CANADIAN CENTRE FOR THE STUDY OF CO-OPERATIVES (CCSC)

The Taxation of Canadian Co-operatives: Historical, Theorical, and Policy Perspectives

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Abstract

This paper explores how Canadian policymakers, and the courts, have defined and conceptualized co-operatives and the taxation of co-operatives over time. Picking up on a long-dormant area of scholarly and policy interest, and drawing on legislative and case law analysis, we find that policymakers and the courts have long struggled with devising taxation policy and legal interpretations that respect the unique co-operative balance between associational and business objectives. We also observe that while the arc of policy and legal developments has bent towards framing co-operatives through the lens of conventional businesses, there remain some important legislative and interpretative differences, including notably the privileging of the member-as-user perspectives. Throughout, we argue that these differences, and others like them, matter for the prospects current and future of the Canadian co-operative movement.

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Introduction

Co-operatives as know them today first emerged in the mid-1800s, well before the rise of what we now know as the administrative or welfare state and its cast of familiar institutions. In these formative years, a group of people could come together and form a co-operative with minimal effort or interaction with the state – formal incorporation was typically not required or expected, there were few or no taxes to pay, and few or no regulations to follow. These conditions prevailed in Canada well into the early 1900s, before governments began mobilizing resources through income taxation and other measures as part of its wartime effort around World War I. Even as recently as the onset of World War II, Saskatchewan's version of co-operative legislation measured a meager 20 pages compared with 150 today and co-operatives were still exempt from the (presumptively temporary) income taxes first introduced as part of the World War I mobilization. But shortly after World War II, things began to change. Governments began to take up more space in the economy, introducing new policies, new rules, and new, higher, income and other taxes to fund its expanding role.

Co-operatives observed the growing role of the state before and after World War II with some alarm, eventually crystalizing their anxiety in the form of a fourth universal co-operative principle, that of autonomy and independence. These fears were not misplaced.[1] As sovereign, the newly empowered state had ample coercive policy tools at its disposal but few as direct and potentially evocative of loss and intervention as income taxation. And indeed, this form of taxation has been a major point of friction but also opportunity between co-operatives and the administrative state. Co-operatives and credit unions in the United States for example routinely engage in lobbying to defend their tax-exempt status, emphasizing[2] importance for their ability to deliver on their mission. In Italy, one of the most fertile jurisdictions for co-operatives, the importance of co-operatives is enshrined in the constitution and anchored in concrete policy: co-operatives are exempt from taxation to the extent they hold surplus funds as indivisible reserves (i.e., capital that cannot be apportioned out to members), with a *quid pro quo* that 3% of their annual surplus fund co-op education and development (Adeler, 2014). In Spain, another fertile grounding for the movement, co-operatives are again anchored in the country's constitution and vested with tax privileges that lower their (relative) effective corporate tax,[3] reflecting the recognition that favourable taxation policy is central to creating a hospitable policy environment for co-operatives (Adeler 2014).

But what of Canada? What do we know about its policy stance as it concerns the taxation of co-operatives? How has that stance evolved over time? In this paper, we set out some answers to these questions. We offer these reflections in working paper form with the goal of eliciting critical scrutiny and with an eye towards eventual academic output. To begin, we take a brief look at the state of study around co-operative taxation and then move to a review of how policymakers in Canada have defined co-operatives in practice, law and theory. As we show, these definitions play an important role in making sense of the measures targeting the co-operative sector. Building on that discussion, we survey existing federal tax measures targeted to co-operatives

[1] The extreme end of this form power could be seen in the Soviet Union, where co-operatives were used as instruments of state power and control and where Soviet officials used their power in an attempted to exert influence over the International Co-operative Alliance (ICA) (Fairbairn 1994)

[2] On average for example, borrowing costs at US credit union are lower than their bank counterparts, a fact attributable in part to their tax exempt status.

[3] By law, co-operatives must allocate a minimum of 20% of their surplus to indivisible reserves and 5% to educational and promotional initiatives. These requirements do not appear, however, to be tied to taxation policy.

and credit unions. We then discuss relevant case law and offer some concluding comments. In the second part of this series, we set out some proposals that could give shape to a new, more favorable, era of co-operative taxation.

The Taxation of Co-operatives in Canada

Despite its central role for creating the conditions for a flourishing co-operative movement, the taxation issue has received little scholarly attention in Canada over the last four decades.[4] Dan Ish wrote the last systematic academic review of co-operative taxation in Canada as part of a larger review of co-operative law *(Law of Canadian Co-operatives)* in 1981. The absence of subsequent scholarly discussion is noteworthy because in the years prior to Ish's text, the topic of co-operative taxation was a matter of considerable public policy debate, with particular attention paid to the cessation of tax-exempt status in 1945 following the recommendations of the Royal Commission on Co-operatives, discussions about the tax treatment of patronage in the Royal Commission on Taxation (Ottawa: Privy Council Office 1966), and the imposition of income taxation on credit unions in 1972.

Policy changes after Ish's text are no less noteworthy. They include for example the introduction of several beneficial measures, including a measure to defer the taxation of dividends paid by agricultural co-operatives to their members, another measure to exempt transactions between credit unions and their centrals from value-added sales tax; measures to facilitate access to tax-deferred registered savings plans (RSPs) for co-operative members; and a recent (2024) measure to incentivize the sale of small and medium sized businesses (SMEs) to worker co-operatives. Not all has been positive: along the way, credit unions lost access to the lower small business income tax rate through a phasing-out process that began in 2013.

In all cases, co-operatives have fought for, or against, these policy changes because they understand the important role that taxation can play in incenting collective action structures (e.g., sale of SMEs to workers) and addressing issues of competitive balance (e.g., phasing out access to the small business rate for credit unions). In every case, the implementation of tax policy begins with defining what we mean by a co-operative or credit union. It is to this matter that we now turn.

What is a co-op? Definitions in practice, law, and theory

To tax is to define. Our investigation begins therefore with the question of definition: what is a co-operative? We can approach this deceptively simple question from three vantage points, namely definitions in practice (i.e., in everyday use), in law, and in theory.

Practice

While co-operative practitioners and scholars are well acquainted with the International Co-operative Alliance (ICA)'s definition of co-ops, it is helpful to begin here because as we shall observe, there are echoes of the ICA definition and core co-operative principles and values in Canadian co-operative and credit union legislation which in turn anchor tax policy. The ICA defines a co-operative as follows:

> An autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. (International Co-operative Alliance 2024)

[4] This paper focuses on for-profit co-operatives. Non-profit co-operatives, like other non-profits, are not subject to income taxation (they are however subject to sales taxes).

We observe the core elements of the ICA definition—autonomy, voluntary, economic and social needs, jointly-owned and democratic—in Canadian policy documents. Thus, the Department of Innovation, Science and Economic Development (ISED) Canada, which has broad responsibility for co-operative matters at the federal level, provides the following definition:

> A business founded by an association of persons seeking to satisfy common needs, such as accessing goods and services, selling products, or improving their quality of life. Unlike traditional businesses that pay out their profits to shareholders, co-operatives redistribute their profits to members in proportion to their participation. (ISED Canada 2025)

In the United States, the Department of Agriculture, which has oversight over matters related to agricultural co-operatives, describes a co-operative as "a business owned and democratically controlled by the people who use its services and whose benefits are derived and distributed equitably on the basis of use." (United States Department of Agriculture 1997). This definition draws explicit attention to the fact that the co-operative gives primacy to the owner's 'user relationship,' that is their interactions with the co-operative either as a buyer or supplier of goods and services. This emphasis on owner-as-user sets co-operatives apart from other organizational forms. In a conventional business for example, the primary relationship is owner-as-investor. In a non-profit or charity, there is no formal ownership; the 'user' of services or goods is typically decoupled from governance.

