



**GEORGIA ELECTRIC
MEMBERSHIP COOPERATIVES
IRC §501(c)(12) COMPLIANCE
AND TRANSPARENCY**



THIS PAGE INTENTIONALLY LEFT BLANK



CONSUMER ENERGY PROGRAM

Georgia Electric Membership Cooperatives: IRC §501(c)(12) Compliance and Transparency

November 2015

A project funded by the Rockefeller Family Fund



ACKNOWLEDGEMENTS

Georgia Watch is grateful to the Rockefeller Family Fund for funding this project and making this research possible.

We would also like to express our gratitude to the Foundation Center for providing an unlimited and unrestricted access to EMCs' Forms 990, both online at www.foundationcenter.org and onsite at 133 Peachtree Street NE, Atlanta, GA 30303, which made the information needed for this report readily available.

Georgia Watch would additionally like to recognize and thank the interns who took part in preparing this report, particularly Anton Stewart, J.D. Candidate, Emory University School of Law, Class of 2017 and Adriana Jaume, J.D. Candidate, Emory University School of Law, Class of 2016.

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
INTRODUCTION	2
IRC §501(c)(12)	3
GEORGIA EMCs AND § 501(c)(12) COMPLIANCE	7
GEORGIA EMCs AND TRANSPARENCY	14
CONCLUSIONS	19
APPENDIX A	i
APPENDIX B	iii

EXECUTIVE SUMMARY

PROJECT DESCRIPTION: Nearly half the population of Georgia is served by Electric Membership Corporations or Cooperatives (EMCs), and a majority claim tax-exempt status under the provisions of the Internal Revenue Code (I.R.C.), § 501(c)(12). The IRS imposes several requirements that an EMC has to meet to qualify for this exemption, namely, that (a) an EMC be organized and operated as a cooperative; (b) it conduct one of the listed or essentially similar activities; and (c) it receive at least 85 percent of its income from members. As we have seen recent examples in Georgia of EMC boards apparently acting more in their own interests than that of their membership, Georgia Watch conducted research into EMC practices regarding IRS requirements and democratic membership involvement in governance.

This project pursues the following goals:

- Assess the compliance of Georgia EMCs with the requirements of Section 501 (c)(12);
- Educate consumers about the process of obtaining and analyzing a bulk of data that may or may not be provided to them by an EMC on its tax status and operations;
- Encourage a greater transparency and openness to members among Georgia EMCs regarding their operating and accounting practices;
- Compile a comprehensive and easy-to-use template that would facilitate any future examination of § 501(c)(12) compliance by an EMC, as well as define good management and accountability practices.

METHODOLOGY: Georgia Watch conducted a review of a sample of six EMCs serving counties in northern, central and southern Georgia that represent the diversity of the state's population, and thoroughly examined those EMCs' most recent bylaws, corporate practices, and tax and financial reports. In addition, Georgia Watch analyzed accessibility of this information to the general public electronically and physically, as well as the means by which it is distributed to the members of the EMCs examined, to draw conclusions as to the commitment of the industry to transparency and openness to public scrutiny.

FINDINGS: Georgia Watch found that five out of the six cooperatives we reviewed were compliant with the minimum requirements of the I.R.C. § 501(c) (12), but we observed a range of commitment to compliance with cooperative principles, especially as it relates to wider inclusion of members on governance matters.

Regarding transparency, Georgia Watch believes that the EMCs should itemize and fully disclose the nature and amounts they invest into related or controlled organizations, and proactively make the information regarding their finances and activities publicly available, including online publication, without the need for an interested person to contact a designated official of the cooperative to obtain this information. A fully itemized list of investments made into associated organizations should be included in financial reports in order to show whether these investments are being correctly reported as “program-related”.

Finally, we believe the nature of the relationship between the EMC and its wholesale electricity supplier(s) should be fully disclosed to the cooperative members and general public to allow for assessment of the reasonableness and appropriateness of the current electricity rates set by the EMCs.

INTRODUCTION

Electric cooperatives have existed in the United States essentially since the advent of electricity, delivering access to the-now most basic utility to remote and rural areas of the country. As a part of New Deal policies, striving to encourage the development of the stagnant economy, the Franklin D. Roosevelt administration took steps to encourage farmers and rural dwellers to take the issue in their own hands and to arrange for electricity supply through their own means. Among the most significant incentives, a tax-exempt status was offered to all qualifying potential cooperatives.¹

The times of the New Deal have long passed, yet to this day cooperatives thrive and multiply, encouraged by a still existing I.R.C. §501(c)(12) that provides an income tax exemption to any qualifying cooperative. However, with the spirit of cooperation between the neighbors to gain light and connection to the outside world gone, so is the original nature of the cooperatives. Today, the majority of them are virtually indistinguishable from investor-owned utility companies that serve the majority of city inhabitants, except they enjoy a tax-free environment and are not allowed to conduct their activities with a view to profit.

Through this research, Georgia Watch set out to assess the current state of affairs in the electric cooperative market, to examine the compliance of the state’s EMCs with the requirements of I.R.C. § 501(c)(12), and to promote a greater transparency among cooperative electricity providers to ensure the maximum benefit for the consumers who are members of EMCs.

¹See e.g., TVA: Electricity for All. Rural Electrification. New Deal Network. <http://newdeal.feri.org/tva/tva10.htm> (Accessed October 23, 2015); Rural Electrification Act 1936, 7 U.S.C. §901 et seq. (West 2015).

