there was resistence to decontrol. Prices paid by consumers for both oil and natural gas were substantially below replacement costs. Consequently, business firms had an insufficient incentive to invest in energy-conserving property. In the absence of free market prices, an economic rationale existed for tax incentives for conservation.

However, since the enactment of the energy credits, crude oil prices have been decontrolled. In addition, natural gas prices are being decontrolled under the National Gas Policy Act. As a result, whatever the original justification for these credits, tax subsidies are no longer needed because businesses now confront the true replacement costs of energy. Consequently, they have sufficent incentive to invest in energy conservation without the need for additional tax credits.

Indeed, PPG Industries, which seeks the credit under S. 2151, apparently was willing to incur the $100 million expense of modifying it chlor-alkali electrolytic cells without the availablity of an energy tax credit. Making such a credit available to PPG Industries retroactively would bestow a windfall to that company of $10 million.

(2) Since the enactment of the energy credits Congress adopted the Administration's Accelerated Cost Recovery System (ACRS) which has removed tax impediments to business investment, including investments now eligible for energy tax incentives. ACRS is available to PPG Industries for its investment in modifications to chlor-alkali electrolytic cells retroactively to January 1, 1981. An energy credit, when combined with ACRS and the regular 10 percent investment tax credit, would result in an excessive subsidy for such an investment.

(3) For the reasons discussed above the Administration proposed to the Congress that business energy tax credits should not be extended beyond December 31, 1982 except for certain transitional investments. An investment in modifications to chlor-alkali electrolytic cells has no justifiable claim than do other energy credit items for an extension of the credits beyond the December 31, 1982 termination date.

(4) In testimony before this Committee the representative of PPG Industries argued that the failure of the Treasury Department to consider adding modifications to chlor-alkali electrolytic cells to the list of eligible items somehow deprived PPG Industries of a credit that it would have received had its application been considered. However, it is far from clear that PPG Industries would have been able to satisfy the congressionally mandated standards that the Secretary of the Treasury

must apply before he can add an item to the list of specially defined energy property.

In order to qualify for addition to the list it is necessary that the principal purpose of the investment be to conserve energy. It appears that a principal purpose here was to construct a more efficient chlor-alkali electrolytic cell, albeit an incidental benefit of the modification is energy conservation. In addition, it must be demonstrated that the energy savings of oil and gas will flow from the availability of the credit. In PPG Industry's case, the fact that the modifications are to be made without a credit demonstrate that availability of the credit will have no incentive effect whatsoever. Furthermore, the energy to be conserved is electric energy which can be generated by the burning of coal. Other standards, relating to the cost to the Government of energy conserved, must also be shown.

We do not believe that PPG Industries has demonstrated that investments in the modification of chlor-alkali electrolytic cells are deserving of more generous tax treatment than is available to any other corporation which invest in new equipment.

Mr. GLICKMAN. Taxation of cooperatives. In general, cooperatives governed by subchapter T of the code are not subject to tax when operating on a cooperative basis with patrons. The advantage of operating on a cooperative basis is that it allows small businesses to form an association which may use its large size to obtain purchasing and marketing economies and efficiencies for the benefit of its patrons without incurring a corporate tax at the association level.

The elimination of the corporate level tax is accomplished by permitting a deduction for distributions or deemed distributions from cooperatives to patrons which are based on the amount of business done by a group of patrons on a cooperative basis.

Such distributions are includible in the income of the patrons. Use of the cooperative form enables patrons to defer the recognition of income in patronage transactions. These benefits are not available with respect to transactions which are not carried out on a cooperative basis.

"Tax-exempt" farmers' cooperatives calculate their income in the same way as subchapter T cooperatives but, in addition, receive other significant tax benefits, including the ability to deduct from gross income dividends paid on capital stock and amounts paid to patrons with respect to earnings derived from business done with the U.S. Government or its agencies or, to a limited extent, from other nonpatronage sources.

S. 1819 is intended to provide crude oil purchasing cooperatives the same tax benefits as are available to farmers' cooperatives. In addition, however, the bill would grant to such cooperatives significant benefits not available to farmers' cooperatives.

S. 1819 would exempt from income tax crude oil purchasing cooperatives. The membership of such cooperatives must consist of independent refiners or subchapter T cooperatives and must be organized for one of the following purposes:

One. Purchasing crude oil and reselling it to members, nonmember independent refiners and nonmember subchapter T cooperatives and turning back to them the proceeds of such resale less something referred to as necessary expenses;

Two. Purchasing supplies and equipment for the use of members, nonmember independent refiners and nonmember subchapter T cooperatives and turning over such supplies and equipment to them at actual cost plus the necessary expenses;

Three. Trading crude oil;

Four. Storing crude oil; and

Five. Insuring risks associated with any of the enumerated activities.

The bill describes necessary expenses as being the greater of 15 percent of the costs allocable to such activity or the amount demonstrated by the cooperative as being properly allocable to the costs of such activity. Crude oil purchasing cooperatives under S. 1819 could operate in a manner which is far less restrictive than farmers' cooperatives.

First, membership of farmers cooperatives is limited to farmers, fruit growers and like organizations. Membership in crude oil purchasing cooperatives is not limited in any respect since, in addition to independent refiners, any subchapter T cooperative may be a member. There is no requirement that the subchapter T members must be independent refiners.

Second, section 521 does not specifically authorize farmers' cooperatives to trade or store agricultural products, nor does it authorize the insurance of risks relating to such activities. S. 1819 does so with respect to the activities of crude oil purchasing cooperatives.

More importantly, S. 1819 allows the oil purchasing cooperative to engage in "any other activity incidental to" the itemized purposes or "designed to increase the efficiency of the associations" in carrying out the itemized activities. This would appear to permit these organizations to engage in refining activities and to purchase and market refined products. It may also permit the cooperatives to construct and sell refining equipment.

Third, S. 1819 contains a "necessary expense" rule which would permit the cooperative to treat as an expense, with respect to a patronage transaction, 15 percent of the costs allocable to such an activity even when the actual cost attributable to the patronage activity is less. This would permit the cooperative to make a profit on cooperative transactions with patrons.

Furthermore, this profit would not be subject to tax to the extent it is distributed to members as dividend on capital stock. Neither section 521 farmers' cooperatives nor any other cooperatives are granted such benefits.

Fourth, S. 1819 would increase the amount of business that can be done on a cooperative basis by crude oil purchasing cooperatives to 25 percent. Under section 521, farmers' cooperatives are limited in the amount of business they can do with nonpatrons to 15 percent of the value of all the cooperative's purchases.

Mr. Chairman, on March 27 of this year, as you stated, this committee held hearings on tax incentives for independent refiners. One of the incentives then considered was a proposal to allow independent refiners to organize crude oil purchasing cooperatives.

At that hearing, the Treasury Department opposed the adoption of the exempt cooperative proposal since we thought that the same ends could be accomplished under subchapter T. Since that time, we have studied the proposal in great detail and have met with representatives of the independent refiners. The Treasury Department remains strongly opposed to the enactment of S. 1819.

Statements submitted on March 27, 1981, on behalf of the American Petroleum Refiners Association and the Independent Refiners

Association of America indicated that the rationale for the exempt cooperatives proposal was:

One. To enable the independent refiners to negotiate long-term oil supply contracts at a level equivalent to that of government-to-government negotiations. That is, it was felt that in dealing with foreign government oil marketing organizations, purchasing cooperatives would have greater bargaining leverage than an individual independent refiner;

Two. To obtain broader access to financial markets; and

Three. To avoid antitrust complications.

It has not been demonstrated that the achievement of the three avowed goals of this legislation cannot be accomplished under current law in a variety of ways.

Independent refiners can combine to attain these goals without incurring a corporate level tax through the use of the partnership form of operation, the corporate form but with the additional cost of a 7-plus percent tax on the intercorporate dividends, or as a subchapter T cooperative.

Although the independent refiners contend that the partnership and corporate forms are deficient for a variety of reasons, a contention with which we disagree, subchapter T of the code can clearly accommodate the three goals.

First, independent refiners can establish cooperatives to purchase crude oil from foreign suppliers under long-term contracts. Their larger size may assist them in dealing with foreign governments on a more advantageous basis.

Second, the combined financial resources of the purchasing cooperatives may permit such organizations to obtain more favorable financing than they would if they seek to purchase oil independently.

Third, whatever antitrust implications exist for subchapter T cooperatives presumably exist for crude oil purchasing cooperatives.

Since under subchapter T such cooperatives will not pay an income tax to the extent they deal with their members or patrons on a cost plus expenses basis—under a cooperative basis—it is not apparent why there is a need to amend the tax law to provide tax exemptions for crude oil purchasing cooperatives. Obviously, independent refiners in this bill must be seeking something more than freedom to operate in a cooperative form on behalf of patrons.

S. 1819 would allow such cooperatives to operate in the same manner as taxable corporations in dealing with nonmembers but without obligation to pay a corporate income tax.

We see no justification for exempting crude oil purchasing cooperatives from income tax where they are not operating on a cooperative basis with customers. In that capacity, they are not different than any other business entity and should be taxed accordingly.

Although Congress has provided rules permitting cooperatives to avoid a corporate level tax, these rules generally apply only to the extent of business done with patrons on a cooperative basis.

While this restriction is relaxed somewhat in the case of farmers' cooperatives, S. 1819 would grant to crude oil purchasing cooperatives benefits in excess of even those available to farmers. There is no justification for such a tax preference.

Finally, such an amendment could have an adverse impact upon the Federal corporate tax receipts to the extent that exempt cooperatives deprive taxable corporations of profits from crude oil purchasing and related business. In addition, companies which must pay corporate taxes currently would be placed at a competitive disadvantage.

Mr. Chairman, for all these reasons, we oppose the enactment of S. 1819, and I will be happy to respond to any questions you might have.

[Statement of Mr. Glickman follows:]

For Release Upon Delivery
Expected at 10:00 a.m. EST

STATEMENT OF DAVID G. GLICKMAN
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE SUBCOMMITTEE ON
ENERGY AND AGRICULTURAL TAXATION
OF THE SENATE COMMITTEE ON FINANCE
MARCH 30, 1982

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to present the Treasury Department's views on S. 1819, a bill to amend the Internal Revenue Code with respect to the taxation of crude oil purchasing cooperatives. Under the bill, crude oil purchasing cooperatives would be treated in a manner similar to that accorded exempt farmers' cooperatives under section 521 of the Code. Consequently, unlike so-called "subchapter T" cooperatives which are taxable on all nonpatronage business, crude oil purchasing cooperatives would be able to claim deductions against income for amounts paid to patrons from nonpatronage sources, including income from business done with the United States and its agencies.

Treasury opposes enactment of S. 1819.

We were recently advised that this Committee is also considering S. 2151, a bill to amend the Code to add an additional item to the list of specially defined energy property. We have not had sufficient time to study the bill and comment on its provisions. However, we would be pleased to forward our comments for the record if the Chairman would permit us to do so.

Taxation of Cooperatives

In general, cooperatives governed by subchapter T of the Code are not subject to tax when operating on a cooperative basis with patrons. The advantage of operating on a cooperative basis is that it allows small businesses to form an association which may use its large size to obtain purchasing and marketing economies and efficiencies for the benefit of its patrons without incurring a corporate tax at the association level. The elimination of the corporate level tax is accomplished by permitting a deduction for distributions (or deemed distributions) from cooperatives to patrons which are based on the amount of business done with the patrons on a cooperative basis. Such distributions are includible in the income of the patron. Use of the cooperative form enables patrons to defer the recognition of income in patronage transactions. These benefits are not available with respect to transactions which are not carried out on a cooperative basis.

"Tax-exempt" farmers' cooperatives calculate their income in the same way as subchapter T cooperatives but, in addition, receive other significant tax benefits, including the ability to deduct from gross income dividends paid on capital stock and amounts paid to patrons with respect to earnings derived from business done with the United States Government or its agencies or (to a limited extent) from other nonpatronage sources.

Description of the Bill

S. 1819 is intended to provide crude oil purchasing cooperatives the same tax benefits as are available to farmers' cooperatives. In addition, however, the bill would grant to such organizations significant benefits not available to farmers' cooperatives.

S. 1819 would exempt from income tax crude oil purchasing cooperatives. The membership of such cooperatives must consist of independent refiners or subchapter T cooperatives and must be organized for ~~the purpose of:~~ one of the (1) purchasing crude oil and reselling it to members, nonmember independent refiners and nonmember subchapter T cooperatives and turning back to them the proceeds of such resale less necessary expenses; (2) purchasing supplies and equipment for the use of members, nonmember independent refiners and nonmember subchapter T cooperatives and turning over such supplies and equipment to them at actual cost plus necessary expenses; (3) trading crude oil; (4) storing crude oil; and (5) insuring risks associated with any of the enumerated activities.

The bill describes necessary expenses as being the greater of 15 percent of the costs allocable to such activity or the amount demonstrated by the cooperative as being properly allocable to the costs of such activity.

Crude oil purchasing cooperatives under S. 1819 could operate in a manner which is far less restrictive than applied to farmers' cooperatives.

First, membership of farmers cooperatives is limited to farmers, fruit growers and like organizations. Membership in crude oil purchasing cooperatives is not limited in any respect since, in addition to independent refiners, any subchapter T cooperative may be a member. There is no requirement that the subchapter T cooperative members must be independent refiners.

Second, section 521 does not specifically authorize farmers' cooperatives to trade or store agricultural products, nor does it authorize the insurance of risks relating to such activities. S. 1819 does so with respect to activities of crude oil purchasing cooperatives. More importantly S. 1819 allows the oil purchasing cooperative to engage in "any other activity incidental to" the itemized purposes or "designed to increase the efficiency of the associations" in carrying out the itemized activities. This would appear to permit these organizations to engage in refining activities and to purchase and market refined products. It may also permit the cooperatives to construct and sell refining equipment.

Third, S. 1819 contains a "necessary expense" rule which would permit the cooperative to treat as a expense with respect to a patronage transaction 15 percent of costs allocable to an activity even when the actual cost attributable to the patronage activity is less. This would permit the cooperative to make a profit on cooperative transactions with patrons. Furthermore, this profit would not be subject to tax to the extent it is distributed to members as a dividend on capital stock. Neither section 521 farmers' cooperatives nor other cooperatives are granted such benefits.

any cooperatives

Fourth, S. 1819 would increase the amount of business that can be done on a nonpatronage basis by crude oil purchasing cooperatives to 25 percent. Under section 521, farmers' cooperatives are limited in the amount of business they can do with nonpatrons to 15 percent of the value of all the cooperative's purchases.

Treasury Position

Mr. Chairman

On March 27, 1981, this Subcommittee held hearings on tax incentives for independent refiners. One of the incentives then considered was a proposal to allow independent refiners to organize crude oil purchasing cooperatives. At that hearing the Treasury Department opposed adoption of the exempt cooperative proposal. Since that time we have studied the proposal in greater detail and have met with representatives of independent refiners. The Treasury Department remains strongly opposed to the enactment of S. 1819.

Statements submitted on March 27, 1981, on behalf of the American Petroleum Refiners Association and the Independent Refiners Association of America indicated that the rationale for the exempt cooperative proposal was: (1) to enable independent refiners to negotiate long-term oil supply contracts at a level equivalent to that of government-to-government negotiations (that is, it was felt that in dealing with foreign government oil marketing organizations, purchasing cooperatives would have greater bargaining leverage than an individual independent refiners); (2) to obtain broader access to financial markets; and (3) to avoid antitrust complications.

