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Is It Time to Revoke the Tax-Exempt Status of Rural Electric Cooperatives?

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Is It Time to Revoke the Tax-Exempt Status of Rural Electric Cooperatives?

W. G. Beecher*

Abstract

Rural electric cooperatives (RECs) were created with government assistance in the mid-1930s as part of a campaign to bring electricity to rural areas in an effort to improve economic output and quality of living. By the early 1950s, the entirety of America had access to electricity, fulfilling the federal government's mission. Today, these cooperatives strongly resemble their for-profit counterparts, but remain tax-exempt under § 501(c)(12) of the Internal Revenue Code. This note will argue that, in light of the changes that RECs have undergone and the environment in which they now operate, their tax-exempt status is no longer warranted and in fact works against REC member interests. This note will then explore the impact of taxing RECs as regular cooperatives, which are subject to taxation under Subchapter T of the Internal Revenue Code.

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I. Introduction

Rural electrical cooperatives¹ (“RECs” or “electrical cooperatives”) are an integral part of the electrical infrastructure in the United States, providing power to a significant portion of the American people.² Despite their size and reach, RECs differ from investor-owned or municipal electric utilities in three distinct ways. First, they function under a cooperative business model, in which the consumers own the utility rather than investors or municipalities.³ Second, RECs were created specifically to serve rural areas where investor- or municipally-owned electric companies did not offer electrical service.⁴ Third, Congress specifically designated RECs as tax-exempt nonprofits⁵ and created a program of federally subsidized loans to speed the electrification of rural America.⁶ These three factors combined to make RECs incredibly effective in spreading access to electricity across the United States: just a few decades after their creation, every corner of the country had gained access to electrical service.⁷

Part II will discuss the history of the rural electric cooperative movement and the reasons why early cooperatives were seen as meriting tax exemption. Part III will explore the types of RECs as well as the organizational and operational requirements necessary to maintain their tax exemption. Part IV considers changes that the electrical cooperative sector

1. This note uses “cooperative” rather than the hyphenated “co-operative” and “nonprofit” rather than “non-profit” or “not-for-profit.” This decision is in keeping with the Internal Revenue Service’s hyphenation practices.

2. See *Co-op Facts and Figures*, NAT’L RURAL ELEC. COOP. ASS’N, <http://www.nreca.coop/about-electric-cooperatives/co-op-facts-figures> (last visited Sept. 28, 2013) [Hereinafter *Co-op Facts and Figures*] (explaining that RECs serve an estimated forty-two million people in forty-seven states) (on file with the WASHINGTON AND LEE JOURNAL OF ENERGY, CLIMATE, AND THE ENVIRONMENT).

3. See *id.* (noting that RECs are private, independent, nonprofit electric utilities owned by the customers they serve).

4. See *infra* notes 9–12 and accompanying text.

5. Although often used interchangeably, nonprofit and tax-exempt are distinct concepts. Nonprofit describes an organizational structure created by state law, whereas tax-exempt is a status bestowed by the Internal Revenue Service on organizations that meet certain requirements. For a discussion of tax exemption requirements, see I.R.S. Publ’n 557 *Tax-Exempt Status for Your Org.* 57–59 (Rev. Oct. 2011).

6. See J. GARWOOD & W. TUTHILL, *THE RURAL ELECTRIFICATION ADMINISTRATION: AN EVALUATION* 60 (1963) (describing the subsidy features of the rural electrification program).

7. See D. CLAYTON BROWN, *ELECTRICITY FOR RURAL AMERICA* 113 (1980) (discussing the success of the rural electrification movement).

has undergone in recent years and the problems that have arisen as RECs have begun to resemble for-profit entities. Lastly, Part V questions the continued value of sustaining the tax and regulatory exemptions of these cooperatives, and explores ways to encourage behavior that is in keeping with cooperative principles.⁸

II. History of the Electric Cooperative Movement

A. The Early Years

Cooperatives were not the first model of electrical distribution in America. In the late nineteenth and early twentieth centuries, almost all electricity was generated and distributed by investor-owned power companies.⁹ In these early years, electricity was primarily available to urban areas, where higher population densities made distribution profitable because the close proximity of customers to one another meant that fewer power lines needed to be strung.¹⁰ These power companies refused to serve rural areas because the overhead cost of wiring and providing service to these areas was deemed to be too much for the company to absorb, and if passed on to the rural customers through price increases, electricity would be prohibitively expensive.¹¹ Moreover, because rural customers lacked the funds to purchase machinery that would use large amounts of electricity, private power companies would not receive sufficient returns on their investments.¹²

With private power companies uninterested, farmers and rural communities began forming cooperatives in the early years of the twentieth century to distribute electricity themselves.¹³ Modeled on those in Canada and Europe, farmers saw the first RECs as little different from the

8. This note will not examine the federal loan program for RECs, a subject that has been thoroughly examined elsewhere. *See, e.g.,* Richard P. Keck, *Reevaluating the Rural Electrification Administration: A New Deal for the Taxpayer*, 16 ENVTL. L. 39, 87–89 (1985) (criticizing subsidized government lending to electrical cooperatives as a costly government venture with no remaining public policy purpose).

9. *See* BROWN, *supra* note 7, at 11–12 (commenting on the state of early electrical distribution in the United States).

10. *See id.* (explaining the financial reasons why urban populations were first to receive electrical service).

11. *See id.* (stating the reasons for the slow rate at which rural areas were being wired by investor-owned power companies).

12. *See id.* (noting the problems with electrifying rural areas).

13. *See id.* at 13 (discussing the early attempts by farmers to organize electrical cooperatives).

agricultural cooperatives that had long served them.¹⁴ Such early attempts at self-help were few, limited in scope, and saw mixed success because organizers faced hostility from the private power companies from which they purchased their electricity.¹⁵ Further, these organizers lacked the technical and managerial expertise to operate the cooperatives.¹⁶ As a result, the 1920 census found that fewer than five hundred thousand of six million farms reported having electric lights.¹⁷ Those numbers dwindled in the rural west and south, where electrification ranged between ten and less than one percent.¹⁸

B. The New Deal and the REA

The Depression-era enactment of the Rural Electrification Act¹⁹ and creation of the Rural Electrification Administration by executive order²⁰ dramatically changed the landscape of power distribution in America.²¹ Although bringing electricity to rural areas had been a progressive cause for the preceding decade, the movement gained vital support from the federal government during the Great Depression as a part of Franklin D. Roosevelt's New Deal.²² In response to increasingly vocal demands for federal action to improve economic output in rural areas, President Roosevelt created the Rural Electrification Administration ("the REA") in May of 1935 to spend the 100 million dollars that Congress had allocated for rural electricity distribution.²³ Despite early government reluctance, providing cooperatives with administrative guidance and low

14. *See id.* at 16–18 (stating that American farmers looked to the success of electrical cooperatives in Canada and Europe, where ninety percent of farms had electricity).

15. *See id.* at 15 (noting the mortality rate of early cooperatives and the causes of their failure).

16. *See id.* (explaining that a lack of necessary expertise damaged early RECs).

17. *See id.* at xv (“[T]he federal census of 1920 . . . reported that of the total 6,000,000 farms in the United States, only 452,620 had electric lights and 643,899 had some form of running water.”).

18. *See id.* at xvi (“The Midwest and South ranked lowest, ranging from 10 percent to less than 1 percent.”).

19. Ch. 432, 49 Stat. 1363 (1936).

20. Exec. Order No. 7037 (May 11, 1935).

21. *See generally* BROWN, *supra* note 7 (discussing the changes that took place in the American electrical utility industry after the enactment of the REA).

22. *See id.* at 35–46 (explaining that tireless advocates of rural electrification—chiefly Morris L. Cooke, who would be appointed the first Director of the REA—and an experimental electric cooperative within the Tennessee Valley Authority highlighted the need and economic feasibility of bringing power to rural communities, greatly bolstering the cause in Washington).

23. *See id.* (chronicling the formation of the REA).

interest loans was soon recognized as the quickest and most efficient means of fulfilling the agency's objectives.²⁴

The choice to foster the formation and growth of electrical cooperatives as a means of national electrification was an overwhelming success.²⁵ In just a few years, the REA had been transformed from a temporary relief organization into a permanent government agency within the Department of Agriculture, making subsidized loans to the hundreds of newly formed RECs that were requesting funds to string electrical wires through their communities.²⁶

The process of rural electrification was rapid: In 1939, approximately twenty-five percent of all farms had electrical service.²⁷ Less than two decades later, the REA had loaned over 2.7 billion dollars to over one thousand cooperatives and other entities, facilitating the electrification of the entire country.²⁸ The original RECs were almost exclusively distribution cooperatives that delivered power to consumers.²⁹ Only after distribution networks were firmly established did RECs begin to generate and transmit their own electricity.³⁰ Most rural electrical cooperatives formed at the REA's encouragement are still in operation today.³¹ They are represented in Washington by the National Rural Electrical Cooperative Association ("NRECA"), whose 905 members own 42% of the nation's electrical distribution lines, and serve an estimated 42 million people in 47

24. See *id.* at 48–57 (recounting how that agency had originally planned to work with private power companies, but ultimately settled on promoting and assisting cooperatives because the private companies failed to present plans that would have made electricity affordable).

25. See *id.* at 74–75 (outlining improvements made by electrification).

26. See *id.* at 58–66 (chronicling changes at the REA as it became a permanent government agency within the Department of Agriculture).

27. See *id.* at 75 (“By 1939 the improvements wrought by electricity were visible in rural life. REA had 417 cooperatives serving 268,000 households and had loaned \$3,644,711 for wiring and plumbing. About 25 percent of all farms had service.”).