Legislation is also shaped by the historical path that gave rise to these definitions. With this in mind, we note that the people who initiated the formal co-op movement (Ish 1981), known as the Rochdale Pioneers, were intentional about distinguishing co-operatives from other organizational forms and the business corporations that were increasingly availing themselves to new legal frameworks that emphasized the over-riding pursuit of profit for investors (Fairbairn 1994). Thus, in a co-operative, the "profit" incurred by the co-op is referred to as a 'surplus' that is returned to members as patronage dividends or is held intentionally by the co-op and reinvested to meet evolving member needs. Surpluses arise out of a need to ensure the viability of the business and only distributed when that viability is assured.

> The Canadian Credit Union Association (CCUA) for its part defines credit unions (a type of financial co-operative) as "full-service financial co-operatives offering the same products and services as other financial institutions." They are distinct from other financial institutions because of "their commitment to understanding members' needs and providing personalized financial advice" and because they are "guided by the co-operative principles and hold strong ethical values." Like other co-operatives, credit union use their surplus to pay patronage, reinvest in the business, or support their community (Canadian Credit Union Association 2025).

A set of co-operative principles and values give further shape to the ICA definition. The values are self-help, self-responsibility, democracy, equality, equity, and solidarity (International Co-operative Alliance 2024); the principles (seven in all) are: voluntary and open membership, democratic member control, member economic participation, autonomy and independence (from government), education, training and information, cooperation among co-operatives, and concern for community (International Co-operative Alliance 2024). We find traces of co-operative definitions, values, and principles in federal legislation, to which we now turn.

Law

The *Canada Co-operatives Act* defines a co-operative entity as "a body corporate that, by the law under which it is organized and operated, must be organized and operated on – and is organized and operated on - co-operative principles."[5] The preamble to the *Canada Co-operatives Act* also effectively incorporates by reference the ICA principles, describing the business of co-operatives as follows:

> WHEREAS co-operatives in Canada carry on business in accordance with internationally recognized co-operative principles;
>
> WHEREAS co-operatives work for the social and economic development of their communities through policies approved by their members;[6]

In short, the Act clearly sets out that by law, co-operatives are expected to operate in accordance with co-operative principles *and* consistent with the ICA definition, are expected to serve the social and economic objectives of their communities (presumably as understood by their membership).

Turning to credit unions, the federal *Bank Act* defines a federal credit union as "a bank that, within the meaning of section 12.1, is organized and carries on business on a co-operative basis."[7] While not invoking the ICA definition, values, or principles, section 12.1 (copied below) nevertheless carries their imprint, invoking notions of democratic control, the user relationship, and the allocation of surplus funds (as opposed to profits). It states that "a federal credit union is organized and carries on business on a co-operative basis if

a) A majority of its members are natural persons;
b) It provides financial services primarily to its members;
c) Membership in the federal credit union is wholly or primarily open, in a non-discriminatory manner, to persons who can use the services of the federal credit union and who are willing and able to accept the responsibilities of membership;
d) Each member has only one vote;
e) A delegate has only one vote even though the delegate is a member or represents more than one member;
f) Dividends on any membership share are limited to the maximum percentage fixed in the federal credit union's letters patent or by-laws; and
g) Surplus funds arising from the federal credit union's operations are used
    i. To provide for the financial stability of the federal credit union,
    ii. To develop its business,
    iii. To provide or improve common services to members,
    iv. To provide for reserves or dividends on membership shares and shares,
    v. For community welfare or the propagation of co-operative enterprises, or
    vi. As a distribution to its members as a patronage allocation.[8]

Theory

Scholars have also looked at the question of definition from a theoretical perspective, often drawing on a mix of practice, law, and economics

[5] *Canada Co-operatives Act*, *Statutes of Canada* 1998, c. 1. https://laws-lois.justice.gc.ca/eng/acts/c-1.7/
[6] *Canada Co-operatives Act*, *Statutes of Canada* 1998, c. 1., preamble https://laws-lois.justice.gc.ca/eng/acts/c-1.7/
[7] *Bank Act*, *Statutes of Canada* 1991, c. 46. https://laws-lois.justice.gc.ca/eng/acts/b-1.01/ . Note that in Canada, most credit unions are incorporated provincially.
[8] *Bank Act*, *Statutes of Canada* 1991, c. 46, s 12.1. https://laws-lois.justice.gc.ca/eng/acts/b-1.01/

to inform their thinking. One of the more prominent scholars on this topic, Henry Hansmann (1996), argues provocatively that we can think of all forms of enterprises as co-operatives. This claim is based on the observation that all firms are owned by a patron group with two main rights, namely control rights at the board level over decision making, and a residual claim, which amounts to the right to share in firm profits up to and including claiming any residual value in the firm upon wind-up (Hansmann 2013).

Co-operatives are distinct from other organizational forms in that their dominant patron group consists of the co-operative's users. In a grocery or financial services co-operative, the user is the person buying their groceries or placing a deposit; in an agricultural, forestry, or fishery co-operative, the user is the farmer, forester, or fisher selling their wares for storage, marketing, or transformation through their co-operative. In all cases, users have a control right and from Hansmann's perspective, some kind of residual claim. In an investor-owned firms (IOFs), the dominant patron group are the suppliers of capital (i.e., shareholders). They are paid a fixed interest rate on their "loans" set at zero for convenience (Hansmann 1999, Hansmann 1996).

Hansmann suggests that co-operatives (as legal entities) play an economic role like that of IOFs but distinct from nonprofits, in that rather than supplying initial financial capital, patrons (i.e., members) supply a level of demand (as customers) or physical inputs (as suppliers) (Hansmann 1980, Hansmann 1996). Corporate statutes may allow co-operatives to distribute net earnings to patrons in the form of patronage (as a return of excess), as a dividend (more in keeping with an IOF) or hold them back to reinvest in the business. Co-operatives also resemble IOFs in that they need to make money in order to be a viable business.

At the same time, co-operatives also share similarities with nonprofits, which Hansmann describes as 'unowned' because they have no dominant patron group with clear control and residual claimant rights. The core similarity is that both co-ops and nonprofits exist in the associational space by pursuing some kind of social objective that may or may not have an economic component. In a non-profit, this is often obvious but in a conventional co-operative, the social objective might be less visible but by meeting and being responsive to member needs, the co-operative also reflects member social aspirations and values, with particularly emphasis often placed on democratic ideals and the principle of care for community. Paired with the focus on a user-relationship, this confluence of economic/enterprise and associational objectives are what make co-operatives unique and, as we shall see, the subject of differential tax treatment.

Types of Co-ops

Policymakers have also tended to differentiate tax treatment by co-operative type. We can distinguish between different co-operative types based on the type of user, be it consumers (grocery, banking, etc.), workers, producers (e.g. farmers, foresters, fishers), multi-stakeholder ('solidarité co-operatives in Québec) or investors (e.g., investment co-operatives). We start with the consumer versus producer distinction because it is arguably the most important and enduring.

To illustrate the difference between a consumer and producer co-operative, consider the case of a dairy-farmer owned cheese co-operative. Here, the co-operative is a tool to further the business interests of the farmer-members because it purchases, transforms, and markets their milk. At the end of each year, the co-operative distributes patronage dividends according to how much milk each member *sells* to the co-operative. Producer co-operatives may also pursue associational

objective, providing for example education and training, opportunities for formal and informal social gatherings, support to rural communities, and representation of farmer and rural interests with policymakers.

In a consumer co-operative, by contrast, patronage dividends are distributed according to how much milk each member *buys* from the co-operative. Here, the co-operative is a vehicle for members to obtain goods and services at fair prices. The co-operative may also play a vital role in the associational life of the members, perhaps by providing important services otherwise unavailable in communities or by helping fund important community infrastructure (Hansmann 1996).

As we will see, Canadian tax law—much like the *Cooperatives Act* itself—shows some evidence of reflecting these differences between the co-operative as a tool for furthering business (i.e. a producer co-operative) and a co-operative as a tool for facilitating access to consumption goods (i.e., a consumer co-operative) as well as the confluence of pecuniary or business interests and association type objectives. Tax legislation similarly recognizes the distinction between producer, consumer and worker co-operatives, with the latter defined as employees who own and manage the business they work for (ISED Canada 2025, BDO Canada 2025). The *Cooperatives Act* has provisions to ensure the centrality of worker-ownership, while the *Income Tax Act* provides incentives for the sale of small businesses to workers (i.e., a worker-co-operative).