It has not been demonstrated that the achievement of the three avowed goals of this legislation can not be accomplished under current law in a variety of ways. Independent refiners can combine to attain these goals without incurring a corporate level tax through the use of the partnership form of operation, the corporate form (but with the additional cost of a seven-plus percent tax on intercorporate dividends) or as a subchapter T cooperative. Although the independent refiners contend that the partnership and corporate forms are deficient for a variety of reasons (a contention with which we disagree), subchapter T of the Code can clearly accommodate the three goals.

First, independent refiners can establish cooperatives to purchase crude oil from foreign suppliers under long-term contracts. Their larger size may assist them in dealing with foreign governments on a more advantageous basis. Second, the combined financial resources of the purchasing cooperatives may permit such organizations to obtain more favorable financing than they would if they seek to purchase oil independently. Third, whatever antitrust implications exist for subchapter T cooperatives presumably exist for crude oil purchasing cooperatives.

Since under subchapter T such cooperatives will not pay an income tax to the extent they deal with their members or patrons on a cost plus expenses basis it is not apparent why there is a need to amend the tax laws to provide tax exemption for crude oil purchasing cooperatives. Obviously, independent refiners in this bill must be seeking something more than freedom to operate in a cooperative form on behalf of patrons.

S. 1819 would allow such cooperatives to operate in the same manner as taxable corporations in dealing with nonmembers but without the obligation to pay a corporate income tax. We see no justification for exempting crude oil purchasing cooperatives from income tax where they are not operating on a cooperative basis with customers. In that capacity they are not different than any other business entity and should be taxed accordingly. Although Congress has provided rules permitting cooperatives to avoid a corporate level tax, these rules generally apply only to the extent of business done with patrons on a cooperative basis. While this restriction is relaxed somewhat in the case of farmers' cooperatives, S. 1819 would grant to crude oil purchasing cooperatives benefits in excess of even those available to farmers. There is no justification for such a tax preference.

Finally, such an amendment could have an adverse impact upon the Federal corporate tax receipts to the extent that exempt cooperatives deprive taxable corporations of profits from crude oil purchasing and related business. In addition, companies which must pay corporate taxes currently would be placed at a competitive disadvantage.

For all these reasons we oppose the enactment of S. 1819.

Senator WALLOP. I gather from your statement the conclusion would be what you just stated.

I guess, one problem that I have with your testimony is that it does address S. 1819 from the Treasury's point of view, but it doesn't address the problem from the Government's point of view, when we said that we were going to try to do something about it.

So it seems to me that rather than addressing that directly, it would have been useful to take some of those portions of the bill which cause some problems and suggest amendment to them, rather than simply an evasive way of doing it.

I doubt very seriously that there are very many independent refiners, former or present, who are in the Treasury Department and can give first-hand advice as to what the problem is that they have faced in making purchases of crude oil from foreign governments, and that is, in essence, what we are trying to do.

Admittedly, since we all talked together a year ago, the problem of foreign governments with crude oil on their hands are different than they were, but I think that somewhere down the road they will be back in a similar kind of way.

Certainly, subchapter T did not do for the independent refiners what they sought, the official sort of government-to-government kind of recognition that they felt was lacking and did not permit them to get their crude oil supplies.

Basically, what we are trying to do with this, or at least what I am trying to do, is not to provide a segment of American industry with a tax position that is not endorsed by another, but I am trying to provide them with the means to access these markets which they have demonstrated through a variety of events that they could not do.

While I can understand some of the reluctance on this, I don't think I agree with the conclusion that it might cost you money. I think that is rather reaching. Certainly the existence of an independent industry, would seem to me to have a revenue return aspect simply because of its existence, either as a competitive force in the marketplace or an employer and a viable thing that is going on.

It is my intention to attempt to proceed with it because I don't think that the revenue loss will be great. It would be a much happier situation if the problems that you have identified, if you could have suggested amendments to them, rather than mere opposition to the concept.

In my heart I cannot believe that it is the position of the Reagan administration that they don't want an independent refining group.

Mr. GLICKMAN. Mr. Chairman, may I respond?

We tried to move in the direction which you are suggesting. We tried to make sure we understood what the problems were, and for that reason, as I stated in my testimony, we met with the industry in trying to make sure that we understood what the problem was.

We kept coming back to the same question every time we started tampering with this, and the problem that bothered us was that they were not going to be taxable, not only on the patronage, but on the amount that they would be dealing with outside third parties.

It seemed to us, in that situation, like in subchapter T, if they deal with outside third parties, they have to pay that corporate tax. To the extent that they make a profit there, they have to pay taxes on it currently.

Thus, we had a great deal of difficulty understanding why they should be dealing with third parties and not having to pay tax immediately.

Senator WALLOP. That may be.

The biggest problem that remains unaddressed by the subchapter T is this sort of recognized government entity that seems to be important to them as they deal with foreign governments for contracts for crude oil supplies. That is what we have to get on their behalf.

Mr. GLICKMAN. I followed this just to make sure I understood. What you are saying, as I understand it, Mr. Chairman, is that you think the subchapter T cooperative would take on a different image with the foreign governments than this new cooperative?

Senator WALLOP. No. I am saying that the new cooperative takes on a level of recognition, the way we had tried—I am not talking about the taxes that are of concern to Treasury but the entity was thought to be necessary, I think it is necessary, and the independent refiners find it necessary, to provide them with some stature that they don't now possess in the eyes of foreign governments who control the crude oil.

That seems to be where we ought to get, and if we could get there in this relatively benign time where crude oil supplies are not a pressing problem for people, we ought to be able to do it with some thought, and without some kind of emergency situation pending over us which creates bad law and creates bad precedents.

So the subchapter T, the fact that it does not appear to give them sufficient stature in the eyes of people with whom they say they have to deal, leaves us with the idea of a crude oil purchasing cooperative, and if we can limit it to independent refiners, and take care of some of the other problems and maintain our position that we are not trying to cost the Treasury anything, that is really not the purpose. We will try to proceed, unless there are some ideas that you may have which will help us succeed in that, we would be happy to proceed.

Mr. GLICKMAN. We will be happy to work with you in that regard.

Senator WALLOP. Thank you very much.

The next is Mr. Ray Bragg, and Mr. Ray Stroupe. Mr. Bragg is the executive director of the American Petroleum Refiners Association. Mr. Stroupe is president of the National Tax Equality Association in Washington, D.C., and he is accompanied by Mr. Jeff DeBoer, director of research and legislative counsel for NTEA.

Good morning, gentlemen. If you would proceed, Mr. Bragg.

STATEMENT OF RAY F. BRAGG, JR., EXECUTIVE DIRECTOR, AMERICAN PETROLEUM REFINERS ASSOCIATION, ACCOMPANIED BY CHARLES BRUCE, ESQ., ADVISORY COUNSEL TO APRA

Mr. BRAGG. Good morning, Mr. Chairman.

I have asked APRA advisory counsel, Charles Bruce, to join me up here to answer any technical questions you might have.

I would like to submit my full testimony, including technical comments, for the record, and focus my oral comments on the practical application of this idea from a businessman's viewpoint.

Senator WALLOP. All the testimony will be received in full into the record.

Mr. BRAGG. Thank you.

The American Petroleum Refiners Association, the largest industry trade association, representing the independent refining industry, appreciates the opportunity of testifying before your subcommittee on the subject of crude oil purchasing cooperatives for independent refiners.

APRA appeared before the subcommittee over a year ago to present our views on a number of tax- and tariff-based incentives which were designed to insure the survival of a healthy, diverse U.S. refining industry. Unfortunately, the health of that industry is much worse today than it was a year ago, or indeed at any point in recent memory.

A recent API survey documents the permanent and temporary shut-in of approximately 2.3 million barrels a day of U.S. refining capacity during the 1 year period from September 1980 to September 1981. This represents 12 percent of total U.S. operable refining capacity. APRA has noted the closure of some 1 million barrels per day of additional capacity since September of 1981.

There is currently a worldwide surplus of refining capacity which is a byproduct of both economic recession and increased conservation. Closure of surplus U.S. refining capacity is, in the main, a result of the reduced demand for refined petroleum products working its way through the marketplace.

Certainly, to the extent that inefficient refineries are shut in, no real economic loss to the Nation as a whole will be felt. However, APRA is concerned that in the present economic contraction, the United States is in some danger of losing an entire sector of the petroleum industry, the locally based independent refining companies, which serve vital markets often not served by the major oil companies.

As many as 60 to 70 independent refiners may have been shut down or mothballed in the last 12 months. In fact, yesterday, I was informed of another company planning to shut down May 1, probably permanently.

In the hearing before your subcommittee last year, one idea emerged as a uniquely appropriate way to assist independent refiners in controling their crude oil costs without Government subsidy. The concept of member-owned independent refiner purchasing cooperatives, organized along the same lines as farmers' cooperatives, is an idea which APRA enthusiastically supports.

An independent refiner, by definition, owns and controls less than 30 percent of the crude oil processed in his refinery. Crude oil, perhaps more so than any other raw material input, is a commodity whose price, as well as availability, is determined to a significant degree by the volume purchased.

An independent refiner, purchasing crude oil in limited volumes on the normal world market, will find his average per barrel crude cost significantly higher than his major oil company competitors, particularly in times of tight supply. A crude oil cooperative will permit independent refiners to channel their purchasing efforts through a central organization thereby reducing average per barrel costs.

Crude oil, in effect, is bought and sold at different tables, and the cooperative idea will permit independent and small refiners through the cooperative to sit at the table where the large crude contracts are available. Generally, these contracts have been available only to the major oil companies, governments, or very large international traders in the past.

APRA endorses the passage of S. 1819 introduced by yourself and Senators Symms, Boren, Long, Matsunaga, Bentsen, and Johnston. This bill should make it much easier for independent refiners to organize for the purpose of purchasing suitable crude oil in bulk volumes.

No subsidy is contained in S. 1819. Cooperatives, like regular corporations, are only as sound or successful as their management. If a crude oil purchasing cooperative makes unsound business decisions, the member patrons will bear the loss. If the cooperative is successful in making bulk purchases at competitive prices, then the crude oil cost of each member will be reduced.

The principal advantage that the cooperative form brings to this particular industry is central purchasing. Independent refiners will have a large central creditworthy member-owned purchasing department through which they can submit their crude oil orders.

This form of organization should prove to be an advantage in a normal market where volume can command discount.

Additionally, permitting these cooperatives to organize in a fashion similar to exempt farmers' cooperatives should have certain practical advantages, including the ability to do business with the Federal Government without fear of losing cooperative status and a guarantee that nonmember patrons will be treated the same as members.

Provision of a special place in the Internal Revenue Code to the prescription of rules under which crude oil purchasing cooperatives must operate will have the practical effect of enhancing the ability of cooperatives in negotiations with foreign producer nations, and this is true for two reasons:

First, the producer country will view the cooperative as having the tacit approval of the U.S. Government; second, the producer will only have to deal with one entity as opposed to several as is the case with various consortia of independent refiners which have been attempted in the past.

The cooperative concept is one which has become accepted as a business entity throughout the world by most foreign governments. Numerous discussions with crude oil traders have convinced APRA of the soundness of the coop idea.

Second, a crude trader can buy crude oil for a number of refineries as easily, perhaps more easily, than for one particular facility. The purchase of large volumes of crude also improves the economics of transportation to the ultimate refining facility.

A successfully organized and competently staffed crude oil purchasing cooperative could reduce the historical practice of smaller independent refiners relying on crude oil middlemen or resellers for the purchase of their crude at premium prices.

This is certainly not to say that all independent refiners will wish to join a cooperative if this legislation passes. Independent refiners are very independent businessmen and the cooperative form of business is an anathema to many. Yet, others realize that if any semblance of an independent refining industry is to remain in the United States some consolidation of effort is required.

APRA views S. 1819 as a modest attempt to encourage independent refiners to help themselves. The legislation should have no revenue effect on the budget during fiscal year 1982 or in outyears.

Indeed, inasmuch as independent refiners are historically high marginal rate taxpayers, revenues may be increased if the coop idea is successful in returning some independent refiners to a taxpaying status. There certainly seems to be little to lose in giving the idea a chance to succeed, and allowing the independents in this industry to graft themselves to the recognized and respected concept, which has proven so successful for independent businessmen in agriculture.

Mr. Chairman, I would like to submit for the record memoranda offering detailed reasons why a partnership or a subchapter T would not adequately address this issue.

Finally, I would like to emphasize, our concern is that business with the Federal Government will not harm the crude oil purchasing cooperative. However, if the Government is concerned about the benefit accruing to a crude oil purchasing cooperative resulting from business with the Government, we would suggest that the Government would be treated as a patron, thereby insuring that that will not occur.

That concludes my comments. I will be happy to answer any questions you might have.

[Statement of Mr. Bragg follows:]

STATEMENT

OF

RAYMOND F. BRAGG, JR.

EXECUTIVE DIRECTOR OF THE

AMERICAN PETROLEUM REFINERS ASSOCIATION

BEFORE THE

SENATE COMMITTEE ON FINANCE

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

REGARDING THE NEED FOR

CRUDE OIL PURCHASING COOPERATIVES

MARCH 30, 1982

WASHINGTON, D.C.

MR. CHAIRMAN: THE AMERICAN PETROLEUM REFINERS ASSOCIATION, THE LARGEST INDUSTRY TRADE ASSOCIATION REPRESENTING THE INDEPENDENT REFINING INDUSTRY, APPRECIATES THE OPPORTUNITY OF TESTIFYING BEFORE YOUR SUBCOMMITTEE ON THE SUBJECT OF CRUDE OIL PURCHASING COOPERATIVES FOR INDEPENDENT REFINERS. APRA APPEARED BEFORE THE SUBCOMMITTEE ON MARCH 27, 1981, TO PRESENT OUR VIEWS ON A NUMBER OF TAX AND TARIFF BASED INCENTIVES WHICH WERE DESIGNED TO INSURE THE SURVIVAL OF A HEALTHY, DIVERSE U.S. REFINING INDUSTRY. UNFORTUNATELY, THE HEALTH OF THE U.S. REFINING INDUSTRY IS MUCH WORSE TODAY THAN WAS THE CASE A YEAR AGO, OR INDEED AT ANY POINT IN RECENT MEMORY. A RECENT AMERICAN PETROLEUM INSTITUTE (API) SURVEY DOCUMENTS THE PERMANENT OR TEMPORARY SHUT IN OF APPROXIMATELY 2.3 MILLION BBLS/DAY OF U.S. REFINING CAPACITY DURING THE ONE-YEAR PERIOD FROM SEPTEMBER 1980 TO SEPTEMBER 1981. */ THIS REPRESENTS TWELVE PERCENT OF TOTAL U.S. OPERABLE REFINING CAPACITY. APRA HAS NOTED THE CLOSURE OF SOME 1 MILLION BBLS/DAY OF ADDITIONAL CAPACITY SINCE SEPTEMBER OF 1980.

THERE IS CURRENTLY A WORLDWIDE SURPLUS OF REFINING CAPACITY WHICH IS A BIPRODUCT OF BOTH ECONOMIC RECESSION AND INCREASED CONSERVATION. CLOSURE OF SURPLUS U.S. REFINING CAPACITY IS, IN THE MAIN, A RESULT OF THE REDUCED DEMAND FOR REFINED PETROLEUM PRODUCTS WORKING ITS WAY THROUGH THE MARKETPLACE.

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*/ AS REPORTED IN THE OIL DAILY OF MARCH 22, 1982.

CERTAINLY, TO THE EXTENT THAT INEFFICIENT REFINERIES ARE SHUT IN, NO REAL ECONOMIC LOSS TO THE NATION AS A WHOLE WILL BE FELT. HOWEVER, APRA IS CONCERNED THAT, IN THE PRESENT ECONOMIC CONTRACTION, THE UNITED STATES IS IN SOME DANGER OF LOSING AN ENTIRE SECTOR OF THE PETROLEUM INDUSTRY--THE LOCALLY BASED INDEPENDENT REFINING COMPANIES. AS MANY AS 70 INDEPENDENT AND SMALL REFINERS MAY HAVE BEEN SHUT DOWN OR MOTHBALLED IN THE LAST 12 MONTHS.