28. See *id.* at 113 (“The agency had, since 1935, loaned a total of \$2,788,136,191 to 983 cooperatives, 44 public power districts, 26 other public bodies and 25 electric companies.”).

29. See Joel A. Youngblood, *Alive and Well; the Rural Electrification Act Preempts State Condemnation Law: City of Morgan City v. South Louisiana Electric Cooperative Ass’n*, 16 ENERGY L.J. 489, 491–92 (1995) (noting that RECs, as a result of the REA, “began to urge rural residents to form cooperatives—private, non-profit membership corporations organized under state law—for the purpose of supplying members with central station power”).

30. See *id.* at 492 (explaining that the construction of transmission and generation facilities (G&Ts), which generate and transmit their own electricity, increased markedly as the “integrity of the rural power distribution improved”).

31. See *id.* at 493 (“Today, most RECs have come full circle and engage not only in the distribution of power, but also in its generation and transmission.”).

states.³² In addition, cooperative electrical generation companies produce nearly 5% of the nation's power.³³ Despite their rural moniker, RECs now serve a significant number of urban and suburban areas as well.³⁴ Throughout this growth and modernization, cooperatives have retained their distinctive business model—and their federal tax-exempt status.³⁵

III. Organization and Tax Characteristics of Cooperatives

A. Types of RECs

RECs fall into two basic categories: distribution cooperatives, and generation and transmission cooperatives (G&Ts).³⁶ Distribution cooperatives, sometimes called “DISCOs,” carry electricity from transmission substations to consumers.³⁷ Because of the expense and technical demands of electrical generation and transmission, the RECs formed during the early years of the REA were almost exclusively created to distribute electricity to rural farms.³⁸ These cooperatives purchased power from investor-owned utilities or Federal Power projects and distributed it to their members.³⁹ Today, many purchase power from other

32. See *Co-op Facts and Figures*, *supra* note 2 (describing the current state of the nation's consumer-owned electric utility network).

33. See *id.* (noting the electrical production of RECs).

34. See Jim Cooper, *Electric Co-ops: From New Deal to Bad Deal?*, 45 HARV. J. ON LEGIS. 335, 336 (2008) (“Most co-ops operate in a few rural counties where customers live far apart, although an increasing number of co-ops serve populous suburbs.”).

35. See Keck, *supra* note 8, at 71 (explaining that the tax exempt status of the cooperatives reduces REC power costs).

36. See Youngblood, *supra* note 29, at 491–93 (describing the benefits of distribution cooperatives and generation and transmission facilities (G&Ts), which have developed as a result of the REA).

37. See *Electricity 101*, NAT'L RURAL ELEC. COOP. ASS'N, <http://www.nreca.coop/about-electric-cooperatives/electricity-101> (last visited Sept. 28, 2013) (“Distribution is the process of carrying electricity from transmission substations to homes and businesses.”) (on file with the WASHINGTON AND LEE JOURNAL OF ENERGY, CLIMATE, AND THE ENVIRONMENT).

38. See GARWOOD & TUTHILL, *supra* note 6, at 14 (“During the first few years of the program, over 80 percent of the customers of REA-borrowers were farmers.”).

39. See COMPTROLLER GENERAL, GENERAL ACCT. OFFICE, CED-81-14, FINANCING RURAL ELECTRIC GENERATING FACILITIES: A LARGE AND GROWING ACTIVITY 7 (1980) [hereinafter FINANCING RURAL ELECTRIC GENERATING FACILITIES] (“For the most part, the cooperatives purchased electric power from Federal power projects or electric companies and distributed it to consumers.”).

cooperatives.⁴⁰ The majority of RECs operating today adhere to this model: 840 of the 905 members of NRECA are solely distribution cooperatives.⁴¹

As their name implies, G&T cooperatives serve to generate power and transmit it to members.⁴² The members of these RECs are not consumers of electricity, but are distributors who sell the electricity to the consumers.⁴³ As REC-owned distribution networks became established after the Great Depression, RECs began to form cooperatives among themselves to assist in the purchasing and distribution of power.⁴⁴ At first, these cooperatives served primarily as service organizations to assist their members in arranging and contracting for the bulk purchase of power.⁴⁵ Eventually, many of them began to build their own generation capability to reduce their dependence on outside sources of electric power.⁴⁶ This process was facilitated in large part by the REA's subsidized loans, which allowed RECs to finance these projects far more easily than investor-owned utilities.⁴⁷ For the first five years of the REA loan program, only about three percent of the REA's loans were for generation and transmission projects.⁴⁸ By the latter half of the 1950s, that number had jumped to thirty-one percent.⁴⁹ The soaring interest rates of the late 1970s and early 1980s allowed RECs to use their highly preferential government loans to finance generation facilities far more affordably than could private companies.⁵⁰

40. See *Electricity 101*, *supra* note 37 (noting that companies which provide both general and transmission functions are now "owned by the distribution cooperatives to whom they supply wholesale power").

41. See *Co-op Facts and Figures*, *supra* note 2 (specifying that out of the 905 NRECA cooperative members, 840 are distribution cooperatives and 65 are G&T cooperatives).

42. See *Electricity 101*, *supra* note 37 (explaining that G&Ts provide both generation and transmission functions).

43. See *id.* ("Many electric utilities are exclusively distribution utilities—that is, they purchase wholesale power from others to distribute it, over their own distribution lines, to the consumer.").

44. See Keck, *supra* note 8, at 47 (describing the shift from purely distribution to G&T).

45. See FINANCING RURAL ELECTRIC GENERATING FACILITIES, *supra* note 39, at 7 ("Initially, these power cooperatives served largely as a service organization for the members, . . . contracting for the purchase of bulk power, which in turn was sold to distribution members.").

46. See *id.* ("[S]ome of these power cooperatives began to build their own generating capability to reduce their dependence on outside sources of electric power.").

47. See *id.* (noting the subsidized loans provided by the REA).

48. See GARWOOD & TUTHILL, *supra* note 6, at 15 (noting the amounts loaned to G&T cooperatives).

49. See FINANCING RURAL ELECTRIC GENERATING FACILITIES, *supra* note 39, at 7 (noting the increase in funds loaned to G&Ts).

50. See John Simpson, *Co-ops Battle Clinton Plan to Cut REA Loan Program*, 131 PUB. UTIL. FORT. 41, 41 (1993) (explaining that REA loans have come under frequent attacks in the last few decades because of the advantages they bestow on RECs. Presidents

During this period, G&T cooperatives began to form joint ventures with private power companies eager to gain access to RECs' dramatically lower borrowing rates.⁵¹ G&Ts nonetheless remain few in number, accounting for only a fraction of NRECA's membership.⁵²

B. Tax Characteristics of Cooperatives

Rural electric cooperatives have been exempt from federal taxation since the Revenue Act of 1916,⁵³ well before the New Deal.⁵⁴ Today, all are organized as nonprofit entities and granted tax-exempt status under § 501(c)(12) of the Internal Revenue Code ("the Code").⁵⁵ This section of the modern Code permits tax exemption for "benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations."⁵⁶ Electrical cooperatives have been viewed as "like organizations" appropriate for tax exemption virtually since their inception.⁵⁷ In 1980, Congress formalized this status by amending § 501(c)(12) to include § 501(c)(12)(C), which explicitly includes RECs in

Reagan, H. W. Bush, and Clinton each sought to reduce the subsidy of loans to RECs, only to be thwarted by Congress).

51. See Joe D. Pace & John H. Landon, *Introducing Competition into the Electric Utility Industry: An Economic Appraisal*, 3 ENERGY L.J. 1, 7 (1982) ("G&Ts and some distribution cooperatives have also received REA loan guarantees in order to finance purchase of ownership shares in investor-owned utilities' large coal and nuclear generating plants.").

52. See *Electricity 101*, *supra* note 37 (noting that only 65 of NRECA's 905 members are G&T cooperatives).

53. Revenue Act of 1916, Pub. L. 64-271, 39 Stat. 756, 767 (codified as amended at 26 U.S.C. § 501(c)(12) (2012)).

54. See Robert P. Carlisle, Note, *Cotter & Co. v. United States: The Federal Circuit Finds the Meaning of Subchapter T to Be Less Than Cooperative*, 47 OHIO ST. L.J. 565, 572 (1986) ("Although the 1913 Act did not specifically mention cooperative associations, it did, nevertheless, exempt from taxation 'agricultural and horticultural organizations.'").

55. See Internal Revenue Code, 26 U.S.C. § 501(c)(12) (2012) (exempting "cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses").

56. *Id.* at § 501(c)(12)(C); see also Treas. Reg. § 1.501(c)(12)-1 (as amended in 1979) ("The phrase of a purely local character applies to benevolent life insurance associations, and not to the other organizations specified in § 501(c)(12).").

