

CORPORATE STRUCTURE
OF A
BEET-ETHANOL INDUSTRY

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Lincoln College, Canterbury, N.Z.

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PREFACE

Report 46 of the Energy Research and Development Committee has explored the potential for energy farming to meet the nation's demand for transport fuels as the supply of world oil becomes increasingly restricted and more importantly in the short run, the world market price for oil becomes increasingly restrictive on the New Zealand economy. Scenarios developed in the Report indicate a potential renewable energy resource from trees and agricultural crops which can be converted to alternative liquid fuels. Although the economics of such production systems were examined in the Report, no attention was paid to the organisational structure under which this potential new industry could develop. The most promising initial option on which this industry could be based was identified in the Report as the conversion of beet crops to the alcohol ethanol. The organisational aspects in this case would be complicated by the need to co-ordinate the flow of beet biomass from many farmers to ensure continuous supplies to a central processing factory within and between seasons. In an industry of strategic importance, such a consideration is crucial, though in many ways it is not greatly different from similar problems involved in the successful operation of beet sugar producing and refining industries in N. America and Europe.

This present paper considers some of the arrange-

ments that could permit a close financial association between farmer producers of beet in a New Zealand industry and the processing factory. Some element of farmer financial involvement in the factory is seen as vital to the long-run success of the venture and implications of various alternative arrangements are presented.

J.B. Dent
Director.

SUMMARY

This report outlines the alternative corporate structures which could be applicable to a beet-ethanol industry in New Zealand. It is apparent that both the Rural Banking and Finance Corporation and the Development Finance Corporation will play major roles in the development of this industry, both in provision of debt capital and in assisting farmers build up their own equity shareholding in the processing Company. With careful preparation it should be possible for farmers, if they so wish, to become closely involved with the development of this new industry, not only as feedstock suppliers but also by participating in the capital structure and management of the processing and product distribution operations.

Section 4 of this report clearly identifies the tax advantages that can accrue from any farmer involvement being organised on a Co-operative basis. Since the actual activities of a beet-ethanol plant may be outside the scope of the current definitions contained in the relevant Acts, an approach to the Commissioner of Inland Revenue for clarification on these matters will be necessary. In addition, legal interpretation of the tax situation relating to a farmer Co-operative which owns only part of the total equity in the processing Company is necessary. There is no doubt, however, that with careful management farmers will be able

to participate in and benefit from all aspects of any agro-industrial system which emerges to produce ethanol from beet in New Zealand.

1. INTRODUCTION

This paper discusses alternative corporate structures which could be applicable in the development of a beet-ethanol industry in mid-Canterbury. The intent of the report is to highlight alternative possibilities and their associated strengths and weaknesses such that both individual farmers, farming groups and other parties may have a clearer understanding of the options. With this background, the appropriate corporate structure and associated financing arrangements can be developed consistent with the specific objectives of the groups involved in any particular development.

Table 1 outlines the statistics relating to a hypothetical beet-ethanol plant sited in mid-Canterbury. The 'all-up' cost of this medium sized plant is estimated at \$10 million, and would involve an average of 170 individual farmer contracts for feedstock supply each year, with an average planted area of 15 ha/farm. The number of farmers involved in feedstock supply over a number of years is taken at 280, 60 per cent of whom receive contracts in any one particular year.¹

Using this example as a basis, Section 2 of this

¹ This relationship has implications for a co-operative company structure where, in general, at least three-fifths of the nominal value of the shares issued should be held by persons engaged in feedstock supply - refer Section 3.

report outlines the alternative options for debt finance, and equity funding is discussed in Section 3. The advantages of a co-operative structure are discussed in Section 4.