IN THE HEARING BEFORE YOUR SUBCOMMITTEE LAST YEAR, ONE IDEA EMERGED AS AN ESPECIALLY APPROPRIATE WAY TO ASSIST INDEPENDENT REFINERS IN CONTROLLING THEIR RAW MATERIAL (CRUDE OIL) COSTS WITHOUT GOVERNMENT SUBSIDY. THE CONCEPT OF MEMBER OWNED INDEPENDENT REFINER PURCHASING COOPERATIVES (ORGANIZED ALONG THE SAME LINES AS FARMERS' COOPERATIVES) IS AN IDEA WHICH APRA ENTHUSIASTICALLY SUPPORTS. AN INDEPENDENT REFINER, BY DEFINITION, OWNS OR CONTROLS LESS THAN 30 PERCENT OF THE CRUDE OIL PROCESSED IN HIS REFINERY. CRUDE OIL, PERHAPS MORE SO THAN ANY OTHER RAW MATERIAL INPUT, IS A COMMODITY WHOSE PRICE AS WELL AS AVAILABILITY IS DETERMINED TO A SIGNIFICANT DEGREE BY THE VOLUME PURCHASED. AN INDEPENDENT REFINER, PURCHASING CRUDE OIL IN LIMITED VOLUMES ON THE WORLD MARKET, WILL TYPICALLY FIND HIS AVERAGE PER BARREL CRUDE COST SIGNIFICANTLY HIGHER THAN HIS MAJOR OIL COMPANY COMPETITORS--PARTICULARLY IN TIMES OF TIGHT SUPPLY.

A CRUDE OIL PURCHASING COOPERATIVE WILL PERMIT INDEPENDENT REFINERS TO CHANNEL THEIR PURCHASING EFFORTS THROUGH A CENTRAL ENTITY, THEREBY REDUCING AVERAGE PER BARREL COSTS. CRUDE OIL

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IN EFFECT IS BOUGHT AND SOLD AT DIFFERENT "TABLES"; AND THE COOP IDEA WILL PERMIT INDEPENDENT AND SMALL REFINERS, THROUGH THE COOPERATIVE, TO SIT AT THE TABLE WHERE LARGE CRUDE CONTRACTS ARE AVAILABLE.

APRA ENDORSES THE PASSAGE OF S. 1819, INTRODUCED BY SENATORS WALLOP, SYMMS, LONG, BOREN, MATSUNAGA, BENTSEN, AND JOHNSTON ON NOVEMBER 5, 1981. THIS BILL SHOULD MAKE IT MUCH EASIER FOR INDEPENDENT REFINERS TO ORGANIZE FOR THE PURPOSE OF PURCHASING SUITABLE CRUDE OIL IN BULK VOLUMES. NO SUBSIDY IS CONTAINED IN S. 1819. COOPERATIVES, LIKE REGULAR CORPORATIONS, ARE ONLY AS SOUND OR SUCCESSFUL AS THEIR MANAGEMENTS. IF A CRUDE OIL PURCHASING COOPERATIVE MAKES UNSOUND BUSINESS DECISIONS, THE MEMBER PATRONS WILL BE PROPORTIONATELY AFFECTED. IF THE COOPERATIVE IS SUCCESSFUL IN MAKING BULK PURCHASES AT COMPETITIVE PRICES, THEN THE CRUDE OIL COSTS OF EACH MEMBER WILL BE REDUCED. THE PRINCIPAL ADVANTAGE THAT THE COOPERATIVE FORM BRINGS TO THIS PARTICULAR INDUSTRY IS CENTRAL PURCHASING. INDEPENDENT REFINERS WILL HAVE A LARGE, CENTRAL, CREDIT-WORTHY, MEMBER-OWNED PURCHASING DEPARTMENT THROUGH WHICH THEY CAN SUBMIT THEIR CRUDE OIL ORDERS. THIS FORM OF ORGANIZATION SHOULD PROVE TO BE AN ADVANTAGE IN A MARKET WHERE VOLUME CAN COMMAND DISCOUNT.

ADDITIONALLY, PERMITTING THESE COOPERATIVES TO ORGANIZE IN A FASHION SIMILAR TO EXEMPT FARMER COOPERATIVES SHOULD HAVE CERTAIN PRACTICAL ADVANTAGES.

* UNDER SECTIONS 521 AND 1382(c)(2), OF THE INTERNAL REVENUE CODE, EXEMPT FARMER COOPERATIVES ARE PERMITTED DEDUCTIONS FOR DISTRIBUTIONS TO MEMBERS FROM NON-PATRONAGE EARNINGS. A SUBSTANTIAL PORTION OF A LARGE CRUDE OIL CONTRACT MAY NEED TO BE TRADED FOR CRUDE OIL OF A MORE SUITABLE GRADE FOR REFINING BY A COOP MEMBER.

* ENACTMENT OF THE NEW SECTION 522 PROVISION FOR CRUDE OIL PURCHASING COOPERATIVES WILL ALLOW THE COOPERATIVE TO DEDUCT DISTRIBUTIONS TO MEMBERS WHICH ARE RELATED TO THE RESALE OR EXCHANGE OF THAT PORTION OF A CRUDE OIL CONTRACT WHICH CANNOT BE PROFITABLY REFINED BY COOP MEMBERS. THIS NEEDED FLEXIBILITY, OCCASIONED BY THE PARTICULAR NATURE OF THE COMMODITY BEING PURCHASED, WILL ASSIST THE COOPERATIVE IN ITS PURCHASING EFFORTS. HOWEVER, IT SHOULD BE REMEMBERED THAT THESE DISTRIBUTIONS WILL BE FULLY TAXABLE TO THE MEMBER PATRONS. AS PREVIOUSLY NOTED, THERE IS NO "EXEMPTION" WITH SO-CALLED EXEMPT COOPERATIVES, JUST AN AVOIDANCE OF DOUBLE TAXATION.

* UNDER EXISTING STATUTES AND IRS PRACTICE, IT IS UNCLEAR WHETHER A FEDERATED OR MULTI-TIERED NON-EXEMPT CRUDE OIL PURCHASING COOPERATIVE COULD PROPERLY BE FORMED UNDER SUBCHAPTER T OF THE INTERNAL REVENUE CODE.

  A CRUDE OIL PURCHASING COOPERATIVE WOULD BEST OPERATE AS A FEDERATED COOPERATIVE, FOR REFINERS COULD ORGANIZE ACCORDING TO THE TYPE OF CRUDE OIL THEIR COMPANIES WISHED THE COOPERATIVE TO ORGANIZE. A FEDERATED COOP COULD ALSO GIVE RECOGNITION TO DIFFERENT SEGMENTS OF THE INDUSTRY, SUCH AS ASPHALT REFINERS. S. 1819 WOULD ALLOW FEDERATED COOPERATIVES TO BE ESTABLISHED.

* S. 1819 MAKES IT CLEAR THAT THE STORAGE OF CRUDE OIL CAN BE A PRINCIPAL PURPOSE OF THE COOPERATIVE. MUCH HAS BEEN SAID IN RECENT MONTHS REGARDING THE NEED FOR ADDITIONAL CRUDE OIL STORAGE BY PRIVATE INDUSTRY. INDEPENDENT REFINERS CAN ILL AFFORD TO INDIVIDUALLY CONSTRUCT ADDITIONAL CRUDE STORAGE CAPACITY AT TODAY'S HIGH CONSTRUCTION COSTS AND INVENTORY CARRYING RATES. WHILE THE PROVISIONS OF S. 1819 AS PRESENTLY DRAFTED CONVEY NO SPECIAL TAX INCENTIVES FOR THE CONSTRUCTION OF STORAGE CAPACITY, INDEPENDENT REFINERS MAY WELL FIND IT LESS COSTLY AND MORE CONVENIENT TO CONSTRUCT STORAGE ON A COOPERATIVE BASIS.

* ACCORDING A SPECIAL PLACE IN THE INTERNAL REVENUE CODE TO THE PRESCRIPTION OF RULES UNDER WHICH CRUDE OIL PURCHASING COOPERATIVES MUST OPERATE WILL HAVE THE PRACTICAL EFFECT OF ENHANCING THE ABILITY OF THE COOPERATIVE IN NEGOTIATIONS WITH FOREIGN PRODUCER NATIONS. THIS IS TRUE FOR TWO REASONS: THE PRODUCER COUNTRY WILL VIEW THE COOP AS HAVING THE TACIT APPROVAL OF THE UNITED STATES GOVERNMENT. ALSO, THE PRODUCER WILL ONLY HAVE TO DEAL WITH ONE ENTITY AS OPPOSED TO SEVERAL, AS IS THE CASE WITH VARIOUS CONSORTIA OF INDEPENDENT REFINERS WHICH HAVE BEEN ATTEMPTED IN THE PAST.

NUMEROUS DISCUSSIONS WITH CRUDE OIL TRADERS HAVE CONVINCED APRA OF THE SOUNDNESS OF THE COOP IDEA. A CRUDE TRADER CAN BUY CRUDE OIL FOR A NUMBER OF REFINERIES AS EASILY, PERHAPS MORE EASILY, THAN FOR ONE PARTICULAR FACILITY. THE ABILITY TO PURCHASE OIL IN LARGE VOLUMES PERMITS A PURCHASER ACCESS TO THE LARGER CRUDE DEALS WITH MORE FAVORABLE ECONOMICS. PURCHASE OF LARGE VOLUMES OF CRUDE ALSO IMPROVES THE ECONOMICS OF TRANSPORTING THE CRUDE TO THE ULTIMATE REFINING FACILITY. A SUCCESSFULLY ORGANIZED AND COMPETENTLY STAFFED CRUDE OIL PURCHASING COOPERATIVE COULD REDUCE THE HISTORICAL PRACTICE OF SMALLER INDEPENDENT REFINERS RELYING ON CRUDE OIL MIDDLEMEN OR RESELLERS FOR THE PURCHASE OF THEIR CRUDE AT PREMIUM PRICES.

THIS IS CERTAINLY NOT TO SAY THAT ALL INDEPENDENT REFINERS WILL WISH TO JOIN A COOPERATIVE IF THIS LEGISLATION PASSES. INDEPENDENT REFINERS ARE VERY INDEPENDENT BUSINESSMEN AND THE COOPERATIVE FORM OF BUSINESS IS AN ANATHEMA TO MANY. YET OTHERS REALIZE THAT, IF ANY SEMBLANCE OF AN INDEPENDENT REFINING INDUSTRY IS TO REMAIN IN THE UNITED STATES, SOME

CONSOLIDATION OF EFFORT MAY BE REQUIRED. APRA VIEWS S. 1819 AS A VERY MODEST ATTEMPT TO ENCOURAGE INDEPENDENT REFINERS TO HELP THEMSELVES. THE LEGISLATION SHOULD HAVE NO REVENUE EFFECT ON THE BUDGET DURING FY 1982 OR IN OUT YEARS. INDEED, INASMUCHAS INDEPENDENT REFINERS ARE HISTORICALLY HIGH MARGINAL RATE TAXPAYERS, REVENUES MAY BE INCREASED IF THE COOP IDEA IS SUCCESSFUL IN RETURNING SOME INDEPENDENT REFINERS TO A TAXPAYING POSITION. THERE CERTAINLY SEEMS TO BE LITTLE TO LOSE IN GIVING THE IDEA A CHANCE TO SUCCEED.

IN CLOSING, APRA WOULD MAKE THE FOLLOWING MINOR TECHNICAL COMMENTS CONCERNING S. 1819:

* WITH REGARD TO MEMBERSHIP IN THE COOPERATIVE, SOME CONCERN HAS BEEN EXPRESSED REGARDING THE EXTENSION OF MEMBERSHIP TO "OTHER SUBCHAPTER T COOPERATIVES." AS WE UNDERSTAND IT, THE INTENT OF THIS PROVISION WAS TO ALLOW RANCHERS, OTHER NON-EXEMPT FARMER COOPS AND CONSUMER COOPS TO JOIN THE PURCHASING GROUP. SOME HAVE EXPRESSED THE FEAR THAT OTHER LARGE CORPORATIONS INCLUDING LARGE INDUSTRIAL USERS AND MAJOR OIL COMPANIES COULD FORM SUBCHAPTER T COOPERATIVES FOR CRUDE PURCHASING REASONS. WHILE APRA DOUBTS THIS WILL HAPPEN AND BELIEVES ANTITRUST STATUTES WOULD PREVENT THIS FROM OCCURRING, WE WOULD NOT OPPOSE LIMITING MEMBERSHIP IN THE COOPERATIVE ONLY TO INDEPENDENT REFINERS, AS IS THE CASE IN H.R. 4739, INTRODUCED BY CONGRESSMAN JENKINS.

* A SECTION SHOULD BE ADDED TO THE BILL DEFINING NON-MEMBER PATRONS OF CRUDE OIL PURCHASING COOPERATIVES TO CONSIST OF ALL INDEPENDENT REFINERS WHO ARE NOT MEMBERS OF THE COOPERATIVE (I.E., HOLD NO CAPITAL STOCK). AS EXEMPT COOPERATIVES MUST TREAT ALL MEMBER PATRONS AND NON-MEMBER PATRONS ALIKE, THIS WILL ENSURE THAT ALL INDEPENDENT REFINERS DEALING WITH THE COOP RECEIVE EQUAL PATRONAGE REFUNDS SHOULD ANY DISTRIBUTIONS BE ACHIEVED.

* S. 1819 AS PRESENTLY DRAFTED WOULD NOT PERMIT CRUDE OIL PURCHASING COOPERATIVES TO ENGAGE IN THE TRANSPORTATION OF CRUDE OIL. APRA WOULD PROPOSE THAT THE COOPS BE PERMITTED TO ENGAGE IN THE TRANSPORTATION OF CRUDE OIL, PARTICULARLY SO LONG AS PIPELINE DEREGULATION IS A POSSIBILITY. AS PIPELINE DEREGULATION COULD INCREASE TRANSPORTATION CHARGES FOR INDEPENDENT REFINERS, THEY SHOULD BE GIVEN EVERY INCENTIVE TO REDUCE THE COSTS OF TRANSPORTING CRUDE OIL.

* WITH REGARD TO S. 1819, IT IS IMPORTANT THAT A CRUDE OIL COOPERATIVE BE GIVEN MAXIMUM FLEXIBILITY TO SELL OR TRADE THAT PORTION OF A CRUDE CONTRACT WHICH CANNOT BE REFINED BY ITS MEMBERS. APRA WOULD PROPOSE THAT UP TO 25 PERCENT OF THE COOPERATIVES INCOME

COULD BE DERIVED FROM NON-PATRONAGE SOURCES WITH SALES TO THE U.S. AND FOREIGN GOVERNMENTS NOT COUNTING FOR PURPOSES OF THE 25 PERCENT RULE. THE PECULIAR NATURE OF CRUDE OIL AS A BULK COMMODITY NECESSITATES THIS. IN FACT, THE SECTION-BY-SECTION ANALYSIS OF S. 1819 INCLUDED IN THE CONGRESSIONAL RECORD OF NOVEMBER 5, 1981, CONTEMPLATES THIS MINOR CHANGE IN EXISTING LAW.

* THE DEFINITION OF "TRADING" IN SECTION 522 (B)(1)(C) SHOULD INCLUDE HEDGING AND OTHER FORMS OF RELATED COMMODITY TRADING.