While credit unions are a type of consumer co-operative, they are often discussed separately because 'financial services' differ from most other goods and services. The peculiarity of credit unions is evident in Hansmann, who describes them as entities whereby members lend the credit union a sum of money which is then lent out to other members, acting much like a bank (as conventionally defined) does of intermediating between members with savings and those who want to borrow. From this vantage point, the co-operative pays the members an interest rate on their loans (a combination of membership share and deposits) and lends their loans at an interest rate such that it is reasonably likely that the co-op will have net earnings after expenses. With this set of features, we may also say that credit unions resemble what Hansmann defines loosely and generally as "capital co-operatives," businesses where investors lend money to the business (i.e., in a credit union context, takes deposits) and then uses it to invest it in some kind of productive asset (in the credit union case, loans), paying its lenders (members) some return on their loan. In that sense, then, we may say that credit unions most resemble Hansmann's generalized description of a conventional business.

But credit unions differ is some important respects, not least being the allocation of voting rights on the basis of one member, one vote. The other way they differ is by distributing surplus (net income) proportionately to the amount each member has lent to the co-op or borrowed from it. Payments are made in the form of patronage or, depending on the legal context, upon liquidation or in the event of a sale to a non-co-operative (Hansmann 1996).[9] In practice, however, credit unions and caisses populaires also pay patronage based on a member's use of a combination of loan products, deposit savings, and other products and services. Or they may not pay patronage at all, preferring to offer lower prices on loans or better rates on deposits, thus in Hansmann's language, balancing the interests

[9] Hansmann, *Ownership of Enterprise*. While Hansmann's depiction of credit unions / caisses has some superficial appeal, it is based on an out-dated understanding of the nature of modern banking, where the act of lending occasions new money creation, with no flow of deposits from savers to borrowers. For a discussion, see Bank of England, Bundesbank, Wray, etc.

of competing patron groups (lenders = depositors versus borrowers).

Finally, multi-stakeholder co-operatives are made up of different patron groups (i.e. consumers, workers, employees, etc.) who share a common goal (ISED Canada 2025). There is no 'dominant' patron group or if there is, its power is attenuated by control rights vested in other patron groups. Multi-stakeholder co-operatives are active in many different sectors, including home care services, recreation and tourism, local economic development, and others (Co-operatives and Mutuals Canada 2025). While we are unaware of taxation measures specifically targeting multi-stakeholder co-operatives, their unique (and potentially costly) governance arrangements suggests that policymakers might have grounds for some sort of tax accommodation.

Legal Perspectives: Co-operatives vs Other Forms

Before turning to a detailed discussion of tax policy, we briefly look at some of the ways that Canadian legislation—leveraging definitions—distinguishes between co-operatives and other business forms, particularly IOFs. In many respects, the legislation governing co-operatives and investor-owned firms are similar and by some accounts, have been growing more alike over decades, (Ish 1981, Ish and Ring, 1995) a process known as 'isomorphism' in the scholarly literature (DiMaggio and Powell 1983; Périlleux and Nyssens 2017). The federal government appears to acknowledge as much, noting that the *Co-operatives Act* is modelled after the *Business Corporations Act* and is conceptualized as a 'companion statute.'[10] And indeed, they are structurally similar. Most of the sections in the acts have similar if not identical headings (see Appendix A for a detailed comparison).

That said, there remain important differences. The *Co-operatives Act* for example has sections devoted to Membership, Corporate Governance, and Capital Structure,[11] all missing from the CBCA. The *Co-operatives Act* also makes use of uniquely co-operative concepts like patronage and surplus and invokes the centrality of the user relationship, as in the following extract from section 155 which sets out that co-operatives may want to return:

> 'all or part of the surplus arising from the operation of the cooperative in a financial year in proportion to the business done with the members with or through the cooperative in that financial year…"

We can interpret the presence of Parts 20 (non-profit housing) and 21 (worker co-operatives) of the *Co-operatives Act* as more evidence that policymakers recognize the unique nature of co-operatives as anchored around the user-relationship and existing outside of a market-based, capitalistic logic. In the case of housing, the act sets out an expectation that the co-operative exists to serve member housing needs, operating on a non-profit basis and hence not taxed, with additional provisions to constrain the potential for financial gain or speculation, and to resolve potential member conflicts up to and including grounds for member termination. In the case of worker co-operatives, the Act limits the percentage of workers who are non-members (i.e., regular employees), a measure that protects the essential quality of this type of co-operative.

We can also observe differences between conventional corporate and co-operative legislation by narrowing our focus to what is

[10] Bill C-25, *An Act to Amend the Canada Business Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act and the Competition Act* 1st sess., 42nd Parliament, SC 2018. https://laws-lois.justice.gc.ca/eng/annualstatutes/2018_8/page-1.html

[11] The *Cooperatives Act* has 386 sections and 24 parts, while the CBCA has 253 sections and 21 parts.

unique to the CBCA and its accompanying regulations. We observe for instance that the CBCA sets out a 'comply and explain' expectations that IOFs strive for some gender balance that if not met, must be explained in public-facing documentation. No such requirement is found in the *Cooperatives Act*. While we cannot say for certain why this is, we note as democratically structured businesses, election outcomes can be unpredictable in a co-operative. It would be inconsistent with the co-operative democratic structure to demand that co-operatives target a certain board composition. We can also see how the primacy of the 'investor' in IOFs shapes the broad structure of the CBCA, which has distinct sections on Corporate Finance, Sale of Constrained Shares, Financial Disclosure, Disclosure Relating to Diversity and Going-Private Transactions and Squeeze-Out Transactions, all sections not found in the *Co-operatives Act*.

In short, the 'companion' status of federal co-operative legislation suggests a subordinate status between the two statutes. One might also interpret their proximity as grounds for similar tax treatment. However, the fact that there is a distinct statute for co-operatives underlines that the view that the two business forms are meaningfully different and worthy of differing tax treatment.

Taxation of Co-operatives

We arrive now at the question of how Canadian tax law treats co-operatives. In general, we can say that Canadian co-operatives are subject to two broad categories of taxation, namely income and value-added sales taxation, each with its own legal dilemma. In the case of income taxation, the core legal dilemma (in case law) boils down to a question of what monies are truly 'retained' by the co-operative and subject to taxation or returned to the member or held in the member's name. From a sales tax perspective, the key question is how to design a value-added sales tax that does not disincentivize co-operative structures such as federations, confederations, centrals, or other apex-member structures that allow co-operative to scale operations without centralizing. We turn to each of these areas of taxation next.

Income Tax

There has been an ongoing policy debate in Canada about whether co-operatives merit differential tax treatment since the introduction of the *Income War Tax Act* in 1917,[12] Canada's first legislative experiment with income taxation (Bilbao 2022). Section 5(f) of the Act exempted "the incomes of mutual corporations not having a capital represented by shares, no part of the income of which inures the profit of any member thereof."[13] It was however unclear whether co-ops fell under this umbrella of "mutual corporations." This confusion took on some importance in the late 1920s, after co-ops—particularly grain marketing co-ops—had grown enough that they began attracting the attention of competitors and policymakers. The result was an increase in litigation around the issue of taxation, through the cases of *Saskatchewan Wheat Pool* and *Fraser Milk*. These cases prompted an amendment to the *Income War Tax Act* to include section 4(p), which explicitly.[14]

We discuss these cases in more detail below but for now, it is important to note that while lacking a formal definition of what it meant to be a co-operative, policymakers nevertheless justified the exemption based on the view that by and large, co-operatives provided a public service by making available goods and services at cost, with no profit motive in either intent or practice (Ish 1981; Royal Commission on Co-operatives 1945).

[12] *Income War Tax Act*, 1917
[13] *Income War Tax Act*, 1917.
[14] *Income War Tax Act,* 1917 s 4(p)

Over time, this view shifted, especially after the Royal Commission on Co-operatives' 1945 report which took the position that there was no justification for the *complete* tax exemption of co-ops. This interpretation took on more salience as co-operatives took up more space in the Canadian economy, with many becoming effectively "big businesses" (Ish 1975). The Commission's recommendations would find their way into policy in 1946 through amendments to the *Income War Tax Act*.