57. See Michael Seto & Cheryl Chasin, *General Survey of I.R.C. 501(c)(12) Cooperatives and Examination of Current Issues*, EXEMPT ORG. 2002 CONTINUING PROF'L EDUC. TECHNICAL INSTRUCTION PROGRAM 176 (2002) (explaining that I.T. 1671, C.B. II-1, 158 (1923) and Rev. Rul. 67-265, 1967-2 C.B. 205 recognized tax-exempt status of rural electric cooperatives).

its scope.⁵⁸ To qualify for tax exemption under 501(c)(12), the Internal Revenue Service (“the Service” or “the I.R.S.”) requires organizations to: (1) be organized and operated under cooperative principles; (2) adhere to the activities for which it was created; and (3) derive no less than eighty-five percent of its income from members.⁵⁹

1. Organization and Operation as a Cooperative

All organizations exempt from federal taxation under § 501(c)(12) must adhere to a cooperative structure.⁶⁰ At its most basic, a cooperative is an organization owned and operated by customers who join together for their mutual benefit.⁶¹ The purpose of the organization must be to help the members serve themselves, rather than to generate a profit.⁶² Outside of these generalities, the diversity of cooperatives makes more specific characteristics difficult to pin down.⁶³ Justice Brandeis once noted this fact when he wrote that “[n]o one plan of organization is to be labeled as truly co-operative to the exclusion of others.”⁶⁴

Nonetheless, the seminal discussion of the cooperative model comes from *Puget Sound Plywood, Inc. v. Commissioner*,⁶⁵ where Judge Pierce identified the three fundamental principles that have persisted since the earliest formal cooperatives:

- (1) Subordination of capital, both as regards control over the cooperative undertaking, and as regards the ownership of the pecuniary benefits arising therefrom;
- (2) democratic control by the worker-members themselves; and
- (3) the vesting in and the allocation among the worker-members of all fruits and increases arising from their cooperative

58. See Miscellaneous Revenue Act of 1980, Pub. L. No. 96-605, 94 Stat. 3521 (codified in scattered sections of 26 U.S.C.) (listing “mutual or cooperative electric company” in § 501(c)(12)(C)).

59. See Seto & Chasin, *supra* note 57, at 177 (identifying the three requirements for tax exemption under § 501(c)(12)).

60. See *id.* at 178 (“[The three] basic requirements apply to cooperatives described in section 501(c)(12) as well as those described in Subchapter T and I.R.C. 521. They must be satisfied to qualify for and maintain exemption under I.R.C. 501(c)(12).”).

61. See Carlisle, *supra* note 54, at 567 (defining “cooperative” as an enterprise owned and operated primarily for the benefit of those using its services).

62. See *id.* (explaining that cooperatives have not been organized “for the production of profit attributable to the enterprise itself,” but to help members serve themselves).

63. See *id.* (noting that the application of specific characteristics to cooperative associations is difficult).

64. *Frost v. Corp. Comm’n*, 278 U.S. 515, 546 (1929).

65. *Puget Sound Plywood, Inc. v. Comm’r*, 44 T.C. 305 (1965), *acq.*, 1966-2 C.B. 3.

endeavor (i.e., the excess of the operating revenues over the costs incurred in generating those revenues), in proportion to the worker-members' active participation in the cooperative endeavor.⁶⁶

The first principle, the subordination of capital, orients the cooperative to serve the member-patrons ("members") rather than those who supplied capital.⁶⁷ The result is that members, the very individuals or entities that patronize the organization, are the primary beneficiaries of cooperative activities.⁶⁸ This orientation is distinct from that of a corporation, where investors have the ability to control the business and receive pecuniary gain based upon their investment.⁶⁹

The second principle, democratic control, requires that members have a voice in the cooperative's operation.⁷⁰ Each member has one, and only one, vote in electing the organization's officers and other important decisions.⁷¹ This is notably different from a corporation, where votes are allocated by share, allowing those with larger ownership stakes to have a greater voice in business decision-making.⁷²

The third principle of cooperatives is the proportional vesting and allocating of profits to members. A cooperative's net income immediately vests to members as "member equity," based on the amount that each member used the organization's services.⁷³ In other words, the cooperative returns to its members the funds that it would otherwise retain as profits

66. *Id.* at 308.

67. *See* Seto & Chasin, *supra* note 57, at 178 (explaining that subordination of capital "requires the contributors of capital to the cooperative, in their status as equity owners, neither control the operations nor receive most of the pecuniary benefits of the cooperative's operations," making cooperatives more member-oriented).

68. *See Puget Sound Plywood, Inc.*, 44 T.C. at 309 ("[T]he fruits and increases which the worker-members produce through their joint efforts are vested in and retained by the workers themselves, rather than in and by the association, as such, which functions only as an instrumentality for the benefit of the workers . . .").

69. *See id.* (distinguishing between the pecuniary gain distribution scheme of a cooperative and that of a corporation).

70. *See* Seto & Chasin, *supra* note 57, at 178 ("A cooperative satisfies [the democratic control requirement] by 'periodically holding democratically conducted meetings, with members, each one with one vote, electing officers to operate the organization'").

71. *See Puget Sound Plywood, Inc.* 44 T.C. at 308 (discussing the second principle of cooperative economic theory). *See also id.* and accompanying text.

72. *See id.* at 309 ("In the case of the corporation-for-profit, . . . equity owners . . . select the management and control the functions and policies of their entity— not on a one-person one-vote basis without use of proxies, but rather through multiple voting in proportion to the number of shares of capital stock which they hold.").

73. *See id.* (noting that profits immediately vest and are retained by the cooperative members).

proportionate to each member's use of the cooperative.⁷⁴ This has the effect of paying back a portion of each dollar spent by members on the cooperative's services during a given period.⁷⁵ Because any profits are instead distributed back to the members as "savings," this model encourages the operation of a cooperative at cost.⁷⁶ Together, these principles of cooperative organization and operation illustrate that they are designed to be owned and controlled by their patrons.⁷⁷

In addition to fundamental principles of cooperative structure, the Service requires electrical cooperatives to follow a number of ancillary rules.⁷⁸ First, RECs must at all times maintain records showing each member's interest in the assets of the organization, and cannot accumulate funds beyond the "reasonable needs of the organization's business."⁷⁹ Upon dissolution, gains from the sale of appreciated assets must also be distributed to members during the ownership period of the asset proportionate to the amount of business between the member and the organization.⁸⁰ Because members' rights and interests cannot be forfeited,⁸¹ former members who have since left the electrical cooperative may be entitled to a portion of the distribution upon dissolution.⁸² In practice, these rules serve to clarify the duties of RECs rather than burden them with additional obligations.⁸³

74. See Seto & Chasin, *supra* note 57, at 178 (explaining that the immediate vesting of profits prevents a cooperative from operating at a profit or a loss).

75. See *id.* ("A cooperative's savings belong to its member-patrons, not the organization, and it must allocate the savings to its member-patrons in proportion to the amount of business it did with each.")

76. See *id.* (discussing how the vesting of excess net revenues acts as "savings" for cooperative members).

77. See *Puget Sound Plywood, Inc.*, 44 T.C. at 307-08 (describing how the cooperative principles work together).

78. See Rev. Rul. 72-36, 1972-1 C.B. 151 (including a question and answer section to provide guidance on the ancillary rules).

79. See *id.* (requiring organizations to keep any records necessary to determine the rights and interests of members, and prohibiting them from accumulating more funds than necessary to operate the organization).

80. See *id.* ("[G]ains should be distributed to all persons who were members during the period which the asset was owned by the organization in proportion to the amount of business done by such members during that period, insofar as is practicable.")

81. See *id.* (explaining that organizations that forfeit rights and interests of former members are not cooperatives and are therefore not exempt).

82. See Rev. Rul. 81-109, 1981-1 C.B. 347 ("Inasmuch as a former shareholder does not receive from the organization his pro-rata share of the annual savings accumulated while he was a member when his membership is terminated upon the sale of his stock, he should receive the distribution upon dissolution.")

83. See Seto & Chasin, *supra* note 57, at 178 (specifying that the revenue ruling serves to explain the Code's requirements).

2. Adherence to Specified Activities

Cooperatives receiving federal tax exemption must hew closely to the activities for which they were created and for which the Code provides exemption. For RECs, this means generating or providing electrical service to members. Courts have held that the sale, repair, manufacture, or financing of electrical appliances, or the installation of electrical systems, are not exempt activities under § 501(c)(12).⁸⁴ If a business is organized as a cooperative and engages in exempt activities, it is immaterial that each of its members are themselves cooperatives, or that it acts in furtherance of rural electrification.⁸⁵ In addition to the activities specifically permitted by the statute, § 501(c)(12) alludes to “like organizations,” a term that the Service has interpreted narrowly:

[I]t is clear that the term “like organizations” as used in the statute is limited by the types of organizations specified in the statute, and is applicable only to those mutual or cooperative organizations which are engaged in activities similar in nature to the benevolent insurance or public utility type of service or business customarily conducted by the specified organizations.⁸⁶

The “public utility type” activities standard has allowed RECs to expand their service offerings in a number of new directions without tax consequences. The Service has specifically determined that a cooperatively structured organization providing public utility type services is a “like organization” appropriate for tax exemption.⁸⁷ As a result, RECs are permitted to own natural gas, water, and sewer services in addition to providing electricity.⁸⁸ Other activities, even those that are energy related, are not tax-exempt. For example, the sale of tanked propane gas is not appropriate for tax exemption because it is not a traditional utility-type

84. See *Consumers Credit Rural Elec. Co-op. Corp. v. Comm’r*, 37 T.C. 136, 143 (1961), *aff’d* 319 F.2d 475 (6th Cir. 1963) (determining that financing consumer purchases was not a “like organization” under the Code).

85. See *id.* at 143 (explaining that merely organizing a business as a cooperative will not automatically bring them into the category of those organizations exempt under § 501(c)(12)).

86. Rev. Rul. 65-201, 1965-2 C.B. 170.

87. See Rev. Rul. 67-265, 1967-2 C.B. 205 (finding “like organization” to mean “those . . . cooperative organizations which are engaged in activities similar in nature to the . . . public utility type of service or business customarily conducted by the specified organizations”).