MR. CHAIRMAN, THIS CONCLUDES MY TESTIMONY. APRA THANKS YOU FOR THE OPPORTUNITY TO TESTIFY AND WOULD OFFER TO ANSWER ANY QUESTIONS THAT YOU OR OTHER MEMBERS OF THE SUBCOMMITTEE MAY HAVE.

Crude Oil Purchasing Cooperatives

Independent and small refiners strongly support H.R. 4739 (Jenkins) and S. 1819 (Wallop, Symms, Long, Boren, Matsunaga, and Johnston) that would permit independent refiners to create Crude Oil Purchasing Cooperatives (COPCs) similar to farmers' cooperatives.

Reasons for proposal

The rationale of the legislation is that since independent and small refiners are prevented due to their size from bidding for large crude contracts, and thus must deal through expensive middlemen, they should be permitted -- indeed, encouraged -- to operate on a coöperative basis. COPCs would be the equivalent of jointly owned and operated purchasing departments; and it is hoped that they will be able to compete successfully with the purchasing departments of the major oil companies.

Revenue effects

This proposal would result in no additional revenue loss. Indeed, it is believed that by helping some independent refiners stay afloat, it will result in revenues being collected which otherwise would not exist. It should also be noted that every dollar earned by a Crude Oil Purchasing Cooperative will be taxed either at the cooperative level or the members level.

Explanation of proposal

The proposed COPCs are modeled closely on farmers' cooperatives. The differences between the two are occasioned by the fact that crude oil is traded in larger bulk than, say, seed or fertilizer. The COPCs are expected to deal in 200-400 M/BPD contracts. The combined refining capacities of the member refineries may not at all times accommodate these contracts, so some portion of a new contract may have to be "hived off" to non-members. In the absence of the proposed provisions, income on such a transaction, unlike similar income earned by a farmers' cooperative, would be taxed at both the cooperative and the members level.

Other than the fact that farmer's cooperatives and COPCs deal in different commodities, the only significant differences between farmers' cooperatives (existing section 521) and COPCs (proposed new section 522) are: (1) COPCs could make purchases for nonmembers up to 25% of the value of all their purchases, rather than 15%, in the case of farmers' cooperatives (this is necessary because of volumes of crude that will be purchased) and (2) for COPCs, the definition of "necessary expenses" which can be held at the cooperative level is the greater of 15% of the costs allocable to purchasing crude or refining supplies and equipment or the amount demonstrated to the IRS as properly allocable to such activities, rather than relying upon a "facts and circumstances" test, as in the case of farmers' cooperatives (a "bright line" rule will reduce the likelihood of controversies upon audit).

Under the proposal, COPCs, like farmers' cooperatives, could be organized in a federated form. Also, as with farmers' cooperatives, business done with the Federal government would not count against the COPC when judging its activities.

The proposal is necessary in that independent and small refiners cannot presently utilize the provisions of section 521 (relating to farmers' cooperatives). Nor can they obtain the same results by forming a Subchapter T non-exempt cooperative. Moreover, a purchasing cooperative is the most natural route to pursue. Consortia of separate companies have proved to have drawbacks. A partnership comprised of specially created subsidiaries of refiners would not arrive at the same results or be as feasible or as likely to be embraced by the industry.

<u>It is desirable for COPCs to be formed under a new section 522 as opposed to existing Subchapter T because:</u>

(1) ~~must treat~~ nonmembers should be treated the same as members

(2) as a section 522 cooperative, distributions to members from nonpatronage earnings would be deductible (this flexibility is required because of the volumes of crude to be purchased);

(2) at present it is unclear whether federated cooperatives can be formed and operated under Subchapter T (federation will allow recognition to be given to different types of refiners located in different geographic regions); and

(3) creation of a separate provision for COPCs may be perceived by foreign crude sellers as a mild form of U.S. government approval (it is hoped that the result will be greater willingness to enter into sales agreements with the COPCs).

<u>An elaborate partnership structure is not a feasible substitute for the cooperative idea for the following reasons.</u>

(1) Independent and small refiners have evidenced a willingness to attempt to form cooperatives under the proposed provisions. For reasons listed below, it is unlikely that they would form a partnership.

(2) A limited partnership, as well as a consortium, has been attempted but has not succeeded, in part because of the "unwieldiness" of the partnership, the difficulty of making timely decisions and producing a single letter of credit for tens of millions of dollars on short notice, and the reluctance of producer countries to view the partnership as a single entity as opposed to a "middleman" representing an aggregation of purchasers. This limited partnership has been dissolved.

(3) Independent and small refiners are generally familiar with the workings of farmers' cooperatives and are aware of the "patronage" and "egalitarian" features of cooperatives. These features are guaran-

teed from the outset and cannot be denied by subsequent actions. "Patronage" means that the fruits of dealing in bulk must be shared on the basis of utilization of the cooperative rather than ownership of capital. "Egalitarianism", in this context, means that nonmember patrons (users) must be treated the same as member patrons.

(4) Underlying the cooperative provisions, which are among the oldest in the Internal Revenue Code, is a "common law" of cooperatives based on the Rochedale principles (developed by the Rochedale Pioneers in England in the mid-1800's). These same principles would adhere to COPCs but not to a partnership or a joint venture. Puget Sound Plywood, Inc., 44 T.C. 305 (1965). See also, Holt, "Farmers' Cooperatives -- Distribution of Profits and Losses" (unpublished paper).

(5) In particular, exempt cooperatives must deal with nonmember patrons on a patronage basis whereas one who is not a member of a partnership can never be assured that he will always be treated by the partnership in a particular fashion. When organizing and building a cooperative, it will be essential to present this "egalitarian" facet to potential patrons and members alike.

Senator WALLOP. Thank you very much, Mr. Bragg.

I think what we will do is to have your testimony, Mr. Stroupe, and then if there are some questions, we will ask you both.

STATEMENT OF RAY M. STROUPE, PRESIDENT, NATIONAL TAX EQUALITY ASSOCIATION, ACCOMPANIED BY JEFF DeBOER, DIRECTOR OF RESEARCH AND LEGISLATIVE COUNSEL, NTEA

Mr. STROUPE. Thank you, Mr. Chairman.

Mr. DeBoer and I, Mr. Chairman, do not appear here as experts in regard to the production or refining or distribution of oil, or oil products. Our concern is with what we believe to be an equally significant matter, and that is the creation of additional cooperative corporations.

We are opposed to the extended tax exemption for crude oil purchasing cooperatives as envisioned in S. 1819 for several reasons.

The National Tax Equality Association does not believe that this legislation is warranted on claims of providing a greater access to the world supplies of crude oil. We support the operation of an unfettered market economy and believe that such an economy will adequately allocate crude oil to efficient small and independent domestic crude oil refineries.

We see no reason for tax-exempt cooperative involvement in maintaining the U.S. strategic oil reserve. We are additionally opposed to any intentions of forming a Federal tax-exempt crude oil purchasing cooperative entity designed to enter into government-to-government type contracts. We believe that the use of the Tax Code in any manner other than as a means to fund the Government is undesirable because of the longrun effects on resource allocation and product prices.

Our main objection to the legislation is the implied support for the continued cooperative special tax status. Our organization supports the reform of existing Federal income tax laws which permit the virtual tax exemption of certain cooperative forms of business enterprise.

In our view, this special cooperative corporate income tax treatment results in a substantial loss of Federal revenue, distorted tax liability, and product pricing facing other U.S. taxpayers, and a stifling of the traditional system of American competition.

We recommend that the fundamental two-tier system of taxation now applicable to corporations and shareholders be extended to cooperatives and their owner-patrons. The present system of cooperative taxation allows a cooperative to retain, at the corporate level, a pool of tax-free capital which can be used for competitive expansion.

In sum, the National Tax Equality Association recommends that this subcommittee take no action which is favorable to the adoption of S. 1819, the crude oil purchasing cooperative bill. Furthermore, we respectfully request that during the search for a more equitable budget, Congress investigate and correct this unwarranted area of Federal income tax favoritism.

Mr. Chairman, I thank you again for the opportunity to appear.

[The statement of Mr. Stroupe follows:]

STATEMENT
OF THE
NATIONAL TAX EQUALITY ASSOCIATION
TO THE
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION
OF THE
U.S. SENATE COMMITTEE ON FINANCE
RE: CRUDE OIL PURCHASING COOPERATIVES
MARCH 30, 1982

SUMMARY OF TESTIMONY

We are opposed to the extended tax-exemption for crude oil purchasing cooperatives as envisioned in S. 1819 for several reasons.

The National Tax Equality Association does not believe that this legislation is warranted on claims of providing a greater access to the world supplies of crude oil. We support the operation of an unfettered market economy and believe that such an economy will adequately allocate crude oil to efficient small and independent domestic crude oil refineries.

We see no reason for tax-exempt cooperative involvement in maintaining the United States strategic oil reserve. And we are additionally opposed to any intentions of forming a federal tax-exempt crude oil purchasing cooperative entity designed to enter into government-to-government type contracts. We believe that the use of the tax code in any manner other than as a means to fund the government is undesirable because of the long run effects on resource allocation and product prices.

Our main objection to this legislation is the implied support for the continued cooperative special tax status. Our organization supports the reform of existing federal corporate income tax laws which permit the virtual tax-exemption of certain cooperative forms of business enterprise.

In our view, the special cooperative corporate income tax treatment results in:

--a substantial loss of federal revenue;

--distorted tax liability and product pricing facing other U.S. taxpayers;

--a stifling of the traditional system of American competition.

We recommend that the fundamental two-tier system of taxation now applicable to corporations and shareholders be extended to cooperatives and their owner-patrons. The present system of cooperative taxation allows a cooperative to retain, at the corporate level, a pool of tax-free capital which can be used for competitive expansion.

In sum, the National Tax Equality Association recommends that this Subcommitee take no action which is favorable to the adoption of S.1819, The Crude Oil Purchasing Cooperative bill. Furthermore, we respectfully request that during the search for a more equitable budget, Congress investigate and correct this unwarranted area of federal income tax favoritism.

I am Ray M. Stroupe, President of the National Tax Equality Association (NTEA), and I am accompanied by Jeff DeBoer, our Director of Research.

The National Tax Equality Association appreciates this opportunity to express our views on S.1819, proposed legislation authorizing the formation of Internal Revenue Code section 521 tax-exempt crude oil purchasing cooperatives.

NTEA consists of some 2,000 firms, mostly small businesses, which support tax equality and are opposed to government-instituted discrimination against taxpaying business. We are opposed to the extended tax-exemption for crude oil purchasing cooperatives as envisioned in S.1819 for several reasons.

We do not believe this legislation is warranted on claims of providing greater access to the world supplies of crude oil. Currently existing, low-tax, Subchapter T cooperative refineries support this belief. Additionally, we cite to the statement presented to this committee one year ago by the Vice President, Energy Resources of the National Council of Farmer Cooperatives[1] asserting, ". . .Farmer cooperatives have already attempted several approaches similar to crude purchasing cooperatives and have had limited success in that effort. . . .In conclusion,. . .they will not assure equitable access to crude oil at competitive prices."

The appropriate method of obtaining crude oil access is the unfettered operation of competition. Much as oil producing countries have recently lowered their crude spot and contract prices in response to industry supply and demand, we believe that the market will adequately allocate crude oil to efficient small and independent domestic crude oil refineries.

Neither do we see any special national security risks which might justify tax-free cooperative involvement in maintaining the U.S. strategic oil reserve.

We feel it totally inappropriate to use the tax system in any manner other than as a means of funding government. Special tax-exemptions and inequitable tax treatment among competing sectors of industry are not the answer to every economic

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[1]See Statement of R. Thomas Van Arsdall, Vice President, Energy Resources, National Council of Farmer Cooperatives, Hearings on Tax Incentives For Domestic Refining Before the Subcommittee on Energy and Agricultural Taxation of the Senate Committee on Finance, 97th Cong., 1st Sess., at 51 (1981).

problem that this country may face. Classic economic theory holds that such provisions, in the long run, create capital resource dislocations and upward pressures on product prices.

We advocate a neutral tax code void of special exemptions, deductions and preferences. We are, therefore, additionally opposed to any intentions of forming a federal tax-exempt crude oil purchasing cooperative designed to enter into government-to-government type contracts.

Furthermore, and of the greatest importance to our business members, NTEA advocates the complete reform of cooperative corporate taxation in general. NTEA is aware of the specious theories used to justify the special co-op tax status. We agree with former IRS Commissioner Mortimer M. Caplin's recommendation that:[2]

> ". . .the fundamental two-tier system of taxation now applicable to corporations and shareholders be extended to cooperatives and their owner-patrons. Cooperatives should be made fully taxable on income which they earn, and where those earnings are subsequently distributed to the owner-patrons of the cooperatives, they should be taxed again -- just as corporate dividends are now."

The right of cooperative corporations to exist and grow unaided by federal subsidies is not objected to or questioned by this organization. However, we totally object to the present cooperative tax-exemption and Subchapter T treatment with its attendant loss of federal revenue (estimated by the Congressional Budget Office to be $670 million for the agricultural cooperatives alone in FY 1983) and stifling effect on traditional American enterprise.

During the search for a more balanced-equitable budget, we suggest that the cooperative accumulation of tax-free capital, at the corporate level, is unjustified and warrants Congressional investigation and correction.

Finally, with your permission, Mr. Chairman, we ask leave to submit, before the record closes, a more detailed statement on the issue of cooperative taxation and ask that it be included in the record.

Thank you.

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[2] Caplin, M.M., Taxing The Net Margins Of Cooperatives: Application of Basic Tax Principles and Analysis of Constitutionality, 58 Georgetown Law Journal 1 at page 4 letter of transmission NTEA reprint (May, 1969).

FEDERAL INCOME TAXATION

OF

COOPERATIVE CORPORATIONS

STATEMENT

BY THE

NATIONAL TAX EQUALITY ASSOCIATION

94-802 O - 82 - 5

INTRODUCTION

The National Tax Equality Association (NTEA) supports the reform of existing federal corporate income tax laws which permit the virtual tax-exemption of certain cooperative forms of business corporation. The current system of taxation is outmoded and has resulted in economic inefficiency through diminished competition as well as a substantial loss of federal revenue. The right of cooperative corporations to exist and to grow unaided by federal subsidies is neither involved nor questioned by this organization.

The proper taxation of cooperative corporations has been a matter that has been reviewed by the Congress, by the Treasury Department, and by the staff of the Joint Committee on Taxation many times. It has been the subject of controversy, hearings, proposed legislation and Treasury rulings almost continuously since 1947. In that time, however, relatively little has been achieved toward eliminating the unfair tax advantage that these corporations enjoy to the detriment of other competing, taxpaying corporations.

Cooperatives are a form of business enterprise in which the patron of the firm is also the owner. Most co-ops are organized under state incorporation laws and thus possess the peculiar corporate legal characteristics of limited liability, entity status, and perpetuity. The act of incorporation necessarily, by definition, entails the creation of a legal entity with an existence independent and apart from its owners.

Individuals who form cooperative corporations generally constitute a particuliar group wishing to consolidate their buying or selling power in order to increase the financial benefits of the marketplace. For example, an agricultural cooperative is generally an organization of farmers banding together for the purpose of selling agricultural products or purchasing necessary farm operational inputs.

As a corporation, the cooperative enters into contracts in its own name and the patrons are not bound by the corporate acts. Co-ops operate for their own account and retain corporate employees. The legal relationship between the co-op and its owner-patrons is essentially identical to that of any other corporation. For a detailed discussion of this relationship please see Caplin, Mortimer M., Taxing the Net Margins of Cooperatives: Application of Basic Tax Principles and Analysis of Constitutionality, 58 Georgetown Law Journal 1, (May 1969).

