

TACKLING THE LAW, TOGETHER:

A Legal Guide to Worker Cooperatives Generally and in Massachusetts

A Project of the Community Enterprise Project of the Harvard Transactional Law Clinics,
in Partnership with Boston Center for Community Ownership and
Lydia Edwards, Attorney at Greater Boston Legal Services and
Fellow at the Sustainable Economies Law Center

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SECTION 1: INTRODUCTION

This document provides an extensive overview of the many areas of law that impact the creation, maintenance, and success of worker cooperatives. The document is intended for use by worker cooperatives, people who support worker cooperatives, and those interested in the worker cooperative movement more generally.

While the relevant state laws discussed in this document are focused on Massachusetts law, worker cooperatives in other states will likely find much of the content to be helpful to their efforts, as well. However, if you wish to start or maintain a cooperative in another state, we recommend that you consult an attorney in your state who is knowledgeable about worker cooperatives, as there are likely state-specific considerations of which you should be aware. Of course, because the specifics of your situation and circumstances will affect how the law applies to you, because laws are constantly changing, and because it would be impossible for this document to comprehensively address all of the legal issues that you may encounter, you should consult a lawyer no matter where you live. In other words, this document does not constitute legal advice and is not meant to replace an attorney.

SECTION 2: COOPERATIVES AND SPECIAL LAWS

A. What is a Cooperative?

The answer to this question depends upon who you ask. One definition is that a cooperative is a “user-owned, user-controlled business that distributes benefits on the basis of use.”¹ Another definition, developed by the International Co-operative Alliance (ICA), describes a cooperative as “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.”² A business is considered a cooperative for purposes of taking advantage of special tax rules under Subchapter T of the Internal Revenue Code (IRC)³ if it complies with these three basic requirements: (1) affords democratic control by the members; (2) vests in and allocates among the members all net profits; and (3) promotes subordination of capital (i.e., power and control are not allocated based on the amount of capital invested).⁴

While there is no one definition of a cooperative, cooperatives around the world generally follow the core principles adopted by the ICA in 1995, which were derived from a weavers cooperative in Rochdale, England in the mid-1800's.⁵ Of course, cooperatives existed long before then; early civilizations used cooperative living practices to fulfill basic human needs for food, water, and shelter.

7 Cooperative Principles

The seven cooperative principles are the standards by which cooperative businesses commit to operate.

Principle #1: Voluntary and Open Membership

Cooperatives are voluntary organizations, open to all people able to use its services and willing to accept the responsibilities of membership, without gender, social, racial, political, or religious discrimination.

Principle #2: Democratic Member Control

Cooperatives are democratic organizations controlled by their members who actively participate in setting policies and making decisions.

Principle #3: Member's Economic Participation

Members contribute equally to, and democratically control, the capital of the cooperative. This benefits members in proportion to the business they conduct with the cooperative rather than in proportion to the capital invested.

Principle #4: Autonomy and Independence

Cooperatives are autonomous, self-help organizations controlled by their members. If the co-op enters into agreements with other organizations or raises capital from external sources, it is done so based on terms that ensure democratic control by the members and maintains the cooperative's autonomy.

Principle #5: Education, Training, and Information

Cooperatives provide education and training for members, elected representatives, managers, and employees so that they can contribute effectively to the development of their cooperative. Members also inform the general public about the nature and benefits of cooperatives.

Principle #6: Cooperation among Cooperatives

Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional, and international structures.

Principle #7: Concern for Community

While focusing on member needs, cooperatives work for the sustainable development of communities through policies and programs accepted by the members.⁶

B. Common Types of Cooperatives

i. Producer Cooperatives

A producer cooperative, also sometimes called a “supplier cooperative” or a “marketing cooperative,” is one that is owned and operated by producers of a tangible product. Producer cooperatives are a way for individual producers to work together to negotiate contracts and access larger markets for their wares. Sometimes processing of the product is handled by the cooperative, which can reduce costs and thereby increase profit margins for the members.⁷ Profits are returned to the producers in proportion to the value of the products they sell to the cooperative. A popular example of a producer cooperative is an agricultural cooperative, such as Ocean Spray Cooperative, which is a global producer cooperative with 700 grower-owners and 2,000 employees.⁸

ii. Consumer Cooperatives

A consumer cooperative is a cooperative business owned by its consumers. Consumers democratically control the operation of the cooperative, and profits earned by the cooperative are returned to the consumers in proportion to the dollars spent on products purchased through the cooperative.⁹ An example of a local consumer cooperative is Harvest Co-Op Market, a supermarket with two locations in the Greater Boston area.¹⁰ Housing cooperatives are another form of consumer cooperative.¹¹

iii. Worker Cooperatives

In this document, we focus on worker cooperatives. Also sometimes called “employee cooperatives,” worker cooperatives are businesses owned and controlled by the people who contribute their labor to the business (typically called “members” or “worker-owners”). Profits are returned to workers in proportion to the hours they work or the value they contribute to the business. Because only members have voting rights, control of the cooperative stays within the workforce.¹² An example of a local worker cooperative is CERO, a zero-waste management company in Dorchester, Massachusetts.¹³

iv. Hybrid Cooperatives

A hybrid cooperative, sometimes called a multi-stakeholder cooperative, is an entity that combines two or more types of cooperatives. The most common type of hybrid cooperative is a combination of a worker cooperative and a consumer cooperative, in which the voting power and the profits are divided between the workers and the consumers.¹⁴ A couple of examples of hybrid cooperatives are Fedco Seeds, a seed and garden supply company that is 60 percent owned by

consumers and 40 percent owned by workers,¹⁵ and the Dorchester Community Food Co-op, which is a community and worker-owned cooperative food market currently under construction.¹⁶

C. Laws Governing Cooperatives in Massachusetts

When a new business is created, it often creates a legal entity. The laws governing business organizations operate at the state level, and Massachusetts offers three statutory options that specifically relate to forming cooperatives:

- Mass. Gen. Laws ch. 157: Cooperative Corporations;
- Mass. Gen. Laws ch. 157A: Employee Cooperative Corporations; and
- Mass. Gen. Laws ch. 157B: Cooperative Housing Corporations.¹⁷

Note that while Massachusetts provides these options specifically for cooperatives, a Massachusetts cooperative may also choose to organize as another type of legal entity, as detailed in **SECTION 3: LEGALLY FORMING YOUR COOPERATIVE**.

i. Cooperative Corporation: Mass. Gen. Laws ch. 157

Chapter 157 of the Massachusetts General Laws was the original cooperative statute in Massachusetts.¹⁸ In addition to the requirements that must be met by all Massachusetts corporations (as detailed in **SECTION 3: LEGALLY FORMING YOUR COOPERATIVE**), a Massachusetts cooperative corporation formed under Chapter 157 must follow a unique set of rules, some of which are very technical.

First, a shareholder of a cooperative corporation may not own more than \$1,000 in shares nor have more than one vote on any subject matter affecting the business.¹⁹ Second, a Massachusetts cooperative formed under chapter 157 must have the word “co-operative” in its name.²⁰ Massachusetts actually penalizes for-profit businesses that use the word “co-operative” in their names without following the rules regarding the apportionment of earnings requirements that are summarized below (excluding employee cooperative corporations).²¹

Third, a Massachusetts cooperative corporation must distribute profits to its shareholders at least once a year.²² It must also maintain a “sinking fund,” which is a reserve that the cooperative corporation is required to have for emergency purposes.²³ The sinking fund must include an amount of money that equates to at least 30% of the value of all stock that has been issued by the cooperative corporation. If the fund contains less than this amount, the cooperative may not distribute profits to its members without first contributing at least 10% of the net profits to the fund.²⁴

Last, a cooperative corporation must distribute its annual profits according to the “apportionment of earnings” rule of Chapter 157:

- First, the company may need to set aside a portion of its profits in the “sinking fund,” as described above;
- Second, the company may (but is not required to) pay dividends to its shareholders;
- Third, the company may (but is not required to) devote a maximum of 5% of its remaining annual profits to “teaching co-operation” (such as holding workshops for members or prospective members on conducting business cooperatively, for example); and
- Finally, the corporation shall distribute its remaining annual profits through “patronage dividends” (which are detailed in **SECTION 6: TAX LAW**).²⁵

Because Massachusetts has an additional statute that is specifically intended for use by worker cooperatives (discussed below), this Chapter 157 statute is typically used to form other types of cooperatives, such as those detailed in **Section 2.B: Common Types of Cooperatives**.

ii. Employee Cooperative Corporation: Mass. Gen. Laws ch. 157A

Though Massachusetts worker cooperatives can be formed under a number of different legal structures (as are discussed in **SECTION 3: LEGALLY FORMING YOUR COOPERATIVE**), worker cooperatives may elect to be governed by chapter 157A.²⁶

First, to elect to be governed as a Massachusetts employee cooperative corporation, the worker cooperative must state in its governing documents that chapter 157A governs the legal entity.²⁷ A worker cooperative governed under Chapter 157A may (but is not required to) include the words “cooperative” or “co-op” in its corporate name.²⁸ The articles of organization or the by-laws of the worker cooperative must include certain information about how the worker cooperative will function, including: (1) qualifications and methods of accepting and terminating members,²⁹ and (2) how often and in what manner net earnings or losses will be apportioned and distributed.³⁰

The worker cooperative must issue a class of voting stock called “membership shares.”³¹ Membership shares must only be issued to members of the worker cooperative and issued for a fee as determined by the directors of the worker cooperative.³² Generally speaking, all voting power is held by the owners of the membership shares, who are known as the “members” or the “worker-owners” of the cooperative.³³

If a worker cooperative no longer wishes to be governed as an employee cooperative corporation, the cooperative may revoke this election through a two-thirds vote of its members

and evidence the change by filing articles of amendment with the Secretary of the Commonwealth.³⁴ The articles of amendment must detail the process of converting membership shares and internal capital accounts (as further discussed in **SECTION 9: WORKER CAPITALIZATION**).³⁵ A worker cooperative cannot consolidate or merge with a non-worker cooperative business unless it has revoked its employee cooperative corporation status through the process outlined above.³⁶

SECTION 3: LEGALLY FORMING YOUR COOPERATIVE

The law does not require business owners to form—i.e., incorporate—a legal entity in order to engage in business.³⁷ When businesses remain unincorporated, the law views the owners of the business as partners in a general partnership.³⁸ The main advantages of running a business as a general partnership are that doing so does not require any formation documents or costs and all of the profits and authority are automatically designated to the owners.³⁹ The downside of running a business as a general partnership is that each owner of the business is personally responsible for 100% of the partnership’s debts and obligations; insurance may be used to offset some of this risk.

Once a business is formed as a legal entity, the assets, debts, and obligations of the business are legally separated from the owners, so long as the owners of the business keep all records and finances separate from those of the owners and otherwise comply with all corporate governance requirements imposed by state law. If, for example, the business enters into a contract and is unable to fulfill its obligations, the harmed party can only sue the business rather than the individual owners, thus keeping the personal assets of the owners shielded from the lawsuit. This separation of assets and risk is known as “limited liability.”⁴⁰

Massachusetts worker cooperatives can—and do—form under a variety of legal business structures. Cooperatives that choose to form a legal entity must choose one statute under which to form, though they may choose to build into their organization some aspects from other structures.⁴¹ The following types of entities are the most common options for worker cooperatives in Massachusetts.⁴² However, because the type of legal entity you choose will impact the ways in which various areas of law apply to your business, choosing a legal entity is an important decision which should be made only after careful consideration of all of the available options and, ideally, after consulting with a lawyer.

A. Common Legal Structures for Massachusetts Worker Cooperatives

i. Corporation

Corporations, often referred to as “C-corporations” in their default state, are business entities that are separate legal entities from their owners, who are known as shareholders. These shareholders may own different classes of stock with different rights assigned to each class.⁴³ Corporations are managed by a board of directors who are typically elected by the shareholders. The board of directors then appoints officers (in Massachusetts, this consists of at least a President, Treasurer, and Secretary⁴⁴) who manage the corporation’s day-to-day operations. Officers of a corporation are usually treated as employees under tax and employment laws, including for minimum wage requirements.⁴⁵

In order to maintain the limited liability afforded by the separate legal entity, corporations must observe certain corporate formalities that are not required of some other entities, such as holding annual board meetings and keeping detailed records of all corporate activities.⁴⁶ One benefit of choosing to form a corporation is the ease of issuing shares of ownership, especially for those organizations that plan to seek outside investment; but for some organizations, the rigid corporate structure may impede the flexibility of the business. Corporations are required to adopt by-laws, which, in addition to the articles of organization, govern how the corporation is to be managed. Unlike articles of organization, by-laws are not filed with the state.