Records of the committee proceedings associated with the 1946 amendments to the Act also highlight the growing sentiment that all forms of enterprise should be subject to taxation based on ability to pay, rather than the nature of ownership: "irrespective of the profession of unselfishness and altruism of mutual organizations, [co-operatives] can and do have income" and therefore should be taxed on that income in an equitable way (Canada. Parliament. Senate. Standing Committee on Banking and Commerce 1946). Again, this shift took place against the backdrop of a co-operative sector that was growing not only in agriculture but also in retail grocery sales, banking, insurance, agriculture, and across a range of other areas of economic activity. Co-ops initially resisted these policy changes, arguing that their reserves were for furthering the business and meeting members' needs rather than profit in the conventional sense. Policymakers, however, were not swayed and have not tended to be sensitive to the subtle difference between earnings retained for eventual use in service delivery versus earnings retained for eventual distribution to members as dividends.

Once policymakers settled on the idea that co-operatives should be subject to income taxation, the question then became how to define taxable income. As we will show, the evolution of co-operative tax policy reveals the push and pull of competing ideologies, with the concept of 'surplus' continuing to exert some influence (pull) on policy as evidenced by its ongoing use in co-operative legislation and the *Income Tax Act* despite the thrust (push) of policy moving towards treating surplus as effectively identical to net income in an IOF.

Income vs Non-Income

Over the years, two tests have emerged to determine whether the money earned by a co-operative could be considered taxable income or not. The first, devised prior to the 1946 changes, looks to intention to make a profit on behalf of the co-op *in its own right* as a legal entity. The second, derived after 1946, became known as the "quality of income" test. It asks whether the principals (the members) have any effective control over any surplus retained by the co-operative or whether the co-operative as an entity has an unrestricted right to use the surplus.[15] Both tests boil down to determining whether the relationship between the member and the co-op could be considered one of agency or whether the co-operative is acting in its own right, a consideration still relevant today.

The Agency Relationship Test

MNR v Saskatchewan Co-op Wheat Producers Ltd (1930)[16] played a decisive role in what emerged as the agency test. The federal government argued that the Wheat Pool's surplus should be subject to income taxation; the Wheat Pool argued its surplus was held for its members, as their agent. From the Wheat Pool's perspective, surpluses were merely "advances" made by members to the co-op that allowed it to fulfill its duties under their agreement. The Wheat Pool prevailed, with the court finding that the surplus was in fact used purely for the benefit of the members (as users) and when not used, was

[15] *Horse Co-operative Marketing Assn., Ltd. v Canada (Minister of National Revenue – M.N.R.)* [1956] Ex.C.R. 393.

[16] *Minister of National Revenue v Saskatchewan Co-operative Wheat Producers Ltd.*, [1930] 1 DTC 186.

returned through patronage.[17] In effect, members retained a right to the money as principals and thus the relationship between the co-op and its members was one of agency. This case also noted that contractual evidence was not necessary to determine the existence of an agency relationship; it could be determined based on a combination of the incorporating statute and associational bylaws (Ish 1981). The result was a simple test: was the co-operative retaining surplus for its members as their agent or for itself, in its own right? If the former, the surplus was tax exempt; if the latter, the surplus was taxable income.[18]

The "Quality of Income" Test

In the years after 1946, policymakers drew on a second (but related) test to assess whether a co-operative was subject to taxation. This test, known as the "quality of income" test, was set out in *Canadian Fruit Distributors Ltd. v MNR* (1954).[19] It cites a similar test from the United States Supreme Court in 1933, where Justice Brandeis stated the test to be as such:

> "Is his right to it absolute and under no restriction, contractual or otherwise, as to its disposition, use or enjoyment? To put it another way, can an amount in a taxpayer's (the co-operative) hands be regarded as an item of profit or gain from his business, as long as he holds it subject to specific and unfulfilled conditions and his right to retain it and apply it to his own use has not yet accrued, and may never accrue?"[20]

The has been summarized as follows: "if the co-op lacks an absolute right to the surplus it retains, then the surplus lacks the "quality of income" that is necessary to bring it within the taxing statute."[21] In other words, unless the co-op has an unconditional right to keep and use the surplus, then the surplus is not taxable as income. The consonance with the agency test is obvious: where the nature of the relationship between the co-op and the member is one of agency, the co-op will not have an absolute right to the retained surplus because members have a right to it as principals (Ish 1981). The surplus would accordingly fail to have the "quality of income" and hence would not be taxable.

The quality of income test was applied again in *Horse Marketing Assn. v MNR* (1956), which gave the most comprehensive review of thinking through the nature of the test.[22] As might be expected, this case highlights the need to consider the rights of the members to the surplus and the relationship between the member and the co-op in determining the true nature of surplus.[23] It goes on to emphasize that if it can be shown that the amounts that the co-op has on reserve (the surplus) do not in fact belong to the co-op, then the "quality of income" test is not met; likewise, if it can be shown that the co-op is an agent of its members, then the reserve is not taxable because the co-op's right to the surplus is not unrestricted – it is not an absolute right.[24] Justice Thorson phrased the "quality of income" question as being a matter of whether or not the co-op's "right [to the surplus is] absolute and under no restriction, contractual or otherwise, as to its disposition, use or enjoyment."[25] If the co-

[17] *Minister of National Revenue v Saskatchewan Co-operative Wheat Producers Ltd.*, [1930] 1 DTC 186.
[18] *Minister of National Revenue v Saskatchewan Co-operative Wheat Producers Ltd.*, [1930] 1 DTC 186.
[19] *Canadian Fruit Distributors Ltd v Canada (Minister of National Revenue – MNR)*, [1954] Ex. C.R. 551.
[20] *Canadian Fruit Distributors Ltd v Canada (Minister of National Revenue – MNR)*, [1954] Ex. C.R. 551.
[21] *Horse Co-operative Marketing Assn., Ltd. v Canada (Minister of National Revenue – M.N.R.)* [1956] Ex.C.R. 393.
[22] *Horse Co-operative Marketing Assn., Ltd. v Canada (Minister of National Revenue – MNR)*, [1956] Ex.C.R. 393.
[23] *Horse Co-operative Marketing Assn., Ltd. v Canada (Minister of National Revenue – M.N.R.)* [1956] Ex.C.R. 393.
[24] *Horse Co-operative Marketing Assn., Ltd. v Canada (Minister of National Revenue – M.N.R.)* [1956] Ex.C.R. 393.
[25] *Horse Co-operative Marketing Assn., Ltd. v Canada (Minister of National Revenue – M.N.R.)* [1956] Ex.C.R. 393.

op has an absolute right to the surplus it retains, then it belongs to the co-op, therefore having the "quality of income" rendering it taxable.

Dominant & Preponderant Purpose Tests

Echoes of these rulings would influence what became known as either the dominant purpose test or predominant purpose test – both terms appear to be used interchangeably in the co-operative case law.[26] This test posits that if the purpose of a co-operative's activity is making a profit,[27] it is considered a business activity and it is taxable[28]. Consider for example the application of the 'dominant purpose' test in the case of *Petty Harbour-Maddox Cove* (2005). In this case, an action was brought by the town against Peerless Fish to recover business and water taxes owing. Peerless Fish argued, among other things, that the town was discriminating against it as an ordinary business corporation because it had failed to impose the same tax on the Petty Harbour Fishermen's Producer Cooperative Society Limited (the only other commercial enterprise[29]). Peerless Fish argued that they ought to be exempt from property tax like the co-operative. The town argued that the co-op was not taxed because its dominant purpose was not to make a profit but to serve its member use needs,[30] thus distinguishing it as a not-for-profit enterprise. The Company for its part argued that the dominant purpose of the co-op was member[31] profit, and therefore the dominant purpose of the co-op could not have been said to be anything other than the making of a profit[32]. The differential tax treatment afforded the co-op versus Peerless Fish amounted to discrimination. It is important to note that this case took place in the context where co-operatives were clearly liable for *income* taxation; this dispute centered around municipal taxation.