Generally speaking, the notion of cooperative organization includes three basic features absent in investor-owned corporations. First, the earnings of the co-op are distributed to the owners on the basis of patronage, or trade, conducted between the patron and the cooperative corporation. Second, the return on capital is usually limited to a maximum of 8 percent. Third, the amount of stock ownership which any one individual stockholder may possess is limited, and that, regardless of the amount owned, each stockholder has only one vote at the stockholders' meeting.

The primary focus of this paper is on the farmer or agricultural cooperative. However, the basis of cooperative taxation applies to all cooperative corporations regardless of their industry or marketplace.[1]

It must be recognized that in today's world, cooperatives are BIG BUSINESS. Farmer cooperatives had combined business volume in 1979 of $56.3 billion. Seven cooperative corporations are listed on Fortune magazine's list of the nation's 500 largest industrial corporations. Three cooperative corporations had assets in 1980 of at least $1 billion.

Cooperative growth continues, and, NTEA maintains, primarily because of favored government policy.

Before examining the tax status of cooperative corporations, please consult the following tables which indicate cooperative markets and cooperative size.

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[1]For instance, Cotter & Company, a wholesale hardware cooperative is exempt from federal income taxes on all profits distributed or allocated to members as patronage dividends. Cotter & Company, and its cooperatively held subsidiary, True Value Hardare, had sales volume of $1.35 billion in 1981.

TABLE I

1979
FARMER COOPERATIVE BUSINESS MARKETS

PRODUCTS MARKETED	COOPERATIVES HANDLING		SUPPLIES PURCHASED
Beans and Peas	59	2,243	Building materials
Cotton and cotton products	473	687	Containers
Dairy Products	495	3,877	Farm Chemicals
Fruits and vegetables	405	1,940	Farm machinery and Equip.
Grain, soybeans, oil	2,488	3,796	Feed
Livestock and products	499	3,972	Fertilizer
Nuts	48	485	Meats and groceries
Poultry products	76	3,062	Petroleum products
Rice	60	3,805	Seed
Sugar products	47	4,517	Other supplies
Tobacco	32		
Wool and mohair	150		
Miscellaneous	111		
Total	4,429	5,212	

TABLE II

Cooperative	Sales (in thousands)	Fortune List 1980	Fortune List 1979
Farmland Industries, Inc.	$4,774,606	80	87
Land O' Lakes, Inc.	3,303,719	109	142
Agway Inc.	2,658,610	147	171
Associated Milk Producers Inc.	2,396,600		
Grain Terminal Association	1,993,305		
Gold Kist Inc.	1,881,562	193	200
AGRI Industries, Inc.	1,733,071		
GROWMARK, Inc.	1,423,760		
CF Industries, Inc.	1,233,107	267	270
Indiana Farm Bureau Cooperative Assn.	1,219,925		
CENEX	1,209,784		
Mid-America Dairymen	1,056,299		
Dairymen, Inc.	881,133		
MFA Incorporated	868,635		
Landmark, Inc.	793,719		
Union Equity Cooperative Exchange	663,437		
Sunkist Growers, Inc.	653,803		
Southern States Cooperative, Inc.	625,930		
Riceland Foods, Inc.	610,000		
Midland Cooperatives, Inc.	523,529	464	436
National Cooperative Refinery Assn.	510,938	470	534
Michigan Milk Producers Association	473,502		

This chart shows the agricultural cooperatives on Fortune magazine's list of the nation's 500 largest industrial corporations (based on 1980 sales) as well as those cooperatives with sales volume great enough to be on the list, but not meeting Fortune's other qualifications.

**Source: USDA

SECTION I

SUMMARY OF FEDERAL INCOME TAX TREATMENT OF COOPERATIVES

I. INTRODUCTION

Corporations operating on a cooperative basis fall into several categories insofar as their federal income tax treatment is concerned.

This section summarizes the tax situation respecting cooperatives in the ordinarily understood sense. The tax treatment of such organizations is covered by IRC §521 and Subchapter T of the Internal Revenue Code which is entitled "Cooperatives and their Patrons." Subchapter T specifically excludes from its coverage a group of specialized institutions, such as mutual savings banks, rural electric and telephone cooperatives, and certain charitable organizations, each of which is especially provided for either in other parts of the Internal Revenue Code or in the substantive law governing the institution.

The cooperatives with which NTEA is concerned may be divided into three major categories: tax-exempt farm cooperatives; nonexempt farm cooperatives and nonfarm cooperatives. These categories are treated alike in at least one major respect. Specifically, patronage dividends which cooperative corporations allocate to their patrons may be deducted in determining taxable income of the cooperative provided the patron consents to take the same amount into his own individual income tax liability.

II. CURRENT FEDERAL INCOME TAX TREATMENT OF COOPERATIVES

Cooperatives generally, whether farm or nonfarm, whether exempt or nonexempt, may deduct the face amount of certain distributions made to their patrons in computing their taxable corporate income.

Sections 1381 to 1388 of the Internal Revenue Code provide the method of computing the taxable incomes of cooperatives and their patrons. These sections were enacted in the Internal Revenue Act of 1962. Prior to that legislation, cooperatives had been allowed to exclude from their income the face amount of noncash patronage dividends while the patrons, although required to include the fair market value of these patronage dividends, valued them at zero. Since only the fair market value of the distributions was subject to individual income taxation, the patron also avoided

The balance of this paper will be divided into five sections. Section I will provide a summary of the federal income tax treatment of cooperatives and compare that with investor-owned corporate taxation. Section II will discuss the negative effects of this special tax status on the marketplace generally. In section III we refute the main co-op justifications for their favored treatment. Section IV presents examples of co-op market growth. Finally, a summary and suggested solutions are presented in section V.

federal income tax. The Internal Revenue Act of 1962 attempted to close this loophole under which neither the cooperative nor the patron paid any tax on non-cash patronage dividends. The theory of the 1962 act was to assure that these distributions would be taxable to either the cooperative or the patron. Briefly, the Act required that in the case of noncash dividends, at least 20% of the distribution must be in cash and the patron must include, in his individual income, the face amount of noncash distribution--even if there was no fair market value.

The present state of cooperative taxation, and the main area of concern to the National Tax Equality Association, is the continued ability of co-ops to deduct from their taxable income allocations known as patronage dividends or, in the case of marketing cooperatives, per-unit retains. After taking the deductions for patronage dividends and/or per-unit retains, the cooperative is subject to the regular corporate income tax rates.

All of the federal income tax law applicable to cooperatives, enacted since 1962, has related to patronage dividends or per-unit retains.

1. Patronage Dividends

Patronage dividends are distributed by a cooperative to its patrons out of the earnings of the cooperative. Patronage dividends may be paid in money, property or certificates of allocation. Patronage dividends are defined as amounts: (a) distributed under an obligation existing before the paid amount was earned by the organizati (b) determined on the basis of business done with or for the patron; and (c) determined by reference to net earnings from business done with or for patrons. IRC § 1388(a). These amounts, patronage dividends, may be deducted from gross income of the cooperatie under certain conditions. The principle condition is the previous consent of the patron to include the same amount in his individual income. To be deducted by the cooperative for a particular taxable year, the patronage dividend must relate to patronage during that year and must be paid or allocated to the patron within 8½ months after the end of the year. If a noncash notice of allocation is declared then 20% of more must be in the form of money, or qualified check. IRC § 1388(c).

This provision effectively allows the cooperative corporation to retain 80% of the declared dividend as tax-free at the corporate lével. While considering the Tax Reform Act of 1969, the House of Representatives enacted a provision to increase the 20% cash payout to 50%; but this provision was not adopted by the Senate and did not become law.

2. Per-Unit Retains

A per-unit retain certificate is issued to a patron to reflect the retention by the cooperative of a portion of the proceeds from the marketing of products for the patron. Through the Revenue Act of 1966 and the Tax Reform Act of 1969, per-unit retains are treated equally, for deductibility purposes, as patronage dividends. In other words, cooperative corporations are allowed to deduct amounts allocated to their patrons as per-unit retains. Again, the patron must include the amount allocated to his account in his gross individual taxable income. See generally IRC §1385.

III. TAXATION OF THE PATRON

Section 1385 of the Internal Revenue Code provides the rules governing the taxability of patronage dividends and per-unit retain allocations received from an exempt or nonexempt cooperative, and nonpatronage dividends from a tax-exempt farmers' cooperative. Generally, these amounts are taxable when received only if the payments consist of money, other property, or qualified written notices of allocation. In the latter event at least twenty percent of the stated amount must be in money or qualified check.

IV. SUMMARY

Cooperatives are nominally subject to corporate rates of taxation. However, co-ops are allowed a deduction from taxable income equal to the amount of co-op earnings allocated to the co-op patron. This allocation is usually referred to as either a patronage dividend or a per-unit retain.

Patronage dividends and per-unit retains do not need to be cash payouts to qualify the co-op for the deduction. The tax code only requires that 20% of the dividend be in cash. The balance may be returned to the patron in certificate form--bearing no interest. It is true that the patron pays individual income tax on the entire allocation, whether cash or certificate. It is also true that the co-op may retain--in the corporate control--80% of the declared patronage dividend as untaxed capital to be used for expansion, merger and market competition.

The above described cooperative taxation system is clearly much different from that of non-cooperative corporations. Non-cooperative, conventional corporations are subject to tax at the corporate level without the benefit of any dividend deduction whether allocated or actually distributed to stockholders. Thus, the income of ordinary non-cooperative corporations is subject to federal taxation at two levels--corporate and individual (when distributed as dividend income)--while cooperative earnings are virtually tax free at the corporate level.

The different tax treatment clearly places the co-op at an advantage vis-a-vis competing non-cooperative enterprises. See table 3 for a comparison of the effective taxation rates of the largest agribusiness co-ops and their competing non-cooperative agribusiness corporations.

The next section will detail the negative effects of the co-op tax status on the economy in general.

Table 3 Effective corporate taxation of cooperatives compared with Competing agribusiness non-cooperatives ---Tax Year 1975

THE 10 LARGEST U.S. AGRIBUSINESS CORPORATIONS

		Tax Rate*
1.	Standard Oil (Indiana)	55.7%
2.	Dow Chemical	36.7%
3.	Kraft	45.8%
4.	Monsanto	30.5%
5.	W.R. Grace	34.7%
6.	Ralston Purina	38.5%
7.	International Minerals & Chemical	37.7%
8.	Williams Cos.	10.6%
9.	International Multifoods	46.8%
10.	Texasgulf	9.2%

THE 10 LARGEST U.S. COOPERATIVES

1.	Farmland Industries	4.8%
2.	Associated Milk Producers	3.3%
3.	Agway	42.9%**
4.	Grain Terminal Association	11.3%
5.	Land O' Lakes	5.4%
6.	Far-Mar-Co	5.9%
7.	Gold Kist	0.0%
8.	Illinois Grain	19.2%
9.	Indinia Farm Bureau Cooperative	14.8%
10.	Farmers Grain Dealers Association of Iowa	16.2%

*Percent of 1975 income paid as income taxes (including foreign taxes for corporations)

**Agway which for various reasons is taxed as a corporation indicates that cooperatives have the ability to pay federal income tax—and still compete effectively.

Data source: Annual reports as compiled by *Business Week*, February 7, 1977.

SECTION II

NEGATIVE EFFECTS ON THE U.S. ECONOMY

Section I of this paper has demonstrated that cooperative earnings remain untaxed at the corporate level as long as the earnings are allocated to an individual patron who has consented to include the same amount in his individual taxable income. This reduced co-op tax liability is known as a "tax expenditure". Recent estimates prepared by the staff of the Joint Committee on Taxation indicate that this tax expenditure is approximately $950 million in fiscal year 1983, and will exceed $1 billion by 1985.[2] This figure becomes even more startling when we recognize that it measures only the tax expenditure benefiting the agricultural cooperatives, a mere 10 percent of all U.S. cooperative corporations. As cooperatives continue to grow, so will this tax expenditure. It must be noted here that when the government requires a certain level of tax revenue to meet its budgetary needs, a shortfall in incoming receipts must be met by other sectors of the economy, or result in deficit spending. Although there are no concrete facts which we can point to, we must assume that all U.S. taxpayers are faced with increased tax burdens in order to offset the tax expenditure given to the cooperative corporations. Again, as cooperatives grow, so grows the tax expenditure, and so grows the resulting tax burden of the non-cooperative U.S. taxpayer.

However great the loss of federal revenue actually is, it is still a minor consideration when compared with the significance of the co-op tax privilege as an impediment to free market competition.

A co-op is a competitive business entity. Cooperative corporations compete with non-cooperatives in the same marketplace for the same business (refer back to table 1.1 to see the agribusiness markets involved). Survival and growth, in a competitive economy, depend to a large extent upon productive efficiency and management decision-making. In other words, survivability depends upon a relatively low unit cost of output. Relative to what?--you ask--relative to the competition.

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[2] Estimates of Federal Tax Expenditures for Fiscal Years 1982-1987, Joint Committee on Taxation, p.11 (March 8, 1982).

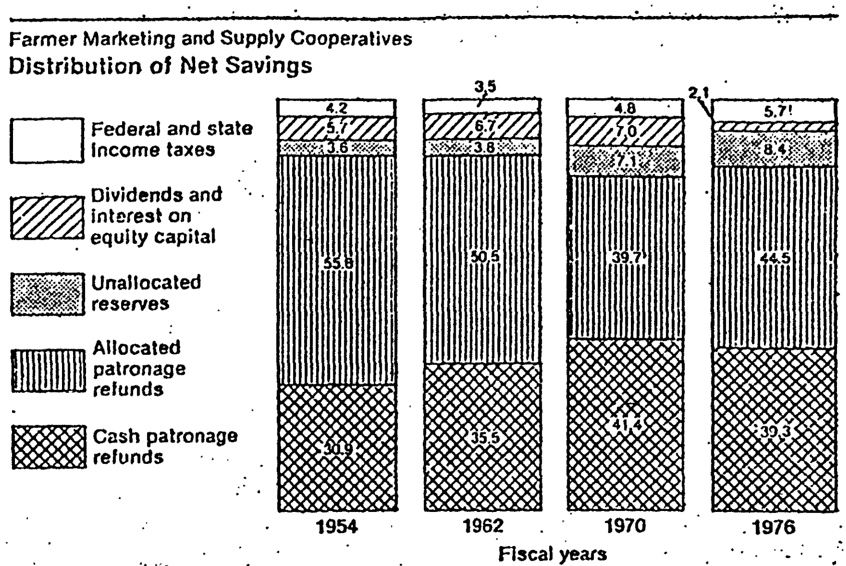
Tax exemption or special tax privileges tend to subsidize the recipient, in this case, the cooperative corporation. Subsidies are sought because, admittedly, they lower the real costs of operation and shift those costs to other sectors of the economy. NTEA contends that the cooperative tax subsidy shifts a corresponding amount of the co-op operational costs directly to the government and indirectly to all other (non-cooperative) U.S. taxpayers.

Artificially low real costs of operation clearly provide a cooperative corporation with a competitive advantage over conventional taxpaying businesses. Businesses that may be superior because of greater efficiency may be driven from the marketplace by those businesses that are subsidized. Examples of the increasing market domination of cooperatives are presented in Section IV. It must be remembered that when a cooperative increases its market share of an industry, then the non-cooperative market share is correspondingly decreased. Basically, in such a situation, taxpaying businesses are displaced by tax-exempt cooperative corporations.

If cooperatives continue to be subsidized through special tax privileges then gradually, but most assuredly, ordinary businesses will be displaced. Resources will be shifted. When this occurs, and it has (milk, for example), then competition ceases to exist. Established economic thinking, the basis of which is the traditional theory of American enterprise, holds that a lack of competition generally results in higher prices and lower output. Clearly, the economy suffers from this tax-induced decline in competition.