A Note about S-corporations: Contrary to popular belief, an S-corporation is not actually a legal structure, but instead is a corporation that elects to be taxed under Subchapter S by filing Form 2553 with the Internal Revenue Service (IRS).⁴⁷ We are not discussing Subchapter S because it is not a tax structure typically chosen by worker cooperatives for reasons too technical to be discussed in this document, though owners of S-corporations, as well as other legal entities, may choose to build certain cooperative principles into their businesses without forming worker cooperatives.⁴⁸

ii. Benefit Corporation

Benefit corporations are corporations in which the directors and officers of the business are “expressly permitted to consider and prioritize the social and environmental impacts of their corporate decision-making” over maximizing financial return to investors.⁴⁹ Benefit corporations are corporations that have elected in their articles of organization to be governed under Mass. Gen. Laws ch. 156E.⁵⁰ In addition to the annual reports and other corporate maintenance requirements of a corporation, a benefit corporation must comply with additional corporate

formalities, including preparing and submitting to the Secretary of the Commonwealth an annual benefits report and designating a “benefits director” to oversee the corporation’s public benefit goals.⁵¹ The corporation may (but is not required to) designate one of its officers as a “benefit officer.”⁵² A benefit corporation should not be confused with “B Corps,” which is not a type of legal structure, but rather a third-party certification that a company has met rigorous “standards of verified, overall social and environmental performance, public transparency, and legal accountability.”⁵³ A business formed under any structure may qualify for a B Corps certification; likewise, forming as a benefit corporation does not guarantee that a business will satisfy B Corps standards.

iii. Cooperative Corporation

As earlier discussed in **SECTION 2: COOPERATIVES AND SPECIAL LAWS**, Massachusetts has a special type of legal entity for worker cooperatives: an employee cooperative corporation. Electing to be an employee cooperative corporation governed under Mass. Gen. Laws ch. 157A requires the cooperative to state in its articles of organization that it has chosen to be governed under the statute.⁵⁴ Like a C-corporation, cooperative corporations can create different classes of stock with different rights and responsibilities.⁵⁵ However, in a cooperative corporation, no shareholder can have more than one vote in the cooperative’s operation, regardless of the number of shares they own.⁵⁶ See **SECTION 2: COOPERATIVES AND SPECIAL LAWS** for more information.

iv. Limited Liability Company (LLC)

An LLC is a business entity that provides the advantage of limited liability to its owners (often called “members,” even if the entity is not organized as a worker cooperative), but has the flexibility to be set up and managed in many configurations. Management of an LLC may be conducted by all or any portion of the members or by individuals who have been designated as managers but who are not members. All of the members and managers of an LLC will have limited liability unless the business agrees otherwise. Although not legally required, it is recommended that LLCs adopt an operating agreement, which functions much like the by-laws of a corporation. Given the complexity of a cooperative’s internal operations—including the need to specify how profits are allocated and how the cooperative’s internal capital accounts will be managed, for example—worker cooperatives operating as LLCs are encouraged to adopt an operating agreement memorializing this information as well as other important governance decisions.

A Note about Nonprofit Organizations: A nonprofit organization cannot be a worker cooperative in the truest sense of the term, since it is not a for-profit business from which profits are shared by the worker-owners. However, some nonprofit organizations choose to infuse democratic management practices and cooperative principles into the governing documents of the organization.⁵⁷ Likewise, nonprofit corporations can serve as important allies of worker cooperatives, by providing technical assistance to worker cooperatives, serving as fiscal sponsors for grant funding, or acting as incubators for cooperatives in their nascent stages.⁵⁸ Many organizations that form as nonprofit corporations at the state level are also 501(c)(3) tax-exempt organizations with the IRS, which means they are formed for religious, charitable, scientific, literary, or educational purposes; they are eligible for federal and state tax exemptions for any income related to their public purpose; and donations made to the organization are tax-deductible for the donors.⁵⁹ Nonprofit organizations that do not have tax-exempt status are treated as for-profit corporations for tax purposes and are therefore subject to income tax and the Massachusetts corporate excise tax.⁶⁰ Like for-profit corporations, nonprofit organizations are required to have a board of directors and officers, though nonprofit organizations do not have owners; any money that is brought into the entity must be used to further its public purpose and cannot be used to privately benefit any individuals. Massachusetts nonprofit organizations are also subject to the oversight of the Attorney General's office, which requires its own set of compliance procedures.⁶¹

B. Legal Structures and Tax Elections

It is important to keep in mind that the legal structure of a business is distinct from its tax structure. For example, a corporation⁶² does not have to be taxed under Subchapter C of the IRC⁶³; instead, it can choose to be taxed much like a partnership if it elects to be taxed under Subchapter S.⁶⁴ Similarly, an LLC can elect to be taxed as a partnership (under Subchapter K),⁶⁵ as a C-corporation (under Subchapter C),⁶⁶ or as a cooperative corporation (under Subchapter T).⁶⁷ Electing a tax structure is an important decision for a worker cooperative and should be undertaken with the advice of a tax professional who is well-versed in this area of law, especially as it applies to worker cooperatives. For more information on the tax treatment of worker cooperatives under Subchapter T, please see **SECTION 6: TAX LAW**.

C. Steps to Forming a Business

- *Create a Business Plan*

Though it is not a legal requirement, most businesses find it helpful to create a business plan, as it is a chance for the owners to think through the purpose of the business, plan for organizing and managing the business, contemplate financial projections, and explore financing options. In addition, many banks and lenders will request to see a business plan before offering their services to a business. The earlier the business thinks through these issues, the better prepared it will be to handle ongoing operations.

- *Choose a Name and Check for Availability*

From a practical perspective, a business should choose a name that is distinct and evocative of the intent of the business. From a legal perspective, the law prevents businesses from using names that are confusingly similar to existing business names in a similar industry.⁶⁸ More specifically, you cannot form a business in Massachusetts using a name that is already used by another legal entity that has filed with the Secretary of the Commonwealth.⁶⁹ Similarly, if you are operating your worker cooperative as a general partnership (meaning, you have not formed a legal entity⁷⁰) and are conducting business under a name that is not your personal name, you must file a business certificate in the city in which you are operating business (sometimes referred to as a “Doing Business As” certificate), and the city will likely prevent you from using the same name used by another business that has applied for a business certificate in that city.⁷¹

- *Choose a Legal Structure*

The legal structure of the worker cooperative will impact how it is treated by other areas of law, including employment law, immigration law, and tax law, and so should be chosen with these myriad of considerations in mind. The type of legal structure you choose will also determine the forms you will need to file with the Secretary of the Commonwealth, as well as the other documents that will need to be drafted and kept with the business’s records.⁷² Because it is such an important decision and is predicated upon a number of technical considerations, choosing a business structure should be undertaken with the assistance of a lawyer who is knowledgeable about worker cooperatives.

- *Adopt Governing Documents*

Governing documents are not filed with the Secretary of the Commonwealth, but are instead kept with the business records and are used for the internal governance of the business. Corporations (including employee cooperative corporations) utilize a governing document commonly referred to as by-laws, while LLCs (even those organized as worker cooperatives) utilize a governing document typically referred to as an operating agreement. Please note that unlike by-laws, which are required, operating agreements are not required by law, though they are highly

recommended. Your governing document will be the blueprint for operating your business and will also serve as evidence to the IRS that you are operating on a cooperative basis. The governing document can provide the requirements for written notices of allocation and outline the way patronage dividends will be distributed among the worker-owners, among other decision-making processes. For more information on the IRS requirements, please see **SECTION 6: TAX LAW**.

- *Obtain Zoning Clearances, Licenses, and Permits*

Businesses must be sure that the location from which they are operating their business is zoned for their intended use, and businesses operating in certain industries may be required to obtain various licenses and permits from Massachusetts and applicable cities before beginning operation. Massachusetts and the cities within it maintain different requirements for what a business needs to operate; these requirements are largely dependent upon the specific types of activities in which the business is engaged. In the City of Boston, for example, there are varying licensing requirements for restaurants, depending on whether the restaurant will have outdoor seating, whether the restaurant will serve alcohol, and whether the license application pertains to an address that currently has a restaurant approved by the City's Licensing Board.⁷³

- *Obtain an Employer Identification Number (EIN) from the IRS*

With very few exceptions,⁷⁴ businesses must obtain an EIN from the IRS for federal tax purposes. You will also use your business's EIN to open a bank account, apply for a credit card, and apply for certain permits or licenses for your business. For more information on EINs, see **SECTION 6: TAX LAW**.

- *Register with the Massachusetts Department of Revenue, if Needed*

If you plan to hire employees or sell items in Massachusetts, your business must register with the Massachusetts Department of Revenue via MassTaxConnect.⁷⁵ This is the system through which businesses report and pay taxes to the state.

- *Obtain General Liability Insurance*

Even if the owners of your business are protected by the limited liability of a legal entity, it may still be a good idea to purchase general liability insurance for your business. While the limited liability of the entity protects your personal assets, an insurance policy can help protect the assets of the business.

SECTION 4: EMPLOYMENT LAW

A primary goal of worker cooperatives is to give the worker-owners control over the activities and profits of the business. However, most of the labor and employment laws that exist at the state and federal level are intended to protect workers who lack control over their livelihoods.⁷⁶ The definition of an employee under the Fair Labor Standards Act⁷⁷ is so broad that “we almost have to start with an assumption that all working people are employees and work backward from there” to prove they are not employees and thus are not subject to employment laws.⁷⁸ For purposes of our discussion, the people who work for or with a business can be divided into four general categories: owners, employees, independent contractors, and interns.⁷⁹

Penalties for misclassification of workers are stringent, particularly in Massachusetts. If a business misclassifies an employee and fails to comply with employment laws, such as minimum wage or workers’ compensation laws, the penalties can include criminal liability for the business owners.⁸⁰ If a business does not comply with minimum wage laws (because, for example, it incorrectly treats a worker as an unpaid intern rather than as an employee), an employee who prevails in a civil suit against that business can be awarded triple the amount that they should have been paid, plus litigation fees.⁸¹

A. Who is a Worker-Owner?

Generally speaking, an owner is a person who has the legal right to possess, use, and convey a piece of property. Since a company is property, a person who invests money in a company in exchange for shares is an owner.

A worker-owner is a specific type of owner in the cooperative context. Worker-owners both work for and own the cooperative. They own the business because they put money into the business, get paid out of the money that the business makes, and make decisions regarding how to run the business. They typically make an initial investment in the business to become worker-owners. At the end of each year, worker-owners receive a portion of the net profits earned by the cooperative, which is distributed to the worker-owners based on hours worked or according to other criteria set by the worker-owners (commonly referred to as “patronage,” which is detailed in **SECTION 6: TAX LAW**).⁸² In a cooperative, governance-level decisions are made democratically by the worker-owners rather than by one person or one group of managers or owners in a stratified system of power, though the cooperative can still have a hierarchical management structure if it so chooses.⁸³

Sometimes, however, cooperatives may have owners that are not worker-owners. Outside investors are permitted to own shares in worker cooperatives so long as the outside owners

adhere to the subordination of capital rule, which requires that the cooperative be controlled by its members rather than by nonmember investors.⁸⁴

Legally speaking, and specifically for the purposes of employment law, the worker-owner in a worker cooperative is treated as either an employee or a partner.⁸⁵ Whether or not a worker-owner is considered a partner under employment law, and therefore exempt from certain employment law requirements, will depend on a number of factors related to the worker-owner's ownership of and control over the cooperative, including the level of oversight of her work, her ability to influence the operations of the business, and whether she shares in the profits and losses of the business, among others.⁸⁶ For more information about these factors, please see **Section 5.B: Undocumented Immigrants and the Worker Cooperative**. For more information about the distinction between employees and partners for purposes of employment law more generally, please see Co-opLaw.org, "Employment Law," available at <http://www.co-oplaw.org/topics-2/employment-law/>.

B. Who is an Employee?

The definition of "employee" varies across the numerous areas of federal and state law in which that term is relevant, which is why, for example, the same person could be considered an employee under tax law but not under workers' compensation law. Oftentimes, the determination of whether someone is an employee for the purposes of a specific area of law comes from interpretation of that law as applied to a particular fact pattern in a court case, since the language of the statute is often vague. For example, the definition of "employee" for purposes of the Massachusetts Wage Act is, in relevant part, "any person employed for hire by an employer in any lawful employment."⁸⁷ The type of legal entity formed by the cooperative is not determinative of whether or not the worker-owners will be considered employees for employment law purposes, though the hierarchical structure of some cooperative corporations (such as corporations where not all worker-owners are board members) may lend itself to a finding that some of the workers are employees rather than partners, as certain worker-owners have less control over the business than others.⁸⁸ Because businesses with employees must comply with a number of requirements on behalf of their employees, including paying minimum wage and overtime and verifying eligibility to work in the U.S., among others, understanding when and why a person might be considered an employee under the various laws and how these determinations will affect that person's ability to own and operate a business is very important.

i. "Employee" Under Massachusetts Workers' Compensation Law

The workers' compensation section of the Massachusetts General Laws states that the definition of an employee includes "every person in the service of another under any contract of hire, express or implied, oral or written."⁸⁹ This definition is important to worker-owners because it

determines which members of the cooperative are eligible to receive workers' compensation benefits (in the event of an accident on the job) under Massachusetts law, and it is important to cooperatives because those cooperatives defined as employers will be required to pay workers compensation benefits for its members.

ii. “Employee” Under Massachusetts Unemployment Insurance Law

For purposes of deciding who is an employee covered by unemployment laws in Massachusetts,⁹⁰ the state uses a three-part test under which any individual performing services will be presumed to be an employee unless the employer can prove all three of the following factors: (1) the worker “has been and continues to be free from control and direction in connection with the performance of [the] services, both under his contract for performance of service and in fact;” (2) the work “is performed either outside the usual course of business for which the service is performed or outside all of the places of business of the enterprise for which the service is performed;” and (3) the worker “is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed.”⁹¹ Failure to withhold federal or state income taxes or to pay workers' compensation premiums with respect to a worker's wages does not determine whether or not that worker is an employee under unemployment insurance law.⁹² This test is mainly used when determining who constitutes an independent contractor⁹³ versus an employee. This definition is important to worker cooperatives because it determines if the cooperative is required to pay unemployment taxes and determines which members of the cooperative are eligible to receive unemployment benefits (in the event of a reduction in workforce for economic reasons, for example) under Massachusetts law.

iii. “Employee” Under Tax Laws

For the purposes of federal tax law, an employee is anyone who performs services for someone else who has the right to control how and what work that will be done.⁹⁴ For purposes of state tax law, the Massachusetts General Laws defer to the IRS for its definition of the term “employee.”⁹⁵ These definitions are important to worker cooperatives because, if the worker cooperative is considered an employer, it will be responsible for withholding the income tax on wages paid to its employees.