88. See I.R.S. Priv. Ltr. Rul. 97-15-045 (Apr. 11, 1997) (concluding that a tax-exempt REC would retain its exemption even after expanding its services in this manner).

service, regulated by the state or reliant on extensive infrastructure.⁸⁹ The I.R.S. has chosen to tax this activity as unrelated business income rather than prohibit it outright as some states have done.⁹⁰ Although this article does not investigate the numerous state statutes governing the operation of RECs, many state courts are unforgiving of deviations from the traditional electrical service role for which these organizations were created.⁹¹

3. The Eighty-Five Percent Requirement

The most significant requirement to maintain tax exemption for most RECs today is the rule that “85 percent or more of [their] income consists of amounts collected from members for the sole purpose of meeting losses and expenses.”⁹² Added with the Revenue Act of 1924, this language allows for some income to be generated by a cooperative from non-member sources.⁹³ The requirement was designed to relax the financial rules governing RECs, permitting them to invest their financial reserves in interest-bearing accounts while nonetheless preventing them from becoming *de facto* investment houses.⁹⁴ For the purposes of the requirement, member income refers only to income that is derived from members and from “like organization” activities.⁹⁵ Thus, income unrelated to electrical service, such as the sale of propane discussed earlier, cannot be counted as member income because it is not a “like organization” activity, even if the sale is made to a member.⁹⁶ Furthermore, income not meeting

89. See Rev. Rul. 2002-54, 2002-2 C.B. 527 (determining that propane sale and distribution was not a utility-type service for purposes of § 501(c)(12)).

90. See *id.* (concluding that the sale of tanked propane would be subject to unrelated business income tax §§ 511–13).

91. See, e.g., *Lewis v. Jackson Energy Co-op. Corp.*, 189 S.W.3d 87 (Ky. 2005) (concluding that rural electric cooperatives are prohibited from distributing propane on the grounds that the state statute defined the permissible activities of cooperatives).

92. 26 U.S.C. § 501(c)(12)(A) (2012).

93. Revenue Act of 1924, Pub. L. 68-176, 43 Stat. 253 (“[M]utual or cooperative telephone companies, or like organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.”).

94. See 65 Cong. Rec. 7, 128–29 (1924) (discussing the purpose of the eighty-five percent requirement).

95. See Rev. Rul. 2002-54, 2002-2 C.B. 527 (determining that income derived from activities that are not “like organization” activities constitutes nonmember income for the purposes of the eighty-five percent member income test).

96. See *id.* (finding that sales of tanked propane to members represent nonmember income for purposes of calculating the eighty-five percent member income test).

these requirements is subject to the unrelated business income tax.⁹⁷ This means that when meeting the eighty-five percent requirement, tax exemption applies only to the “like organization” activities and does not shield the organization’s other ventures from federal taxation.⁹⁸ The eighty-five percent requirement is computed each taxable year, and an REC may fail the test one year while passing it in subsequent years.⁹⁹

There is a surprising amount of complexity in the eighty-five percent requirement. First, the scope of member income and permissible “losses and expenses” has yet to be settled by the Service and the courts.¹⁰⁰ In addition, there are a number of categories of income that the federal statute specifically excludes from the eighty-five percent requirement, such as income from “qualified pole rentals” or “nuclear decommissioning” transactions.¹⁰¹ The I.R.S. has further determined that profits from the sale of excess fuel at cost during the year of its purchase need not be counted.¹⁰² While these complexities affect peripheral cases, the basic REC model meets the eighty-five percent requirement when it bills its members at cost and does not deviate from its core business.

IV. Problems with RECs Today

A. Changing Identity

Most electrical cooperatives were organized with the specific purpose of serving poor rural areas that would not otherwise receive electrical service.¹⁰³ They generally formed as a response to the unwillingness of private power companies to extend service into rural areas,

97. *See id.* (“The unrelated business income tax provisions, §§ 511–513, provide that the income of a cooperative exempt under § 501(c)(12) is subject to unrelated business income tax if the income is derived from an activity unrelated to its exempt purpose.”).

98. *See id.* (concluding that tax exemption does not apply to non-exempt activities, even though the organization’s utility-type activities may be exempt).

99. *See* Rev. Rul. 65-99, 1965-1 C.B. 242 (describing the annual computation of the eighty-five percent requirement).

100. *See* Clayton S. Reynolds, *Tax-Exempt Electric Cooperatives: A Discussion of Issues Relating to the 85% Member Income Requirement*, 55 TAX LAW. 585, 600–02 (2002) (exploring various ambiguities in the eighty-five percent member income requirement).

101. *See* § 501(c)(12)(C) (excluding income earned from qualified pole rentals, certain sales of electric energy distribution and transmission services, any nuclear decommissioning transaction, or any asset exchange or conversion transaction).

102. INTERNAL REVENUE SERVICE, PUBL’N 557: TAX-EXEMPT STATUS FOR YOUR ORG. 58 (2011) (“An electric cooperative’s sale of excess fuel at cost in the year of purchase is not income for purposes of determining compliance with the 85% requirement.”).

103. *See* PATRICK DAHL, *THE NEXT GREATEST THING* 40–41 (Richard A. Pence ed., 1986) (describing the incredible lack of services and conveniences in rural areas caused by the lack of electricity in the early twentieth century).

and with encouragement of the federal government.¹⁰⁴ Municipal power companies were even less helpful.¹⁰⁵ While the lack of electricity was seen by progressives as an inequity, it took on dramatic new importance as the federal government looked for ways to improve rural economic output during the Great Depression.¹⁰⁶ Thus, the creation of the REA put the government directly in the business of promoting rural electrification, and providing loans and administrative guidance was quickly determined to be the most efficient way forward.¹⁰⁷

Well before the REA made electrical cooperatives an integral part of the nation's electrical network, the federal government had granted these and similar cooperatives tax exemption with the Revenue Act of 1918.¹⁰⁸ The exemption was granted—and is maintained today—on the premise that RECs serve a public good without profit motives, and are therefore worthy of tax exemption.¹⁰⁹ Cooperatives and other mutual organizations have enjoyed a privileged status since the first income tax in America, with one senator in 1894 calling the intent to tax such organizations a “crowning infamy.”¹¹⁰ Popular sentiments aligned with the realities of the time: cooperatives and mutual companies were recognized as ways to protect poor and rural farmers from their precarious economic environment.¹¹¹ Furthermore, mutual and cooperative organizations at the time were so small and generated so little income that Congress noted that “[t]he securing of returns from them has been a source of annoyance and expense and has resulted in the collection of either no tax or an amount which is

104. See BROWN, *supra* note 7, at 11–12 (noting the reasons for the slow rate at which rural areas were being wired by investor-owned power companies).

105. See *id.* at 52 (recounting the unwillingness of municipal power companies to partner with the REA to extend service to rural areas).

106. See *id.* at 35–39 (discussing the rural electrification work of the Tennessee Valley Authority). The Tennessee Valley Authority was an important forerunner to federal electrification programs. Specifically designed to improve the lives of the people living in and around the Tennessee River in numerous ways, the TVA launched a government-sponsored REC with great success, showing the social and economic benefit of providing electricity to rural areas, but also the financial feasibility of electrical cooperatives. *Id.*

107. See *id.* at 47–57 (explaining that the continued refusal of investor-owned power companies left cooperatives as the only viable partners for the REA).

108. See Revenue Act of 1918, Pub. L. No. 65-254, 40 Stat. 1057 (providing tax exemption for local mutual organizations and other “like organizations of a purely local character”).

109. See *id.* § 231(10) (stating that tax exemption for these organizations resulted from their income consisting of fees collected from members for the sole purpose of meeting expenses rather than to collect a profit).

110. See James J. McGovern, *The Exemption Provisions of Subchapter F*, 29 TAX L. 523, 526 (1976) (quoting Senator Hill during the 1894 debate over the mutual savings banks' exemption).

111. See *id.* at 536 (discussing the rationale for exempting mutual and cooperative organizations).

practically negligible.”¹¹² RECs were viewed as especially noble because of the era in which they emerged. In addition to the hope and modernity they brought to farming communities, electrical cooperatives were seen as a stand by small farmers against greedy capitalists at a time when the Great Depression highlighted the disparities of class and wealth in America.¹¹³

The United States today looks very different, and the question of continued tax exemption of RECs should now be revisited. First and most importantly, the goal of national electrification has been achieved; by 1962, 97.6% of farms were receiving central service station electricity.¹¹⁴ The REA was created to combat the poverty of rural farming communities, granting them access to a world of mechanized equipment, electric lighting, and indoor plumbing.¹¹⁵ There is no question that rural areas now have these amenities. No household or business in America today is denied access to electricity because of its geographic location.¹¹⁶ The mission, therefore, has been successfully accomplished. This is important because the federal government launched the REA and its REC-friendly policies for the sole purpose of rural electrification and development.¹¹⁷ The REA persists today however, repackaged as the Rural Utility Service within the Department of Agriculture.¹¹⁸

In completing the government’s mission, the cooperatives themselves have changed. The first RECs were truly community affairs, with a handful of neighbors organizing a cooperative for the wiring of their farms.¹¹⁹ Modern RECs are large, complex, and hierarchical organizations often far removed from the community spirit that defined their early years.