Some commentators (usually cooperative spokesmen) claim that the special tax treatment for co-ops is designed to assist, and does assist, the individual patron; the farmer in an agricultural cooperative. This is difficult to understand especially since the patron does not benefit financially from the cooperative arrangement unless he patronizes the cooperative. Even for the farmer-patron, the portion of the patronage refund returned to him in cash is quite small in comparison with that locked into cooperative equity. Table #5, following, shows the distribution of net savings by farmer marketing and supply cooperatives. That portion of the bar graph representing "allocated patronage refunds" is the farmer equity interest--it also represents that portion of a patronage dividend deducted from the cooperative corporate tax liability and retained at the corporate level.

Table #5



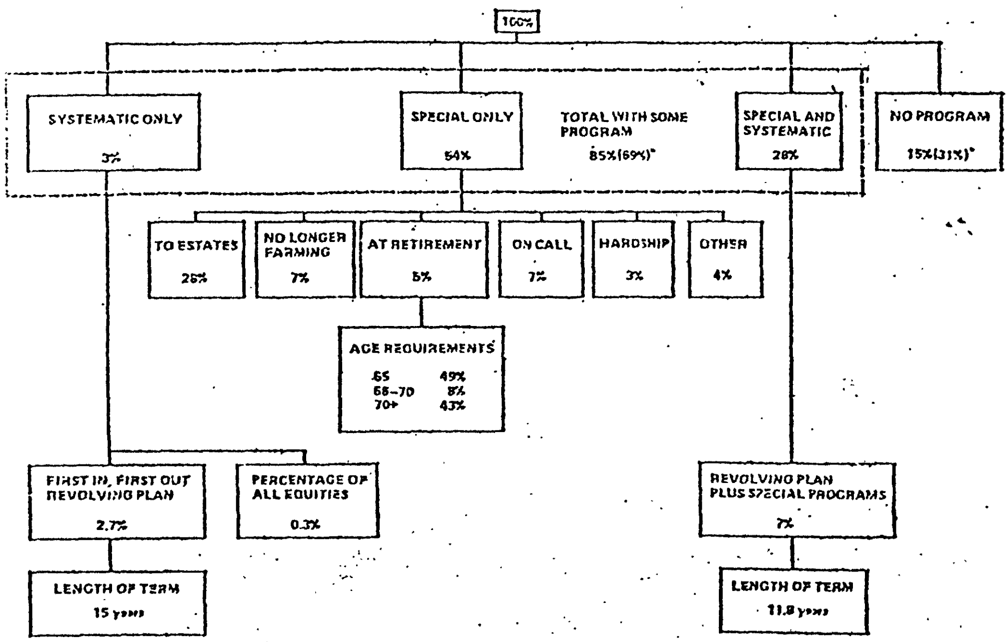
Figures in bars are percent of total net savings at close of fiscal years.

USDA

The difficulties a farmer-member faces in getting the co-op to which he belongs to redeem his equity investment may actually be individually detrimental. Officials of the Farmers Home Administration (FmHA) in the USDA say it is becoming increasingly difficult for farmers to repay loans. The national rate of delinquency on payments is the highest in memory--58 percent. Perhaps this delinquency rate would be lower if the cooperative paid out a greater percent of the patronage dividend in cash.

The following chart reveals that one third of all the members of local farm supply cooperatives belong to co-ops that do not redeem equity investment at all! Most of the remainder belong to cooperative corporations that only redeem equity at the member's death or retirement. Clearly the true direct beneficiary of this cooperative tax arrangement is the cooperative corporation itself and not its patrons.

:ENTRALIZED FARM SUPPLY COOPERATIVES EQUITY REDEMPTION PROGRAMS, FISCAL YEAR 1974-75



*NOTE: Figures in parentheses represent percentage of U.S. Centralized Farm Supply Cooperative membership.

SOURCE: Farmer Cooperative Service, *Equity Redemption Practices of Agricultural Cooperatives*, FCS Research Report 41 (Washington: U.S. Department of Agriculture, April 1977).

Supporters of the current cooperative taxation scheme have also claimed that this tax savings on the part of the cooperative is passed along to consumers in the form of lower prices and is therefore desirable. NTEA does not subscribe to this view because, as was stated above, tax privileges tend to diminish competition and it is competition which generates lower prices. Also, regardless of the truth of any price savings, NTEA again maintains that the increased amount of taxes which the consumer-taxpayer must pay because of the tax expenditure to the cooperative corporation offsets any price benefit.

THUS, the special cooperative corporate income tax treatment results in:

--a substantial loss of federal revenue;

--higher tax payments by other non-cooperative U.S. taxpayers;

--a stifling of the traditional American system of competition.

SECTION III

Cooperative Justifications

Cooperative spokesmen defend their favored tax status with two basic arguments : (1) the cooperative taxable income has been shifted from the corporation to the owner-patron; (2) patronage dividends are actually price rebates which are deductible by all corporations.

I. Cooperatives cannot shift taxable income.

Cooperative have relied upon the argument that an obligation to pay patronage dividends shifts cooperative corporate income to the owner-patrons. This is in direct conflict with one of the fundamental findings of the Supreme Court in this area; namely, that the party earning income cannot by agreement shift that income to another U.S. taxpayer , Lucas v. Earl, 281 U.S. 111 (1930). In Lucas v. Earl, a husband had irrevocably assigned to his wife the right to receive half of any salary he would earn during an indefinite period. In holding the salary taxable to the husband, notwithstanding the fact that he had no legal right to receive it, the Supreme Court stated:

> There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangement and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it.

281 U.S. 114-115.

A later decision, National Carbide Corporation v. Comm'r., 336 U.S. 422,436 (1949), put it this way: "Our decisions require that income be taxed to those who earn it, despite anticipatory agreements designed to prevent vesting of the income in the earner. . . . "

Cooperatives are separate corporate entities engaged in carrying on business. They perform a variety of customary business functions--distribution, wholesaling, manufacturing, and the like. These functions are carried out by the cooperatives' own employees, officers, and directors, and utilize the cooperatives' own assets.

By any standard, such activities create or augment wealth; and in doing so, they produce income. Whatever is done through combinations and arrangements of factors of production, all along the route from extraction of raw materials to sale of finished products (including marketing activities), adds to the value of the products. Under competitive conditions the value added is fully used to reward the factors that have made the added value possible, including payment for the use of capital and a return for the assumption of risk. All this is just as true for the cooperatives as for other forms of enterprise.

The staffs of the Treasury and the Joint Committee on Taxation have admitted that cooperatives are corporations and have income which has remained untaxed to the cooperative. In 1951, a joint study entitled, "The Power of Congress to Tax Cooperatives on Net Margins," stated that: "The net margins of the cooperatives are income to them within the meaning of the Sixteenth Amendment and may constitutionally be taxed as such."

Again in 1960, a Treasury spokesman stated to the Ways and Means Committee that: "Opponents of the Treasury proposal. . . will argue that a cooperative, because of its legal relationship to its patrons, has no income. As I pointed out earlier. . ., we do not believe that such an argument is well founded."

According to the rules that apply to other businesses, this profit or income of the cooperative corporation may not be shifted to the patron. It would not matter, from the standpoint of the taxing authority, whether the cooperative elects to distribute the income in the form of patronage dividends or retain the same as additions to capital. The obligation to pay a tax on the earnings of the cooperative rests with the cooperative corporation itself.

II. Patronage Dividends are not price adjustments.

a. General principles.

A corporation cannot reduce its taxable income by paying dividends to its owners. Section 316 of the Code defines a dividend as "any distribution of property made by a corporation to its shareholders . . .out of its earnings and profits. . . ." On the other hand, a corporation can reduce its taxable income by deducting "ordinary and necessary expenses paid or incurred. . . in carrying on any trade or business," IRC §162(a).

The cooperatives' most vigorously advanced argument as to why there should be no corporate income tax applicable to cooperatives stems from their characterization of patronage dividends as price adjustments. This theory views the initial prices paid by a cooperative to its patrons for their produce (or charged its patrons for goods sold them) as underpayments (or overcharges). Subsequent distributions of the funds remaining in the hands of the cooperative after the deduction of its expenses are considered to be final adjustments of the prices originally owed by the co-op for the produce it purchased (or refunds of the overcharges for the goods sold).

b. Nature of price adjustments.

Businesses often give price rebates or discounts to customers in connection with the sale of merchandise to them. Such rebates are normally deductible as ordinary and necessary business expenses even when they are not made simultaneously with the sale. SEE, e.g., Polley v. Westover, 77 F.Supp. 973 (S.D. Calif. 1948). They are deductible as a part of the expense of selling because their objective is the production of profit: they are intended to increase earnings by (a) increasing the volume of business or (b) retaining present business by meeting competition. Similarly, where a business buys goods at a premium, the premium portion of the price is excludable from gross income (as a part of the cost of goods sold) when the goods are subsequently resold.

c. Patronage dividends differ from price adjustments.

Unlike customary price rebates, patronage dividends are not properly classifiable as business expenses. It is settled that expenses lacking a profit objective are not deductible business expenses. See, e.g., Samuel Yanow, 44 T.C. 444 (1965); Lamont v. Comm'r, 339 F 2d 377 (2nd Cir. 1964). By the very nature of the cooperative's organizational structure, the purpose and function of patronage dividends is to eliminate rather than to increase profits. Patronage dividends could not, therefore, qualify for the deduction under the basic section 162 rules.

The discussion presented here is limited. An expanded view on this topic may be found in the law review article, Taxing the Net Margins of Cooperatives: Application of Basic Tax Principles and Analysis of Constitutionality, Mortimer M. Caplin, 58 Georgetown Law Journal at page 31 (May 1969).

SECTION IV

COOPERATIVE MARKET GROWTH

Statistics compiled by the U.S.D.A. indicate that the number of U.S. agricultural cooperatives is declining reflecting a continuing trend of co-op merger, consolidation and acquisition. While the exact number of non-agricultural U.S. cooperatives is not available, the Cooperative League of the USA estimates there to be at least 45,000 cooperative businesses now operating. All of these co-op enterprises, agricultural and non-agricultural, compete in the marketplace under a favored Federal income tax status.

The consolidation and merging of cooperative businesses has coincided with a period of tremendous growth in co-op business volume and overall market share. For example, net agricultural cooperative marketing volume has increased from $6.4 billion in 1950 to a record $56.3 billion in 1979. This represents a 29 percent increase in just two years from 1977 volume of $43.6 billion. Total cooperative business volume consists of marketing products , sales of supplies and receipts from related services such as trucking, storage, ginning, and drying.

Gross business volume, which includes sales among cooperatives, was $77.4 billion in 1979 or 30.1 percent greater than the 1977 gross volume of $59.5 billion. The nation's 100 largest agricultural cooperatives have grown even quicker. Even with inflation, overall sales growth looks,and is, impressive. From 1976 to 1980, the price index for all farm products rose 32.4 percent and the consumer price index 44.9 percent. In comparison, sales of the top 100 increased 71.7 percent in the same period, $29.3 billion to $50.3 billion. Three of these large cooperative corporations had assets of at least $1 billion in 1980 compared to only 1 in 1976.

The fact that cooperative sales growth generally outpaced the rate on inflation underscores the increasing market share of U.S. agriculture going to the agricultural cooperatives.

The growth in market share per product is equally astounding. Between 1950 and 1974 the cooperatives' share of the total grain market jumped from 26 percent to 44 percent. In this same period, the cooperative market share of dairy and milk products climbed from 48 percent to 77 percent. Meanwhile, the share of the farm market supplied by purchasing cooperatives also increased dramatically. Cooperatives doubled their share of the fertilizer market, from 15 percent to 30 percent. The amount of petroleum products sold by cooperatives rose from 21 percent to 30 percent, an increase of about 50 percent.

As the market share of the cooperatives has increased, the proportion of the market held by private business has declined. The NTEA does not attribute this phenomenal cooperative market growth entirely to their special tax status. Additionally, cooperatives enjoy other favorable government policies. NTEA, and other groups, question the merits of continuing to favor the well-entrenched cooperatives.

Tax Discrimination and Antitrust Immunity

The detrimental effects arising from the tax exemption of cooperative corporations are exacerbated by the antitrust immunity granted them under the Capper-Volstead Act. This Act has been loosely interpreted to allow, within a certain undefined sphere, the exercise of monopoly power by farm cooperatives. The Act permits cooperatives to raise prices, although section 2 of the Act prohibits "undue price enhancement"--unfortunately without defining precisely what this phrase means. Courts have interpreted the Act in such a way as to extend a significant degree of antitrust immunity to cooperatives, especially with respect to section 1 of the Sherman Act, and section 7 of the Clayton Act, which restricts mergers injurious to competition.

In addition, section 6 of the Clayton Act widens the cooperative antitrust immunity even further.

The result has been increasingly centralized local and regional markets for agricultural products--demonstrated by abnormally high concentration ratios. This problem is particularly acute in the dairy industry, where, according to a Department of Justice study, "In December 1970, in nine of the sixty-two federal orders, 100 percent of all producers serving the market belong to one cooperative. In more than half (thirty-two) of the orders, 80% or more of the producers in the order market belonged to one cooperative."[3]

Their antitrust immunity has enabled cooperatives to take over many private firms and other cooperatives with impunity. Funded by the capital generated by tax subsidies. cooperatives, like other types of business, find expansion through acquisition to have significant advantages over internal expansion. Cooperative acquisition of private firms is steadily eroding the corporate tax base, thereby increasing the tax burden of the remaining taxpaying concerns. This only accentuates the effects of tax discrimination and further accelerates the trend towards cooperative concentration.

The resulting concentrated structure of many agricultural markets is most conducive to the exercise of monopoly power. Although this situation is problematical enough, the tax exemption and market order system together may generate a further tendency towards cooperative monopoly. As noted in a FTC staff report, "In practically every market where a cooperative has achieved a dominant position in its market, that market has been regulated through either a federal or a state marketing order or both. The evidence . . . does suggest that marketing order provisions facilitate the preservation and spread of market power by a dominant cooperative and may increase the returns to a cooperative."[4]

There is widespread recognition among economists that one of the most essential prerequisites for effective competition and economic efficiency is freedom of entry. However, the general effect of most federal market orders is to limit or prevent free market entry.[5] Because of the foreclosure of new entrants by the market orders, dominant cooperatives, flushed with tax subsidies, can concentrate on the elimination of existing

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[3] Department of Justice, Federal Milk Market Orders and Price Supports, 1976.
[4] Federal Trade Commission, Staff Report on Agricultural Cooperatives, 1975, p.138.
[5] See National Commission for the Review of Antitrust Laws and Procedures Report, 1979, p.266.

competitors by predatory pricing, and then take over their undervalued assets through acquisition. Certainly a most glaring example of manipulation of market orders and predatory behavior is that of Associated Milk Producers, Inc., which according to the Department of Justice, has utilized such tactics to establish a monopoly of milk production throughout much of the central United States.

The Capper-Volstead Act supposedly grants only a limited antitrust immunity to cooparatives, and section 2 of the Act authorizes the Secretary of Agricultural to police and eliminate "undue price enhancement." But in the entire time since the Act became law, the secretary has never once reprimanded a cooperative for the exercise of monopoly power. The National Commission for the Review of Antitrust Laws and Procedures noted that, "That Commission is concerned that the Capper-Volstead Act creates the potential for cooperative monopoly. . . . Testimony before the Commission shows that the threat of monopoly by some cooperatives is now substantial. . . . in the future less than twenty cooperatives will control the nation's milk supply.[6]

Ultimately, of course, it is the American consumer who foots the bill for the monopoly pricing of cooperatives. According to a Department of Justice study, the milk market order system alone is costing consumers about $100 million each year.