C. Who is an Independent Contractor?

In Massachusetts, the wage and hour laws presume that workers are employees; as a result, it is difficult for a worker to qualify as an independent contractor. For example, even a mutual agreement between the employer and the worker to treat the worker as an independent contractor

is not enough to overcome this presumption.⁹⁶ Generally speaking, a worker is an independent contractor, and not an employee, if the employer lacks a certain level of control over the work completed by the worker. Typically, an independent contractor:

- has control over how the task will be performed (the employer merely tells the worker what task to accomplish);
- has his own independent business in which he performs the service in question for many different employers;
- works for the business on a predetermined project;
- uses his own tools rather than tools provided by the employer; and
- performs a service for the employer that is outside the scope of what that employer's business normally does.

Failure to satisfy just one of these factors may result in a worker being classified as an employee under wage and hour laws.

An example of a typical independent contractor relationship is when a restaurant hires a construction company to fix the restaurant's roof. The construction workers use their own tools to fix the roof, determine how and during what hours they will fix the roof, and perform work (fixing a roof) that the restaurant does not normally do. The construction company fixes roofs for many different businesses and is itself an independent business. In this example, the construction company is an independent contractor of the restaurant.⁹⁷

A cooperative might be tempted to label employees as independent contractors in an attempt to sidestep employment law requirements,⁹⁸ but doing so could have adverse consequences for the cooperative.⁹⁹ If an employee sues, claiming he was misclassified, and prevails, the employer would be accountable for all past and continuing obligations associated with the correct classification. Worker-owners will likely never be considered independent contractors because of the requirement that the service be performed outside the usual course of the business of the employer.¹⁰⁰ When thinking about the employee/independent contractor distinction from an immigration law perspective, however, keep in mind that although employers are not required to file a Form I-9 for independent contractors, it is prohibited by federal law for businesses to contract with an independent contractor knowing that they are not authorized to work in the United States.¹⁰¹

D. Who are Volunteers and Interns?

Under federal law, for-profit companies cannot have volunteers.¹⁰² Though it is possible for nonprofit organizations to have volunteers (so long as the organization complies with the

requirements related to the classification of workers as volunteers¹⁰³), true worker cooperatives are for-profit entities, and therefore the laws related to volunteers are outside the scope of this document.

For-profit companies can have unpaid interns,¹⁰⁴ but the internship program must satisfy a strict 6-prong test¹⁰⁵ if the intern is not going to be paid. Massachusetts law is more stringent than federal law and requires that interns in the state be paid minimum wage unless they are under a training program in some type of charitable, educational, or religious institution.¹⁰⁶ Among other requirements, the federal test requires that the training for any such intern is similar to that given in an educational environment, that the intern does not do the work of a regular employee, and that the employer does not derive any immediate advantage from the intern's work.¹⁰⁷ The purpose of these laws is to ensure that the interns derive learning from their work and are not exploited for the benefit of the business.¹⁰⁸

E. Frequently Asked Questions

There are many gray areas of employment law with respect to how the laws apply to worker cooperatives. Below, we have included a list of questions that you may have with respect to workers within your own cooperative. While there might not be a definite answer to some of these questions, we have tried to include potential ways to deal with them.

How do worker cooperatives classify people for employment law purposes during the transitional period between working for the cooperative and becoming a worker-owner?

Because there is a strong presumption under employment law that all workers are employees, workers who are not currently owners of the worker cooperative and do not yet share in the decision-making responsibilities of the worker cooperative will likely be considered employees during this period of transition, and therefore the cooperative should be prepared to comply with the various protections afforded to employees during this time, as described in **Section 4.B: Who is an Employee?**. However, worker cooperatives that are considering bringing undocumented worker-owners into the cooperative must consider that undocumented workers cannot be employees for purposes of the I-9 requirement.¹⁰⁹ For more information related to undocumented worker-owners, please see **Section 5.B.ii: “Onboarding” of Undocumented, Prospective Worker-Owners**.

Do workers' compensation laws apply to owners in cooperatives? If someone is not an employee but is a worker-owner, how does workers' compensation work?

It depends. “[E]mployees must be covered by a valid workers’ compensation policy at all times.”¹¹⁰ According to the official Massachusetts website of the Executive Office of Labor and

Workforce Development, if the cooperative is an unincorporated business or formed as an LLC, it is not required to carry workers' compensation insurance for its worker-owners.¹¹¹ However, such worker-owners now have the option to purchase workers' compensation for themselves, if so desired.¹¹² To obtain coverage, the cooperative should contact an insurance broker to inquire about purchasing a policy. An officer or director of a corporation who owns at least 25% interest in the corporation may exempt himself from the requirements of the Workers' Compensation Act by filing a form with the Department of Industrial Accidents.¹¹³

Who is exempt from paying unemployment taxes, and, if a worker is not required to do so, can a worker-owner voluntarily pay into the system and receive benefits?

According to the Department of Unemployment Assistance (DUA), only sole proprietors, members of general partnerships, and single-member LLCs are exempt from paying unemployment taxes; in turn, the workers of these types of businesses are not eligible to receive unemployment benefits.¹¹⁴ These workers cannot elect to receive benefits by voluntarily paying into this system. Because sole proprietorships and single-member LLCs involve only one owner, in practice, a worker cooperative would only be exempt from paying unemployment taxes if the worker cooperative remains unincorporated and thus is considered a general partnership. The DUA only considers the legal structure of the business when determining whether a worker is eligible for benefits, so if the business is formed as anything else but a sole proprietorship, a general partnership, or a single-member LLC, it will be required to pay unemployment taxes.¹¹⁵

Many worker cooperatives are built to withstand work shortages or service slowdowns through reducing hourly compensation or hours worked, as needed. But if people must be let go and worker-owners are not eligible for unemployment benefits, a worker cooperative may want to consider maintaining an account within its retained earnings that is set aside for unemployment insurance-like benefits for such members. Another option would be for members to have the ability to take loans from their internal capital accounts that they can pay back at a fixed interest rate.

Who is exempt from paying into the Massachusetts Workforce Training Fund Program (WTFP), and, if a cooperative is not required to pay into it, can it choose to voluntarily pay into the system and receive benefits?

The WTFP provides resources to Massachusetts businesses to fund training for employees and is paid into by businesses as a surcharge to the unemployment tax. So, if a business is not eligible for unemployment benefits, it is not required to pay into the WTFP and is not eligible to benefit from that program. Also, like unemployment taxes, those not required to pay into the WTFP are not eligible for the benefits, and so they may not opt to do so.¹¹⁶

SECTION 5: IMMIGRATION LAW

A. Immigration Law Basics

People who reside in the U.S., but who are not U.S. citizens or nationals (“noncitizens”), can be divided into two groups: nonimmigrants and immigrants.¹¹⁷ “Nonimmigrants” are noncitizens who are admitted to be present in the United States on a temporary basis as a tourist, student, seasonal agricultural worker, professional worker, or in any of a number of other capacities.¹¹⁸ “Immigrants,” on the other hand, are further divided into two classes: lawful permanent residents and undocumented immigrants. Lawful permanent residents, or “green card” holders, may generally reside and be employed in the U.S. indefinitely; in general, noncitizens obtain this status (1) by having certain family members who are U.S. citizens or lawful permanent residents,¹¹⁹ (2) for employment-related reasons,¹²⁰ (3) by being the victim of criminal activity and helpful to law enforcement,¹²¹ (4) by being the victim of human trafficking,¹²² or (5) if granted asylum.¹²³

Undocumented immigrants are not legally permitted to be present or employed in the U.S.¹²⁴ Although it is not a crime for an undocumented immigrant to remain present in the U.S.,¹²⁵ it is a civil violation, and an undocumented immigrant can be placed in removal proceedings at any time.¹²⁶ Some undocumented immigrants can, however, obtain temporary or permanent relief from deportation under limited circumstances, such as through programs like Deferred Action for Childhood Arrivals (DACA) or through other forms of discretionary relief.¹²⁷

With very limited exceptions,¹²⁸ no employer, including a cooperative, may hire an undocumented immigrant for employment or continue to employ an undocumented immigrant if the employer is aware of the immigrant’s unlawful status.¹²⁹ If a cooperative does hire an undocumented worker, however, that worker will receive certain protections under workplace laws, including wage and hour and anti-discrimination laws.¹³⁰ As detailed below, federal immigration law does not expressly prohibit undocumented immigrants from working for a business that they own, such as a cooperative, so long as the worker-owner does not fall within immigration law’s definition of “employee.” Similarly, Massachusetts law does not expressly bar business ownership by undocumented immigrants. However, it is important to keep in mind that this area of law has not been settled, meaning there is no explicit statute or regulation on the issue, agreement among the federal circuit courts, or Supreme Court decision on the subject.

For More Information on Business Ownership by Undocumented Immigrants: Because of this document's focus on worker cooperatives, we address immigration law and issues surrounding undocumented immigrants through that lens. For a more detailed review of this area of law more generally, please consult a resource we prepared specifically regarding these issues, titled A Legal Overview of Business Ownership for Immigrant Entrepreneurs in Massachusetts, and located at:

<http://clinics.law.harvard.edu/tlc/files/2015/09/TLC-Immigrant-Entrepreneurs-Overview.pdf>.

B. Undocumented Immigrants and the Worker Cooperative

i. Undocumented Immigrants as Worker-Owners

As earlier discussed, federal law forbids businesses from hiring any employee who the business knows lacks authorization to be employed in the United States.¹³¹ The government enforces this restriction by requiring all employers to complete a form, called the Form I-9, for every person the business employs.¹³² Forms I-9 are not submitted to the government; instead, employers must keep the forms for a certain number of years so that government agents can inspect them upon demand.¹³³ On the Form I-9, the employee must provide certain information proving that the employee is authorized to be employed.¹³⁴ The falsification of this information, or the use of someone else's information, is a crime.¹³⁵ The employer, in turn, must affirm that the employer has examined the employee documentation, that the documentation appears genuine, and that the employer believes the employee to be authorized for the employment.¹³⁶ The person preparing the Form I-9 on behalf of the employer does not need to provide any information establishing that he has any particular immigration status.¹³⁷ Failure to comply with the Form I-9 requirements, or knowingly hiring undocumented workers for employment, puts the employer at risk for significant fines and penalties.¹³⁸

Independent contractors are not considered employees for purposes of the Form I-9, so employers who hire independent contractors do not have to complete a Form I-9 for their independent contractors.¹³⁹ However, it is still illegal to hire an independent contractor knowing that the worker is unauthorized to perform the work in the United States.¹⁴⁰

Recent decisions in the Office of the Chief Administrative Hearing Officer (OCAHO), an administrative court that handles cases related to the employment of undocumented workers, have determined that Forms I-9 do not need to be completed for owners of a business who also work for that business, such as worker-owners of a cooperative.¹⁴¹ For the purposes of the Form I-9, the court stated that a worker is an owner of a business, and not an employee, if he has a substantial ownership interest in the business and controls all or part of the business.¹⁴² A key

factor to this determination, according to these court decisions, is whether the worker wields a sufficient level of control over the business. The court considers many factors in determining whether a worker exercises a sufficient level of control. According to these court cases, a worker—such as a worker-owner of a cooperative—is less likely to be an employee, and therefore more likely to be exempt from the Form I-9 requirement as an owner, as more of the following factors are met:

- The worker is subject to minimal or no supervision.
- The worker does not report to a supervisor.
- The worker can influence the business's general operations and strategic direction.
- Other individuals involved in the business consider the worker to be an owner instead of an employee.
- The worker cannot easily be hired or fired by the business.
- The worker shares in business profits and losses.¹⁴³

A worker-owner of a cooperative must own at least part of the business—as a shareholder, partner, or the equivalent of a shareholder or partner (such as a member of an LLC)—in order to be considered an owner, though no court has determined whether a certain threshold percentage of ownership is required. The worker's official or unofficial title in the business is not determinative.¹⁴⁴ This means that, despite one's characterization as a “worker-owner” of a cooperative, he still could be classified as an employee under immigration law if, for example, many of the above factors are not met.

Also, a worker-owner of a cooperative can be exempt from the Form I-9 requirement as an owner, regardless of the legal structure of the cooperative (LLC, corporation, etc.), and a worker-owner's designation under state law or federal tax law as an owner, employee, or independent contractor is also not determinative of the question of whether the federal immigration laws consider the worker to be an owner.¹⁴⁵ However, note that in contrast to worker-owners in an LLC or in the various partnership models, a worker-owner of a cooperative formed as a corporation who is also an officer of the corporation is still considered to be an employee for the purposes of federal and state income taxation, which means that employment taxes for those owner-officers must be withheld at the entity level.¹⁴⁶

This exemption from the Form I-9 requirement for worker-owners is particularly promising for undocumented members of a worker cooperative, since they are by definition owners of the business. Note, however, the complication posed by the democratic control principle of cooperatives: since cooperative members have equal say on matters affecting the cooperative, the more members a cooperative has, the less likely any individual member can be said to exercise a sufficient level of control over the business. No court has assessed and resolved this issue.

Although the analysis of who must complete a Form I-9 is firmly established in the OCAHO courts, federal courts that have authority over OCAHO have never decided whether undocumented immigrants may own and work for a business in the United States. Moreover, the federal immigration enforcement authorities appear to believe that undocumented immigrants cannot do so, in apparent contrast with the OCAHO court decisions.¹⁴⁷ Accordingly, there remains a risk that an undocumented immigrant who owns a business could be asked to complete a Form I-9. Even if immigration enforcement authorities or OCAHO determine that an undocumented person does not need to complete a Form I-9, remember that this person could still face immigration proceedings if they have violated other immigration laws, such as overstaying a temporary visa¹⁴⁸ or unlawfully entering and remaining in the United States.¹⁴⁹ Consult a lawyer for the latest developments in this area of law.

ii. “Onboarding” of Undocumented Worker-Owners

A common practice among worker cooperatives is to institute a probationary period before officially extending an invitation to an individual to join the cooperative as a worker-owner. This probationary period gives the cooperative the opportunity to gauge whether an individual is a good fit with the cooperative before granting the individual the power inherent in membership rights. Oftentimes, a prospective worker-owner will be hired as an employee for the duration of the probationary period. If all goes well, at the end of the probationary period, the cooperative will invite the employee to make an initial capital contribution¹⁵⁰ and become a worker-owner of the cooperative.