112. H.R. REP. NO. 64-922, at 4 (1916).

113. See DAHL, *supra* note 103, at 39–59 (discussing the era in which early RECs, and later the REA, were formed).

114. U.S. DEP’T OF AGRIC., RURAL ELECTRIFICATION ADMINISTRATION, REPORT OF THE ADMINISTRATOR, 16 (1962).

115. See AMITY SHLAES, THE FORGOTTEN MAN: A NEW HISTORY OF THE GREAT DEPRESSION 175 (2007) (discussing the government’s goals for rural electrification). The Roosevelt administration’s four goals were to (1) provide electricity to homes and farms; (2) increase its use in all homes to provide a better standard of living; (3) reduce the cost of electricity to the average consumer; and (4) create a “new and more prosperous form of society.” *Id.*

116. See DAHL, *supra* note 103, at 75 (extolling the triumph of the rural electrification cause).

117. See SHLAES, *supra* note 115 and accompanying text.

118. The REA was rolled into the Rural Utility Service as part of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994. Pub. L. No. 103-354, 108 Stat. 3209 (codified at 7 U.S.C. § 6901 *et. seq.*).

119. See DAHL, *supra* note 103, at 82 (recounting the creation of the early RECs as community affairs that went door-to-door to secure support for electricity).

The median electrical cooperative has 13,000 members,¹²⁰ with the largest having nearly a quarter million spread over 8,100 square miles.¹²¹ RECs today hold monopolies over their service areas, are managed by highly paid professionals, and have lobbyists in Washington.¹²² Moreover, they are now widely seen as *de facto* public utilities because of their obligation to offer membership to all those living in their defined geographic service area, and the necessity of electricity in modern living.¹²³ This growth and formalization has made RECs into big business: today they collectively serve 42 million people and have assets totaling \$140 billion.¹²⁴ The \$40 billion in revenue that they collected in 2010, however, remains exempt from federal taxation.¹²⁵

In addition, RECs are no longer strictly rural. The communities they serve have grown from rural towns into small cities as suburban sprawl has replaced farmland.¹²⁶ The Rural Electrification Act defines rural as any area “not included within the boundaries of any city, village, or borough having a population in excess of fifteen hundred inhabitants.”¹²⁷ Although the populations of their service areas have swelled—driving down the distribution costs per customer—RECs have continued to operate as usual.¹²⁸ This is sometimes true even where portions of their service area are annexed by a municipality with its own electrical service.¹²⁹ RECs

120. See *Co-op Facts and Figures*, *supra* note 2 (listing the median number of members today).

121. See *2011 Annual Report*, PEDERNALES ELECTRICAL COOPERATIVE 6, available at http://www.pec.coop/docs/default-source/annual-reports/2011_Annual_Report.pdf?sfvrsn=5 (showing the Pedernales Electrical Cooperative in Texas to be the largest REC in the country, with 203,810 members holding 242,331 active accounts at the close of 2011 and covering a service area nearly the size of New Jersey) (on file with the WASHINGTON AND LEE JOURNAL OF ENERGY, CLIMATE, AND THE ENVIRONMENT).

122. See Cooper, *supra* note 34, at 339 (stating that the NRECA serves as the trade association and lobbying arm for RECs).

123. See ROGER D. COLTON, THE REGULATION OF RURAL ELECTRIC COOPERATIVES § 1.1.2 (1993) (noting the different factors that have generally led modern courts to conclude that RECs are public utilities, even where exempt from state utility commission jurisdiction).

124. See *2011 Annual Meeting Fact Sheet*, NATIONAL RURAL ELECTRICAL COOPERATIVE ASSOCIATION (Mar. 2012), <http://www.nreca.coop/members/Co-opFacts/Documents/AnnualMeetingFactSheet.pdf> (totaling the impact of RECs today) (on file with the WASHINGTON AND LEE JOURNAL OF ENERGY, CLIMATE, AND THE ENVIRONMENT).

125. See COLTON, *supra* note 123 (noting the revenue RECs received in 2010).

126. See GARWOOD & TUTHILL, *supra* note 6, at 27 (discussing the rise in urban sprawl and its relation to RECs).

127. 7 U.S.C. § 924 (2012).

128. See *Co-op Facts and Figures*, *supra* note 2 (showing the current status of electric cooperatives and their relative distribution cost to investor- or publicly-owned corporations).

129. See, e.g., *City of Morgan City v. S. Louisiana Elec. Co-op. Ass'n*, 31 F.3d 319, 324 (5th Cir. 1994) (determining that a municipality's attempt to condemn an REC's service area so that the members would become customers of the municipal power company was

currently provide electricity to suburbs of cities such as Atlanta, Orlando, Washington, D.C., Cincinnati, Fort Worth, Austin, Denver, and Nashville.¹³⁰ Today wholly 29.2% of the counties served by RECs are classified as metropolitan, 9.4% of which have populations of one million or more.¹³¹ These changes are significant because of the economic realities they represent. REC tax exemption is premised on the belief that cooperative members are too dispersed for electrical service to be provided to them profitably.¹³² If population densities are such that other power companies can now profitably provide electricity to a cooperative's service area, the REC's tax exemption no longer advances the public interest, and should not continue. In sum, the reality of modern RECs is far different than their venerable forebears. The sentiments that insulated the first generation of RECs from taxation regulation are not applicable to modern RECs.

B. Straying from Their Mission as RECs and Tax-Exempt Nonprofits

Many electric cooperatives today have drifted from their duties as nonprofits and their obligations as cooperatives. First, some RECs are failing to provide "at-cost" service to their members by unnecessarily retaining member equity rather than refunding it or lowering their rates.¹³³ While there is no bright line rule governing the return of member equity or the lowering of rates, RECs have kept an increasing portion of member equity that should have been returned to their members or not collected at all.¹³⁴ In 2006 alone, equity across all RECs grew by \$2 billion, though only \$499 million was refunded.¹³⁵ Because members are not generally provided with statements of their total equity in the organization (though such

impermissible and frustrated the purpose of the Rural Electrification Act to provide affordable power to rural areas).

130. See Cooper, *supra* note 34, at 350 (listing a number of cities the suburbs of which have expanded into regions served by RECs).

131. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-04-647, RURAL UTILITIES SERVICE: OPPORTUNITIES TO BETTER TARGET ASSISTANCE TO RURAL AREAS AND AVOID UNNECESSARY FINANCIAL RISK 4 (2004) (noting the proportion of populations served in non-rural areas).

132. The cooperative model was promoted by the REA only after investor-owned and municipal power companies found serving rural areas prohibitively expensive. See BROWN, *supra* note 7, at 48–54 (recounting how that agency had originally planned to work with private power companies).

133. See Cooper, *supra* note 34, at 355–56 (explaining the practice of retaining member equity and producing non-itemized bills for cooperative members).

134. See *id.* at 351 (discussing the volume of member equity that RECs now keep).

135. See *id.* at 352 (noting that these large refunds represent only a fraction of the sum that could be refunded).

records must be kept) or the refund rates of other cooperatives, they are left uninformed, grateful for any funds returned to them.¹³⁶ The funds retained by RECs are used in lieu of loans because they are viewed as even less expensive and more readily available than subsidized loans from the Rural Utilities Service.¹³⁷ Member equity is also used to fund efforts to prevent mergers and takeovers, despite the fact that such takeovers could result in greater efficiency and lower rates for members.¹³⁸ Even when not used in these ways, equity is not actively benefitting members: A number of metrics suggest that RECs are overcapitalized by roughly ten to thirty percent.¹³⁹ Despite their obligation to remit capital, the lax oversight and minimal reporting requirements make returning member equity difficult to monitor and enforce.¹⁴⁰ Easy access to member equity funds weakens the incentive for more efficient operation, and does not comport with cooperatives' member-focused principles.¹⁴¹

In addition to withholding member equity, some RECs have expanded their operations away from electrical generation and transmission.¹⁴² Most of these new ventures are in other utility sectors (sewer, water, telephone, etc.), but some are simply for-profit subsidiary ventures.¹⁴³ As mentioned above, the I.R.S. now allows cooperatives to distribute propane, even though this activity is unrelated to electricity and is not a utility-type activity.¹⁴⁴ Some RECs have gone even further, using subsidiaries to diversify into golf courses, newspapers, shopping centers,

136. *See id.* (discussing the rate at which RECs refund member equity and the disclosures surrounding this rate).

137. *See id.* at 367 (explaining that REC administrators view member equity as a free or extremely cheap source of capital).

138. *See id.* at 340 (noting that most RECs contribute to a fund that serves to prevent takeover attempts and territorial disputes).

139. *See id.* at 365 (concluding that RECs are overcapitalized based on their TIER and equity as a percent of assets).

140. *See id.* at 345 (“Co-ops continue to be largely free from regulation due to political reluctance to interfere with what appear from the outside to be smoothly-running operations. . . . Customer ownership is another reason for lack of scrutiny. In theory, electric co-ops are continually self-regulating . . .”).

141. *See id.* at 351 (stating that NRECA has warned its members to return member equity in order to preserve their tax and legal statuses).

142. *See id.* at 341 (discussing a Texas cooperative that borrowed money to buy a golf course).

143. *See Maintain Cooperatives' Exemption from FCC Pole Attachment Oversight*, NAT'L RURAL ELEC. COOP. ASS'N (Apr. 29, 2013), <http://www.nreca.coop/wp-content/uploads/2013/07/FastFactsPoleAttachment.pdf> (arguing that cooperatives charge the lowest rates for cable and telecommunication services) (on file with the WASHINGTON AND LEE JOURNAL OF ENERGY, CLIMATE, AND THE ENVIRONMENT).