TABLE 1

Industry Statistics for
Hypothetical Beet-Ethanol Plant

Factory size:	250 ODTPD (oven dry tonnes feedstock per day)
Capital cost - land, buildings and plant:	\$10 million
Operating period:	180 days
Feedstock type:	Fodder beet - average farm yield 100t/ha at 18% DM
Feedstock requirement:	1390 wet tonnes/day 250,000 wet tonnes over the campaign
Contracted area:	2500 ha
Average area contracted/ farmer:	15 ha
Number of contracts let:	167
Number of potential farmer suppliers:	280
Contract price (delivered to the factory):	\$60/ODT \$1080/ha
Net return to the farmer:	\$430/ha

2. DEBT FINANCE

An overall debt:equity ratio of not more than 60:40 is assumed for the first plant, implying a requirement of \$6 million of debt capital.² Although some institutional lenders may be interested in covering this liability, the logical source of funds for a project of this type is the Development Finance Corporation of New Zealand (DFC).³

As a development bank the DFC adopts a flexible approach to financing commercially viable projects with sound development features. Emphasis is placed on the need to develop the financing package appropriate for the project concerned. In this role DFC assists and advises on the following issues:

- (a) evaluation of the proposal;
- (b) negotiations with local and offshore financiers;
and
- (c) development of a suitable financial package for the project.

² In special circumstances, higher ratios are permitted by some lenders (e.g. DFC) provided the cash flow is strong enough and the debt:equity ratio can be brought into line after a short operating period.

³ A detailed discussion of the DFC lending policy is given in Appendix 1. If other institutional lenders were approached for debt capital, both the attractiveness and security of the investment may be improved if the shareholders took up a substantial number of partly paid up shares. The investor could then always call on these shares if the need arose. Another option is to form a Company Limited By Guarantee, which would, in essence, provide the same security.

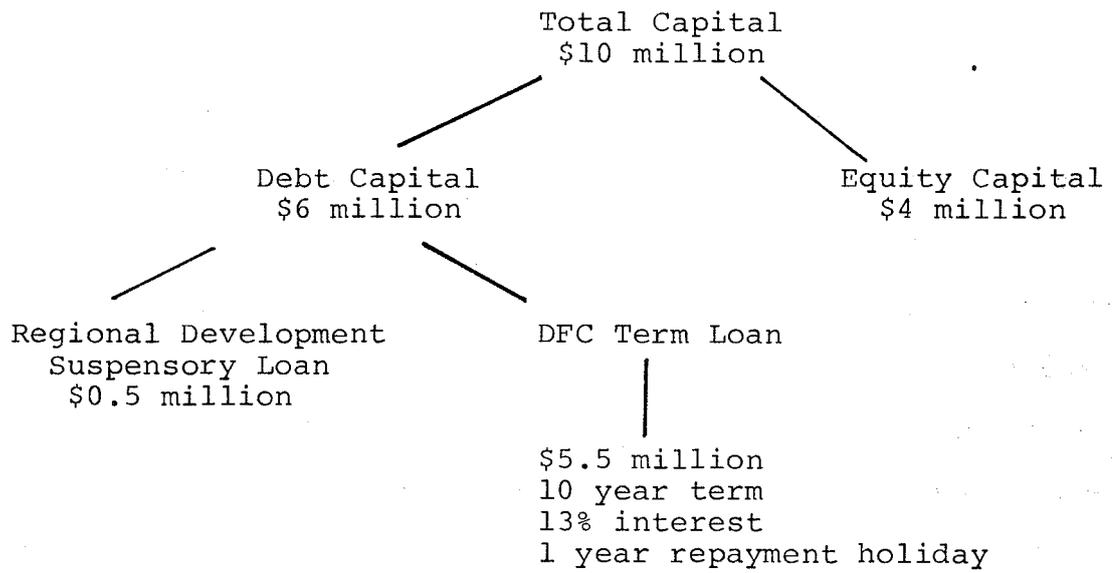
For major projects the financing package generally includes a combination of the finance facilities and perhaps also a consortium of financiers to achieve the optimum funding mix.

As outlined in Appendix 1, a beet-ethanol project in mid-Canterbury would, in all probability, be eligible for a suspensory loan through the Regional Development Scheme operated by the Department of Trade and Industry. Although the normal maximum value of these types of suspensory loans is \$100,000⁴, the import substitution, employment creation, and technology proving aspects of the first beet-ethanol plant would build a strong case for Ministerial approval to exceed the limit, perhaps up to, say, \$500,000. The remaining \$5.5 million could be covered by a DFC Term Loan over 10 years with a repayment holiday of one year and preferential interest rate of around 13 per cent. Alternatively, DFC could arrange a consortium of financiers involving on-shore and off-shore loans. The broad financial structure is illustrated in Figure 1.