This practice is problematic for undocumented, prospective worker-owners. First, if an undocumented, prospective worker-owner is classified as an employee during the probationary period, she becomes subject to the Form I-9 requirement, and the cooperative is barred from employing her. Second, even if the undocumented, prospective worker-owner is not classified explicitly as an employee, it will be difficult (if not impossible) to argue that she has a substantial ownership interest in the business and exercises a sufficient level of control over it. While the ownership interest requirement could be satisfied by a financial investment in the cooperative business, without membership rights, a prospective worker-owner would have little (if any) control over the business.

Solutions to this issue have been proposed, but remain untested. One proposal involves the creation of a corporate (or LLC) member of the cooperative, whose shareholders or members would be the prospective worker-owners of the cooperative. For example, a cooperative could have an LLC as one of its members. The prospective worker-owners that are undergoing the probationary process would be members of the LLC. Because the LLC would have an ownership interest in the cooperative and associated membership rights, the prospective worker-owners also would have such interests and rights in the cooperative—albeit to a smaller degree—through

their interests and rights in the LLC member of the cooperative. With those interests and rights, the prospective worker-owners arguably would have a sufficient level of control and thus be considered owners rather than employees for immigration law purposes.

Another proposal would involve prospective worker-owners entering into contracts with the cooperative to purchase membership rights, including voting rights, for a set period of time—essentially, the probationary period. The contracts then would allow the cooperative the irrevocable option to “buy back” the membership rights at the end of the probationary period. The purchasing of membership rights arguably would grant undocumented, prospective worker-owners an ownership interest and a sufficient level of control, allowing them to be exempt from the immigration law employment prohibition.

A final proposal would be to induct candidates as members from their first day of work, with sufficient vetting of the candidates occurring before they become members, as well as the institution of organizational policies that permit the cooperative to more easily fire these new members during the first six months.¹⁵¹ However, since these new members could be fired more easily than other members, they may not wield a sufficient level of control over the business to be considered owners under the OCAHO cases discussed above.

Recall that none of these proposals have been tested, and regardless of the specific “onboarding” structure chosen, a cooperative seeking to avoid the Form I-9 requirement will likely need to bear at least some risk for an undocumented individual during this probationary period. Cooperatives faced with this unique issue should consult a lawyer for more information.

SECTION 6: TAX LAW

One of the most important legal benefits of operating as a cooperative business is the access to Subchapter T of the IRC. In short, Subchapter T allows a cooperative that chooses to be taxed as a corporation to distribute certain profits to its members, which normally would trigger a tax obligation on behalf of the cooperative, in a way that is tax-free to the cooperative. In order to qualify for this tax benefit, a business must satisfy certain requirements that are detailed below.

However, cooperatives are not required to be taxed under Subchapter T. Depending on the type of legal structure chosen, a cooperative may elect to be taxed as a C-corporation (under Subchapter C of the IRC) or as a partnership (under Subchapter K of the IRC), for example. Because the benefits of Subchapter T are unique to and commonly enjoyed by cooperatives, this section will focus on taxation under Subchapter T and relevant Massachusetts tax laws. For more information on alternative forms of taxation, consult a tax lawyer or accountant.

Regardless of the tax election made by a business, it is important for both the cooperative and its members to pay their federal and state taxes. The IRS makes it easy for even undocumented worker-owners to pay taxes, by allowing such owners to obtain individual taxpayer identification numbers (ITINs), which are accepted in lieu of social security numbers (SSNs) on federal and Massachusetts tax returns. The steps to obtain an ITIN and the tax issues unique to undocumented worker-owners are outlined below.

A. “Patronage” in a Worker Cooperative

A concept specific to Subchapter T and the taxation of cooperatives is that of “patronage.” “Patronage” refers to a cooperative member’s individual contribution to the cooperative’s business. In a worker-owned cooperative, patronage is generally measured by the number of hours worked. However, the definition of patronage can be tailored to fit the cooperative’s business and detailed in the cooperative’s governing documents.

The basic principle of Subchapter T is that cooperatives may distribute profits to its members and that such distributions are tax-free to the cooperative, as long as those profits are both sourced and distributed on the basis of member patronage. Therefore, in the case of a tax-free distribution of profits (called a “patronage dividend” and detailed below), a worker-owner that works twice as many hours as a fellow worker-owner stands to receive twice the share of profits received by that fellow worker-owner. This idea is contrary to regular corporate distributions of profit, which are based on ownership interest (i.e., one’s stake in a corporation that is based on the amount of money invested in it).

B. Subchapter T and Federal Income Tax

i. Tax Treatment of Cooperative “Corporations”

For federal tax purposes, a corporation electing to be taxed under Subchapter T is treated as a taxable entity that is distinct from its taxable shareholders. This separation produces a so-called “double tax”: a tax imposed on the corporation based on its profits and a tax imposed on the corporation’s shareholders based on the corporation’s distributions of profits to them. Subchapter T allows a corporation “operating on a cooperative basis”¹⁵² to distribute profits by paying “patronage dividends,” which the cooperative corporation then may deduct from its taxable income. By doing so, Subchapter T effectively eliminates the double tax for profits distributed to members as patronage dividends, which are taxable to the members only.

Distributions of profit to members must satisfy certain requirements to qualify as patronage dividends and thus be deductible by a cooperative, including:

- they must be paid from profits earned from member patronage;
- they must be paid to members in proportion to their individual patronage; and
- they may take the form of either cash distributions or credits to members' capital accounts (through so-called "qualified written notices of allocation"), but must consist of at least 20% cash.

Consider the example of a cleaning cooperative with two worker-owners, Carolyn and Michelle (who are treated as employees for tax purposes), and one employee, Matt.

- The cooperative's governing document dictates that:
 - Any portion of its annual net profits that results from the work of a non-member will be retained by the cooperative, and the remainder will be distributed to worker-owners as patronage dividends; and
 - 70% of patronage dividends will be paid as cash and the remainder will be paid through qualified written notices of allocation.¹⁵³
- At the beginning of the tax year, Carolyn and Michelle's capital accounts each contain \$1,000.
- During the tax year, the cooperative earns \$100,000 from all of its cleaning jobs.
- The earnings are a result of 5,000 total hours worked by the worker-owners and employee:
 - Carolyn: 2,500 hours (1/2 or 50% of total hours)
 - Michelle: 2,000 hours (2/5 or 40% of total hours)
 - Matt: 500 hours (1/10 or 10% of total hours)
- After paying all of its expenses, including supply costs and Carolyn, Michelle, and Matt's wages, the cooperative is left with \$10,000 in net profits.

First, to determine what portion of the net profits would need to be retained by the cooperative, one would need to calculate what portion of the net profits is attributable to non-member labor. Since Matt is the only employee and non-member of the cooperative, the portion of the profits attributable to his labor contributions would be retained by the cooperative. Since he contributed 1/10 of the total labor, 1/10 of the net profits would be retained by the cooperative ($\$10,000/10 = \$1,000$). This \$1,000 would be held by the cooperative and not by any individual worker-owner. Because this \$1,000 would not be distributed as a patronage dividend, the cooperative would need to pay taxes based on that portion of the profits.

Then, since the cooperative's governing document says that the remainder of net profits is distributed to the worker-owners as patronage dividends, one would need to determine what portion of the remaining net profits is to be distributed to each of Carolyn and Michelle. Total hours of member labor (or patronage) are 4,500, so that Carolyn's portion of total patronage is

5/9 (or 2,500/4,500) and Michelle's is 4/9 (or 2,000/4,500). Therefore, Carolyn's patronage dividend would total \$5,000 ($5/9 \times \$9,000$), and Michelle's would total \$4,000 ($4/9 \times \$9,000$).

Finally, since the cooperative's governing document says that 70% of patronage dividends are distributed in cash, Carolyn would receive \$3,500 of her patronage dividend in cash; the remaining \$1,500 would be credited to her capital account. Michelle would receive \$2,800 in cash, and the remaining \$1,200 would be credited to her capital account.

At the end of the tax year:

- The cooperative retains \$1,000 in its corporate account;
- Carolyn receives \$5,000 in patronage dividends: \$3,500 in cash, and \$1,500 in qualified written notices of allocation;
- Michelle receives \$4,000 in patronage dividends: \$2,800 in cash, and \$1,200 in qualified written notices of allocation;
- Carolyn's capital account started with \$1,000 and now has \$2,500; and
- Michelle's capital account started with \$1,000 and now has \$2,200.

Since the source of the profits distributed to Carolyn and Michelle is member patronage, and the distributions are made on the basis of Carolyn and Michelle's respective patronage, the distributions qualify as patronage dividends and are deductible by the cooperative. The \$9,000 paid as patronage dividends to Carolyn and Michelle therefore are not taxable to the cooperative. Again, since the \$1,000 of non-member-source profits is not distributed as a patronage dividend, it is taxable to the cooperative.

Note that a worker-owner's capital account is not a separate bank account. Funds in a worker-owner's capital account are accounted for separately from the cooperative's funds, but are typically held in the same corporate bank account. Because of this, qualified written notices of allocation serve dual purposes: (i) as part of a patronage dividend, they reduce the double tax imposed on the corporation, and yet (ii) they provide the cooperative with capital to reinvest in the cooperative's business. Depending on how the cooperative handles the matter in its governing document, a worker-owner normally is able to recover the funds in his capital account over a specified number of years or upon departure from the cooperative.¹⁵⁴

ii. Tax Treatment of Members' Patronage Dividends

Patronage dividends are taxable to worker-owners when the patronage dividends are paid, whether they are paid as cash or as qualified written notices of allocation.¹⁵⁵ In the cleaning cooperative example above, Carolyn would be taxed on the full \$5,000 patronage dividend she received during the tax year, despite the fact that she received only \$3,500 in cash. When the

qualified written notice of allocation equaling \$1,500 is eventually redeemed for cash and distributed to her from her internal capital account, she is not taxed on that sum, since she already was taxed on the full \$5,000 patronage dividend.

The IRC does provide the option of a cooperative issuing a “nonqualified” written notice of allocation.¹⁵⁶ A nonqualified written notice of allocation is a credit to a member’s capital account from patronage-based profits that does not qualify as a patronage dividend.¹⁵⁷ Therefore, it is not deductible by the cooperative and is not taxable to the given member.¹⁵⁸ Once the nonqualified written notice of allocation is redeemed by the cooperative, the cash paid is deductible by the cooperative and taxable to the member.¹⁵⁹ The general principle is that a written notice of allocation must be taxable to either the cooperative or its member during the year in which it is issued. In other words, either the credit is deductible by the cooperative and taxable to its member, or the credit is taxable to the cooperative and not taxable to its member.

Generally, if you are self-employed, you must pay a self-employment tax based on your self-employment income.¹⁶⁰ Self-employment income refers to an individual’s income from carrying on a trade or business.¹⁶¹ Whether patronage dividends are taxable to cooperative members as ordinary income or additionally are subject to self-employment taxes is unresolved.¹⁶² The Tax Court has stated that patronage dividends paid to cooperative members are subject to self-employment tax if the dividends are paid from income derived from the members’ business with the cooperative.¹⁶³ In essence, the patronage dividends must be derived from the cooperative member’s trade or business.¹⁶⁴ This commonly is the case in the agricultural cooperative context, where farmers more explicitly transact business with the cooperatives of which they are members and receive patronage dividends that are closely tied to their individual businesses.¹⁶⁵

Members of a worker cooperative, on the other hand, do not necessarily carry on their own trades or businesses. Where worker-owners are paid wages, such as in the cleaning cooperative example above, members have a reasonable argument that any patronage dividends received are not subject to self-employment tax: it would be inconsistent to receive both employment income and self-employment income for the same work from the same entity.¹⁶⁶ Because of its unresolved nature, please consult a tax lawyer for the latest developments in this area of law.

iii. Tax Treatment of “Partnership” Distributions

Partnerships and entities that elect to be treated as partnerships for tax purposes (such as LLCs that elect to be taxed under Subchapter K) are not subject to the double tax discussed above. Instead, profits (and losses) flow directly to members of those entities and are taxable to the members only. Because of this, cooperatives treated as partnerships for tax purposes have no need for the “pass through” benefits of Subchapter T. Instead, the worker-owners solely are responsible for paying self-employment taxes, which are imposed at the same rate as

employment taxes. Rather than sharing the tax burden with the cooperative—as is the case where cooperatives pay employment taxes in the Subchapter T context, for example—worker-owners bear the entirety of the tax burden. Worker-owners must pay self-employment taxes on their respective portions of the cooperative’s earnings, including earnings retained by the cooperative, and must do so on a quarterly basis. This is a more significant administrative burden than that encountered by the average person in a typical job.

For this reason, some cooperatives elect to be taxed under Subchapter T rather than as a partnership under Subchapter K. Under Subchapter T, portions of worker-owners’ wages are withheld for tax payment purposes, and worker-owners receive Form W-2s and are responsible for paying taxes annually—which is a familiar process for most workers. Additionally, a cooperative can deduct business expenses related to employee benefits. Perhaps most importantly, under Subchapter T, a cooperative—and not its worker-owners—is taxed on its retained earnings.