144. *See supra* notes 69–70 and accompanying text.

and hotels.¹⁴⁵ While income from these activities would presumably be classified as taxable “nonmember” income for purposes of the eighty-five percent requirement, such an expansion into for-profit ventures shows the need for regulatory oversight and runs counter to the spirit which granted RECs their tax-exempt status.¹⁴⁶

V. Remedies

A. New Scrutiny of Nonprofits

Taken as a whole, nonprofit electrical cooperatives today act much like their for-profit counterparts.¹⁴⁷ Despite their humble roots, today’s RECs are large and professionally managed organizations that are a far cry from their populist past.¹⁴⁸ Moreover, many seem to have lost focus on their member-centric mission, failing to adhere to their traditional nonprofit purposes.¹⁴⁹

This situation is not unique to RECs.¹⁵⁰ Nonprofit hospitals have seen their purpose and place in the community change in a manner that mirrors what has happened to electrical cooperatives.¹⁵¹ Originally founded as almshouses to provide medical care to the poor, hospitals have transformed into large, professional, and economically viable businesses with wealth and power far exceeding their charitable forebears.¹⁵² This transformation has resulted in charges that nonprofit hospitals do not

145. See Steven Mufson, *Defaults Plague Little-Known Lender*, WASH. POST, Apr. 30, 2007, at D1 (discussing the financial problems related to some RECs’ non-utility investments).

146. See Reynolds, *supra* note 100, at 596 (discussing the I.R.S. conclusion that all subsidiary income is classified as non-member income).

147. See Roger D. Colton & Doug Smith, *Co-Op Membership and Utility Shutoffs: Service Protections that Arise as an Incident of REC Membership*, 29 IDAHO L. REV. 2, 2–3 (discussing the populist movement from which RECs developed and the similarities between RECs and investor-owned utilities)

148. See *id.* at 5 (“RECs are no longer small groups of individuals who have voluntarily banded together to serve themselves.”).

149. See *id.* (“RECs are most often large, complex, hierarchical organizations that are often far removed—physically as well as in spirit—from the needs of their less fortunate members.”).

150. See, e.g., James B. Simpson & Sarah D. Strum, *How Good a Samaritan? Federal Income Tax Exemption for Charitable Hospitals Reconsidered*, 14 U. PUGET SOUND L. REV. 633, 663 (“Charitable hospitals have become wealthy institutions, with power and presence in the community far beyond their almshouse forebears.”).

151. See *id.* (discussing the practice of charitable hospitals denying care to those for whom they were meant to provide care).

152. See *id.* at 634–44 (discussing changes in the hospital industry).

provide charitable care sufficient to justify their tax exemption.¹⁵³ Because the public they serve is not meaningfully different from their for-profit counterparts, these hospitals have been subjected to increasing scholarly criticism for the tax breaks that they receive.¹⁵⁴

The line between nonprofit and for-profit activities has blurred in other sectors as well.¹⁵⁵ Nonprofits have increasingly entered sectors once reserved for private industry or government, prompting complaints of unequal tax burdens for otherwise equal organizations.¹⁵⁶ In 1984, the Small Business Administration released a report that questioned the continued value of tax-exemption for nonprofits that did not provide a clear public benefit.¹⁵⁷ Although this report and subsequent Congressional hearings¹⁵⁸ did not ultimately change the Service's treatment of nonprofits, the subject continues to be discussed by Congress and the general public.¹⁵⁹

B. Increased Oversight

Many of the more troubling REC activities persist in part because of lax oversight.¹⁶⁰ The malfeasance of electrical cooperatives received

153. See CONG. BUDGET OFFICE, 109TH CONG., NONPROFIT HOSPITALS AND THE PROVISION OF COMMUNITY BENEFITS 2 (2006), available at <http://www.cbo.gov/ftpdocs/76xx/doc7695/12-06-Nonprofit.pdf> (finding that 4.7% of operating expenses go to uncompensated care, which is not significantly greater than the 4.2% spent by for-profit hospitals).

154. See, e.g., M. Gregg Bloche, *Health Policy Below the Waterline: Medical Care and the Charitable Exemption*, 80 MINN. L. REV. 299, 404 (1995) (“[T]he current federal tax exemption of nonprofit hospitals is neither explicable nor justifiable in terms of the logic or efficiency or reward for virtue.”).

155. See Heather Gottry, *Profit or Perish: Non-Profit Social Service Organizations & Social Entrepreneurship*, 6 GEO. J. ON POVERTY L. & POL’Y 249, 250 (1999) (suggesting that the operations of nonprofits are very similar to those of for-profit businesses because nonprofits also generate large profits, pay high salaries, make investments, and engage in lobbying efforts).

156. See *id.* at 256 (“As non-profits began to enter the for-profit arena, the Small Business Administration and a collection of other trade groups began pressuring the Government to . . . decrease the overall tax exemptions granted to non-profits.”).

157. See OFFICE OF ADVOC., U.S. SMALL BUS. ADMIN., UNFAIR COMPETITION BY NONPROFIT ORGANIZATIONS WITH SMALL BUSINESS: AN ISSUE FOR THE 1980S (1983) (“[T]he fact that nonprofits are increasingly competing with for-profit firms in a wide range of activities is evidence that many nonprofits are not providing ‘public goods’ which private competitive firms will not otherwise provide.”).

158. See, e.g., *Unrelated Business Income Tax: Hearing Before the Subcomm. on Oversight of the House Ways and Means Comm.*, 100th Cong. 217–20 (1987) (statement of Joseph O’Neil, Chairman, Business Coalition for Fair Competition).

159. See Gottry, *supra* note 155, at 273 (noting the continued interest in the subject despite the lack of Congressional action).

160. See Colton & Smith, *supra* note 147, at 4 (highlighting that RECs are not within the jurisdiction of state public utility commissions).

Congressional attention in 2008 after directors of the nation's largest REC gave themselves excessive salaries, bonuses, and other compensation whilst using \$700,000 of member equity to fund lavish personal travel and entertainment.¹⁶¹ These abuses stemmed from the lack of transparency in the REC's operation and the closed election process.¹⁶² While cooperative leaders sought to paint the incident as an isolated case of board corruption, the investigation highlighted how little information members have about the operations of their cooperatives.¹⁶³

Electric cooperatives are subject to minimal regulatory oversight.¹⁶⁴ As *de facto* public utilities, RECs are subject to consumer protection statutes and common law duties to the people in their service areas.¹⁶⁵ Additionally, the principles and structure that undergirds cooperatives are designed to prevent the sort of abuses that can manifest with private utilities.¹⁶⁶ While these elements are theoretically sufficient, in reality they are inadequate to prevent inefficiencies and the mistreatment of members.¹⁶⁷ Despite the prevalence of state statutes addressing the formation and operation of cooperatives, state utility commissions do not generally govern RECs.¹⁶⁸ In fact, only thirteen states regulate the rates charged to members, a mere seven of which regulate RECs comparably to private power companies.¹⁶⁹ The Federal Energy Regulation Commission has authority over wholesale sales and bulk transmission of electric power, but is explicitly excluded from regulating cooperatives.¹⁷⁰ The Rural

161. See generally *Governance and Financial Accountability of Rural Electric Cooperatives: The Pedernales Experience: Hearing Before the H. Comm. on Oversight and Gov. Reform*, 110th Cong. (2008), available at <http://www.gpo.gov/fdsys/pkg/CHRG-110hrg46194/html/CHRG-110hrg46194.htm> [hereinafter *Pedernales Hearing*] (discussing the misdeeds of the Pedernales board).

162. See *id.* (noting, through the statements of several witnesses, that lack of oversight and the closed election of directors were at the root of the abuses).

163. See *id.* (underscoring the lack of information that the members had as the events unfolded).

164. See Colton & Smith, *supra* note 147 and accompanying text.

165. See COLTON, *supra* note 123, § 4 (discussing the common law duties that RECs owe to their members and to the people in their service areas).

166. See Melissa A. Jamison, *Rural Electric Cooperatives: A Model for Indigenous Peoples' Permanent Sovereignty Over Their Natural Resources*, 12 TULSA J. COMP. & INT'L L. 401, 440 n.255 (2005) ("The [investor-owned utilities] would only provide such services if farmers would pay costs of construction, which at the time, could be as high as \$2,000 per mile.").

167. See Colton & Smith, *supra* note 147, at 5 (arguing for consumer protections from RECs similar to those that consumers have from investor-owned utilities).

168. See Gottry, *supra* note 159 and accompanying text.

169. See Cooper, *supra* note 34, at 342 n.50 (discussing the state regulation of RECs).

170. See Public Utility Act of 1935, Pub. L. 74-333, 49 Stat. 847 (codified as amended at 16 U.S.C. §§ 791A *et seq.*) (designating the Federal Power Commission as an independent

Utilities Service has authority over RECs, but can only enforce affirmative covenants, spending limitations, and financial disclosure requirements connected to its loans.¹⁷¹ Moreover, almost half of the money loaned to electrical cooperatives today comes from the National Rural Utilities Cooperative Finance Corporation, a nonprofit bank created by the RECs.¹⁷² Loans originating from this lender have no public reporting requirements.¹⁷³ In fact, the only organization that has authority over all electrical cooperatives is the I.R.S., which can withhold tax-exempt status from organizations that do not meet its exemption prerequisites.¹⁷⁴ Furthermore, I.R.S. Form 990, which must be completed by all tax-exempt organizations annually, is the only publicly available document common to all electrical cooperatives.¹⁷⁵ In sum, RECs are largely unmoored from regulatory oversight, and face only negligible public reporting requirements.¹⁷⁶

There is no doubt that a state-sanctioned regional monopoly of an essential service raises the potential for abuse and inefficiency.¹⁷⁷ Municipal and investor-owned utilities are subject to rate and other regulations by federal and state utility commissions because of the inherent vulnerability of their customers.¹⁷⁸ RECs have escaped this regulation by claiming that they are not utilities but are instead nonprofits created to serve the public

agency, and giving neither the Federal Power Commission nor its successor agency, the Federal Energy Regulatory Commission, authority to regulate RECs).