⁴ No interest is payable on such loans.

FIGURE 1

Financial Structure Showing Breakdown
of Debt Finance



3. EQUITY FINANCE

In the previous section it was suggested that the minimal equity contribution would need to represent 40 per cent of the total liabilities, or around \$4 million. Farmers could either raise this equity capital directly, perhaps by share purchases in proportion to the area of beet which they would contract to plant over a specified period.

Alternatively, the equity capital could be funded to varying degrees by another party, but with rights attached to allow the farmers or farmer groups to take up their equity share as funds permitted; for example, by a retention from their payments for feedstock supply. This means that another party would initially hold the equity stock, but farmers would have the right to purchase shareholding from this company, financing such purchases from the money received from selling beet to the processing company.

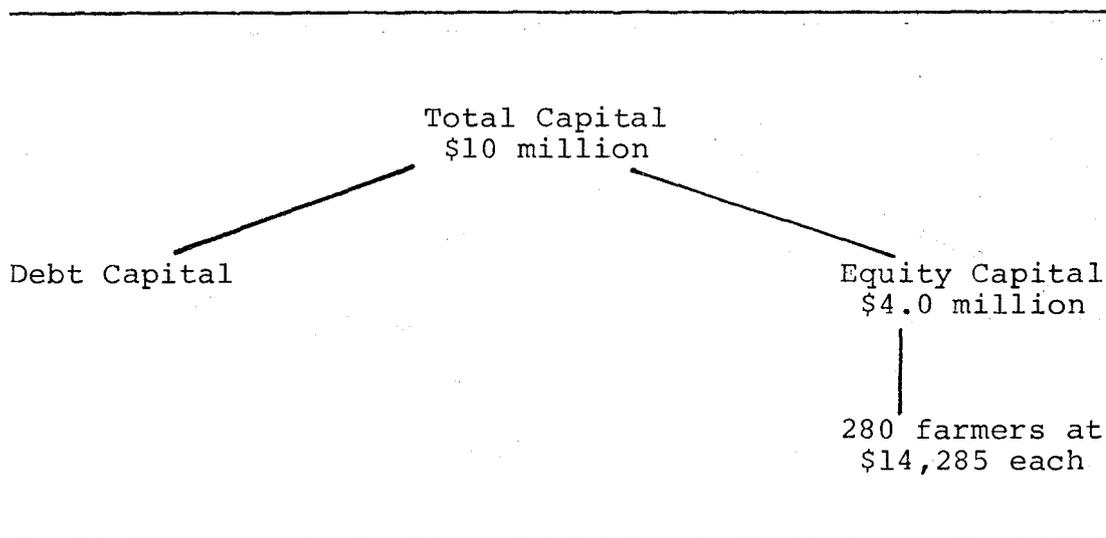
3.1. Farmer Purchase of Equity Stock

If individual farmers were to take up all the equity in the processing company, thus creating a processing plant wholly owned by suppliers, the total equity requirement of \$4 million could be spread over the 280 feedstock suppliers representing an individual contribution of \$14,285 as shown in Figure 2.

Alternatively, there may be advantages in farmer suppliers linking in with another company or group of companies