Through this report, we identify the best practices in the industry in a hope that this will encourage electric membership cooperatives to ensure that their members' best interests are put first, as required by law and their organizational nature. Georgia Watch also developed a simple checklist to assess compliance of an EMC with the provisions of law and their general openness in relation to members and the public.

In preparing this report, Georgia Watch reviewed data primarily from sources available to the public, including websites of the EMCs that were part of the sample pool, data from the Georgia EMC (an umbrella association of the state's cooperatives), U.S. Census data, and IRS regulations. We aimed to simulate an environment that a prudent cooperative member may find himself or herself in, should he or she decide to conduct similar research.

I.R.C. § 501(c)(12)

I.R.C. § 501(c)(12) exempts the following types of organizations from income tax:

- benevolent life insurance associations of a purely local character;
- mutual ditch or irrigation companies;
- mutual or cooperative telephone companies;
- mutual or cooperative electric companies; and
- "like organizations".²

Since the object of this research is electric cooperatives, we shall concentrate on organizations of that type.

To qualify for the above exemption, an EMC must: be organized and operated as a cooperative, and receive 85 percent or more of its income from members for the sole purpose of meeting losses and expenses each year.

ORGANIZATIONAL AND OPERATIONAL REQUIREMENTS

A company seeking exemption under I.R.C. § 501(c)(12) must be organized as a mutual or cooperative organization. The IRS states that there is no legal distinction between the two terms³; therefore, we are going to use them interchangeably.

²26 U.S.C. § 501(c)(12) (2012).

³See IRM 7.25.12.5(1).

Since the Internal Revenue Code does not give any definition of either “mutual” or “cooperative company”, we shall examine the judicial practice to locate a proper interpretation of the term. The U.S. Tax Court in *Puget Sound Plywood, Inc. v. Commissioner*, 44 T.C. 305, 307-308 (1965), defined a cooperative as “an organization established by individuals to provide themselves with goods and services or to produce and dispose of the products of their labor. The means of production and distribution are those owned in common and the earnings revert to the members, not on the basis of their investment in the enterprise, but in proportion to their patronage or personal participation in it.”

Under this definition, a cooperative must possess the following essential attributes:

- **Democratic control**, which simply means that in order to be considered a cooperative, a company applying for a § 501(c)(12) exemption must be controlled by its members through democratically conducted meetings with a mandatory quorum, where each member has one vote.
- **Operation at cost**, which requires that any excess of operating revenues (excess revenue over expenses) are allocated among members;
- **Subordination of capital**. This attribute implies that capital contributors (investors) neither control the operation, nor receive most of the financial benefits provided by a cooperative. This is achieved by ensuring that members control savings and other monetary benefits, rather than investors or shareholders. Nothing in this rule, however, prevents a cooperative from issuing nonvoting interest-bearing stock, so long as the number of shares is kept reasonable, and so long as the shareholders do not receive voting rights, accept a fixed-rate dividend as the sole form of interest available to them, and do not directly or indirectly participate in savings or profits. The rationale behind this requirement is plain and simple. While it is understandable that in many instances a cooperative may require outside funds to finance long-term asset purchases, giving shareholders voting rights would make the organization indistinguishable from an ordinary company limited by shares and make it hard to justify a practice of granting select few a tax exemption. At the same time, shareholders receive a fixed dividend in exchange for their money, which in the eyes of the law makes an adequate consideration for the invested money.⁴

⁴I.R.M. 7.25.12.5(2).

Of those additional criteria listed, B and C appear to be the most problematic for EMCs in Georgia, as the majority of those studied for this project appear to have a provision in their bylaws allowing the formation of capital reserves and withholding disbursements of funds to members.

The IRS additionally requires⁵ that a cooperative applying for a § 501(c)(12) exemption meets the following criteria:

- A. The organization must keep adequate records of each member's rights and interests in its assets.
- B. The organization must distribute any savings to members in proportion to the amount of business done with them based on the "operation at cost" principle.
- C. The organization must not retain more funds than it needs to meet current losses and expenses.
- D. The organization cannot forfeit a member's right and interest in the organization upon termination of membership.
- E. Upon dissolution, the organization must distribute the gains from the sale of any appreciated assets to all persons who were members during the period that the organization owned the assets, in proportion to the amount of business done by the members during that period.

Of those additional criteria listed above, **B** and **C** appear to be the most problematic for EMCs in Georgia, as the majority of those studied for this project appear to have a provision in their bylaws allowing the formation of capital reserves and withholding disbursements of funds to members. On its surface, this seems to be against the requirements set out by the IRS. However, a greater examination of facts outside the scope of this project would be necessary to determine compliance.

⁵Rev. Rul. 72-36, 1972-1 C.B. 151; I.R.M. 7.25.12.5(3).

ACTIVITIES TEST

A cooperative applying for exemption under I.R.C. § 501(c)(12) is also obliged to pursue one of the listed or “like” activities, which includes EMCs. We shall note, however, that financing of any type or sort of the purchase of the electricity, or property, plant and equipment related to production thereto is not a “like” activity for the purposes of tax exemption.

EIGHTY-FIVE PERCENT MEMBER INCOME TEST

Among the most important test that cooperatives must pass is the 85% member income requirement. It implies that at least 85% of all income received by an EMC in a fiscal year should come from its members rather than from outside sources, such as investments from non-members. The operating income should be paid by members to the EMC in return for the performance by the latter of one of the exempt activities. An EMC must pass the test annually to maintain its tax-exempt status, otherwise that status will be lost and the company will be liable to pay income tax as if accrued from regular business activities.⁶

Certain types of earnings, most notably pole rentals, are excluded from the computation of 85% for the purposes of this because they are inherent or incidental to the supply of electricity to members.