171. See Cooper, *supra* note 34, at 344 (describing the limited authority that the Rural Utility Service has over cooperatives).

172. See Keck, *supra* note 8, at 57 (discussing the National Rural Utilities Cooperative Finance Corporation, which was formed by RECs at the urging of Congress as way to reduce reliance on REA loans).

173. See Cooper, *supra* note 34, at 344 (stating that these loans do not require public disclosures).

174. See Seto & Chasin, *supra* note 59 and accompanying text.

175. See Cooper, *supra* note 34, at 359–60 (“The only new window on co-op performance is the availability of IRS Form 990, a disclosure required from any tax-exempt entity.”).

176. See *id.* at 343 (“[C]oops are lightly regulated at both the federal and state level.”).

177. See Note, *Condemnation of Public Utilities: A New York Statute and a New Approach*, 54 COLUM. L. REV. 916, 916 (1954) (“But since monopolistic power opens the door to abuse, these . . . utilities are ordinarily subjected to government regulation.”).

178. Public utilities commissions are found in all fifty states and are represented collectively by the National Association of Regulatory Utility Commissions. These commissions generally cite consumer protection as one of their missions. For example, the California Public Utilities Commission states on its website that it “serves the public interest by protecting consumers and ensuring the provision of safe, reliable utility service and infrastructure at reasonable rates, with a commitment to environmental enhancement and a healthy California economy.” CAL. PUB. UTIL. COMM’N, <http://www.cpuc.ca.gov/puc/> (last visited Oct. 3, 2013) (on file with the WASHINGTON AND LEE JOURNAL OF ENERGY, CLIMATE, AND THE ENVIRONMENT).

good.¹⁷⁹ The courts no longer accept this line of argument, and one court notes that designation as a utility “does not depend on legislative definition, but on the nature of the business or service rendered.”¹⁸⁰ Yet RECs are nonetheless specifically exempt from most state utility commissions.¹⁸¹ This freedom from scrutiny is premised on the idea that, in addition to their noble and populist past, the cooperative model was inherently self-regulating and without profit motive.¹⁸² Electrical cooperatives, the argument went, did not need regulation.¹⁸³ While this may have been true at the time of their provincial origins, their present size and complexity undermines this rationale, as evidenced both by the scandals that have emerged and the persistent failure of cooperatives to refund member equity.¹⁸⁴ Because today’s RECs can subject their members to abuses and overcharges no different than investor-owned or municipal power companies, they should now face similar regulatory scrutiny.¹⁸⁵ Cooperatives may argue that the rural nature of their members drives up their per-capita distribution costs, making their rates incomparable to the more densely populated areas served by private and municipal power companies.¹⁸⁶ However, these differences are minimal and shrinking, and are easily outweighed by the need for transparency and oversight.¹⁸⁷ Subjecting RECs to the same cost-of-service regulations as their municipal and investor-owned peers would ultimately benefit their members.¹⁸⁸

Increased transparency could eliminate some of the more problematic electric cooperative activities.¹⁸⁹ For example, the I.R.S. could require RECs to annually disclose data relating to their member equity accounts.¹⁹⁰ Cooperatives forced to disclose the amount of member equity

179. See COLTON, *supra* note 123, § 1.1.2 (discussing the determinative characteristics of whether RECs should be treated as a public utility).

180. *Aberdeen Cable TV Serv. v. City of Aberdeen*, 176 N.W.2d 738, 741 (S.D. 1970) (quoting 73B C.J.S. *Public Utilities* § 2 (2013)) (internal quotation marks omitted).

181. See Cooper, *supra* note 34, at 342 n.53 (noting that only thirteen states regulate RECs).

182. See *id.* at 345 (noting that RECs appear to some to be “smooth running operations”).

183. See *id.* (“In theory, electric co-ops are continually self-regulating . . .”).

184. See *supra* Part IV, *supra*.

185. See Colton & Smith, *supra* note 167 and accompanying text.

186. See Keck, *supra* note 8, at 70–71 (discussing the differing costs of serving rural versus urban customers).

187. See *id.* (concluding that these differences are negligible).

188. See Cooper, *supra* note 34, at 368 (arguing “at cost” service will see reduced rates, volume, or patronage capital, which are benefits for members).

189. See *id.* at 370 (highlighting governance as a way to achieve “at cost” service and prevent cooperatives from retaining surplus member equity).

190. See *id.* at 373 (“Empowerment begins with requiring all co-ops to disclose each member’s equity stake at least annually.”).

they retain would feel pressured to return more of it because members would have more insight into the finances of their cooperative.¹⁹¹ In the absence of other regulations, such disclosure could be achieved through amendments to I.R.S. Form 990.¹⁹² This form was revised in 2008 to encourage good governance of tax-exempt organizations through increased transparency.¹⁹³ The revisions have dramatically increased the required disclosures of financial information and governance practices.¹⁹⁴ Most notably, the form seeks to address concerns surrounding nonprofit hospital activities by requiring them to complete a series of industry-specific questions in Schedule H, on the theory that requiring the disclosures will yield better practices.¹⁹⁵ RECs could be tasked with a similar reporting requirement.¹⁹⁶ Requiring disclosures specific to RECs could force these cooperatives to publicly release financial and governance information important to their members.¹⁹⁷ Although they do not share the community benefit requirement of hospitals or other charities, RECs could provide information about financial health, voting policies, and equity accounts that would likely be of interest to their members.¹⁹⁸ Members would then be able to make informed decisions when voting in REC board elections, and could replace directors with whom they became sufficiently dissatisfied.¹⁹⁹

191. See *id.* at 339 (“[C]o-ops have tried to hide information from their members—information to which owners are entitled in other business contexts.”).

192. See Sheilah O’Halloran & Van Zimmerman, *The New Form 990*, 263-APR N.J. L. 9, 9 (2010) (discussing the I.R.S.’s use of Form 990 to increase review of compliance of tax exempt organizations).

193. See *id.* at 10 (describing recent changes to the Form 990).

194. See *id.* (detailing the different types of information that the revised Form 990 requires to be disclosed).

195. See Eileen Salinsky, Nat’l Health Policy Forum, The George Washington Univ., Background Paper No. 67, Schedule H: New Community Benefit Reporting Requirements for Hospitals 4 (2009), available at http://www.nhpf.org/library/background-papers/BP67_ScheduleH_04-21-09.pdf (discussing the details and intentions of schedule H) (on file with the WASHINGTON AND LEE JOURNAL of ENERGY, CLIMATE, AND THE ENVIRONMENT).

196. See Cooper, *supra* note 34, at 359 (arguing comparisons with other cooperatives would allow for greater industry-wide understanding of cooperative procedures).

197. See *2013 Instructions for Form 990 Return of Organization Exempt From Income Tax*, INTERNAL REVENUE SERVICE (Dec. 2, 2013), <http://www.irs.gov/pub/irs-pdf/i990.pdf> (“Some members of the public rely on Form 990 or 990-EZ as their primary or sole source of information about a particular organization.”) (on file with the WASHINGTON AND LEE JOURNAL of ENERGY, CLIMATE, AND THE ENVIRONMENT).

198. See Cooper, *supra* note 34, at 373 (discussing methods of empowering cooperative members, such as disclosure of members’ equity and allowance of proxy voting).

199. See Puget Sound Plywood, Inc., 44 T.C. at 308 (noting the democratic nature of cooperatives).

C. Removing Tax-Exempt Status

Increasing the disclosure requirements in Form 990 will fully address the complexity and varied operations of RECs today. While additions to this disclosure statement might provide valuable information, they would not go far enough to protect members from abuse and inefficiency, nor would they empower individual members who live within state-ordained regional electrical monopolies. RECs may have been originally exempt from federal income taxation because of their humble and honorable purpose, but they were also exempt on the theory that there would be no income to tax; every dollar that the cooperative did not spend on its operations was to be returned to the members.²⁰⁰ Thus, such cooperatives were nonprofits by design.²⁰¹ Modern RECs that retain member equity above their operating costs undermine this rationale.²⁰² Their use of member funds for non-operational expenditures shields them from market forces that might encourage more efficient business practices.²⁰³ Because members lack information about the funds owed to them and the value they receive as members, RECs have little incentive to seek more honest and efficient operations.²⁰⁴

A better approach may be to remove the § 501(c)(12)(C) exemption entirely.²⁰⁵ While this might at first appear unduly harsh to RECs, the reality is that this change would free them to pursue ventures available to other power companies while simultaneously encouraging more efficient operations.²⁰⁶ This is not to say that RECs would be abolished and replaced with investor-owned corporations.²⁰⁷ Removing their tax exemption would not alter their status as cooperatives or their duty to conform to cooperative principles: RECs would still be obligated to serve members rather than

200. See Seto & Chasin, *supra* note 57, at 178 (discussing the centrality of the subordination of capital to the cooperative structure).

201. See Cooper, *supra* note 34, at 345–46 (discussing fundamental characteristics of electric cooperatives at their creation, including their status as non-profit companies).

202. See *id.* at 350–51 (noting that NRECA found that the failure of cooperatives to return equity to their customers was a fundamental problem).

203. See *id.* at 363–67 (“Some co-ops operate almost entirely on equity, if only due to their board’s distaste for debt. Equity is perceived as either costless or extremely cheap.”).

204. See *id.* at 352 (stating that members are grateful for any refund and do not compare their investment with their refund).