The 'predominant' purpose test—again effectively the same thing as the dominant purpose test in the co-operative context—has been most notably and most recently applied in *Re Regional Assessment Commissioner et al and Caisse Populaire De Hearst Ltee* (1983). In this case, the respondent credit union had been assessed for property taxes (again, not income taxes) as if it were a bank and taxed accordingly. It appealed this finding, claiming that it was not liable for taxes because it did not operate as a bank - or as a for-profit business for that matter - under section 66 of *The Assessment Act*.[33] In its ruling, the court had to contend with two core issues: was the respondent credit union in fact carrying on business as a "banker or other financial business" —was this its predominant purpose— and if so, did the Assessment Commissioner have the right to change the assessment of their land from residential to commercial? In determining how the respondent credit union should be taxed, the Court decided that the preponderant purpose of its activities was to provide loans to members for provident and productive purposes at a low cost, rather than making a profit.[34] As a result, it ruled that the credit union was *not* carrying business on as a bank and thus it was not subject to property tax.[35]

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[26] Importantly, however, the dominant purpose test in other areas of law has different implications. In litigation for example, the dominant purpose test is used to determine if the litigation privilege applies. (Mann 2014)

[27] *Elm Ridge Country Club Inc. v. Minister of National Revenue*, (1995) CarswellNat 601.

[28] *Petty Harbour-Maddox Cove (Town) v Peerless Fish Co.,* 2005 NLTD 187

[29] *Petty Harbour-Maddox Cove (Town) v Peerless Fish Co.,* 2005 NLTD 187.

[30] *Petty Harbour-Maddox Cove (Town) v Peerless Fish Co.,* 2005 NLTD 187. *para 30*

[31] *Petty Harbour-Maddox Cove (Town) v Peerless Fish Co.,* 2005 NLTD 187. *para 32*

[32] *Petty Harbour-Maddox Cove (Town) v Peerless Fish Co.,* 2005 NLTD 187. *para 33*

[33] *Ontario (Regional Assessment Commissioner) v. Caisse populaire de Hearst Ltée,* [1983] 1 S.C.R. 57

[34] *Ontario (Regional Assessment Commissioner) v. Caisse populaire de Hearst Ltée,* [1983] 1 S.C.R. 57

[35] *Ontario (Regional Assessment Commissioner) v. Caisse populaire de Hearst Ltée,* [1983] 1 S.C.R. 57

The preponderant purpose test, and the related notions of credit unions meeting "provident and productive purpose" needs, also shaped the outcome in an earlier but less cited case, *Stouffville District Credit Union and Village of Stouffville* (1966)[36]. In this case, Stouffville District Credit Union applied for an order from the village declaring that it was not liable to be assessed as a business under s. 9 of *The Assessment Act*, as it was not[37] a "business" or "a banking or financial business." Using the preponderant purpose[38], the Court ruled that the credit union's preponderant purpose was, much like in the subsequent *Hearst* case, to provide loans for provident and productive purposes, thus distinguishing it from banks and other financial businesses. It could not be said to be a "corporation carrying on a banking business."

However, the Court also ruled that the credit union could be categorized as a *financial* business[39] because while its preponderant purpose was to provide easier (low cost) credit for provident and productive purposes, it also could structure the business to make a profit from which it could declare and pay dividends (as distinct from patronage rebates or patronage dividends). Here, the Court noted that Section 44 of the Ontario *Credit Unions and Caisses Populaires Act*[40] states that "Membership shares confer on the holder the right to receive dividends declared on the shares and to receive the remaining property of the credit union on dissolution."[41] Notably, this provision in the Act makes reference plainly to "dividends" and not *patronage* dividends and invokes residual claimant rights ('dissolution' provisions) that are core to the Hansmann's perspective (interestingly, the Stouffville decision took place *before* credit unions became subject to income taxation).

In short, the Stouffville case highlights the challenging nature of the dual nature of a cooperative business. It is, at once, an enterprise that (sometimes) meets the borrowing needs of members, what might be considered its 'associational' identity, while its capacity to generate surplus might suggest it should be subject to taxation, especially if those surpluses are paid out in dividends (as distinct from patronage) or in a windup, distributed to the membership. We turn now to exploring in more detail the question of the taxation of patronage.

Patronage Distributions

Since the amendments to the 1946 *War Tax Act*, co-operative income has been subject to taxation. However, if a co-operative is deemed to have income in its own right, and is therefore taxable, it can reduce taxes owing by making patronage distributions to members, reducing taxable income by the amount as the distribution (Ish 1981).[42] Further, by deducting patronage payments, co-operatives potentially shift the tax burden to the members who receive patronage distributions[43] depending on the nature of the relationship between the member and the co-operative (Ish 1981): where the member is the final consumer of the purchased goods and services, patronage payments are not taxed;

[36] *Stouffville District Credit Union Ltd. and Village of Stouffville*, [1966] 2 O.R. 139
[37] *Stouffville District Credit Union Ltd. and Village of Stouffville*, [1966] 2 O.R. 139
[38] *Stouffville District Credit Union Ltd. and Village of Stouffville*, [1966] 2 O.R. 139
[39] *Stouffville District Credit Union Ltd. and Village of Stouffville*, [1966] 2 O.R. 139
[40] *Credit Unions and Caisses Populaires Act, 2020*, SO 2020, c 36, Sch 7, s 44.
[41] *Stouffville District Credit Union Ltd. and Village of Stouffville*, [1966] 2 O.R. 139

[42] It is important to note that the Income Tax Act is very clear than *any* for-profit business can pay patronage rebates and receive the same tax treatment. However, the incentives to make such payments will be lesser in IOFs since every patronage return paid out to customers reduces profits for distributions to investor-shareholders.
[43] Section 135(7) of the *Income Tax Act* states that patronage dividends shall be included in the income of the recipient in the year in which the payment was received but as we note later, will not be considered taxable if a rebate on purchases.

where the member uses their purchases from the co-operative as inputs into a business, they may be subject to taxation.

There is another important consideration around income tax as it concerns patronage distributions involving situations where co-operatives serve members and non-members, people with no formal membership relationship to the co-operative (i.e., no governance or residual claimant rights). In these situations, if all customers—members and non-members alike—do not receive equal patronage allocations, the co-operative's deduction is limited to the share of its total business (including capital gains) associated with interactions with members. We can represent this constraint in equation form, as shown in Equation 2 below (derived from the definitions in equation 1).

$$Total\ Business\ (TB) = Member\ Business\ (MB) + NonMember\ Business(NMB) \quad (1)$$

$$Maximum\ Deduction = TB * \left(\frac{MB}{TB}\right) \quad (2)$$

Tax Deferred Co-operative Share Program

As noted, consumer members do not pay tax on patronage received whereas members of producer co-operatives will generally be subject to taxation of their patronage payments. The rationale for this different tax treatment hinges on the nature of the relationship between the member and the co-operative and the nature of the transaction. Consumer purchases are for final consumption; producer purchases are inputs into production. Thus, we can think of patronage back to consumer members are a kind of rebate or price reduction for goods and services no different than a business offering its products on sale. A patronage distribution to a producer member may in some circumstances also be viewed as a rebate but with tax implications because the producer member operates a business. As the operator of a business, the producer member will, in filing their monthly or quarterly withholding taxes, deduct the cost of inputs, including the cost of inputs purchased from the co-operatives, from their revenue to arrive at taxable income. If at year-end, a producer member receives a patronage distribution on purchases used to further their business, they will have under-reported taxable income (by deducting too many expenses) and have taxes owing. Where the member-producer receives part of their patronage distribution in the form of equity instead of cash, they may find themselves having to pay taxes but without the related available cash (because it is tied up in co-op equity).