- **Qualified pole rentals.** This means any rental of a pole (or other structure used to support wires) if the pole (or other structure) is used: (a) by the electric company to support one or more wires that are used by the company in providing electric services to its member; and (b) pursuant to the rental to support one or more wires (in addition to wires described in (a)) for use in connection with the transmission by wire of electricity or of telephone or other communications. The term rental, for this purpose, includes any sale of the right to use the pole (or other structure).
- Any provision or **sale of electric energy transmission services** or ancillary service **if** the services are provided on a nondiscriminatory open access basis under an open access transmission tariff **approved or accepted** by the Federal Energy Regulatory Commission (FERC) or under an independent transmission provider agreement **approved or accepted** by FERC (other than income received or accrued directly or indirectly from a member).

⁶I.R.M. 7.25.12.8.

- The provision or **sale of** electric energy distribution **services** or ancillary services if the services are provided on a nondiscriminatory open-access basis to distribute electric energy **not owned by the mutual** or electric cooperative company:
 - To end-users who are served by distribution facilities not owned by the company or any of its members (other than income received or accrued directly or indirectly from a member), or
 - Generated by a generation facility not owned or leased by the company or any of its members and which is directly connected to distribution facilities owned by the company or any of its members (other than income received or accrued directly or indirectly from a member).
- Any **nuclear decommissioning transaction**.
- Any **asset exchange or conversion transaction**.⁷

The same applies to state and federal grants. Provided that the grants (a) become part of the capital; (b) are not paid as compensation for services; (c) are subject to conditions imposed by the grantor; (d) benefit the corporation commensurate with its value; and (e) are ordinarily employed to generate additional income (Rev. Rul. 93-16, 1993-1 C.B. 26), they may be excluded from computations of income for the purposes of the 85% member income test.⁸

Further, voluntary donations in the form of gifts are not taken into account for the purposes of the test either. However, any other tax-exempt income, apart from gifts, should be counted towards the permitted 15% non-member income.

GEORGIA EMCs AND § 501(c)(12) COMPLIANCE

METHODOLOGY

SAMPLE: Georgia Watch selected six EMCs out of the pool of 42 serving the state population on the basis of the membership size, demographics and population density within the service area, as well as geographic location in the state of Georgia. The sample pool reflects the racial and socioeconomic diversity of the population of Georgia.

⁷I.R.M. 7.25.12.8.1(5).

⁸List of the types of earnings with descriptions is replicated from M. Seto; C. Chasin, *supra*, at 188.

North Georgia EMC serves Whitfield, Murray, Gordon, Catoosa, Chattooga, Floyd and Walker Counties, all in northern Georgia. As per the 2010 Census data, the area served by North Georgia EMC has the highest percentage of Hispanic/Latino population outside major urban areas of Georgia, with 1/3rd and 1/7th of the population in Whitfield and Murray Counties respectively identifying as Hispanic/Latino. Catoosa and Walker Counties, on the other hand, are predominantly Caucasian. Membership: approximately 98,000.⁹

Snapping Shoals EMC covers the areas of Newton, Rockdale, Henry, DeKalb, Butts, Walton, Jasper and Morgan Counties in Central Georgia. This cooperative serves a significant part of Georgia's African American population, most notably in DeKalb County. As per the 2010 Census, 54.3% and 45.8% of DeKalb County and Rockdale County population respectively identified as African American. Membership: roughly 95,000.

Slash Pine EMC serves Atkinson, Clinch, Lanier, Echols, Ware, Berrien, Lowndes and Charlton Counties in southern Georgia. The area is sparsely populated, with less than one person per square mile population density in some areas, most notably in Clinch and Echols Counties. Membership: about 6,000.

Diverse Power EMC serves Calhoun, Clay, Harris, Heard, Meriwether, Muscogee, Randolph, Quitman and Troup Counties in west Georgia. Of those nine, Muscogee County has the highest population density in parts of the state that are served by EMCs. Membership: approximately 35,000.

Sawnee EMC, serving Forsyth, Fulton, Cherokee, Hall, Dawson, Gwinnett and Lumpkin Counties, just to the north of Atlanta Metro Area, represents a yet another part of Georgia population, namely, middle-to-high income households. In Forsyth County alone, the median household income was \$87,605, according to U.S. Census Bureau data, almost twice the state average of \$49,179 and the highest in Georgia. Membership: about 165,000.

Central Georgia EMC serves Bibb, Butts, Clayton, Fayette, Henry, Jasper, Jones, Lamar, Monroe, Morgan, Newton, Pike, Putnam and Spalding Counties, just to the south of metropolitan Atlanta. This is a yet another cooperative that provides energy to a significant part of Georgia's African American population (e.g. 53.8% and 43% of the population of Bibb and Newton Counties identify as Black or African American, as per the most recent census data). Membership: around 52,000.

⁹Here and below: membership numbers are provided as per the EMCs' annual reports or websites.

The IRS in its 2002 General Survey of I.R.C. § 501(c)(12) Cooperatives and Examination of Current Facts¹⁰ instructs us to assess whether a cooperative satisfies the principles and requirements for § 501(c)(12) organizations as a question of fact, that is, by answering it with reference to facts and evidence, and inferences therefrom.

With that in mind, Georgia Watch examined the provisions of bylaws of each EMC listed above, as well as their articles and Form 990 filings, against the requirements described in the previous chapter of this research to draw conclusions regarding the compliance of the said EMCs with the IRS regulations for I.R.C. § 501(c)(12) organizations and to their continuing commitment to remaining tax-exempt entities of cooperative nature.