These advantages and disadvantages, as well as the business’ individual circumstances, should be thoroughly considered by a cooperative when deciding on the appropriate tax structure to adopt. However, even though a cooperative—formed as an LLC, for example—may initially elect to be treated as a partnership for tax purposes, it usually may change its election, so that it is treated as a corporation for tax purposes, and thus may take advantage of Subchapter T.

C. Massachusetts Income Tax

Entities that are treated as corporations for tax purposes and do business in Massachusetts are subject to the Massachusetts corporate excise tax.¹⁶⁷ Generally speaking, the excise tax is the sum of a tax based on net income and a tax based on the entity’s net worth or tangible personal property.¹⁶⁸ In the case of an S-corporation, though, the corporate excise tax depends on the entity’s gross receipts for the tax year.¹⁶⁹ Nonetheless, the minimum corporate excise tax in Massachusetts is \$456.¹⁷⁰ Tax-exempt organizations, as well as a number of other entities that are inapplicable to worker cooperatives, are exempt from the Massachusetts corporate excise tax.¹⁷¹ However, limited liability companies that choose to be taxed as corporations are subject to the Massachusetts corporate excise tax.¹⁷²

D. Undocumented Worker-Owners and Taxpayer Identification Numbers

The IRS and Massachusetts Department of Revenue require taxpayers to identify themselves with identification numbers at both the individual and business entity levels. The IRS and Massachusetts Department of Revenue accept both the SSN and the ITIN from individual taxpayers and the EIN from business entity taxpayers.

i. Individual Taxpayer Identification Number

Individual taxpayers who do not have and are not eligible to obtain a SSN, such as undocumented immigrants, may apply for an ITIN by submitting Form W-7 (Application for IRS ITIN) to the IRS.¹⁷³ Like the federal government, Massachusetts accepts ITINs in lieu of SSNs from individual taxpayers.¹⁷⁴

The IRS is prohibited from sharing taxpayer information with other federal and state agencies with certain exceptions, such as court-ordered disclosures and Department of Justice criminal investigations.¹⁷⁵ Massachusetts imposes similar confidentiality restrictions on the Department of Revenue.¹⁷⁶ Therefore, it is unlikely that immigration enforcement authorities would learn of an undocumented immigrant's status because of tax forms submitted by the undocumented immigrant to federal or Massachusetts tax collection agencies.

ii. Employer Identification Number

For federal and Massachusetts tax purposes, any businesses that have employees must obtain an EIN.¹⁷⁷ Even if they do not have employees, corporations and most LLCs must obtain an EIN, and banks typically require an EIN in order for a business to open a bank account. To obtain an EIN, a business may submit Form SS-4 (Application for Employer Identification Number) to the IRS or apply by phone or online. Apart from the basic information required by Form SS-4, a corporate applicant must provide the name and taxpayer identification number of its "responsible party." A responsible party is a person or entity that has sufficient control over the conduct of the corporate entity.¹⁷⁸ The taxpayer identification number of the corporate applicant's responsible party may be a SSN, ITIN, or EIN.¹⁷⁹

E. Federal and Massachusetts Tax Forms

Because of the complexity and evolving nature of the federal and state tax statutes, you should consult an accountant or tax lawyer to confirm the specific tax filings that need to be filed by you and your business.

SECTION 7: COOPERATIVE CONVERSIONS

A. What are Cooperative Conversions?

Businesses do not need to begin as worker cooperatives. A cooperative conversion is when an existing, non-cooperative business makes the decision to transition to a cooperative business. There are several ways conversions can occur and several important questions and issues businesses should consider before converting to a cooperative business.

Who should consider a conversion to a worker-owned cooperative?

Conversions can be a great option for retiring business owners who would like their businesses to stay rooted in particular communities. Conversions are also an attractive option for business owners who want to sell their businesses, but who would like the businesses to retain their missions or cultures when the owners leave. Conversions can facilitate retaining and rewarding talented employees, since responsibility is distributed among employees who become worker-owners and who therefore are able to directly participate in governance of the business.¹⁸⁰ Family businesses sometimes struggle to succeed after they are passed on to the next generation. Sometimes, these businesses close or are sold to new owners who may not share the founders' mission or may move jobs out of the community.¹⁸¹ A conversion to a cooperative business is one way these businesses can stay in operation and succeed after periods of transition.

What are some of the steps to converting to a worker-owned business?

There are several steps involved when converting a business to a worker-owned cooperative. This section is not meant to be a “how-to” guide, but rather a brief overview; appropriate legal and financial experts should be consulted before a business attempts to convert. For more information about cooperative conversions, please see the helpful resources included in the footnotes to this section.

When deciding to convert to a cooperative model, there are many issues that should be considered by the business's current owners and potential worker-owners. The relationship between the current owners and employees should be assessed, especially if the owner plans to stay with the company.¹⁸² If current employees plan to be the worker-owners, the owner(s) must trust that the employees will be able to competently run the business.

Another important consideration is the current profitability of the business. A conversion may not be the best option for a company that is struggling financially. A worker-owned company does not need to make large profits, but consistent, positive net cash flow increases the

likelihood the business will succeed.¹⁸³ If a leveraged buyout is being used to finance the conversion,¹⁸⁴ it becomes essential that a business be profitable. The cooperative model may not be a viable option for owners focused on maximizing financial return.

Businesses considering a cooperative conversion should consider creating a steering committee and assembling professional advisors.¹⁸⁵ The advisors can evaluate the business to see if a conversion is feasible, assess the financial health of the business, and determine actual and potential liabilities of the business. The prospective worker-owners should receive extensive training and education about democratic governance and business ownership. An independent valuation of the business should also occur. A neutral appraisal of the business is essential because of the differing interests of current owners and potential worker-owners.

After the consultation with the steering committee's advisors, the structure of the deal should be determined. This includes how and from where the potential worker-owners will secure financing for the deal (discussed in more detail in **SECTION 8: FINANCING**) and the structure of the buy-out process from the current owners. In conjunction with the financing and structuring of the deal, a decision must be made regarding whether the governing documents of the existing business can be amended to effectuate the conversion or whether a new legal entity should be created.¹⁸⁶

The conversion process should be transparent to everyone involved, and the employees need someone who is representing their interests. The employees should consider getting their own legal representation, separate from the current owners. The new worker-cooperative needs to establish how it will handle any existing business debt and any "baggage" the business may have (e.g., a pending lawsuit or other potential liabilities). The current owners and potential worker-owners should consult their advisors on any existing intellectual property rights the business may have and whether these rights need to be assigned or licensed.¹⁸⁷

While a conversion can be completed in as little as six months, it is often a process that lasts several years.¹⁸⁸ The sale of the business does not need to happen all at once; owners who wish to give up control gradually may structure a multi-step buy-out of the business.¹⁸⁹ A longer conversion process may be preferable for a retiring business owner who wishes to gradually transition out of the business.¹⁹⁰ Likewise, converting to a worker-owned business can be a cultural shift for many new worker-owners, as they must transition from the boss/employee mentality to a workplace under democratic control.¹⁹¹ Accordingly, training (and budgeting for training) of new worker-owners on the cooperative model remains important even after the conversion process is completed.¹⁹² In addition, periodic check-ins with professional advisors post-conversion can help ensure the cooperative's ongoing success.¹⁹³

***A Note about ESOPs:** Employee stock ownership plans (ESOPs) provide a way to give employees ownership in an existing, non-cooperative business. ESOPs are a type of employee benefit plan that can be used to transfer some ownership of a business to its employees.¹⁹⁴ An ESOP is essentially a stock sale to employees, making them part owners of the business.¹⁹⁵ Cooperatives and ESOPs are often discussed together because of a shared tax benefit (i.e., capital gain tax deferrals), but they differ in significant ways.¹⁹⁶ First, employees who have ownership through an ESOP typically do not have a meaningful say or a vote regarding how the business is run as they would in a cooperative.¹⁹⁷ If the employees receive stock with voting power, the vote would be proportional to the percentage of stock owned rather than as “one-person, one-vote.” ESOPs are often offered to employees at a favorable price as part of retirement and are used as a way to motivate and reward employees.¹⁹⁸ Because this document focuses on worker cooperatives, we will not discuss ESOPs in depth.¹⁹⁹*

B. Common Examples of Conversions

How a conversion is shaped will depend on the individual business, but some of the ways in which a conversion can be structured include: (1) owner sells to existing employees and stays with the company; (2) owner sells to existing employees and leaves the company; (3) owner converts to a cooperative form and brings in new founding worker-owners; and (4) existing employees either leave and create a cooperative or restart a failed business.²⁰⁰ Identifying the best option will depend on the particular needs and goals of the business.

Real Life Conversion Example: Real Pickles

Real Pickles is a Massachusetts worker-owned cooperative that makes and distributes naturally-fermented and raw pickles from regionally-grown vegetables.²⁰¹ The business launched in 2001 and underwent a conversion to a worker-owned cooperative in 2013 in order to preserve its social mission and retain high-quality employees.²⁰² During a six-month preparation process, five founding worker-owners met weekly to discuss several issues, including the governance and managing structure of the cooperative and the business mission. Determining the future earnings projections was a critical piece before moving forward, because the business would need to grow at a certain rate to pay off the purchase price. The membership shares were set at \$6,000, but the worker-owners needed to raise a total of \$500,000 in capital in order to purchase the business. In order to fund the buy-out, the business negotiated an investment from the Cooperative Fund of New England’s Cooperative Capital Fund and launched a successful Direct Public Offering.²⁰³

SECTION 8: FINANCING

Whether a worker cooperative is formed as a start-up business or through a conversion, many of these cooperatives will require a large amount of capital. Others will require very little initial investment. For a start-up cooperative, funds will be needed for the business to begin operating; in a conversion, financing will be required when the worker-owners purchase the business. Capital for the business can come in the form of debt, equity, or grants. There are benefits and disadvantages to each type of capital, which are discussed below.

Certain types of capital are considered securities and may need to be registered with state or federal securities regulators. Broadly defined, a security is a financial instrument that represents ownership (typically in the form of stock), a creditor relationship (such as a loan), or rights to obtain ownership (such as an option to buy stock).²⁰⁴ Securities laws regulate all sales of securities, regardless of the amount of people they are being sold to and the type of company that is offering the security, though the way that securities laws will apply to a particular transaction will differ depending on the circumstances. Any attempt to seek investment in your business in exchange for ownership shares implicates securities laws, and thus a cooperative that is considering raising money through equity investment should consult legal advice before doing so. Failure to comply with federal and state securities laws can have significant penalties. Any time that a cooperative is dealing with an outside investor, the worker-owners should contact a lawyer to confirm the business is complying with all relevant securities laws.

A. Debt Financing

Debt financing is the process of borrowing money that is promised to be paid back to the lender according to the terms of repayment specified in the loan, typically with interest. The lender does not receive an ownership interest or vote in the activities of the business; for this reason, debt is arguably a less flexible means of financing than equity. However, debt is arguably a more secure means of financing for the lender, since if the business falls into bankruptcy proceedings, any money held by the business will be distributed among its creditors, including lenders, before money is returned to the investors.

Debt usually comes in the form of a secured loan, meaning that the business borrowing the money must back the loan with collateral. If the business borrowing the money cannot repay the loan, the lender will take the collateral. A mortgage is one example of a secured loan. The collateral for the mortgage is the house; if the borrowers are unable to make mortgage payments, the lender (typically a bank) can seize the house. An unsecured loan occurs when money is borrowed without being secured by collateral; the lender relies on the borrower's creditworthiness and accepts the risk, possibly in return for a higher interest rate.

Cooperatives can receive capital in the form of debt by taking out loans from friends and family members or from a bank or credit union. Traditional banks may be unfamiliar with the cooperative model and thus may be hesitant to lend to a cooperative business that does not have existing assets or sufficient cash flow to secure the loan. In order to overcome this barrier, banks may require certain members to make personal guarantees of the loan; since the democratic structure of the cooperative prohibits a member from wielding additional control over the business in exchange for the personal guarantee, such a requirement may be a barrier for some cooperatives to accessing capital. However, there are several local and national lending institutions that lend specifically to cooperatives, including the Cooperative Fund of New England here in Massachusetts, and that are more comfortable working with cooperatives at a nascent stage.²⁰⁵

Another option for cooperatives seeking to finance their business is convertible debt, which is money that is borrowed as a loan but provides the lender with the option to convert the debt into equity (i.e., ownership in the company) at a later specified time. How and when the conversion to equity may occur is determined in writing at the time the convertible debt is issued.

B. Equity Financing

Equity is money that is invested in a business in exchange for ownership in the business, typically sold to the investor in the form of shares (also called “stock”) upon which the investor hopes to make a return in the form of dividends, as well as potentially through future sale of that ownership interest. When someone speaks about “investing” in a company, they typically are referring to equity investment. Equity financing is high-risk; while the investor may earn a return on the investment, there is a chance they will lose their investment altogether. One advantage of equity from the business’s perspective is that it is flexible, since the money received by the business does not have to be returned according to a payment schedule or with interest, as is required with debt financing. In a cooperative, membership shares are a form of equity investment, but the business can also have other classes of non-voting shares that non-members can purchase.

Since traditional investors typically receive voting rights and may expect a certain rate of return on their investment, they may not be used to the cooperative ownership model of “one member, one vote” or comfortable without having a competitive expected rate of return.²⁰⁶ However, for those cooperatives with access to mission-driven investors, Direct Public Offerings may be a viable way to raise capital from the public.²⁰⁷ Unlike an Initial Public Offering (IPO), when raising capital through a Direct Public Offering (DPO), a company does not need to register as a public company with the SEC in order to complete a DPO, though there are state securities filing requirements with which to comply.²⁰⁸ Starting in May of 2016, companies will also be able to

crowdfund across the country for equity investment in their businesses; this may prove to be an exciting and successful vehicle for growth for worker cooperatives.²⁰⁹

What is a Direct Public Offering?