Policymakers have recognized that this timing issue may pose challenges to co-operatives, and especially agricultural co-operatives. In 2005, the federal government created the Tax-Deferred Co-operative Share Program (TCDS), available to Canadian-based agricultural co-operatives whose principal activity is farming or providing goods and services required for farming (Department of Finance 2024). Under this program, members can defer tax payments on patronage dividends paid in the form of equity until the co-operative buys (with cash) back the shares or the member disposes of them in some other way (Department of Finance 2024b). This measure allows agricultural co-ops to increase their cash holdings by reducing taxes owing by declaring equity patronage payments in the form of equity while simultaneously serving as a capitalization and resilience strategy (Barett 2020). While originally set to last ten years, the program has been renewed several times, most recently in the 2025 budget. Of note, co-operatives are limited to paying no more than 85% of their surplus under this program.

Capital Gains Exemption for Worker Co-op Sales

Agricultural co-ops are not the only type of co-op to receive targeted tax treatment. Worker co-operatives and financial co-ops (credit unions

and caisses populaires) have also been the subject of differential tax treatment. In the 2024 federal budget for example, the federal government introduced new tax incentives to make selling a business to a worker co-operative corporation (WCC) a more appealing option (Department of Finance Canada 2024a, 14). Under this new measure, where a business owner sells their business to a worker co-op, they are eligible for a $10 million capital gains exemption (BDO Canada 2025). This exemption previously only applied to transfers of businesses to Employee Ownership Trusts (EOTs). The intention behind granting this exemption is to encourage business owners to sell to employee-owned firms (i.e., EOTs and WCCs) and avoid shuttering businesses that are often vital hubs for communities and/or employers for their employees (Canadian Worker Co-op Federation 2024).

To qualify, the business transfer must be a "qualifying co-operative conversion" (Miller Thomson 2025). A "qualifying co-operative conversion" consists of a transfer of shares of a predecessor corporation to a WCC that meets several requirements: the WCC must reside in Canada, must be formed under provincial or federal legislation, and must have been established for the purposes of employing its members. Further, at least 75% of the WCC's employees must hold a membership share and each initial membership share is issued in exchange for a nominal amount determined in the same manner for all members and is offered to each employee following the completion of an applicable probationary period (not longer than 12 months). Further, at least one third of the directors of the WCC must be qualifying co-operative workers, and no more than 40% of the directors of the WCC can own 50% or more of the outstanding shares or debt of the predecessor corporation (Miller Thomson 2025). Lastly, the bylaws of the WCC include a procedure for allocating, crediting or distributing any surplus earnings of the WCC, including a requirement that no less than 50% of those earnings be paid based on the remuneration earned by the qualifying co-op workers from the WCC or the labour contributed by these members (Miller Thomson 2025).

In addition to these requirements, the WCC would also need to meet the definition set out under section 359(1) of the *Canada Co-operatives Act* (Canadian Worker Co-op Federation 2024). This definition states that the "worker co-operative" means "a co-operative whose prime objectives are to provide employment to its members and to operate an enterprise in which control rests with the members."[44] Shifting our focus to a different type of co-operative, we now turn to discuss credit unions and their tax treatment over time.

Credit Unions

Unlike the rest of the co-operative sector, credit unions remained exempt from income taxation until 1972, shielded by the argument that their objective was to serve "limited groups of people basically on a non-profit basis" through the provision of "specialized services" that helped individuals who often lacked access to basic financial services. The Royal Commission's 1945 report for example stated that "credit unions provide a useful supplement to other lending institutions and that the continued development of credit unions is desirable from the standpoint of the public interest."

As with the rest of the co-operative sector, credit union success eventually attracted critical scrutiny from competitors and policymakers, with the former mobilizing to lobby against what they perceived as an unfair credit union tax advantage.

[44] *Canada Co-operatives Act*, *Statutes of Canada* 1998, c. 1., section 359(1) https://laws-lois.justice.gc.ca/eng/acts/c-1.7/

Policymakers listened. In its 1971 White Paper on taxation, the federal government proposed taxing credit unions the same as banks, noting for example that "with the increased scope of [the] activities and operations [of credit unions], some of them are in real competition with other financial institutions," meriting a shift away from their tax-exempt status. In the face of a strong counter-lobby by a united front of credit unions and Desjardins caisses, the federal government introduced a compromise that became known as the Additional Deduction for Credit Unions (ADCU), a measure designed to incentivize the build-up of capital (equal roughly to 5% of assets) by taxing credit union profits at the small business income tax rate rather than the general corporate rate which at the time, could represent a gap of as much as 25 percentage points (Department of Finance, 1971; 1973). The ADCU was framed as a bridging mechanism from no-income taxation to some-income taxation that recognized the credit union movement's (as it was then called) growing place in the banking sector, role in funding small businesses, and their associative responsibilities as leaders and supporters of rural and other communities.

As recently as the late 1990s, the federal government defended the ADCU from criticism on the grounds that credit unions played a critical role in ensuring a degree of competition in Canada's banking sector and often provided services to underserved people and parts of the country (Task Force on the Future of the Canadian Financial Services Sector 1998). In its 2013 budget, however, the federal government said it would be phasing out the ADCU over a five-year period beginning in 2013,[45] the stated goal being to "level the playing field with the private sector." Behind the scenes, federal policymakers also expressed frustration that some credit unions had structured their business such that they retained access to the ADCU despite ceasing to be what most observers would consider 'small' businesses.[46] Indeed, the federal government carefully noted that truly small credit unions retained access to the small business tax rate through the more conventional small business deduction test rather than the ADCU.[47] The "phase out" mechanism was subject to abuse by larger credit unions and had ceased to work as intended.

While the historical policy rationale for the ADCU lost some of its original force, credit unions initially lobbied against the elimination of the ADCU—and later argued in favour of introducing a new roughly equivalent measure—that would address what they perceived as inequities in corporate income taxation. These inequities included their inability to access the capital gains tax exemption, a powerful incentive for investors to buy bank shares (for example), that helps generate sustained demand for the capital needed to operate and meet regulatory requirements. In the end, federal policymakers were unpersuaded, falling back on 'level playing' field and 'modernization' arguments that emphasized the importance of bringing credit union taxation in-line with the taxation of other for-profit corporate forms. In so doing, they implicitly (never explicitly) invoked 'preponderant' purpose test type arguments suggesting that large credit unions were essentially bank-like in all important respects.

[45] Bill C-60, *An Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 21, 2013 and Other Measures* 1st Sess., 41st Parliament, SC 2013, c. 33, https://lop.parl.ca/staticfiles/PublicWebsite/Home/ResearchPublications/LegislativeSummaries/PDF/41-1/c60-e.pdf

[46] One of the authors of this paper, Marc-Andre Pigeon, was working for the credit union sector at the time and frequently engaged with Department of Finance officials.

[47] Bill C-60, *An Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 21, 2013 and Other Measures* 1st Sess., 41st Parliament, SC 2013, c. 33, https://lop.parl.ca/staticfiles/PublicWebsite/Home/ResearchPublications/LegislativeSummaries/PDF/41-1/c60-e.pdf

Value Added Taxation

The GST/HST aims to tax *final* consumption, the point where the consumer purchases a product or good. They differ from a sales tax in that unlike a sales tax, the GST/HST apply all the way through the production chain. Firms pay GST/HST on items they purchase as inputs into their production but offset those costs with tax credits from the sale of their goods to other firms. There are two exceptions to this rule. First, policymakers categorize some products (e.g., groceries) as "zero rated," meaning the GST/HST rates are set at zero. Firms that sell zero-rated products can claim tax credits for any GST/HST paid on inputs. Second, policymakers have categorized a selection of other products, most notably financial services, as "tax exempt." Firms that sell GST/HST "tax exempt" products *cannot* claim tax credits for any sales taxes they may have paid on their inputs. These distinctions matter for the ensuring discussion.

The main concern with value added sales taxes from a co-operative perspective is whether they disincentivize the kinds of structures used by co-operatives (e.g., federations, confederations, centrals) to obtain economies of scale. Through successful lobbying, credit unions obtained an exemption from the GST/HST on financial services transactions between themselves and their centrals, effectively replicating the GST/HST tax-free status of transactions between a bank headquartered in Toronto and its branches in British Columbia (for example).