The chart on the next page illustrates the benefits of tax-free capital and antitrust immunity. The corporate structure of this large cooperative, Farmland Industries, Inc., does not appear to NTEA to be anything other than a corporate conglomerate, which has integrated itself both vertically and horizontally into the marketplace. This corporate structure, which is not unusual for large cooperatives, provides a clear example of why the special cooperative tax breaks are unwarranted and must be removed.

see chart on next page

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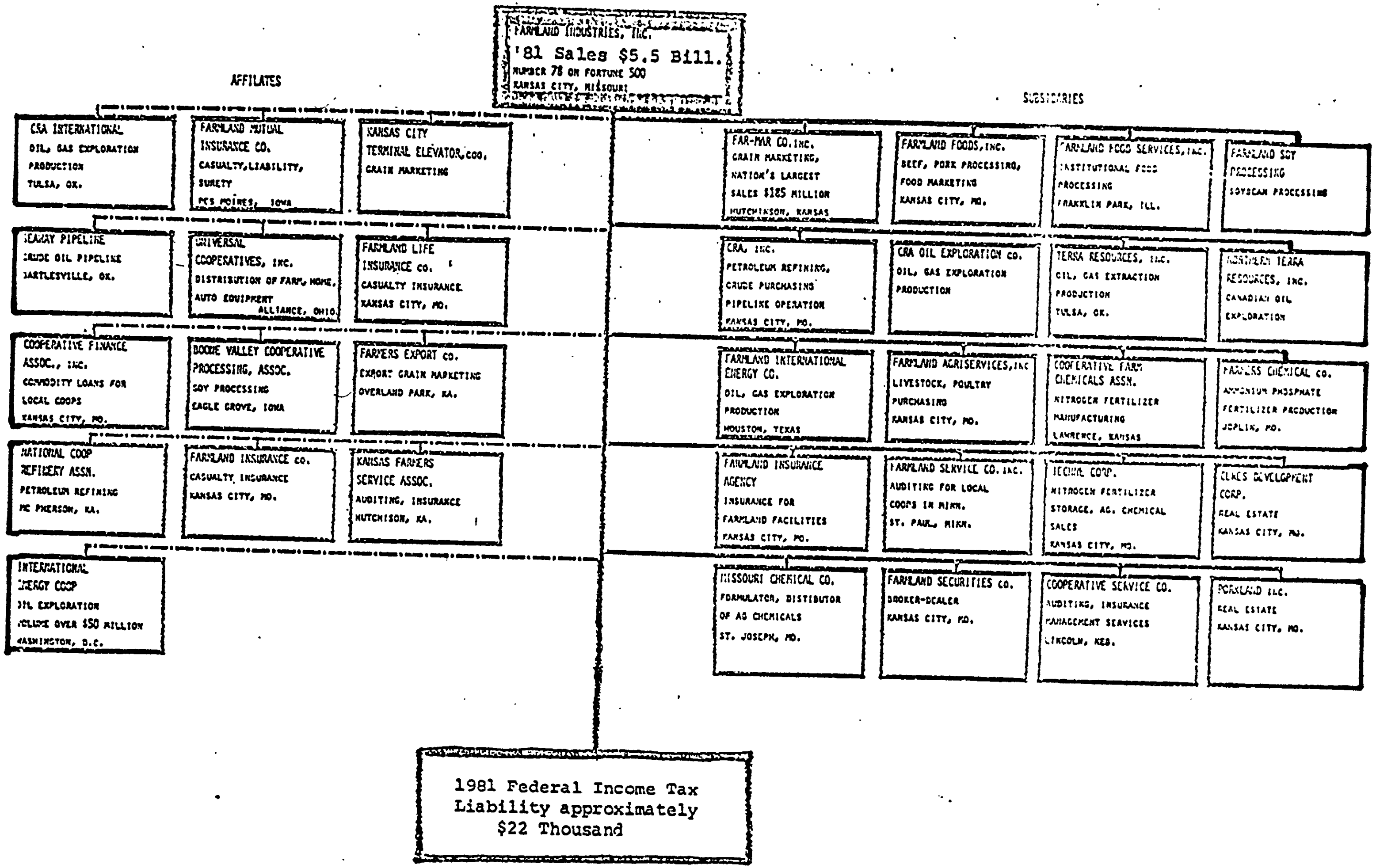
[6] National Commission for the Review of Antitrust Laws and Procedures Report, 1979, p. 258-259.


FARMLAND INDUSTRIES, INC.
'81 Sales $5.5 Bill.
NUMBER 78 ON FORTUNE 500
KANSAS CITY, MISSOURI
AFFILATES
SUBSIDIARIES
CRA INTERNATIONAL
OIL, GAS EXPLORATION
PRODUCTION
TULSA, OK.
FARMLAND MUTUAL
INSURANCE CO.
CASUALTY, LIABILITY,
SURETY
DES MOINES, IOWA
KANSAS CITY
TERMINAL ELEVATOR COO.
GRAIN MARKETING
SEAWAY PIPELINE
CRUDE OIL PIPELINE
BARTLESVILLE, OK.
UNIVERSAL
COOPERATIVES, INC.
DISTRIBUTION OF FARM, HOME,
AUTO EQUIPMENT
ALLIANCE, OHIO
FARMLAND LIFE
INSURANCE CO.
CASUALTY INSURANCE
KANSAS CITY, MO.
COOPERATIVE FINANCE
ASSOC., INC.
COMMODITY LOANS FOR
LOCAL COOPS
KANSAS CITY, MO.
BOONE VALLEY COOPERATIVE
PROCESSING, ASSOC.
SOY PROCESSING
EAGLE GROVE, IOWA
FARMERS EXPORT CO.
EXPORT GRAIN MARKETING
OVERLAND PARK, KA.
NATIONAL COOP
REFINERY ASSN.
PETROLEUM REFINING
MC PHERSON, KA.
FARMLAND INSURANCE CO.
CASUALTY INSURANCE
KANSAS CITY, MO.
KANSAS FARMERS
SERVICE ASSOC.
AUDITING, INSURANCE
HUTCHISON, KA.
INTERNATIONAL
ENERGY COOP
OIL EXPLORATION
VOLUME OVER $50 MILLION
WASHINGTON, D.C.
FAR-MAR CO. INC.
GRAIN MARKETING,
NATION'S LARGEST
SALES $125 MILLION
HUTCHINSON, KANSAS
FARMLAND FOODS, INC.
BEEF, PORK PROCESSING,
FOOD MARKETING
KANSAS CITY, MO.
FARMLAND FOOD SERVICES, INC.
INSTITUTIONAL FOOD
PROCESSING
FRANKLIN PARK, ILL.
FARMLAND SOY
PROCESSING
SOYBEAN PROCESSING
CRA, INC.
PETROLEUM REFINING,
CRUDE PURCHASING
PIPELINE OPERATION
KANSAS CITY, MO.
CRA OIL EXPLORATION CO.
OIL, GAS EXPLORATION
PRODUCTION
TERRA RESOURCES, INC.
OIL, GAS EXTRACTION
PRODUCTION
TULSA, OK.
NORTHERN TERRA
RESOURCES, INC.
CANADIAN OIL
EXPLORATION
FARMLAND INTERNATIONAL
ENERGY CO.
OIL, GAS EXPLORATION
PRODUCTION
HOUSTON, TEXAS
FARMLAND AGRISERVICES, INC
LIVESTOCK, POULTRY
PURCHASING
KANSAS CITY, MO.
COOPERATIVE FARM
CHEMICALS ASSN.
NITROGEN FERTILIZER
MANUFACTURING
LAWRENCE, KANSAS
CHEMICAL CO.
AMMONIUM PHOSPHATE
FERTILIZER PRODUCTION
JOPLIN, MO.
FARMLAND INSURANCE
AGENCY
INSURANCE FOR
FARMLAND FACILITIES
KANSAS CITY, MO.
FARMLAND SERVICE CO. INC.
AUDITING FOR LOCAL
COOPS IN MINN.
ST. PAUL, MINN.
CORP.
NITROGEN FERTILIZER
STORAGE, AG. CHEMICAL
SALES
KANSAS CITY, MO.
DEVELOPMENT
CORP.
REAL ESTATE
KANSAS CITY, MO.
MISSOURI CHEMICAL CO.
FORMULATOR, DISTIBUTOR
OF AG CHEMICALS
ST. JOSEPH, MO.
FARMLAND SECURITIES CO.
BROKER-DEALER
KANSAS CITY, MO.
COOPERATIVE SERVICE CO.
AUDITING, INSURANCE
MANAGEMENT SERVICES
LINCOLN, NEB.
PORKLAND INC.
REAL ESTATE
KANSAS CITY, MO.
1981 Federal Income Tax
Liability approximately
$22 Thousand

SECTION V

SUMMARY--SOLUTIONS

Cooperatives provide useful services to their owners, and have afforded member-producers with a suitable corporate form with which to market their products. But it is an illusion to believe that government promotion of cooperative monopoly power constitutes anything other than a means of transferring wealth from consumers to producers. As such it is at variance with the principles of a free market economy and consumer sovereignty. The differential tax treatment of cooperatives and conventional corporations means that in the long-run, capital invested in the cooperative sector earns a higher rate of return than the same capital invested in the non-cooperative sector. The result of such differential rates of return is inevitable.

Capital will flow to those markets where its after-tax rate of return is highest. In the long run, non-cooperatives simply cannot compete with cooperatives in the same markets. The steady growth in market share by cooperatives is ample demonstration of this point. The absence of competition, in any market, tends to drive prices up and output down. Only equal competition serves the best interests of both the consumer and the producer.

Now is the time to put cooperatives and conventional corporations on an equal competitive footing so that the entire U.S. economy may benefit from the economic effects of competition. Now is the time to end this area of income tax favoritism that results in nearly $1 billion in uncollected federal revenues.

Suggested solutions to this situation of federal income tax favoritism follow.

Suggested Solutions

(1) Retain current tax law-Under current law the cooperative corporation, by paying 20 percent of its earnings in cash patronage dividends, can allocate the other 80 percent of the earnings and retain them for market expansion purposes. This special tax privilege has no justification and gives co-ops an unfair competitive advantage over conventional, taxpaying corporations.

(2) Tax co-ops in the same manner as ordinary corporations-This suggestion taxes all business corporations including cooperatives in the same manner and on the same basis. It makes cooperative corporations bear their fair share of the tax burden, and is the only solution that achieves total tax justice.

(3) Increase co-op cash payouts-In order to ease the competitive advantage of cooperatives, NTEA suggests increasing the required cash payout (currently 20 percent) to at least 50 percent of cooperative patronage dividend distributions. This would result in greater competitive equality through a reduction in the cooperative pool of tax-free capital. Note this solution was suggested, and agreed to by the U.S. House of Representatives in 1969, but did not pass the Senate.

(4) Repeal of the corporate income tax on dividends distributed to shareholders-Although this proposal would be a step towards co-op--private investor corporate tax equality, it has several disadvantages, mainly political.

(5) Excise tax on cooperatives-It would not be unconstitutional to levy on cooperatives an excise tax measured by their net income. For those who insist that cooperative corporations have no taxable income, an excise tax equal to the income tax for corporations might be the answer.

Although NTEA regularly advocates taxing the net margins of cooperatives in the same manner as ordinary corporate profits, (suggestion #2) we believe that any of the above suggestions(suggestions #2-5) represent a step towards tax equality and certainly warrant Congressional consideration and investigation.

Senator WALLOP. Thank you, Mr. Stroupe.

Mr. Bragg, the biggest concern has been voiced against the idea of crude oil purchasing cooperatives is that the same result can be accomplished by other means, subchapter T or other more complex partnership arrangements. Would you elaborate as to why these structures are not adequate?

Mr. BRAGG. Yes, Mr. Chairman. As a section 522 cooperative under the proposed law, distribution to members from nonpatronage earnings would be deductible. This is a flexibility that we understand, in talking with the industry people, would be required because of the volumes of crude oil that need to be purchased. We are looking at somewhere in the neighborhood of 50,000 to 100,000 barrels per day contracts. Substantial amounts of this oil may need to be sold to third parties who are not patrons of the cooperative, depending upon the type of crude oil involved.

Second, at present it is unclear whether federated cooperatives can be formed and operated under subchapter T. Federation will allow the recognition to be given to different types of refineries located in different types of geographic regions, whether we are talking about Wyoming or Indiana.

Third, creation of a separate provision for crude oil purchasing cooperatives may be perceived by foreign crude sellers as a mild form of U.S. Government approval, and it is hoped that this will result in more willingness on their part to enter into sales.

I will point out to you, in your opening comments you spoke of the problems of free market in this particular commodity. I guess the best example was the Saudi Arabian Government, which has not only made it clear to anyone interested in entering into contracts with them, but also has made consistent public statements that it is their plan to enter into no further arrangements with customers who are not foreign governments or already existing customers of their production company.

This situation is reasonably consistent throughout. It is much easier for foreign governments to go in and negotiate contracts with oil-producing countries than it is for the independent businessman today.

Senator WALLOP. Do you think that they would recognize a structure like this as an entity of the United States, do you have any reason to believe that they would?

Mr. BRAGG. There is continued interest on their part in wanting to know what our strength is and whether or not we are functioning officially. We certainly know that other types of partnership and consortia of various structures have not been successful.

In fact, to date, we have not been able to locate a single effort jointly done by small and independent refiners that has successfully resulted in long-term competitively priced crude oil contracts. We see no reason not to try this, particularly when there is no cost to the Federal Government.

Senator WALLOP. Right now in terms of access, as Mexico comes along and Canada increasing their crude oil supplies to maybe China or some other parts of the world, would this be a moment in time for independent refiners using a subchapter T-type of corporation for purposes of obtaining long-term contracts?

Mr. BRAGG. Quite possibly this may be the only window in this whole decade where we will have an opportunity to negotiate and establish a working relationship that has never been established before. We certainly know that in times of tight crude supplies, we cannot establish those relationships.

Senator WALLOP. Would you take a look at Mr. Glickman's testimony? It seems to me that he raises some valid points, but not specific in an attempt that we could accommodate those without doing violence to the concept of crude oil purchasing cooperative for independent refiners.

Mr. Stroupe, under ordinary circumstances it might be so that a small independent refiner can compete in the marketplace and can compete without this, but I don't believe that can exist given the dominance of certain areas of the crude supply situation that exists in the world both by foreign government in cooperatives, namely OPEC, and by the natural and sometimes beneficial and sometimes complicated power of the major oil companies.

They are a force that does not exist so much in other areas of competition in the industrial market, both from the standpoint of dealing with governments who have made up their minds that they themselves will act not as a purchasing cooperative but a sales cooperative.

So, you know, the world changes a little bit where you have that as an entity plus the obvious power that the major oil companies have in dominating crude oil supplies both here and abroad, but particularly abroad.

While I appreciate generally the concept that you are expressing, when I balance that against whether there is a fundamental benefit to having breadth in our economy as well, and to see that we don't subsidize, because I don't think that it is my idea and I don't think that it is Mr. Bragg's expression that they seek subsidy, but simply access in a very complicated market which is not a free market already because of Government actions and present other entities that exist.

I appreciate everybody's testimony and we will work on it. If you would comment on those things that Mr. Glickman brought up because I do think he raises some valid points. It is not your intent and certainly not mine that we run up a big subsidy process, but that we do provide the means whereby the independent industry can survive.

Mr. BRAGG. I will be glad to continue to work with the Treasury to see if we can resolve any of their concerns.

Senator WALLOP. Thank you both very much.