205. See *id.* at 375 (acknowledging the possibility of removing tax exempt status from wealth cooperatives).

206. See *id.* at 374 (“Selective removal [of federal subsidies] could also be an effective enforcement tool against co-ops that refuse to become more efficient or member-friendly.”).

207. See Clayton S. Reynolds, *What Then to Do with A Non-Cooperative Cooperative?*, 56 TAX LAW. 825, 825 (2003) [hereinafter *Non-Cooperative Cooperative?*] (explaining that the primary purpose of cooperatives still is to provide the best price to their members).

investors, provide equal voting for members, and remit member equity.²⁰⁸ Rather, they would be taxed as *non-exempt* cooperatives.²⁰⁹

Subchapter T of the Code governs the taxation of non-exempt cooperatives.²¹⁰ Even before this Subchapter was enacted as part of the Revenue Act of 1962,²¹¹ it was the Service's longstanding position that member equity distributed to members could be deducted from a cooperative's taxable income, provided that it was operating according to cooperative principles.²¹² Under this arrangement, cooperatives are subject to taxation like any corporation, but with the ability to deduct the equity returned to members.²¹³ To take advantage of this subchapter, they still must operate according to cooperative principles.²¹⁴ Subchapter T additionally requires that cooperatives separate their member and non-member income when calculating their gross income so that they cannot use an operating loss of their membership activities to offset gains from non-member activities.²¹⁵ While the I.R.S. has advocated that fifty percent of the cooperative's value should be derived from members,²¹⁶ it conceded that failing to meet this benchmark would not deny a cooperative access to the benefits of Subchapter T.²¹⁷

208. See *id.* at 828 (discussing the requirement that non-exempt cooperatives still follow cooperative principles).

209. See I.R.C. §§ 1381–88 (2012) (eliminating applicability of Subchapter T).

210. See I.R.C. § 1381(a)(2)(C) (excluding cooperatives “engaged in furnishing electric energy” to rural areas from this subchapter).

211. Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960 (codified as amended in scattered sections of 26 U.S.C.).

212. See Rev. Rul. 54-10, 1954-1 C.B. 24 (1954) (“A cooperative association may exclude from its gross income true patronage dividends when made pursuant to a prior agreement between the cooperative organization and its patrons.”); see also Rev. Rul. 57-59, 1957-1 C.B. 24 (1957) (concluding that income derived from non-members cannot be excluded from gross income).

213. See Joel E. Miller, *Which of a Nonexempt Co-Op's Earnings Are Tax-Exemptible Under Subchapter T*, 24 J. REAL EST. TAX'N 355, 361–62 (1997) (discussing the tax deductions available to cooperatives under Subchapter T).

214. See *Non-Cooperative Cooperative*, *supra* note 207, at 828 (noting the I.R.S. requirement that organizations adhere to fundamental cooperative principles in order to take advantage of Subchapter T).

215. See *Farm Serv. Co-op. v. Comm'r*, 619 F.2d 718, 727 (8th Cir. 1980) (stating that member and non-member income must be segregated for the purposes of calculating gross income).

216. See Rev. Rul. 72-602, 1972-2 C.B. 510 *modified by* Rev. Rul. 93-21, 1993-1 C.B. 188 (explaining the I.R.S.'s position that fifty percent of the company's business needed to come from members to maintain cooperative status under Subchapter T).

217. See Rev. Rul. 93-21, 1993-1 C.B. 188 (abandoning its previous stance).

RECs would presumably object to losing their tax-exempt status.²¹⁸ Although their tax burden would be small compared to their size, the amount of taxation could still be substantial.²¹⁹ Their trade organization, NRECA, would object to this change because it undermines the REC image as organizations committed to community improvement.²²⁰ Nonetheless, removing RECs' § 501(c)(12) exemption and subjecting them to taxation as non-exempt cooperatives would have two significant benefits.²²¹ First, it would allow a cooperative to pursue income from non-member patrons without restrictions on the business activity or a member-business requirement.²²² Such activities would be taxed separately from unallocated member income, in order to prevent the offsets previously mentioned.²²³ This would allow RECs that want to diversify into new areas the room to do so without the limitations of the eighty five percent requirement.²²⁴ However, because RECs do not have investors, there would be little incentive to engage in projects that do not benefit members.²²⁵ Permitting electrical cooperatives to diversify would allow them to meet the needs of their members more successfully.²²⁶

218. See *Maintain Cooperatives' Exemption from FCC Pole Attachment Oversight*, NAT'L RURAL ELEC. COOP. ASS'N (Apr. 29, 2013), <http://www.nreca.coop/wp-content/uploads/2013/07/FastFactsPoleAttachment.pdf> (objecting to the loss of federal pole attachment status, which is argued to a part of cooperatives charging cost based rates) (on file with the WASHINGTON AND LEE JOURNAL of ENERGY, CLIMATE, AND THE ENVIRONMENT).

219. See *Farm Serv. Co-op.*, 619 F.2d at 727 ("A nonexempt cooperative simply may not use patronage losses to reduce its tax liability on nonpatronage-sourced income.").

220. See, e.g., *Local Initiatives*, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION, <http://www.ect.coop/category/newsmakers/local-initiatives> (last visited Dec. 16, 2013) (highlighting the democratic and community-focused elements of its member cooperatives) (on file with the WASHINGTON AND LEE JOURNAL of ENERGY, CLIMATE, AND THE ENVIRONMENT).

221. See Miller, *supra* note 213, at 358 ("Very early on, it became evident that they could function more efficiently if they commanded large sums of money beyond what could be raised from outside lenders.").

222. See *id.* at 359 (discussing the how the Service categorizes different forms of cooperative income).

223. See *id.* (discussing the different tax treatment of member and non-member income).

224. See Rev. Rul. 2002-54, 2002-2 C.B. 527, *supra* note 95 and accompanying text.

225. See Mufson, *supra* note 145, at D1 (quoting a Fitch rating analyst's claim that a cooperative's primary goal is to provide competitive rates for its members).

226. For example, Dominion, an investor-owned utility spanning four states, offers customers a variety of home protection services that augment the electrical, gas, and water services it provides. See *Home Protection*, DOMINION ENERGY SOLUTIONS, <https://dominionenergy.com/en/home-protection> (last visited Oct. 3, 2013) (presenting a range of services that Dominion offers in addition to providing electricity) (on file with the WASHINGTON AND LEE JOURNAL of ENERGY, CLIMATE, AND THE ENVIRONMENT).

In addition to allowing them to expand the menu of services they offer, ending the tax exemption of electrical cooperatives would greatly incentivize the distribution of member equity.²²⁷ RECs would be able to exclude from taxation not only income from members, but also the income from any activity directly related to the cooperative's principle function.²²⁸ Because holding onto member equity increases the tax burden, cooperatives would be more willing to stand by their cooperative principles and return equity to the members.²²⁹ A prototypical REC would be subject to only the smallest amount of taxation because almost all of its income over operating costs would be vested in member accounts and distributed to members on a regular basis.²³⁰ Because this remittance could have tax consequences for some members, the cooperative would be pressed to charge members as near cost as possible.²³¹ The nuances of Subchapter T and the permutations of its application are beyond the scope of this note. It is nonetheless clear that taxation encourages RECs to remit member equity and pursue more efficient operations.²³²

VI. Conclusion

Some RECs retain many characteristics from their New Deal-era creation as democratically managed organizations serving poor rural communities that might otherwise struggle to afford electric service.²³³ Many others are now large and professionally managed organizations whose members view them as little different from for-profit utilities.²³⁴ Such organizations lack transparency or accountability, allowing inefficient and detrimental practices to fester.²³⁵ Without regulations, disclosures, or taxation, there is no outside force to encourage RECs to pursue honest and efficient operations.²³⁶ The tax and regulatory exemptions that RECs have maintained through the years serve no contemporary purpose and fail to

227. See Reynolds, *supra* note 207, at 837 (highlighting the I.R.S.'s arguments regarding consequences of failure to operate at cost).

228. See Miller, *supra* note 213, at 365–67 (discussing the types of income that are considered “directly related” to a cooperative’s principle business).

229. See Reynolds, *supra* note 227 and accompanying text.

230. See Cooper, *supra* note 183 and accompanying text.

231. See Miller, *supra* note 213, at 362 (discussing the tax consequences that cooperative distributions would have for different members).

232. See Reynolds, *supra* note 227 and accompanying text.

233. See Cooper, *supra* note 34, at 336 (“Most co-ops operate in a few rural counties where customers live far apart . . .”).

234. See Bloche, *supra* note 154 and accompanying text.

235. See Colton & Smith, *supra* note 167 and accompanying text.

236. See Colton & Smith, *supra* note 164 and accompanying text.

benefit cooperative members.²³⁷ On the contrary, they shield cooperatives from their obligations to remit equity to their members and seek more efficient business practices.²³⁸ Lifting the tax exemption of § 501(c)(12) would subject RECs to taxation under Subchapter T of the Internal Revenue Code, which would encourage efficient practices, allow expansion into new ventures, and expose it to a greater degree of market forces.²³⁹ The government sought to help rural citizens gain access to electricity by protecting electric cooperatives from taxation and regulation.²⁴⁰ These protections now work to insulate cooperatives that do not act in their members' best interest.²⁴¹ Maybe it is time for them to end.

237. See Cooper, *supra* note 188 and accompanying text.

238. See Cooper, *supra* note 205 and accompanying text.

239. See Cooper, *supra* note 206 and accompanying text.

240. See BROWN, *supra* note 22 and accompanying text.

241. See Cooper, *supra* note 206 and accompanying text.