Crucially, the exemption adopts a broad definition of 'financial services' that extends beyond its formal definition: *any* transaction between a credit union and its central is tax exempt, above and beyond those set out in section 123 of the *Excise Tax Act* ("ETA"), which we reproduce as Appendix B.[48] Specifically, section 150 of the ETA extends the exemption to transactions among credit unions which are part of a "closely related group," which includes members who are "listed financial institution[s]" (credit unions are considered financial institutions).[49] Unlike banks and other financial institutions, credit unions have historically turned to credit union-owned Centrals to provide a range of services (e.g., payments, liquidity, marketing, human resources, and even loan adjudication) that would have been uneconomical for each of them to provide inhouse. If services between credit unions and Centrals or other credit unions were subject to GST/HST, they would be disadvantaged compared with their bank counterparts who are able to provide these services in house, tax free.

Of note, until 2023, if a credit union earned more than 10% of its revenue from sources other than those specified in the *Income Tax Act* , it did not qualify as a credit union (for GST/HST purposes), and accordingly would not be privy to the aforementioned GST/HST rules, more echoes of the preponderant purpose test. Credit unions today earn considerable fee income from the sale of wealth management and other non-traditional 'provident' products and services. Given the changing nature of the credit union business, the 2023 Federal Budget removed this "revenue test" from the definition of a credit union to align with the reality of modern credit union operations (Canada Revenue Agency 2024). [50]

Discussion

Policymakers have over time come to structure co-operative income taxation by distinguishing between that portion of net income retained and

[48] *Excise Tax Act*, *Revised Statutes of Canada* 1985, c. E-15. s 123. https://laws-lois.justice.gc.ca/eng/acts/e-15/

[49] *Excise Tax Act*, *Revised Statutes of Canada* 1985, c. E-15. https://laws-lois.justice.gc.ca/eng/acts/e-15/

[50] "Excise and GST/HST News – No. 114," Canada Revenue Agency, January 2024, https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/news114/news114-excise-gst-hst-news-no-114.html.

used by the co-operative at its sole discretion as a corporate entity, and that portion of net income it redistributes to members through patronage allocation. The former is taxable in the hands of the co-operative; the latter is not. Co-operatives deduct patronage allocations from income. In so doing, policymakers appear to have (intentionally or not) drawn on the 'agency' and related 'quality of income' tests. Money returned to members through patronage can plausibly be conceptualized as part of the co-operative's agency relationship with its members.

In some important ways then, the income tax treatment of co-operatives in Canada aligns well with Hansmann's claim that we can think of all enterprises as co-operatives. They differ only, and primarily, in who constitutes the dominant patron group. In the case of IOFs, the dominant patron group is the suppliers of capital (investors). In co-operatives, input suppliers (producer co-operatives) or consumers commit to 'supplying' enough demand to operate a viable business or in the case of credit unions, supply 'loans' in the form of deposit funding. In all cases, individuals create an entity—corporation or a co-operative—to serve their economic interests, be it generating a return on their investment (IOFs) or access to goods and services on some kind of preferential terms (co-operatives). In all cases, the entity can be interpreted as the 'agent' of the dominant patron group, accountable for representing its collective interests through a 'nexus of contracts.' Thus, if Hansman is right that all for-profit business are fundamentally similar in structure, it seems reasonable to conclude they should all be treated the same way from a tax perspective much like was argued in the Peerless case. And for the most part, the arc of corporate taxation has bent in this direction, towards identical tax rates and identical tax treatment of patronage payments. While there is no reason to believe that Hansmann' arguments have shaped the evolution of co-operative taxation in Canada, his arguments do appear to reflect an important part of the zeitgeist around changes to co-operative taxation.

That said, Hansmann's perspective and indeed, the evolving nature of taxation policy in Canada, appears increasingly to downplay the associational part of what it means to be a co-operative (i.e., purpose perspective) or the fundamentally different nature of the underlying capital structure: whereas IOFs can easily raise funds from the sale of equity instruments that are liquid and whose values fluctuate roughly in line with profitability, co-operatives sell a form of equity that is *illiquid* and whose value never fluctuates. As our brief review of the policy environments in Spain and Italy suggest, and as will discuss in more detail in the second part of this series, these distinctions matter a great deal for the viability or not of the co-operative business model.

Conclusion

In the years following Dan Ish's review of co-operative legislation, the taxation of co-operatives has changed in important ways. And yet, academic or even sustained co-operative sector attention to the issue has been minimal. Since co-ops continue to be vital to Canada's economic and social development and since we know that taxation policy plays a critical role in creating a favourable policy context, a clear understanding of their tax treatment and the theory that shapes the discourse around taxation is necessary to ensure that policy is effective and constructive going forward.

This paper has sought to address this gap by documenting federal tax measures impacting co-operatives and credit unions, analyzing associated case law, and assessing the implications of these changes. In the end, we find that the debate about co-operative taxation measures hinges on the question of how similar co-ops are to ordinary business corporations (IOFs) and whether those differences are

sufficient to warrant different tax treatment. In thinking about this question, it is critical to remember that co-operatives operate to serve the needs of members, not expectations of a return on investment that can be realized through the sale of shares. This 'member-service' orientation finds expression in the context of 'surplus,' a term used to make clear that a co-operative that brings in more money than it spends does so with the expectation that it will either return these monies to the members or hold on to it for re-investment in the business to meet the rebate needs of current and future members. The co-operative has no innate incentive, structurally, to extract maximal surplus value from its member-customers—its shares trade at par (i.e., don't fluctuate in value), its residual value is at least in principle owned inter-generationally, and its purpose transcends pure profit maximization logic.[51]

Co-operatives exist to meet associational needs, a point that judging by case law, courts struggle to operationalize. Co-operatives live in *two* places, not one, rendering judgements more complex. They not only seek to be viable business but also provide 'places' where members can act collectively, engage in democratic deliberation, use the co-operative structure to make available goods and services that are important to their communities, and direct some part of the surplus to the furtherance of the co-operative *movement*, a good in and of itself.

Finally, it is useful to remember that taxation is one of government's most powerful policy tools. Beyond its revenue-generating function, policymakers can use taxation policy to incentive behaviours and discourage others. As the cases of Italy and Spain suggest, these measures can matter a great deal for the overall well-being of the sector. Over the last 70 years, policymakers in Canada have gradually adjusted tax policy to disadvantage the co-operative form under the guise of a 'level playing field,' clearly signaling a preference for IOFs by means of generous capital gains exemption and dividend-gross up rules, a point we return to in the second part of this series. In a time of unprecedented geopolitical, climate and economic uncertainty and the concentration of economic control in fewer and fewer hands, it is time for policymakers to bend the historical policy arc in the other direction, to adopt tax incentives that support co-operatives and credit unions in their mission to serve member needs and build a more just democratic society. In the second part of this series, we offer suggestions for how this can be done.

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[51] That said, it is important to recognize that isomorphic propensities may lead to different behaviour in fact. Further, the co-operative corporate form offers no guarantees against principal-agent problems.