Mr. STROUPE. Thank you, Mr. Chairman.

Senator WALLOP. Now on to S. 2151, and we have Mr. Robert Mitchel, vice president of finance of Pittsburgh Plate Glass Industries, Inc., Pittsburgh, Pa., accompanied by Mr. Edward Sproull, vice president, tax administration.

Good morning, gentlemen. You may proceed, Mr. Mitchel.

STATEMENT OF ROBERT H. MITCHEL, VICE PRESIDENT OF FINANCE, PPG INDUSTRIES, INC., ACCOMPANIED BY EDWARD I. SPROULL, VICE PRESIDENT, TAX ADMINISTRATION

Mr. MITCHEL. Thank you, Mr. Chairman.

My name is Robert H. Mitchel. I am vice president, finance, for PPG Industries. Accompanying me this morning is Edward I. Sproull, vice president, tax administration, for PPG.

We appreciate this opportunity to present PPG's views in support of S. 2151 and request that PPG's written statement, as previously submitted, be included in the record.

Senator WALLOP. It will be included in the record in its entirety.

Mr. MITCHEL. Thank you.

PPG is a major manufacturer of glass, chemicals, coatings and resins, and fiberglass. It employs some 28,000 people domestically in 41 manufacturing and research facilities in 17 States.

In 1980, PPG consumed about 105 trillion Btu's of energy. This was down from 1976 consumption of 139 trillion Btu's. Overall, the company has improved its energy efficiency by more than 23 percent since 1972 while increasing production and sales.

PPG spent approximately $187 million for energy in 1981. This represents about 7 percent of the company's U.S. sales dollars. In the competition for corporate investment dollars, energy-saving projects or other types of investments are considered in light of projected economic benefits. Therefore, the blind pursuit of energy conservation for conservation's sake is a luxury PPG, and I suspect most companies, cannot afford in their highly competitive markets.

The legislation before the subcommittee, S. 2151, would allow the chlor-alkali industry to realize the incentive to save energy intended by Congress when it passed the Energy Tax Act of 1978. The chlor-alkali industry is the second largest industrial user of electricity in the United States and is highly energy intensive.

The bill would add modifications to chlor-alkali electrolytic cells to the list of specified energy property under the Energy Tax Act of 1978, and thus qualify investments in such property as eligible for a 10-percent energy investment credit.

The 1978 act provided for 11 specified items of energy property to qualify for energy tax credits, and for authority for the Secretary of the Treasury to specify additional qualifying property for tax credits by regulations. To our knowledge, the Secretarial authority has not been exercised to qualify a single item in this category despite the fact that these provisions are scheduled to expire at the end of 1982.

Proposed regulations were issued concerning the procedures for applying for qualification as specially defined energy property in January 1981, public hearings were held in April, and there has been no other action.

Aware of the fact that the energy tax credits would expire at the end of 1982, PPG attempted to satisfy the administrative requirements for obtaining a determination of eligibility for energy-saving modification of its chlor-alkali electrolytic cells. There has been no response.

The proposed regulations require that an item added to the list of specially defined energy property must be "similar in function" to certain items specifically listed in the Internal Revenue Code. The chlor-alkali electrolytic cell is similar in function to modifications to alumina electrolytic cells, which are specifically eligible for the energy tax credits as specially defined energy property under the Tax Code.

Chlor-alkali electrolytic cell modification save energy in essentially the same manner as the presently eligible alumina electrolytic cell modifications. These modifications are motivated by energy efficiency. They would not increase the productive capacity of the cells and are not periodic replacements of cell components.

The modifications to alumina electrolytic cells were specified by congressional amendment in 1980 after no action was taken by the IRS on the aluminum industry's application. We seek a remedy to a problem identical to that encountered by the aluminum industry. As a member of the chlor-alkali industry, PPG supports S. 2151 to allow the same energy-efficiency investment incentive.

Without a favorable tax ruling or legislative action and an extension of the time to qualify, a current $100 million project at one of PPG's chlor-alkali facilities will be denied the tax credits anticipated when it was funded, and installation of energy-saving technology by PPG and other companies in the chlor-alkali industry will likely give way to other corporate investments for a number of years. For example, PPG's current project alone, if completed, will reduce energy consumption by some 450,000 barrels of fuel-oil equivalent per year.

We believe S. 2151 provides a mechanisn for realizing the intent of Congress because, in our opinion, industrial energy tax credits pay for themselves, free up generated capital for other investment, and are significant incentives to encourage industry in total to help move our country toward energy self-sufficiency.

I appreciate this opportunity to testify before the subcommittee on this issue of importance to the chlor-alkali industry. I would be happy to try and answer any of your questions.

Thank you very much.

[The statement of Mr. Mitchel follows:]

STATEMENT

OF

ROBERT H. MITCHEL

VICE PRESIDENT, FINANCE

PPG INDUSTRIES, INC.

SUBMITTED TO THE

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

OF THE

SENATE COMMITTEE ON FINANCE

MARCH 30, 1982

Mr. Chairman, distinguished Members of the Subcommittee, my name is Robert H. Mitchel. I am Vice President, Finance, of PPG Industries, Inc. (PPG). I am accompanied by Edward I. Sproull, Jr., Vice President, Tax Administration, for PPG. We sincerely appreciate the opportunity to appear before the Subcommittee to express PPG's views in support of S. 2151.

PPG is a major manufacturer of glass, chemicals, coatings and resins, and fiber glass products, headquartered in Pittsburgh, Pennsylvania. The company operates 41 major manufacturing and research facilities in 17 states, employing approximately 28,000 people nationwide.

As an industrial manufacturer, for which energy is a substantial portion of operating needs and costs, we have a significant interest in legislation which encourages investments in energy-conserving property. Specifically, we would like to focus on the chlorine and caustic soda portion of our chemical manufacturing business, and why we believe S. 2151 provides a mechanism for equitably implementing the intent of Congress regarding energy tax credits when it enacted the Energy Tax Act of 1978.

While energy is a substantial cost item to PPG (in 1981, it totalled about $187 million), it is not our only cost and represents some five to seven percent of total sales dollars. Therefore, although energy costs have soared and are expected to increase further, they are still only one important cost item among many costs. Within a corporation, competition for the capital expenditure dollar requires management to consider the ultimate cost. As such, the blind pursuit of energy conservation for conservation's sake is a luxury we cannot afford to pursue in our highly competitive markets.

S. 2151 would make modifications to chlor-alkali electrolytic cells specifically eligible for the 10 percent energy investment credit. The chlor-alkali industry is highly energy-intensive, requiring large amounts of electricity. It is the second largest industrial user of electrical energy in the United States, just behind the aluminum industry. Electrolytic cells are used to electrically charge a salt brine which, in turn, generates two co-products: chlorine and caustic soda. Chlorine is a basic chemical, widely produced in this country and the world, and is used as an intermediate feedstock in producing a host of organic and inorganic chemicals. For example, chlorine is a basic component of solvents for degreasing and dry cleaning, insecticides, refrigerants, lubricant additives and monomers for making plastics such as polyvinyl chloride. The second major use of chlorine is as a bleaching agent in the pulp and paper and textile industries. Another major use, of course, is for the sanitation of water.

The co-product, caustic soda, is a basic raw material for the chemical, pulp and paper, rayon, cellophane, aluminum, soap, textile and petroleum refining industries.

The use of tax credits as an incentive to stimulate the modernization of industrial processes is a concept that is well established in our tax system. Tax credits were first approved by Congress in 1962 with the enactment of the investment credit.

Congress appropriately recognized the incentive effects of tax credits when it enacted, as part of the Energy Tax Act of 1978, business energy credits to encourage industrial energy conservation. It realized that the energy marketplace, with its myriad of price controls, was not sending the proper price signals to consumers, and, therefore, offered an incentive to reduce U. S. dependence on foreign oil supplies and bring energy supply and demand into balance.

The Energy Tax Act of 1978 included a tax credit for one category of energy conservation investment called "specially defined energy property". This category of eligible investment included a list of 11 specified items of property, such as heat wheels and recuperators. In addition, authority was given to the Secretary of the Treasury or his delegate to specify additional qualifying property by regulations. To our knowledge, since Congress enacted these provisions in 1978, the Secretary and the I.R.S. have not exercised their authority to qualify a single item in this category despite the fact that these provisions are scheduled to expire at the end of this year. Virtually all that has been done by the Treasury and the I.R.S. is to issue proposed regulations concerning the procedures for applying for qualification as specially defined energy property under the Secretarial authority.

Representatives of PPG testified at hearings on the proposed procedural regulations last year. However, we were aware of the fact that the credit would soon expire, and PPG filed an application under the proposed procedural regulations for qualifying its chlor-alkali cell modifications for the energy tax credit. We also proceeded with a modification program at one of our chlor-alkali facilities with the expectation that this application would be approved.

Proposed Regulation section 1.48-9(f)(15)(v)(A) requires that an item added to the list of specially defined energy property must be "similar in function" to items specifically listed in the Internal Revenue Code. The chlor-alkali electrolytic cell is "similar in function" to "modifications to alumina electrolytic cells" which are specifically eligible for the energy credit as specially defined energy property under Code section 48(l)(5)(L). Chlor-alkali electrolytic cell modifications save energy in essentially the same manner as the presently eligible alumina electrolytic cell modifications.

We are here today to express our support for S. 2151 which will allow the same energy-efficiency investment incentive to the chlor-alkali industry as was earlier provided to the aluminum industry by Congressional action. At one of PPG's chlor-alkali plants, which uses electricity generated by oil and natural gas, cell modifications will reduce energy consumption by some 460,000 barrels of fuel-oil equivalent each year. We would also like to point out that these modifications are basically motivated by energy efficiency. They would not increase the productive capacity of the cells and are not periodic replacements of cell components, since the existing cell configurations can continue to be used for a number of years.

PPG's current cell modification project represents a single expenditure at one plant of approximately $100 million and, if completed, would result in an energy saving estimated at 25 percent of current energy usage. We have calculated that the investment and energy saving would fall within the mid-range of eligibility under the "qualified industrial energy efficiency property" (QIEEP) concept contained in S. 750, on which we testified before this Subcommittee last October. Without a favorable Treasury Department ruling or legislative action to specifically make eligible these electrolytic cell modifications for a sufficient period of time to qualify for a credit, this project will be denied the energy tax credits which were anticipated when funding for the project was approved by our Company. In addition, a failure to allow the energy credit for installations of cell modification technology at other PPG plants and those of others in the chlor-alkali industry may well cause these proposed energy conservation investments to give way to less risky corporate expenditures.

The problem confronting the chlor-alkali industry for its electrolytic cell modifications is identical to that which confronted the aluminum industry in 1980. As was the case with alumina cell modifications, an application was submitted to the I.R.S., but no action was taken on this application. A specific amendment was then enacted in 1980 to make alumina cell modifications specifically eligible for the credit retroactive to 1978 in order to cover investments which had been made in anticipation of a favorable ruling under the application. A similar approach should be taken for chlor-alkali modification investments which were made in anticipation of a favorable ruling on a previously filed application. We therefore support the legislation's effective date of January 1, 1981. Passage of S. 2151 would ensure completion of PPG's current project and enable similar modifications at other facilities after December 31, 1980, to be treated equally with other energy properties such as the legislatively-qualified alumina electrolytic cells.

We believe S. 2151 provides a mechanism for realizing the intent of Congress for the second largest industrial user of electricity in the Nation, continues national efforts to move toward greater energy independence, and complements the economic direction set by President Reagan to strengthen the economy, reduce inflation, increase productivity, and add to in-place capital formation efforts. We believe energy tax credits pay for themselves, free up generated capital for further investment, are incorrectly characterized as revenue losses, and are significant incentives to encourage industry in total to help move our country toward energy self-sufficiency.

Senator WALLOP. Thank you, Mr. Mitchel.

I have two questions from Senator Long, which he asked that you might respond to.

The first one is, how many chlor-alkali producers are there?

Mr. MITCHEL. There are approximately 20, something in that range. About eight or nine of them are major producers. There are a number of smaller producers.

Senator WALLOP. Do you expect all of them to be beneficiaries of this legislation, or do you think PPG will be the primary beneficiary?

Mr. MITCHEL. We would expect that PPG would have benefits of something in the range of $10 to $15 million on our total program. We can't speak for the rest, but we believe that they would also have the need for certain modernizations and that this incentive might well encourage them to make some energy savings investments that otherwise might not be made.

Senator WALLOP. You have not had any contact with other producers?

Mr. MITCHEL. No, sir.

Senator WALLOP. I don't think they have made any contact with the committee on the bill, or prior to it, and that is why I was wondering.

What do you expect the impact of the current decline in energy prices to be on your decision to proceed with conservation?

Mr. MITCHEL. We believe that the current decline in oil prices is probably temporary. As you know, most other energy sources are continuing to increase in price. At this stage, since our projection is that energy costs are going to continue to increase, we have made no change because we are making our decisions on the basis of our long-term expectations of energy costs, and we still expect them to continue to increase.

Senator WALLOP. Are you aware of my bill S. 750, the Industrial Energy Act?

Mr. MITCHEL. Yes, sir. I believe one of our people testified in regard to that bill.

Senator WALLOP. It would appear that that might be an area of perhaps greater success because it is not likely that we will get those conservation tax credits extended this year, I think, given all the problems that are on our plate, and it is a pretty full plate.

Are there any other Federal, State, or local government incentive programs or assistance programs available for chlor-alkali electrolytic cells?

Mr. MITCHEL. No, sir, not that we are aware of at this time. However, the State of Louisiana passed a law late last year under which the project might qualify for a sales tax exemption on certain items.

Senator WALLOP. Does the accelerated cost recovery assistance passed in last year's tax act provide any incentive for chlor-alkali cell modification investment?

Mr. MITCHEL. Actually, it doesn't. The new ACR legislation would allow us to write off this investment over a 5-year period, as you realize. The chemical industry, under the ADR had a 7½-year life with a double declining balance method of depreciation.

On a $100 million investment, the present value difference from a tax view point of the ACR versus the ADR is about $1.5 million, and that is a very minor change in the present value benefits of the ACR's in this particular industry.

Senator WALLOP. I am somewhat lost in that. It would sound by your answer as though there was some.

Mr. MITCHEL. There is a minor benefit of the ACR's to investment in the chemical industry. Our calculations indicate that the different economic effect is $1.5 million for each $100 million of investment.

Senator WALLOP. Or 1½ percent?

Mr. MITCHEL. Yes, sir.

Senator WALLOP. I appreciate your coming here to offer us your testimony on it. You can be certain that the subcommittee will look at it.

The whole area of conservation credits is one which continues to capture the imagination, and I think it still has sufficient means of changing the attitude and industrial performance of the country as any. I still believe that conservation is by definition efficiency, and efficiency in conservation is production, and that ought to do something for us in the world market.

It is hard, frankly, when you are facing the kinds of budget problems and revenue problems that exist today, which exist for a variety of reasons, but one of the things that they exist for is the slowdown in the world's economy, to say nothing of our own. Those chickens and those eggs, I guess, will be identified by those who can look back on this moment.

I honestly believe that there will be a way out of this, but I don't think that it is a particularly useful time for people to be running around in circles quoting each other, which seems to be basically what we are hearing from big business, a lot of concern expressed and very little resolution expressed, except "if you do anything about it, fellow, don't do it at my expense." This is one of the frustrations of sitting on this committee.

So I appreciate your coming down.

Mr. MITCHEL. Thank you very much.

Senator WALLOP. Thank you very much.

There being no other business to come before the subcommittee, we will stand adjourned.

[Whereupon, at 10:30 a.m., the subcommittee adjourned to reconvene at the call of the Chair.]

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