FIGURE 2

Financial Structure with Processing
Plant Wholly Owned by Farmers

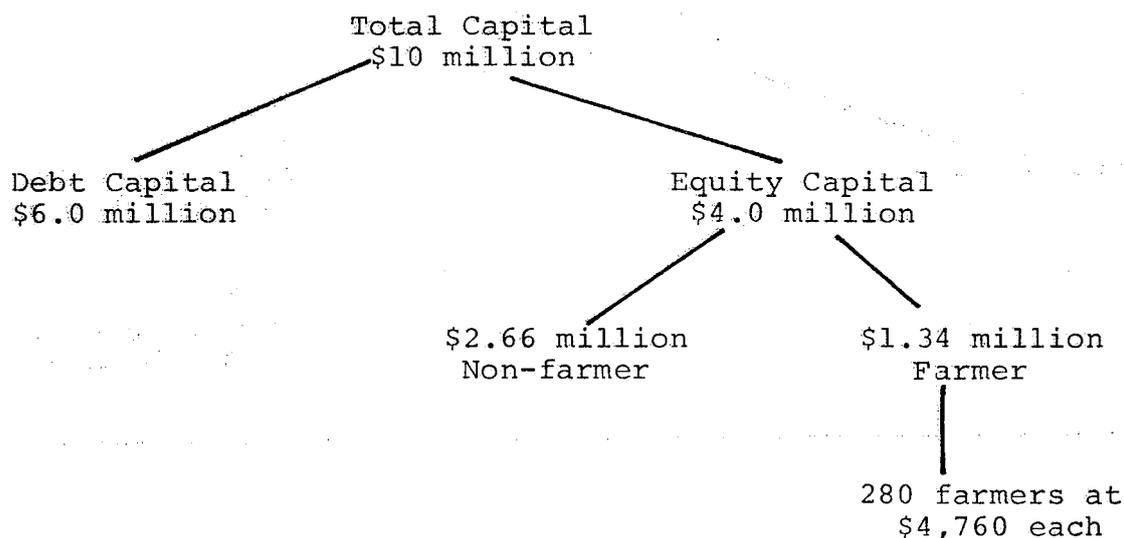


which have expertise in the processing and distribution of ethanol - in this situation, if one-third of the total equity were held by farmers, the individual farmer contributions would average \$4,760 as illustrated in Figure 3.

There are two sources of cash for farmers to provide for their equity capital contributions; their own capital assets, or the Rural Banking and Finance Corporation. Experience with other similar agri-business developments, both in New Zealand and overseas, suggests that the availability of significant equity capital contributions directly from farmers is limited. Some accountants and solicitors suggest that an industry such as this might expect an average of \$750/farmer, while others discount this level as too

FIGURE 3

Financial Structure with Farmers
Holding One-Third of Equity



optimistic.⁴ It seems unlikely that individual farmers in a district could contribute an overall average of \$4,760 from their cash assets to enable an uptake of one third of the equity stock.

A possible way in which farmers could raise their share of equity finance is through the Rural Banking and Finance Corporation (RBFC), where the capital is raised

⁴ The uptake of shares by farmers could be made more attractive if the share capital was called up over 18 months or two years. This would spread the demand for cash over more than one financial year.

against a corresponding mortgage on their property. This procedure has been used to finance other farming developments in New Zealand, particularly Farmer Co-operatives, although not to the scale implicit in this project. It is, however, an administratively easy option since some of the farmers would already have term liabilities with the Rural Bank, and the registration of new mortgages or variation of existing mortgages to provide equity capital for share purposes should be straightforward. Since, however, it is not normal policy for the RBFC to lend for equity investment, initial application would be necessary to the RBFC Board for approval, which, if forthcoming, could be followed by individual farmer applications at their local RBFC office.

As outlined, the actual equity contribution would average \$4,760/farm if farmers held a one-third equity shareholding, or up to \$14,285/farm if totally farmer owned. If shareholding were related to contracted area, the variation between farmers could be substantial. In this situation a 60 ha (four times the average size) contract would require \$19,040 (one-third farmer shareholding) or \$57,140 (total farmer shareholding). This variability is demonstrated in Table 2.

The normal (1980) prime lending rate for RBFC mortgages is 9 per cent, although refinance lending is currently at 11 per cent. It is probable that the prime rate of 9 per cent would apply to those farmers who applied for

TABLE 2

Individual Farmer Contributions

Total Equity	Total Equity Holding \$4 million	
	Totally Farmer Owned Equity Contribution \$4 million	One-third Farmer Owned Equity Contribution \$1.34 million
Individual Farmer Contributions		
	-----\$/farmer ^a -----	
Contract size		
7.5 ha	7,142	2,380
15 ha	14,285	4,760
30 ha	28,570	9,520
45 ha	42,855	14,280
60 ha	57,140	19,040

^a For the average size contract of 15 ha, 280 potential farmer suppliers would need to contribute the capital indicated, but only two thirds or 167 would actually receive contracts in any particular year - refer Table 1.

mortgages so that they could take up equity shareholding in the plant. The term of these loans would normally be from 10 to 15 years, although longer terms could be considered if individual farm debt:equity ratios were high and a tight cash flow position prevailed.