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Appendix A: Comparing the CCA and CBCA

	***Canada Cooperatives Act*, S.C. 1998, c. 1)**	***Canada Business Corporations Act*, R.S.C., 1985, c. C-44**
Preamble	Yes	No
Parts	24	21
Sections	386	253
Unique Parts to Each Act:	Part 5 - Membership, Part 6 - Corporate Governance, Part 8 - Capital Structure, Part 20 – Additional Provisions Respecting Non-profit Housing Cooperatives, Part 21 – Additional Provisions Respecting Worker Cooperatives, Part 23 – Continuance, Part 24 – Consequential Amendments, Repeal and Coming into Force	Part VI – Sale of Constrained Shares, Part XIV.1 Disclosure Relating to Diversity (Comply or explain provision), Part XVI – Going-private Transactions and Squeeze-out Transactions
Common Parts:	Part 1 – Interpretation and Application, Part 2 – Incorporation, Structure and Organization, Part 3 – Capacity and Powers, Part 4 – Registered Office and Records, Part 7 – Directors and Officers, Part 9 – Proxies, Part 10 – Insider Trading, Part 11 – Compulsory Acquisition, Part 12 – Security Certificates, Registers and Transfers, Part 13 – Financial Disclosure, Part 14 – Trust Indentures, Part 15 – Receivers, Receiver-managers and Sequestrators, Part 16 – Fundamental Changes, Part 17 – Liquidation and Dissolution, Part 18 – Investigations, Part 18.1 - Apportioning Award of Damages, Part 19 – Remedies, Offences and Punishment, Part 21.1 – Documents in Electronic or Other Form, Part 22 – General	Part I – Interpretation and Application, Part II – Incorporation, Part III – Capacity and Powers, Part IV – Registered Office and Records, Part V – Corporate Finance, Part VII – Security Certificates, Registers and Transfers, Part VIII – Trust Indentures, Part IX – Receivers, Receiver-managers and Sequestrators, Part X – Directors and Officers, Part XI – Insider Trading, Part XII – Shareholders, Part XIII – Proxies, Part XIV - Financial Disclosure, Part XV – Fundamental Changes, Part XVII Compulsory and Compelled Acquisitions, Part XVII – Liquidation and Dissolution, Part XIX – Investigation, Part XIX.1 Apportioning Award of Damages, Part XX – Remedies, Offences and Punishment, Part XX.1 Documents in Electronic or Other Form, Part XXI – General

Appendix B: The Definition of Financial Services in the *Income Tax Act*

financial service means

(a) the exchange, payment, issue, receipt or transfer of money, whether effected by the exchange of currency, by crediting or debiting accounts or otherwise,

(b) the operation or maintenance of a savings, chequing, deposit, loan, charge or other account,

(c) the lending or borrowing of a financial instrument,

(d) the issue, granting, allotment, acceptance, endorsement, renewal, processing, variation, transfer of ownership or repayment of a financial instrument,

(e) the provision, variation, release or receipt of a guarantee, an acceptance or an indemnity in respect of a financial instrument,

(f) the payment or receipt of money as dividends (other than patronage dividends), interest, principal, benefits or any similar payment or receipt of money in respect of a financial instrument,

(f.1) the payment or receipt of an amount in full or partial satisfaction of a claim arising under an insurance policy,

(g) the making of any advance, the granting of any credit or the lending of money,

(h) the underwriting of a financial instrument,

(i) any service provided pursuant to the terms and conditions of any agreement relating to payments of amounts for which a credit card voucher or charge card voucher has been issued,

(j) the service of investigating and recommending the compensation in satisfaction of a claim where

(i) the claim is made under a marine insurance policy, or

(ii) the claim is made under an insurance policy that is not in the nature of accident and sickness or life insurance and

(A) the service is supplied by an insurer or by a person who is licensed under the laws of a province to provide such a service, or

(B) the service is supplied to an insurer or a group of insurers by a person who would be required to be so licensed but for the fact that the person is relieved from that requirement under the laws of a province,

(j.1) the service of providing an insurer or a person who supplies a service referred to in paragraph (j) with an appraisal of the damage caused to property, or in the case of a loss of property, the value of the property, where the supplier of the appraisal inspects the property, or in the case of a loss of the property, the last-known place where the property was situated before the loss,

(k) any supply deemed by subsection 150(1) or section 158 to be a supply of a financial service,

(l) the agreeing to provide, or the arranging for, a service that is

(i) referred to in any of paragraphs (a) to (i), and

(ii) not referred to in any of paragraphs (n) to (t), or

(m) a prescribed service,

but does not include

(n) the payment or receipt of money as consideration for the supply of property other

than a financial instrument or of a service other than a financial service,

(o) the payment or receipt of money in settlement of a claim (other than a claim under an insurance policy) under a warranty, guarantee or similar arrangement in respect of property other than a financial instrument or a service other than a financial service,

(p) the service of providing advice, other than a service included in this definition because of paragraph (j) or (j.1),

(q) the provision, to an investment plan (as defined in subsection 149(5)) or any corporation, partnership or trust whose principal activity is the investing of funds, of

> **(i)** a management or administrative service, or
>
> **(ii)** any other service (other than a prescribed service),
>
> if the supplier is a person who provides management or administrative services to the investment plan, corporation, partnership or trust,

(q.1) an asset management service,

(r) a professional service provided by an accountant, actuary, lawyer or notary in the course of a professional practice,

(r.1) the arranging for the transfer of ownership of shares of a co-operative housing corporation,

(r.2) a debt collection service, rendered under an agreement between a person agreeing to provide, or arranging for, the service and a particular person other than the debtor, in respect of all or part of a debt, including a service of attempting to collect, arranging for the collection of, negotiating the payment of, or realizing or attempting to realize on any security given for, the debt, but does not include a service that consists solely of accepting from a person (other than the particular person) a payment of all or part of an account unless

> **(i)** under the terms of the agreement the person rendering the service may attempt to collect all or part of the account or may realize or attempt to realize on any security given for the account, or
>
> **(ii)** the principal business of the person rendering the service is the collection of debt,

(r.3) a service (other than a prescribed service) of managing credit that is in respect of credit cards, charge cards, credit accounts, charge accounts, loan accounts or accounts in respect of any advance and is provided to a person granting, or potentially granting, credit in respect of those cards or accounts, including a service provided to the person of

> **(i)** checking, evaluating or authorizing credit,
>
> **(ii)** making decisions on behalf of the person in relation to a grant, or an application for a grant, of credit,
>
> **(iii)** creating or maintaining records for the person in relation to a grant, or an application for a grant, of credit or in relation to the cards or accounts, or
>
> **(iv)** monitoring another person's payment record or dealing with payments made, or to be made, by the other person,

(r.4) a service (other than a prescribed service) that is preparatory to the provision or the potential provision of a service referred to in any of paragraphs (a) to (i) and (l), or that is provided in conjunction with a service referred to in any of those paragraphs, and that is

> **(i)** a service of collecting, collating or providing information, or

(ii) a market research, product design, document preparation, document processing, customer assistance, promotional or advertising service or a similar service,

(r.5) property (other than a financial instrument or prescribed property) that is delivered or made available to a person in conjunction with the rendering by the person of a service referred to in any of paragraphs (a) to (i) and (l),

(r.6) a service (other than a prescribed service) that is supplied by a *payment card network operator* in respect of a *payment card network* (as those terms are defined in section 3 of the *Payment Card Networks Act*) where the supply includes the provision of

(i) a service in respect of the authorization of a transaction in respect of money, an account, a credit card voucher, a charge card voucher or a financial instrument,

(ii) a clearing or settlement service in respect of money, an account, a credit card voucher, a charge card voucher or a financial instrument, or

(iii) a service rendered in conjunction with a service referred to in subparagraph (i) or (ii),

(s) any service the supply of which is deemed under this Part to be a taxable supply, or

(t) a prescribed service; (*service financier*)

ABOUT THE CANADIAN CENTRE FOR THE STUDY OF CO-OPERATIVES

The Canadian Centre for the Study of Co-operatives (CCSC) is an interdisciplinary research and teaching centre located on the University of Saskatchewan campus. Established in 1984, the CCSC is supported financially by major co-operatives and credit unions from across Canada and the University of Saskatchewan (USask). Our goal is to provide practitioners and policymakers with information and conceptual tools to understand co-operatives and to develop them as solutions to the complex challenges facing communities worldwide. We are formally affiliated with the Johnson Shoyama Graduate School of Public Policy at the University of Saskatchewan and the University of Regina. The connection strengthens the capacity of everyone involved to develop research and new course offerings dedicated to solving social and economic problems. Our most recent collaborative work has resulted in a new Graduate Certificate in the Social Economy, Co-operatives, and Nonprofit Sector.

OUR FUNDERS

The CCSC and USask acknowledge with gratitude the support and commitment of our funders. These organizations provide the CCSC with resources and leadership, helping us to develop the knowledge needed to construct co-operative solutions to the increasingly complex challenges facing global communities. Since the CCSC opened its doors in 1984, our co-op and credit union sector partners have contributed nearly $12 million to co-operative teaching, research, and outreach.

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