A DPO involves offering an investment opportunity in a business directly to the public, including to accredited and non-accredited investors.²¹⁰ The business, in this case the cooperative, offers the investment without using a middleman (like an investment bank, as needed in an IPO).²¹¹ By using a DPO, the business is limited in how much money it can raise, but the business can avoid federal securities filings that are typically necessary to offer securities directly to the public. Compliance materials will still need to be submitted to state securities regulators in every state where the securities will be offered.²¹² In Massachusetts, small businesses can raise capital via a DPO by filing a Small Company Offering Registration (SCOR) application. This allows a business to raise up to \$1 million in a year (or up to \$5 million in certain situations) with less onerous disclosure requirements.²¹³

Before deciding to go forward with a DPO, a cooperative must decide whether it is the right option for them and should consult with professionals familiar with DPOs in the cooperative context. These professionals should ensure that all securities laws and all other legal formalities have been followed.²¹⁴ The entity should also decide what type of security is being offered (stock, debt, convertible debt, etc.). Depending on the type of security the entity wants to offer, this may involve converting to a different legal structure (for example, from an LLC to a corporation). While a DPO is an easier process than an IPO, it is still a very complicated undertaking, and so the entire process, including the offering document and legal documents for the offering, should be drafted and overseen by the appropriate professionals.

Once everything is in order, all the necessary materials should be sent to the state securities regulators. After receiving regulatory approval, which can take anywhere from a few weeks to a few months, the cooperative can begin to market and sell the securities. In Massachusetts, a business has one year to raise funds, and must submit a new application to continue to raise funds after the year has passed.²¹⁵ This can be an expensive and time-consuming process and should only be undertaken if the cooperative believes the DPO will be a success. Successful DPOs typically occur with cooperatives that already have a strong following and buy-in from the community.

Real Life DPO Example: CERO

CERO, a Massachusetts-based waste management cooperative, launched a successful DPO that closed in July 2015.²¹⁶ CERO was approved four months after filing with Massachusetts securities regulators.²¹⁷ The offering was open to Massachusetts residents, and the minimum investment amount was \$2,500, with investments ranging from \$2,500 to \$25,000.²¹⁸ Through a successful marketing campaign, CERO was able to raise \$340,000, was able to qualify for a \$100,000 line of credit from the Cooperative Fund of New England, and raised \$31,000 in tax-deductible donations through a separate fund drive.²¹⁹

C. Grants

Cooperatives can sometimes receive capital through grants and donations, which is money given to the business with no exchange of ownership and that does not need to be paid back. There are funds, such as Boston Impact Initiative²²⁰ and Cooperative Fund of New England,²²¹ that award grants to support cooperative development. Crowdfunding donation sites like Indiegogo²²² are another way that businesses can solicit donations.

There are some potential obstacles for worker cooperatives to obtain grants and donations, however. With a grant, you may need to find a fiscal sponsor through which to funnel the funds, since many funders only donate to tax-exempt nonprofit organizations, who can then use that money to further their mission by donating it to the cooperative (assuming their mission is aligned with cooperative development). It is important to keep in mind that any money received by a for-profit business, such as a worker cooperative, regardless of whether it was channeled through a fiscal sponsor and therefore tax-deductible to the donor, is not tax-exempt for the business, and so it must be counted among the business's taxable income. Similarly, contributions donated through crowdfunding websites, assuming the funds are not funneled through a fiscal sponsor, are not a tax-deductible donation for the donor and are taxable income for the business.²²³

SECTION 9: WORKER CAPITALIZATION

Because of the potential complexity involved in allocating profits on the basis of patronage, which varies among worker-owners and with time, money management within a cooperative is critical to its long-term sustainability. One money management practice that can be adopted by worker cooperatives is the use of internal capital accounts (as introduced in **SECTION 6: TAX LAW**). Internal capital accounts are based on accounting principles and have little to do with bank accounts; in fact, funds within a cooperative's capital accounts are held collectively in the

cooperative's corporate bank account. Generally, each worker-owner of the cooperative has an individual capital account which contains her initial capital contribution (i.e., the fee paid to the cooperative when the worker-owner first joins) and tracks the receipt and payment of patronage dividends issued in the form of written notices of allocation. The cooperative also has a capital account (usually called a "collective account") which tracks all profits that are retained by the cooperative rather than distributed to worker-owners.²²⁴

In order to maximize the value of using internal capital accounts, a cooperative should always keep its capital accounts up-to-date. For example, whenever patronage dividends are paid and a portion of profits is retained by the cooperative, all worker-owners' capital accounts, as well as the cooperative's collective account, should be updated. When a new worker-owner joins the cooperative, an internal capital account should be created for her, including the amount of the initial capital contribution she made. And when a cooperative makes distributions to worker-owners from their internal capital accounts, their capital accounts should be updated accordingly.

A worker cooperative has a significant amount of flexibility in the way it structures and manages its internal capital accounts, which is detailed in its governing documents.²²⁵ Because of this, the initial founders need to think about how the internal capital accounts will operate throughout the cooperative's entire life cycle. Important considerations that affect the management of internal capital accounts include:

- How much will new worker-owners need to pay to join the cooperative?
- What percentage of patronage dividends will be distributed through written notices of allocation rather than cash?
- What percentage of annual profits will the cooperative retain for reinvestment in its business?
- Will the portion of patronage dividends paid to worker-owners as written notices of allocation earn interest that will be paid to the worker-owner?
- Perhaps most importantly, how are the funds in a worker-owner's capital account distributed upon his departure from the cooperative? Can the cooperative afford to pay the entirety of it at once?²²⁶

With tough questions like these answered before the cooperative is legally formed, and the answers incorporated into the cooperative's governing documents, the cooperative is more likely to be managed smoothly and to grow sustainably. For more information on internal capital accounts and how to structure them within your cooperative's governing documents and financial records, consult a lawyer or a tax professional well-versed in this area of worker cooperative law.²²⁷

SECTION 10: ADDITIONAL RESOURCES

While we certainly hope that this resource has proven valuable to you, there are many additional resources available to those looking to start, maintain, or grow a healthy worker cooperative. For impressive databases of helpful information for worker cooperatives, please visit the following links and peruse the various resources included in the footnotes:

- U.S. Federation of Worker Cooperatives Resource Directory, available at <https://usworker.coop/usfwc-resources>
- [cooplaw.org](http://www.co-oplaw.org/), an e-resource library hosted by the Sustainable Economies Law Center (SELC), available at <http://www.co-oplaw.org/>
- The ICA Group Resource Library, available at <http://ica-group.org/shop/>

ENDNOTES

¹ CHARLES T. AUTRY & ROLAND F. HALL, *THE LAW OF COOPERATIVES* 8 (2009).

² ICA is a global membership association of co-ops and co-op support organizations. INT'L CO-OPERATIVE ALLIANCE, *Co-operative identity, values & principles*, <http://ica.coop/en/whats-co-op/co-operative-identity-values-principles> (last visited Nov. 29, 2015).

³ 26 U.S.C. §§ 1381–88 (2012).

⁴ *Puget Sound Plywood, Inc. v. Commissioner*, 44 T.C. 305 (1965), acq., 1966-1 C.B. 3.

⁵ ILL. COOP. COUNCIL, *History of Cooperatives*, <http://illinois.coop/about-coops/history-of-cooperatives/> (last visited Nov. 29, 2015); 7 *Cooperative Principles*, National Cooperative Business Association CLUSA International, <https://www.ncba.coop/7-cooperative-principles> (last visited Nov. 29, 2015).

⁶ *Supra* note 2.

⁷ NEB. COOP. DEV. CTR., *Types of Cooperatives*, <http://ncdc.unl.edu/typescooperatives.shtml> (last visited Nov. 29, 2015).

⁸ OCEAN SPRAY, *How we built our cooperative*, <http://www.oceanspray.coop/Our-Cooperative.aspx#ourHistory> (last visited Nov. 29, 2015).

⁹ CULTIVATE.COOP, *Consumer Cooperative*, http://cultivate.coop/wiki/Consumer_cooperative (last visited Nov. 29, 2015).

¹⁰ HARVEST CO-OP MKTS., <http://www.harvest.coop/> (last visited Nov. 29, 2015).

¹¹ Because housing cooperatives are outside the scope of this document, we will not discuss them here. For more information on the state laws governing housing cooperatives, please see MASS. GEN. LAWS ch. 157B.

¹² Northcountry Cooperative Foundation, *Worker Cooperative Toolbox, In Good Company: A Guide to Cooperative Employee Ownership* 1, 47 (2006), <http://www.uwcc.wisc.edu/pdf/In%20Good%20Company%20a%20Guide%20to%20Cooperative%20Employee%20Ownership.pdf>.

¹³ COOP. ENERGY, RECYCLING & ORGANICS, <http://www.cero.coop/> (last visited Nov. 29, 2015).

¹⁴ CULTIVATE.COOP, *Multi-stakeholder cooperatives*, http://cultivate.coop/wiki/Multi-stakeholder_cooperatives (last visited Nov. 29, 2015); please see **Section 6: Tax Law** for more information on how profits are distributed to workers.

¹⁵ FEDCO SEEDS CO-OP SEED PACKERS, *About Fedco*, https://www.fedcoseeds.com/about_fedco.htm (last visited Nov. 29, 2015).

¹⁶ DORCHESTER CMTY. FOOD CO-OP, <http://www.dorchesterfoodcoop.com/about/> (last visited Nov. 29, 2015).

¹⁷ *Supra* text accompanying note 11.

¹⁸ MASS. GEN. LAWS ch. 157, § 1 (2015); *see generally* David Ellerman & Peter Pitegoff, *The Democratic Corporation: The New Worker Cooperative Statute in Massachusetts*, 11 N.Y.U. REV. L. & SOC. CHANGE 441, 452–58 (1982) (indicating that Chapter 157 predates Chapter 157A).

¹⁹ MASS. GEN. LAWS ch. 157, § 2 (2015).

²⁰ § 3. “Association,” “company,” “exchange,” “society,” and “union” are acceptable in lieu of “co-operative.” *Id.*

²¹ § 8.

²² § 2.

²³ *Id.*

²⁴ *Id.*

²⁵ § 6.

²⁶ MASS. GEN. LAWS ch. 157A, § 3 (2015). Massachusetts law refers to worker cooperatives as “employee cooperatives.” *Id.* For consistency in this document, this section will use the terminology “worker cooperative” instead of “employee cooperative” as used in the statute.

²⁷ *Id.*

²⁸ § 5.

²⁹ § 6.

³⁰ § 8.

³¹ § 6(b).

³² § 6(b)–(c). Members have all the rights and responsibilities of shareholders of a corporation governed under Mass. Gen. Laws c. 156B. § 6(d).

³³ § 7(a).

³⁴ § 4.

³⁵ § 11.

³⁶ *Id.*

³⁷ The law may impose other requirements on unincorporated businesses, such as certain permitting and licensing requirements (depending on the industry). If the business is operating under a name other than the owner’s legal name, the business must register the business name by filing a business certificate with the city in which the business is located. *See* MASS. GEN. LAWS ch. 110, § 5 (2015).

³⁸ If the business only has one owner, it is viewed as a sole proprietorship, though the information related to general partnerships still applies.

³⁹ A partnership agreement is an optional (but recommended) internal governance document that can be used to assign rights and responsibilities and outline decision-making processes among the partners.

⁴⁰ Limited liability is not absolute; the owners of the business can still be personally liable in certain situations, such as when the owners are not acting within the scope of their role as an agent of the business.

⁴¹ For example, a business formed under the LLC statute may choose to have a board of directors, similar to that required of a corporation.

⁴² Worker cooperatives cannot be nonprofit organizations, as nonprofit organizations cannot be owned. Limited partnerships (LPs) and limited liability partnerships (LLPs) are not discussed here because they are uncommon legal structures for worker cooperatives.

⁴³ MASS. GEN. LAWS ch. 156D, § 6.01 (2015)

⁴⁴ § 8.40.

⁴⁵ Please see **Section 5: Immigration Law** and **Section 6: Tax Law** for more information regarding how immigration law and taxation, respectively, affect the treatment of workers in a worker cooperative. Note that MASS. GEN. LAWS ch. 149, § 148 specifically excludes cooperative associations from its requirements for regular payment of wages, unless the employees of the cooperative request otherwise.

⁴⁶ MASS. GEN. LAWS ch. 156D, §§ 7.01, 16.01.

⁴⁷ 26 U.S.C. § 1362 (2015); Form 2553 is available at <https://www.irs.gov/pub/irs-pdf/f2553.pdf> (last visited Dec. 05, 2015).

⁴⁸ As a brief overview, the income, losses, deductions, and credits of the corporation taxed under Subchapter S pass through to individual shareholders in proportion to their ownership, thus avoiding the impact of “double taxation” (which is explained in **Section 6: Tax Law**). *See* 26 U.S.C. § 1366 (2012); *S Corporations*, INTERNAL REVENUE SERV., <https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/S-Corporations> (last visited Nov. 29, 2015). A corporation can elect this tax treatment if every shareholder consents to the election and only if the corporation and its shareholders can meet certain requirements. 26 U.S.C. § 1362. Specifically, in order to be an S-

corporation, the company must be a domestic corporation with no more than 100 shareholders, the company cannot have more than one class of stock, and shareholders must be individuals who are either a U.S. citizen or a resident alien. 26 U.S.C. § 1361(b) (2012). Whether someone is a resident alien can be determined by the substantial presence test, which generally requires the individual to have been present in the United States for a certain period of time and to not have a “closer connection” to a foreign country. For more information, please see CMTY. ENTER. PROJECT, HARVARD TRANSACTIONAL LAW CLINICS, A LEGAL OVERVIEW OF BUSINESS OWNERSHIP FOR IMMIGRANT ENTREPRENEURS IN MASSACHUSETTS (2015), available at <http://clinics.law.harvard.edu/tlc/files/2015/09/TLC-Immigrant-Entrepreneurs-Overview.pdf> [hereinafter IMMIGRANT ENTREPRENEURS OVERVIEW].