FINDINGS

ORGANIZATIONAL & OPERATIONS TEST

	Democratic control	Operation at cost	Subordination of capital
North Georgia EMC	√	?	√
Snapping Shoals EMC	√	√	√
Slash Pine EMC	√	√	√
Diverse Power EMC	√	√	√
Sawnee EMC	√	√	√
Central Georgia EMC	√	√	√

As noted above, we gave each EMC the benefit of doubt prior to drawing any conclusions about their compliance with the IRS regulations. In addition, since the regulations themselves are vague and somewhat ambiguous, we did our best to avoid labelling any of the EMCs as “non-compliant”, so long as they met the minimum requirements expressly spelled out by the Internal Revenue Service. Finally, the IRS directs us to examine the compliance with the I.R.C. § 501(c)(12) provisions as a question fact, therefore we shall refrain from making assumptions regarding compliance, unless we have overwhelming evidence that the practices of any given cooperative go against the prescribed modes of conduct.

DEMOCRATIC CONTROL

Even though we marked all six EMCs as compliant with the minimum requirements of the IRS regulations, that is, that the cooperative be controlled by its members through meetings with obligatory quorum where each member has only one vote, Georgia Watch found that the majority of the cooperatives studied for this project apparently made little to no effort to ensure a truly democratic and inclusive governance that would involve at least 5% of members.

...the majority of the cooperatives studied for this project apparently made little to no effort to ensure a truly democratic and inclusive governance that would involve at least 5% of members.

For instance, bylaws of North Georgia EMC (Art. III, §§1-2) provide that the cooperative is controlled by its members through annual and special meetings with an obligatory quorum (Art. III, §4), where each member present has one vote (Art. III, §5). Art. III, §4, at the same time, sets the required quorum at 300 members. North Georgia EMC has approximately 98,000 members as of today, as per the website of the cooperative, which means that the mutual allows roughly 0.03% of members to make decisions on the affairs of the whole organization.

Bylaws of Sawnee EMC, §§3.01-3.05, similarly provide that the cooperative is governed by its members through annual and special meetings with obligatory quorum where each member has only one vote. However, if one were to have a closer look at the said obligatory quorum, Bylaws, §3.04, establish the same at 150 members, which is less than 0.01% of the total of roughly 164,000 members of Sawnee EMC.

Taking into account that both North Georgia EMC and Sawnee EMC¹¹ prohibit proxy and mail voting, we believe that the EMCs unnecessarily limit possible participation of members. We encourage both our pool sample members and other EMCs in Georgia that have similar provisions in their bylaws to allow postal voting to ensure

Taking into account that both North Georgia EMC and Sawnee EMC prohibit proxy and mail voting, we believe that the EMCs unnecessarily limit possible participation of members.

OPERATION AT COST

I.R.C. § 501(c)(12) requires that tax exempt cooperatives allocate all operating profits among their members. All EMCs that Georgia Watch studied for this project provide in their bylaws (usually in the article titled “Non-Profit Operation”) that they are non-profit organizations run for the benefit of their members. The statement by itself is purely declaratory, so Georgia Watch looked further into the bylaws of our sample to establish how this principle is implemented and enforced by them.

Only our review of North Georgia EMC raised questions relative to operating at cost. The sole provision in its bylaws that relates to operation at cost that Georgia Watch found was Art. X, §2, which obligates the EMC to keep books and records in a manner that would allow it to compute the amount of capital contributed by each member. This apparently falls short of allocation of profits to members required by the IRS.

¹¹The same applies to Central Georgia EMC; Bylaws; §3.05.

SUBORDINATION OF CAPITAL

Upon consideration of bylaws of all cooperatives Georgia Watch selected for the sample pool, we believe that all EMCs are compliant with this requirement of the test. We did not find any fact or evidence that would indicate that any of the mutual organizations studied for this project would provide substantial (or any in most cases) amount of benefits to non-members.

We encourage the cooperatives to either fully disclose how and on which conditions the aforesaid investments were made and/or stop participating in any investment activities altogether.

ADDITIONAL REQUIREMENTS

As we noted above in the chapter providing the general outline of the IRS requirements for § 501(c)(12) organizations, the most problematic areas of compliance here are (a) the distribution of savings to members in proportion to the amount of business done with them; and (b) non-retention of funds in excess of what the cooperative needs to meet its current losses and expenses.

Similar to its operation at cost issues, North Georgia EMC may be non-compliant with the distribution of savings requirement, as its contract with TVA explicitly prevents it from distributing capital to members. If the EMC follows the letter of its agreement, we believe that such non-distribution may constitute a breach of the first listed requirement.

As for the non-retention of funds, all EMCs seem to be provisionally compliant with the requirement, given, however, that they all made in most cases non-specified “program-related” investments, as per their Form 990 filings.¹² We assume that making investments means that an organization has capital in excess of its operational costs, therefore, we encourage the cooperatives to either fully disclose how and on which conditions the aforesaid investments were made and/or stop participating in any investment activities altogether.

Additionally, Sawnee EMC is of particular interest here, as it made a certain investment in the amount of \$494,666 into a certain non-disclosed “program-related” activity, which is the highest non-specified investment amount Georgia Watch encountered during review of the six EMCs.

¹²See Form 990, Schedule D, Part VIII, of any EMC for this purpose.

ACTIVITIES TEST

This test did not present any problem for the EMCs we studied, as the organizations were involved substantially or solely in the provision of electricity to members. Any incidental or side services were either insignificant or not rendered at all.