⁴⁹ SEC’Y COMMONWEALTH MASS., *Memorandum: New Legislation, Massachusetts General Chapter Laws Chapter 156E, Effective December 1, 2012*, <http://www.sec.state.ma.us/cor/corpdf/Notice%20regarding%20Benefit%20Corporations.pdf>; see MASS. GEN. LAWS ch. 156E, § 10 (2015).

⁵⁰ MASS. GEN. LAWS ch. 156E, § 4.

⁵¹ § 11.

⁵² § 13.

⁵³ CERTIFIED B CORPS., *About B Lab*, <https://www.bcorporation.net/what-are-b-corps/about-b-lab> (last visited Nov. 29, 2015).

⁵⁴ MASS. GEN. LAWS ch. 157A, § 3 (2015).

⁵⁵ *Id.*

⁵⁶ § 6.

⁵⁷ See, e.g., RED SUN PRESS, *About Red Sun*, <http://www.redsunpress.com/aboutus1.html> (last visited Nov. 30, 2015). For information regarding worker self-directed non-profits, see Sustainable Economies Law Center, *Webinar on Worker Self Directed Nonprofits: Workplace Democracy in Nonprofit Organizations*, YouTube (June 2, 2015), <https://www.youtube.com/watch?v=uU1w9uXGGLY>.

⁵⁸ For more information, please refer to **Section 8: Financing**.

⁵⁹ 26 U.S.C. 501(c)(3) (2015).

⁶⁰ MASS. GEN. LAWS ch. 63, § 39 (2015).

⁶¹ These procedures include registering with the Non-Profit Organizations/Public Charity Division of the Attorney General of Massachusetts, filing an annual Form PC, and if the organization is going to solicit funds over \$5,000 per year, it must first obtain a Certificate of Solicitation. For more information on these procedures, please visit Attorney General Maura Healey, *FAQs about Charitable Organizations*, <http://www.mass.gov/ago/doing-business-in-massachusetts/public-charities-or-not-for-profits/information-for-existing-charities/faqs-about-charities.html> (last visited Nov. 29, 2015).

⁶² The same statement would be true if the word “C-corporation” was replaced with “Employee Cooperative Corporation” or “Benefit Corporation.”

⁶³ 26 U.S.C. §§ 301-385.

⁶⁴ 26 U.S.C. §§ 1361-1379.

⁶⁵ 26 U.S.C. §§ 701-777.

⁶⁶ 26 U.S.C. §§ 301-385.

⁶⁷ See generally 26 U.S.C. §§ 1381-88 (2012). Taxation under Subchapter T is discussed at length in **Section 6: Tax Law**.

⁶⁸ 15 U.S.C. § 1125(a); 15 U.S.C. § 1051(b).

⁶⁹ MASS. GEN. LAWS ch. 156D, § 4.02 (2015).

⁷⁰ Please see the conversation about general partnerships and unincorporated businesses in **Section 3: Legally Forming Your Cooperative**.

⁷¹ See *supra* text accompanying note 37.

⁷² Please see **Section 3: Legally Forming Your Cooperative** for more information on types of business organization. See the state Corporations Division website for links to the forms, SEC’Y COMMONWEALTH MASS., *Corporations Division*, <http://www.sec.state.ma.us/cor/> (last visited Nov. 30, 2015).

⁷³ For more information and guides on licensing and permitting in the city of Boston, please visit <http://www.cityofboston.gov/business/permitguides>.

⁷⁴ Please visit this IRS website to decide if you need an EIN: INTERNAL REVENUE SER., *Do You Need an EIN?*, <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Do-You-Need-an-EIN> (last visited Nov. 29, 2015).

⁷⁵ Please visit this webpage for more information on registration with the Massachusetts DOR: *See* DEP'T OF REVENUE, COMMONWEALTH OF MASS., *Login or Register*, <http://www.mass.gov/dor/e-services/webfile-overview-table.html#Login%20or%20Register%20for%20MassTaxConnect> (last visited Nov. 29, 2015).

⁷⁶ JANELLE ORSI, PRACTICING LAW IN THE SHARING ECONOMY 367 (2013).

⁷⁷ 29 U.S.C. § 203(e)(1) (2014).

⁷⁸ ORSI, *supra* note 76, at 374.

⁷⁹ Under federal and Massachusetts law, for-profit businesses cannot have volunteers; for that reason, we will not discuss volunteers herein.

⁸⁰ MASS. GEN. LAWS ch. 149, § 148B (2015).

⁸¹ § 150; *see also* David C. Henderson, *Massachusetts Law on Interns Even Tougher than Federal Rules*, MASS. LAWYERS WEEKLY (Sept. 22, 2014), <http://www.nutter.com/files/Uploads/Documents/MLW-Henderson-Massachusetts-law-on-interns-even-tougher-than-federal-rules-9.22.14.pdf> (providing a detailed summary of Massachusetts laws governing interns).

⁸² Please see **Section 6.A: “Patronage” in a Worker Cooperative** for more information.

⁸³ *See* U.S. FED’N OF WORKER COOPERATIVES, *What is a Worker Cooperative?*.

<https://usworker.coop/sites/default/files/What%20is%20WC%201.pdf> (last updated June 2007).

⁸⁴ *See infra* note 152 (providing more information on subordination of capital).

⁸⁵ *See supra* note 45 for provision in Massachusetts employment law that specifically applies to cooperative associations.

⁸⁶ *See infra* note 143.

⁸⁷ MASS. GEN. LAWS ch. 149, § 1 (2015); *see also* Stanton v. Lighthouse Financial Services, Inc., 621 F.Supp.2d 5 (2009).

⁸⁸ For more information about the effect of entity choice on worker classification, please see Co-opLaw.org, “Employment Law,” available at <http://www.co-oplaw.org/topics-2/employment-law/> (last visited Dec. 15, 2015).

⁸⁹ MASS. GEN. LAWS ch. 152, § 1 (2015).

⁹⁰ MASS. GEN. LAWS ch. 151A, § 2.

⁹¹ *Id.* For a summary of the law in this area, *see* Robert M. Shea, *The Massachusetts Independent Contractor Law: Serious Problems and Difficult Choices for Businesses in Massachusetts*, MORSE, BARNES-BROWN, PENDLETON PC, http://www.mbbp.com/resources/employment/independent_contractor.html (last visited Dec. 3, 2015).

⁹² MASS. GEN. LAWS ch. 151A, § 2.

⁹³ For more information on independent contractors, please refer to **Section 4.C: Who is an Independent Contractor?**

⁹⁴ *See* INTERNAL REVENUE SERV., *Employee (Common-Law Employee)*, <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Employee-Common-Law-Employee> (last updated Nov. 2, 2015).

⁹⁵ MASS. GEN. LAWS ch. 62B, § 1 (2015).

⁹⁶ *See* Athol Daily News v. Bd. of Review of the Div. of Emp’t & Training, 786 N.E.2d 365, 369–70 (Mass. 2003).

⁹⁷ IMMIGRANT ENTREPRENEURS OVERVIEW, *supra* note 48, at 23–25.

⁹⁸ For a discussion about the difference between independent contractors and employees, *see generally* Charles J. Muhl, *What is an Employee? The Answer Depends on the Federal Law*, MONTHLY LAB. REV., Jan. 2002, available at <http://www.bls.gov/opub/mlr/2002/01/art1full.pdf>.

⁹⁹ MASS. GEN. LAWS ch. 149, § 150 (2015).

¹⁰⁰ § 148B.

¹⁰¹ 8 U.S.C § 1324a(a)(4) (2012).

¹⁰² 29 C.F.R. 553.101 (2015); *see also* U.S. DEPT. OF LAB., *Fair Labor Standards Act Advisor: Volunteers*, <http://webapps.dol.gov/elaws/whd/flsa/docs/volunteers.asp> (last visited Dec. 05, 2015).

¹⁰³ *Id.*

¹⁰⁴ In Massachusetts, it is virtually impossible for a for-profit business to have a legally-compliant unpaid internship program and should therefore not attempt to do so without legal advice.

¹⁰⁵ WAGE AND HOUR DIV., U.S. DEPT. OF LAB., FACT SHEET #71: INTERNSHIP PROGRAMS UNDER THE FAIR LABOR STANDARDS ACT, (Apr. 2010), <https://www.dol.gov/whd/regs/compliance/whdfs71.pdf> [hereinafter FACT SHEET #71].

¹⁰⁶ MASS. GEN. LAWS ch. 151, § 2 (2015).

¹⁰⁷ *See* FACT SHEET #71, *supra* note 105; *see also* Nancy Vary & Julia Zuckerman, *Intern or Employee? Another Federal Appeals Court Rejects DOL Test*, FOR YOUR INFORMATION (Oct. 6, 2015),

https://hrlaws.services.xerox.com/wp-content/uploads/sites/2/2015/10/hrc_fyi_2015-10-06.pdf (discussing recent Circuit Court of Appeals decisions that reject the Department of Labor test).

¹⁰⁸ ORSI, *supra* note 76, at 401.

¹⁰⁹ For more information on the Form I-9 Requirement, please see **Section 5.B: Undocumented Immigrants and the Worker Cooperative**.

¹¹⁰ PUBLIC INFORMATION OFFICE, DEPT. OF INDUSTRIAL ACCIDENTS, MASS. DEPT. OF LABOR, *Employers' Guide to the Massachusetts Workers' Compensation System*,

<http://www.nahant.org/documents/services/forms/Inspectors/erguide.pdf> (last visited Nov. 29, 2015).

¹¹¹ MASS. EXEC. OFFICE OF LABOR AND WORKFORCE DEV., *Who Needs Workers' Compensation Insurance in Massachusetts?*, MASS.GOV, <http://www.mass.gov/lwd/workers-compensation/investigations/who-needs-workers-compensation-insurance-in.html> (last visited Nov. 29, 2015); MASS. GEN. LAWS ch. 152, § 1(4) (2015).

¹¹² MASS. EXEC. OFFICE OF LABOR AND WORKFORCE DEV., *supra* note 111; § 1(4).

¹¹³ MASS. EXEC. OFFICE OF LABOR AND WORKFORCE DEV., *supra* note 111; § 1(4).

¹¹⁴ DEPT. OF UNEMPLOYMENT ASSISTANCE, MASS. EXEC. OFFICE OF LABOR AND WORKFORCE DEV., THE EMPLOYER'S GUIDE TO UNEMPLOYMENT INSURANCE 6, <http://www.mass.gov/lwd/docs/dua/business/employer-handbook.pdf> (last visited Nov. 29, 2015).

¹¹⁵ This clarification came from a call with the Department of Unemployment Assistance on Nov. 17, 2015.

¹¹⁶ COMMONWEALTH CORPORATION, *Frequently Asked Questions*, WORKFORCE TRAINING FUND, <http://www.commcorp.org/sites/page.cfm?p=118#Eligible%20Applicants> (last visited Nov. 29, 2015).

¹¹⁷ 8 U.S.C. § 1101(a)(15) (2012).

¹¹⁸ *Id.*

¹¹⁹ *See* § 1153(a).

¹²⁰ *See* § 1153(b).

¹²¹ *See* § 1101(a)(15)(U).

¹²² *See* § 1101(a)(15)(T).

¹²³ *See* § 1158.

¹²⁴ §§ 1324a(a), 1227(a)(1)(B).

¹²⁵ *Arizona v. USA*, 132 S.Ct. 2492, 2505 (2012).

¹²⁶ § 1227(a)(1)(B).

¹²⁷ § 1229b(b).

¹²⁸ An exception is the “casual employment by individuals who provide domestic service in a private home that is sporadic, irregular or intermittent.” 8 C.F.R. § 274a.1(h) (2009). Consult an immigration lawyer for details.

¹²⁹ § 1324a(a)(1).

¹³⁰ *See, e.g., Hoffman Plastic Compounds, Inc. v. NLRB*, 535 U.S. 137 (2002).

¹³¹ § 1324a(a)(1).

¹³² § 1324a(b).

¹³³ § 1324a(b)(3).

¹³⁴ § 1324a(b)(1); USCIS Form I-9.

¹³⁵ 18 U.S.C. § 1028A(a)(1) (2012).

¹³⁶ § 1324a(b)(1)(A); USCIS Form I-9.

¹³⁷ USCIS Form I-9.

¹³⁸ DEPT. OF HOMELAND SEC., *Penalties*, U.S. CITIZENSHIP AND IMMIGRATION SERVICES, <http://www.uscis.gov/i-9-central/penalties/penalties> (last visited Nov. 29, 2015).

¹³⁹ 8 C.F.R. § 274a.1(f) (2014); *USA v. Lorenzo Robles*, 2 OCAHO 309, 1991 WL 531738 (Mar. 29 1991).

¹⁴⁰ § 1324a(a)(4).

¹⁴¹ *See, e.g., USA v. Speedy Gonzalez Construction, Inc.*, 11 OCAHO 1228, 2014 WL 5419578 (Sept. 19, 2014).

¹⁴² *See, e.g., id.*

¹⁴³ *See Clackamas Gastroenterology Associates, P.C. v. Wells*, 538 U.S. 440, 449–50 (2003).

¹⁴⁴ *See USA v. Two for Seven, LLC*, 10 OCAHO 1208, 2014 WL 278900 (Jan. 15, 2014).

¹⁴⁵ *See, e.g., IMMIGRANT ENTREPRENEURS OVERVIEW* *supra* note 48, at 30–31.

¹⁴⁶ *See* 26 U.S.C. § 3402(a) (2011); *see* INTERNAL REVENUE SERV., *Paying Yourself*, <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Paying-Yourself> (last visited Dec. 04, 2015).