85% MEMBER INCOME TEST

As was the case with the activities test, this one is of the least concern, as none of the EMCs studied derived less than 90%¹³ of its income from sources other than members. This logically flows from the fact that the cooperatives do not engage substantially in any other activities, apart from provision of electricity to members, so the majority of cash flow we see on Forms 990 results from member payments for the kWh of energy the cooperatives supply. Additionally, a certain percentage of money receipts originate from pole rentals, which is permitted by the IRS and does not affect the figures for this particular test.

BEST PRACTICES AND RECOMMENDATIONS

As we noted elsewhere in this chapter, we did not find major discrepancies between the requirements of I.R.C. §501(c)(12) and related IRS regulations and bylaws of the EMCs studied for this project. However, we would like to note that among the studied cooperatives, some of them adopted better practices than the rest.

For instance, as far as the operational and organizational test is concerned, we would like to commend the efforts of Snapping Shoals EMC and Diverse Power EMC in keeping the cooperatives democratic and ensuring wider participation of members in the governance of the cooperative. The former's 2012 annual meeting boasted 1,720 members (or 1.8% of all members) in attendance. Moreover, Snapping Shoals EMC held its 2015 annual meeting in the Georgia International Horse Park, which has a practically unlimited capacity, with the main events taking place at Charles C. Walker Arena, which has a seating capacity alone of 4,500 people. That would account for 5% of Snapping Shoals EMC's members. Together with proxy and mail votes, which this EMC does not prohibit (Art.II, §10), that brings it to the margin sufficient to claim a democratic mandate.

As for the Diverse Power EMC, while it cannot claim the numbers as high as those of Snapping Shoals EMC, it still does not ban proxy and mail voting in its bylaws, and it selects venues conveniently located in two areas served by the cooperative, that have a capacity sufficient to accommodate more members than usually attend the meetings. As of May 2015, the cooperative, as per its newsletter of August 2015, had around 35,000 members, of whom at least 2.3% (815) attended the last annual meeting. While the number is seemingly low, we believe that the cooperative itself is making its best effort to involve the members into the governance and follows good industry practices for ensuring democratic control over its affairs by members.

¹³Diverse Power EMC, as per its Form 990, has the highest percentage of member-sourced income, namely 98%.

We would like to underline, again, that it is of utmost importance that the two EMCs mentioned in the previous two paragraphs allow postal and proxy voting. While Georgia Watch shares the concern of the EMCs who ban the practice to avoid the accumulation of votes, we also believe that the benefits of allowing it outweigh the possible costs. Given that there is not a single cooperative in Georgia that has fewer than thirty thousand members, the costs of hiring the venue big enough to accommodate that kind of crowd may be prohibitive. Therefore, postal and proxy voting may be the exact solution to the issue of low turnout and poor member participation in annual meetings.

Furthermore, we believe that cooperative members, if given the choice between driving for an hour to a meeting venue and putting an envelope into a mailbox, would be more willing to use the latter option and actually realize their right to participate in the governance of the cooperatives with minimum effort. That, in its turn, shall direct cooperatives back to their roots, that is, to being true member-owned and run organizations.

As for the operation at cost, Georgia Watch believes that practices utilized by Snapping Shoals and Central Georgia EMCs are worth noting. Not only do the two provide in their bylaws¹⁴ that all operating profit in excess of cost shall be allocated to capital accounts of the patrons; both cooperatives also give their members annual notices of the exact amounts credited to their accounts to keep them up-to-date on the exact share of cooperative's capital that belongs to them. The others opted to keep this information to themselves, instead providing members with the aggregate amount of operating profit received by the cooperative in any given period and formulas of a varying degree of complexity that would purportedly allow the consumers to compute the amounts credited to their accounts themselves.

Finally, Georgia Watch believes that actively investing in bonds and other enterprises may constitute a breach of an additional requirement listed in Rev. Rul. 72-36, 1972-1 C.B. 151; I.R.M. 7.25.12.5(3). We encourage the cooperatives to limit non-essential investments (that is, those that are not related to generation and transmission of power) and to fully disclose and itemize the same both on their annual reports and Form 990s to keep the IRS and the public fully informed and aware of the financial activities and health of the cooperatives.

¹⁴ Art. VII, §§2-3 and §9.02 respectively.

GEORGIA EMCs and TRANSPARENCY

METHODOLOGY

Georgia Watch based its analysis of the transparency of EMCs in its sample pool on two basic and apparent criteria:

Availability of information. Georgia Watch required three documents as a point of reference to analyze transparency and compliance of each particular EMC with the provisions of I.R.C. § 501(c)(12): (a) its articles of incorporation and/or bylaws; (b) its Forms 990 filed with the IRS in the past financial years; and (c) its financial statements, whether audited or not, and reports supplied to the members to assess whether the performance of cooperative is communicated to the consumers in a clear, concise, and comprehensible manner. We started with researching sample pool EMCs' websites, as any prudent consumer would. If any or none of the above papers were available on the websites, we attempted a wider search, most notably through the Foundation Center, which makes all Form 990 IRS filings publicly available through its databases.

Clarity and correctness of filings, reports, and bylaws of each EMC.

While Georgia Watch acknowledges that clarity may be a subjective criterion of evaluation, we assessed it from the point of view of a prudent consumer and made conclusions on the basis thereof. In addition, there are some objective clarity requirements imposed by the IRS upon the cooperatives. For example, cooperatives should account for member and non-member income/expense received/incurred by an EMC within each reporting period. Correctness for the purposes of this criterion merely means the compliance of each Form 990, bylaw, and statement examined by Georgia Watch with the IRS rules and regulations, good business practices, and the law of the state of Georgia and the United States.

AVAILABILITY OF INFORMATION

Georgia Watch was able to retrieve the following documents from the websites of the EMCs studied:

	Articles/Bylaws	Form 990	Annual Report	Audited Financial Statement
North Georgia EMC	✓			
Snapping Shoals EMC	✓		✓	✓
Slash Pine EMC				
Diverse Power EMC			✓	
Sawnee EMC	✓		✓	✓
Central Georgia EMC	✓			

We suggest that bylaws should be made available online on every single EMC's website, clearly and unambiguously marked as such.

Of those listed, Snapping Shoals and Sawnee EMC were the only two that openly provided virtually all information required for this research on their websites. We believe it is of an utmost importance for the consumers to be aware of and have full access to at least the bylaws of the EMC prior to signing up for the membership. Every bylaw that Georgia Watch encountered in preparing this report stated that the same became an inseparable part of the agreement between the final consumer and the EMC. Since the said provisions may directly affect the rights of the EMC members and potentially limit their ability to seek remedies for a breach of the agreement through judicial means, we suggest that bylaws should be made available online on every single EMC's website, clearly and unambiguously marked as such.

EMCs should make their IRS Form 990 filings and annual reports publically available on their websites.

We also believe that it is equally important for the current members to be aware of the ways their money is spent by the cooperative. Since none of the cooperatives Georgia Watch has encountered in the course of this researched appeared to make its Form 990 available to members, the only source of financial information that could shed light upon the dealings and financial health of the EMCs was their annual reports. Of our sample pool, only three EMCs published their annual reports online; and of those three only two, the above-mentioned Snapping Shoals and Sawnee EMC, included or incorporated an audited financial statement into the annual report. EMCs should make their IRS Form 990 filings and annual reports publically available on their websites.

CLARITY AND CORRECTNESS OF FILINGS, REPORTS, AND BYLAWS

Apart from several minor technical discrepancies, none of the bylaws studied for this project were of any concern for the purposes of this chapter. The majority of bylaws that Georgia Watch examined for the purposes of this research were overloaded with legalese and were, in our opinion, hard to read and understand to an average consumer without an extensive legal background. Therefore, we would suggest that all provisions affecting the rights and obligations of the consumers, such as those related to meetings, membership, and non-profit status of the EMC, be simplified and made available to the members together with the initial membership package. Not only would that facilitate the relationships between EMCs and their customers, it would also help EMCs avoid having parts of their agreements with customers struck down by the courts on the basis of unconscionability.

We would suggest that all provisions affecting the rights and obligations of the consumers, such as those related to meetings, membership, and non-profit status of the EMC, be simplified and made available to the members together with the initial membership package.

Our major finding for the purposes of this subchapter was the potentially incorrect filings of Form 990 by five out of six EMCs studied for this project. Form 990, Sch. D, Part VIII, is specifically provided for the EMCs and other § 501(c) exempt organizations to report investments into program-related activities and organizations. As per the IRS¹⁵, an investment is program-related if:

1. Its primary purpose is to accomplish one or more of the cooperative's exempt purposes;
2. Production of income is not a significant purpose of the investment.

¹⁵<https://www.irs.gov/instructions/i990sd/ch02.html#d0e820> (Accessed Oct 14, 2015).

To satisfy the first condition the investments must be of such nature that they would not have been made except for their relationship to the exempt purposes. The investments include those made in functionally related activities that are carried on within a larger combination of similar activities related to the exempt purposes.¹⁶

In determining whether the production of income or property appreciation is a significant purpose of the investment, the IRS will check whether general market investors would make the same investment on the same terms. The IRS further notes that the fact that an investment incidentally produces significant income or capital appreciation is not, in the absence of other factors, a sign of non-compliance. Georgia Watch interprets this as an indication that the production of income should not be a stated purpose of the investment that is labelled program-related.¹⁷

Finally, the IRS explicitly states¹⁸ that a mere provision of funds for the exempt purposes is not a functionally related activity within the meaning it is used on the Form 990 and, arguably, such provision of funds should not per se be treated as a program-related investment.

Of all EMCs selected for the purposes of this study, the only unambiguously compliant filing was that by North Georgia EMC, which correctly identified an investment into the National Rural Utilities Cooperative Finance Corporation (CFC) as unrelated¹⁹, since (a) CFC's primary purpose is a mere provision of funds to the electric cooperatives²⁰, which, as we noted above, most likely does not qualify investments therein as "program-related", and (b) CFC commercial papers are available to general market investors and, judging by the ratings²¹, a prudent for-profit investor is likely, in our opinion, to purchase the same paper on the same terms, since they are more likely than not to produce steady income.

Furthermore, North Georgia EMC's program-related investment did not exceed the 5% of total assets threshold, which would trigger the requirement to itemize the same in Form 990, Sch. D, Pt. VIII. While Georgia Watch believes that for the sake of transparency and greater accountability, it would be commendable to itemize those investments, North Georgia EMC was not under an obligation to do so and is, therefore, fully compliant with the filing requirements.

¹⁶As the IRS provides no further guidance as to the interpretation of the requirements in the Schedule D instructions, Georgia Watch used the interpretation provided elsewhere in the IRS manuals and guidelines. <https://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Program-Related-Investments> (Accessed October 14, 2015).

¹⁷As above, fn. 15.

¹⁸<http://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Functionally-Related-Business> (Accessed Oct 1, 2015).

¹⁹See Form 990, Sch.D, Part VII (2014).

²⁰See https://www.nrucfc.coop/content/cfc/about_cfc.html (Accessed Oct 1, 2015).