¹⁴⁷ See DEPT. OF HOMELAND SEC., *I-9 Central: Who Needs to Complete Form I-9?*, U.S. CITIZENSHIP AND IMMIGRATION SERVICES, <http://www.uscis.gov/faq-page/i-9-central-who-needs-complete-form-i-9#t17071n46926> (last visited Nov. 29, 2015).

¹⁴⁸ 8 U.S.C. § 1227(a)(1)(C) (2012).

¹⁴⁹ 8 U.S.C. § 1182(a)(6)(A)(1) (2012).

¹⁵⁰ It should be noted that cooperatives have significant flexibility regarding how they handle initial capital contributions. For example, they may require a fee to be paid upfront or instead may institute a payment plan under which small portions of the new worker-owner's wages are allocated to his internal capital account over time until the fee is paid in full.

¹⁵¹ Credit for this idea is owed to Sara Stephens at the Sustainable Economies Law Center.

¹⁵² The Tax Court has listed three defining characteristics of a business "operating on a cooperative basis": (i) the subordination of capital (i.e., "[c]apital is subordinated when the control and benefits of the cooperative is in the hands of the member patrons rather than in any equity investors of the cooperative"); (ii) democratic control of the business by its members (i.e., "voting is on a one-member, one-vote basis"); and (iii) "the vesting and allocation of profits to members in proportion to their active participation in the organization" (i.e., distribution of profits must be on the basis of patronage). See JACOB MERTENS, LAW OF FEDERAL INCOME TAXATION § 34A:4 (2005).

¹⁵³ See ICA GROUP, *Written Notices of Allocation*, <http://ica-group.org/wp-content/uploads/2015/04/Internal-Capital-Accounts.pdf> (last visited Nov. 29, 2015) (describing the difference between a qualified and nonqualified written notice of allocation).

¹⁵⁴ In fact, the Internal Revenue Code's definition of "qualified written notice of allocation" mandates that the recipient have the right to redeem the written notice in cash after 90 days after its issuance. 26 U.S.C. § 1388(c) (2012).

¹⁵⁵ 26 U.S.C. § 1385(a) (2012).

¹⁵⁶ 26 U.S.C. § 1382(b) (2012).

¹⁵⁷ See § 1385(a)–(c).

¹⁵⁸ See § 1382(b).

¹⁵⁹ *Id.*

¹⁶⁰ See generally 26 U.S.C. §§ 1401-03 (2012).

¹⁶¹ 26 U.S.C. § 1402(b) (2012).

¹⁶² See GREGORY R. WILSON, TAXATION OF PATRONAGE DIVIDENDS FROM WORKER COOPERATIVES: ARE THEY SUBJECT TO EMPLOYMENT TAX? (2008), available at [http://www.gwilson.com/documents/Article4\(PatronageDivTax\).pdf](http://www.gwilson.com/documents/Article4(PatronageDivTax).pdf) [hereinafter, *Taxation of Patronage Dividends*].

¹⁶³ Bot, 118 T.C. 138 (2002).

¹⁶⁴ *Id.*

¹⁶⁵ Wilson, *Taxation of Patronage Dividends* at 5.

¹⁶⁶ *Id.* at 5-6.

¹⁶⁷ MASS. GEN. LAWS ch. 63, § 2 (2015).

¹⁶⁸ §§ 2–2A.

¹⁶⁹ § 2B.

¹⁷⁰ § 2B(b).

¹⁷¹ § 68C.

¹⁷² *Id.*; see also Massachusetts Department of Revenue, Limited Liability Companies and Limited Liability Partnerships, available at <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/business-income-taxes/limited-liability-companies-and-limited.html> (last visited December 21, 2015)

¹⁷³ 26 C.F.R. § 301.6109-1(d)(3)(ii) (2012). For a more detailed description of the process to obtain an ITIN, see IMMIGRANT ENTREPRENEURS OVERVIEW, *supra* note 48.

¹⁷⁴ See Massachusetts Substitute W-9 Form, available at <http://www.mass.gov/osc/docs/forms/vendorcustomer/newmass-w9.pdf>.

¹⁷⁵ See 26 U.S.C. § 6103 (2012).

¹⁷⁶ See 830 MASS. CODE REGS. 62C.21.1 (LexisNexis 2015).

¹⁷⁷ 26 C.F.R. § 301.6109-1(a)(ii)(C)-(D); *see also* MASS. DEPT. OF REVENUE, *Obtaining Identification Numbers*, <http://www.mass.gov/dor/businesses/current-tax-info/guide-to-employer-tax-obligations/obtaining-identification-numbers.html>.

¹⁷⁸ INTERNAL REVENUE SERV., *Instructions for Form SS-4* (Rev. Jan. 2011) at 3, available at <https://www.irs.gov/pub/irs-pdf/iss4.pdf>.

¹⁷⁹ *Id.*

¹⁸⁰ SUSTAINABLE ECONS. LAW CTR., *Converting to a Cooperative - Benefits of a Cooperative Conversion*, <http://www.co-oplaw.org/topics-2/conversion> (last visited Nov. 29, 2015).

¹⁸¹ PROJECT EQUITY, *Why Worker Coop Conversions and Ownership Make Sense Now*, <http://www.project-equity.org/business-conversions/conversions-and-ownership-make-sense-now-federal-reserve-bank-10-15-15> (last visited Nov. 29, 2015).

¹⁸² ICA GROUP, *ENSURING YOUR LEGACY: SUCCESSION PLANNING AND DEMOCRATIC EMPLOYEE OWNERSHIP*, (2015), available at <http://ica-group.org/wp-content/uploads/2015/02/Ensuring-Your-Legacy-Succession-Planning-and-Democratic-Employee-Ownership.pdf>.

¹⁸³ *Id.*

¹⁸⁴ A leveraged buyout is a transaction that is financed through a combination of equity and debt, where the revenue and assets of the business are used as collateral for the borrowed money.

¹⁸⁵ *See* SUSTAINABLE ECONS. LAW CTR., *Converting to a Cooperative - Steps to Cooperatize*, <http://www.co-oplaw.org/topics-2/conversion> (last visited Nov. 29, 2015) [hereinafter *Steps to Cooperatize*]; Cat Johnson, *How To Convert a Business into a Worker-owned Cooperative* (June 18, 2014), <http://www.shareable.net/blog/how-to-convert-a-business-into-a-worker-owned-cooperative> (last visited Nov. 29, 2015). Advisors should include cooperative developers, lawyers, and accountants.

¹⁸⁶ *Steps to Cooperatize*, *supra* note 185.

¹⁸⁷ For more information regarding cooperative conversions, please see DEMOCRACY AT WORK INST., *More Info for Conversions*, <http://institute.coop/tools/for-worker-coops/conversions> (last visited Nov. 29, 2015).

¹⁸⁸ For an example of a conversion timeline, see DEMOCRACY AT WORK INST., *Cooperative Transition - Timing (weeks)*, <http://institute.coop/sites/default/files/resources/co-op%20conversion%20timing%20chart.pdf> (last visited Nov. 29, 2015).

¹⁸⁹ *Steps to Cooperatize*, *supra* note 185.

¹⁹⁰ *Steps to Cooperatize*, *supra* note 185.

¹⁹¹ *Steps to Cooperatize*, *supra* note 185.

¹⁹² *See generally* SUSTAINABLE ECONS. LAW CTR., *THINK OUTSIDE THE BOSS* (2013), available at <http://www.co-oplaw.org/worker-co-op-resources/manuals/>.

¹⁹³ Johnson, *supra* note 185.

¹⁹⁴ JANELLE ORSI & EMILY DOSKOW, *THE SHARING SOLUTION* 399 (2009).

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ For more information, please see THE ESOP ASS'N, *How do ESOPs Work?*, <http://www.esopassociation.org/explore/how-esops-work> (last visited Nov. 29, 2015).

²⁰⁰ PROJECT EQUITY, *Typology of Coop Conversions*, <http://www.project-equity.org/business-conversions/typology-of-coop-conversions> (last visited Nov. 29, 2015).

²⁰¹ REAL PICKLES, *Our Mission*, <http://www.realpickles.com/about.html> (last visited Nov. 29, 2015).

²⁰² REAL PICKLES, *Our Story*, http://www.realpickles.com/about_story.html (last visited Nov. 29, 2015).

²⁰³ PROJECT EQUITY, *Case Study: Real Pickles*, <http://www.project-equity.org/case-studies-business-conversions/case-study-real-pickles> (last visited Nov. 29, 2015).

²⁰⁴ An option gives an investor the right, but not an obligation, to buy a stock, bond, commodity, or other instrument at a specified price within a specified time period.

²⁰⁵ COOP. FUND OF NEW ENGLAND, *Who is Eligible?*,

http://www.cooperativefund.org/b_c_ds_cfne_loan/lending_policies (last visited Nov. 29, 2015).

²⁰⁶ SUSTAINABLE ECONS. LAW CTR., *Financing a Cooperative*, <http://www.co-oplaw.org/topics-2/financing> (last visited Nov. 29, 2015).

²⁰⁷ *Id.* Private placements may be an additional option for cooperatives looking to bring in outside equity investors, but due to space considerations, will not be discussed in this document. For more information about private placement offerings (as well as other great information related to finance for cooperatives), please see generally R.P. Burrasca, Susan Grossberg, Anne Misak, and Jason Wiener, *An Introduction to Financing for Cooperatives, Social Enterprises, and Small Businesses* (June 2015), available at

http://neweconomy.net/sites/default/files/resources/finance_guide_final_june_2015.pdf.

²⁰⁸ CUTTING EDGE CAPITAL, *DPO FAQs*, <http://www.cuttingedgecapital.com/dpofaqs> (last visited Nov. 29, 2015); INC., *Direct Public Offerings*, <http://www.inc.com/encyclopedia/direct-public-offerings.html> (last visited Dec. 1, 2015).

²⁰⁹ For more information, see Bradley C. Weber & Michael J. Minahan, *Two Years and Essentially As Proposed: SEC Adopts Final Crowdfunding Rules*, GOODWIN PROCTER (Nov. 13, 2015), http://www.goodwinprocter.com/Publications/Newsletters/Client-Alert/2015/11_13-Two-Years-and-Essentially-As-Proposed_SEC-Adopts-Final-Crowdfunding-Rules.aspx.

²¹⁰ For more information on non-accredited investors, please see INVESTOPEDIA, *Non-Accredited Investor*, <http://www.investopedia.com/terms/n/nonaccreditedinvestor.asp> (last visited Nov. 29, 2015).

²¹¹ CUTTING EDGE CAPITAL, *What is a Direct Public Offering a.k.a. Investment Crowdfunding?*, <http://www.cuttingedgecapital.com/what-is-a-direct-public-offering> (last visited Nov. 29, 2015).

²¹² *Id.*

²¹³ See SEC'Y OF THE COMMONWEALTH OF MASS, *Corporate Finance Section*, <http://www.sec.state.ma.us/sct/sctfin/finidx.htm#fee> (last visited Nov. 29, 2015).

²¹⁴ Cooperative corporations and employee cooperative corporations governed by MASS. GEN. LAWS ch.157 or 157A are exempt from Massachusetts registration requirements if the capital stock issued does not exceed \$50,000 and “no expenditure is made by or on its behalf in connection with the issuance or sale of its securities other than the actual expenses of organization, calling or holding meetings of incorporators or shareholders, printing, mailing, and taxes.” MASS. GEN. LAWS ch. 110A, § 402(12).

²¹⁵ See SEC'Y OF THE COMMONWEALTH OF MASS, *Uniform Forms*, <http://www.sec.state.ma.us/sct/sctfrm/frmidx.htm> (last visited Nov. 29, 2015); N. AM. SEC. ADM'S ASS'N, *SCOR Overview*, <http://www.nasaa.org/industry-resources/corporation-finance/scor-overview> (last visited Nov. 29, 2015).

²¹⁶ CUTTING EDGE CAPITAL, *\$340,000 Raised by Composting and Recycling Worker Cooperative in Massachusetts*, (July 8, 2015), <http://www.cuttingedgecapital.com/cerodpo>.

²¹⁷ *Id.*

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ For more information, see BOS. IMPACT INITIATIVE, *About Us*, <http://bostonimpact.com/> (last visited Nov. 29, 2015).

²²¹ For more information, see COOP. FUND OF NEW ENGLAND, *CFNE Products*, http://www.cooperativefund.org/b_c_ds_cfne_loan/eligibility_standards (last visited Nov. 29, 2015).

²²² For more information, see INDIEGOGO, *How it Works*, <https://www.indiegogo.com/learn-how-to-raise-money-for-a-campaign> (last visited Nov. 29, 2015).

²²³ INDIEGOGO, *How about tax?*, <https://support.indiegogo.com/hc/en-us/articles/204738008-How-about-tax-> (last visited Nov. 29, 2015).

²²⁴ Please note that funds allocated to a collective account are always subject to tax. In the case of a cooperative that has elected for tax treatment under Subchapter T, the cooperative is responsible for paying those taxes. On the other hand, in the case of a cooperative that has elected for partnership tax treatment, the worker-owners are responsible for paying those taxes since the funds are considered income of the worker-owners.

²²⁵ See **Section 3: Legally Forming Your Cooperative** of this document for further discussion of governing documents.

²²⁶ While the answers to such questions will depend on a cooperative's specific business, see The ICA Group's publication on internal capital accounts for a number of suggested best practices. See *infra* note 227.

²²⁷ For more information on internal capital accounts, please see ICA GROUP, *Internal Capital Accounts: An Illustrated Guide to the Internal Capital Account System for Worker Cooperatives*, <http://ica-group.org/wp-content/uploads/2015/04/Internal-Capital-Accounts.pdf> (last visited Nov. 29, 2015).