²¹https://www.nrucfc.coop/content/cfc/investor_relations/institutional_investing/cfc_commercial_paper.html (Accessed Oct 1, 2015).

Other EMCs cannot claim the same degree of accuracy as North Georgia EMC. For example, Snapping Shoals EMC and Central Georgia EMC²² simply report their program-related investments as “Patronage capital in associated organizations” without any further clarification or any degree of specificity whatsoever. Without that information, we (or the IRS) could not assess whether the investments the two cooperatives made could be classified as program-related or not and whether the cooperatives’ filing practices are in line with the IRS requirements. Furthermore, the IRS instructions for Form 990, Schedule D, specifically require that the cooperatives report each investment on a separate line of the said Schedule D, Part VIII, including the information on whether the investment is a loan or equity investment, and the name of the organization receiving the investment.²³

Georgia Watch suggests that these EMCs reassess their reporting standards and seek clarification from the IRS as regards the correct designation of the CFC investments prior to filing this year’s Forms 990.

Unlike North Georgia EMC, Slash Pine, Diverse Power, and Sawnee EMCs listed their CFC investments as program-related.²⁴ We noted above that it was less than clear whether those could be classified as such; therefore, Georgia Watch suggests that these EMCs reassess their reporting standards and seek clarification from the IRS as regards the correct designation of the CFC investments prior to filing this year’s Forms 990.

²²See Snapping Shoals EMC’s Form 990, Sch. D, Pt. VIII (2014) and Central Georgia EMC’s Form 990, Sch. D, Pt. VIII (2013).

²³<https://www.irs.gov/instructions/i990sd/ch02.html#d0e820> (Accessed October 14, 2015).

²⁴See respective EMCs’ Forms 990, Sch. D, Pt. VIII.

CONCLUSIONS

Through this research and reporting, Georgia Watch hopes to encourage cooperative members to become more involved in the governance and financial oversight of the organizations to which they belong. Their collective ownership of the cooperative gives them the leverage sufficient to influence the practices of their EMC through democratic means, if they use the rights vested in them by law.

As for the material findings of this research, Georgia Watch would like to underline the following:

RECOMMENDATIONS

- More needs to be done by the cooperatives to ensure full and exhaustive compliance with the requirements of the IRS;
- Greater transparency and accountability of EMCs to their members should be promoted and encouraged;
- EMCs should make bylaws, IRS Form 990 filings and annual financial reports publically available on their websites;
- The governance of the cooperatives, as it was noted above, should be more inclusive and open to all members of the cooperatives;
- We encourage the EMCs to allow at least postal voting so that those members who cannot visit annual meetings may have their voices heard and accounted for by the organization that they own;
- EMCs should consistently adhere to their original purpose and concentrate on their primary function, that is, providing electricity at reasonable rates to their members. Consistently engaging in investment activities, be those investments program-related or not, goes against the original spirit of the cooperatives and the goal that they were created to achieve.
- To achieve the goal mentioned above and to eliminate potential risks of non-compliance with IRS rules and regulations, Georgia Watch encourages EMCs to provide a more detailed account of their annual spending on the reports they present to member meetings for approval and Forms 990 that they file with the IRS.
- We further recommend that Georgia EMCs request a ruling from the IRS that would straightforwardly define which investments qualify as "program-related" to avoid any possible confusion and misreporting in the future.

APPENDIX A

I.R.C. §501(c)(12) AND TRANSPARENCY CHECKLISTS

<u>I.R.C. §501(c)(12)</u>	
<u>Test</u>	<u>Where and What to Look For</u>
<u>Organizational and Operational Test</u>	<p style="text-align: center;"><u>Democratic Control</u></p> <p><u>Where:</u> EMC rules relating to democratic control are normally contained in organization's bylaws (usually Article called "Members" or "Meeting of Members"). Bylaws are available either on the website of the EMC, from the Foundation Center physically or at www.foundationcenter.org, together with Form 990, or at the EMC office. EMC may not refuse a member's request to read bylaws.</p> <p><u>What:</u> The article should provide for obligatory meetings of members with a preset quorum where each member has only one vote. If at least one of these is missing, the cooperative is apparently non-compliant with this requirement.</p> <p style="text-align: center;"><u>Operation at Cost</u></p> <p><u>Where:</u> For the purposes of this prong of the test, both bylaws and Form 990s should be examined. A Form 990 is usually available from the Foundation Center (see above).</p> <p><u>What:</u> 1) In bylaws – the Article usually called "Non-Profit Operation" is relevant. The article should provide for some form of allocation of capital in excess of operating costs to members. Even if the capital is kept by the EMC but accounted for and debited to members' capital accounts and not retired until the Board decides otherwise, this condition is satisfied. 2) In Form 990: Parts VIII (Statement of Revenue) and IX (Statement of Functional Expenses), particularly Line 4 of the former (Benefits paid to members) and Lines 7-24 of the latter.</p> <p style="text-align: center;"><u>Subordination of Capital</u></p> <p><u>Where:</u> Typically, the examination of the EMC's website suffices for this purpose. Bylaws may also be relevant.</p> <p><u>What:</u> If the EMC issues any type of stock, bonds, or other securities, provisions of bylaws and provisions of the issue may be examined. Otherwise, a simple look at the website and the list of services provided by the EMC is enough. If the EMC provides solely electricity to members and provides other benefits predominantly to members, this condition is met.</p>
<u>Activities Test</u>	<p><u>Where:</u> Form 990.</p> <p><u>What:</u> Part VIII, Line 2. If the line does not contain any other sources of income but sales of electricity, this test is passed.</p>

APPENDIX A

<u>I.R.C. §501(c)(12) (Continued)</u>	
<u>Test</u>	<u>Where and What to Look For</u>
<u>85% Member Income Test</u>	<p><u>Where:</u> Form 990, Part VIII.</p> <p><u>What:</u> Line 2g should make up at least 85% of the total given in Line 12. If it does not, the cooperative is in breach of the requirement.</p>
<u>Additional Requirements</u>	<p><u>Where:</u> Bylaws, Form 990, Audited Financial Report/Statement (available either on the EMC's website or from the EMC physically upon request).</p> <p><u>What:</u> 1) For requirements A, B, D, and E, as listed in the Chapter "I.R.C. §501 (c)(12)" above, bylaws contain most of the required information. A and B are usually found in the Article "Non-Profit Operation" and the bylaws should provide that the organization credits all revenues in excess of operational costs to capital accounts of members in proportion to their capital contributions. Requirements D and E are usually met by spelling out in bylaws (normally Articles "Termination of Membership" and "Dissolution of Assets Upon Dissolution" respectively) the exact formulae pronounced in the requirements.</p> <p>2) For requirement C – Form 990 (Pts VIII and IX), Audited Financial Report/Statement. While it is hard to trace whether and how the cooperative actually pays benefits to and for members (Form 990, Pt. IX, Line 4), they should at minimum credit those amounts to individual capital accounts of the members.</p>
<u>Transparency</u>	
<u>Availability of Information</u>	<p><u>Where:</u> EMC's website, Offices of the EMC, Annual EMC Meeting; Foundation Center (at www.foundationcenter.org).</p> <p><u>What:</u> 1) Bylaws are available either from the EMC (on the website or at the office), or from the Foundation Center (physically or online; usually as an attachment to Form 990); 2) Form 990 is available to the public from the Foundation Center; 3) Annual Reports and Audited Financial Statements are available either on the EMC website or from the EMC physically.</p>
<u>Correctness and Clarity of Filings</u>	<p><u>Where:</u> Typically Form 990 and/or Audited Financial Statement.</p> <p><u>What:</u> Form 990, Schedule D, Pts. VII and VIII. While the status of many investments is unclear due to the lack of the straightforward IRS ruling, it is recommended to check whether the EMC itemizes both types of investments in the list instead of providing a generic term, such as "investment in related organizations" or "investment into unrelated organizations" and sum in one line.</p>

APPENDIX B

I.R.C. §501(c)(12) REQUIREMENTS CHECKLIST

I.R.C. §501(c)(12) Requirements		
Yes	No	Organizational and Operational Test: Democratic Control
<input type="checkbox"/>	<input type="checkbox"/>	Is the EMC controlled by its members through annual/special meetings?
<input type="checkbox"/>	<input type="checkbox"/>	Do annual/special meetings have a preset obligatory quorum for the number of members participating?
<input type="checkbox"/>	<input type="checkbox"/>	Does each member have only one vote in the meetings?
Yes	No	Organizational and Operational Test: Operation at cost
<input type="checkbox"/>	<input type="checkbox"/>	Does the EMC generate any operating revenues in excess of costs?
<input type="checkbox"/>	<input type="checkbox"/>	If the answer to the above is 'Yes', does the EMC allocate the revenues to its members?
Yes	No	Organizational and Operational Test: Subordination of Capital
<input type="checkbox"/>	<input type="checkbox"/>	Do members control the operation of the EMC by electing the board of directors?
<input type="checkbox"/>	<input type="checkbox"/>	Does the EMC have outside, non-member investors?
<input type="checkbox"/>	<input type="checkbox"/>	Do investors have any influence over operation of the EMC?
<input type="checkbox"/>	<input type="checkbox"/>	Does anyone but members, most notably non-member investors, receive a significant amount of financial benefits provided by the EMC, monetary or otherwise?
<input type="checkbox"/>	<input type="checkbox"/>	Do shareholders/investors of the EMC, if any, have a right to vote in the annual meetings?
Yes	No	Organizational and Operational Test: Additional Requirements
<input type="checkbox"/>	<input type="checkbox"/>	Does the EMC keep clear and adequate record of the amount of capital contributed by each member?
<input type="checkbox"/>	<input type="checkbox"/>	Does the EMC credit savings and revenues in excess of costs to members' capital accounts in proportion to the amount of business done to them, i.e. proportionally to the amount of capital contributions made by each member?
<input type="checkbox"/>	<input type="checkbox"/>	Does the EMC keep more funds than needed to meet its <u>current</u> losses and expenses?
<input type="checkbox"/>	<input type="checkbox"/>	Does the EMC forfeit member's rights and interests in the EMC upon termination of membership?
<input type="checkbox"/>	<input type="checkbox"/>	Is there a provision in bylaws stating that the EMC will distribute the gains from the sale of any of its assets of value to all persons who were members during the period that the organization owned the assets, if the EMC is being dissolved?
Yes	No	Activities Test
<input type="checkbox"/>	<input type="checkbox"/>	Does the EMC render any services other than provision of electricity or like services to members and/or third parties?
Yes	No	85% Member Income Test
<input type="checkbox"/>	<input type="checkbox"/>	Does the EMC derive at least 85% of its income from members through electricity rates and fees, and/or from other exempt activities listed in the subchapter on the matter above?
LEGEND:		Answers in light green boxes signify compliance with the IRS requirements
		If the answer selected is in a light red box, the EMC may be non-compliant with the IRS requirements

Georgia Watch
55 Marietta Street, NW, Suite 903
Atlanta, GA 30303
www.georgiawatch.org