3.2. Indirect Equity Holding

Where it is not possible for farmers directly

to take up equity in the processing plant, another party could take up shareholding on their behalf, and on such terms and conditions that the shares gradually revert to the feedstock suppliers.⁵ The DFC can, in some circumstances, fulfil this role. The following quotations extracted from Appendix 1 of this report highlight the DFC's potential contribution.

"Equity participation by DFC is considered only where a further equity contribution is necessary to create a proper balance between shareholders' funds and long term debt finance (i.e. an equity ratio of 40 per cent). DFC equity support is however always limited to a level below 50 per cent of the total equity investment of the project."

"The type of equity finance selected is dependent on the particular financing package for a project and could, for example, be in the form of ordinary shares, redeemable preference shares or specified preference shares. It is DFC's policy not to hold equity investments for a term longer than seven years with the realisation of the shares normally undertaken in consultation with the company's directors."

As an alternative to DFC there are cases where equity funds have been provided to Agribusiness Companies by the Producer Boards. An example would be the use of Meat Board funds to provide some of the equity for the Southland Co-operative Phosphate Company Ltd. It is understood,

⁵ It is assumed in this discussion that any other non-farmer groups which may be involved in an equity share would not allow their paid up capital to be used to underwrite borrowings to finance farmer shareholding or alternatively, provide a guarantee for such borrowings.

however, that release of Meat Board funds requires the approval of the Minister of Agriculture and Fisheries, and such approval is dependent on "the proven use of these funds to benefit the Meat Industry". This approval would appear to be unlikely since energy farming represents a movement away from traditional farming patterns. Nevertheless, substantial by products from a beet/ethanol industry in the form of beet pulp and beet tops may be the basis for some development in the meat producing sector. Similarly, finance from the other Producer Boards is unlikely to be forthcoming. Other farmer Co-operatives or Dairy Companies may be prepared to assist, but it would appear the DFC offers the most likely source of interim equity capital for this type of venture.

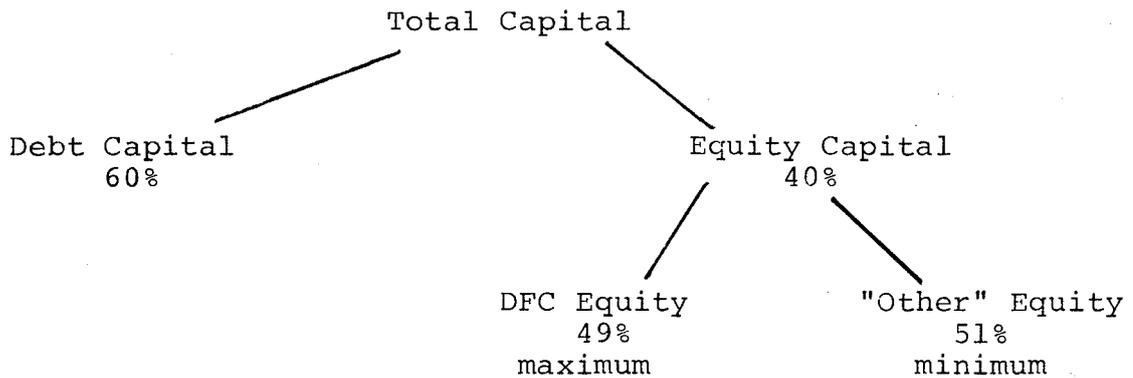
If the DFC were involved in equity financing, two conditions apply,

- (a) shareholders funds should represent at least 40 per cent of the total capital (although a lower percentage may be acceptable in some circumstances), and
- (b) DFC equity support is always limited to a level below 50 per cent of the total equity holding in the investment. Figure 4 outlines this situation in general terms.

Shares are normally taken up by the DFC as specified preference shares, redeemable shares, or as ordinary

FIGURE 4

General Conditions of DFC Equity
Financing



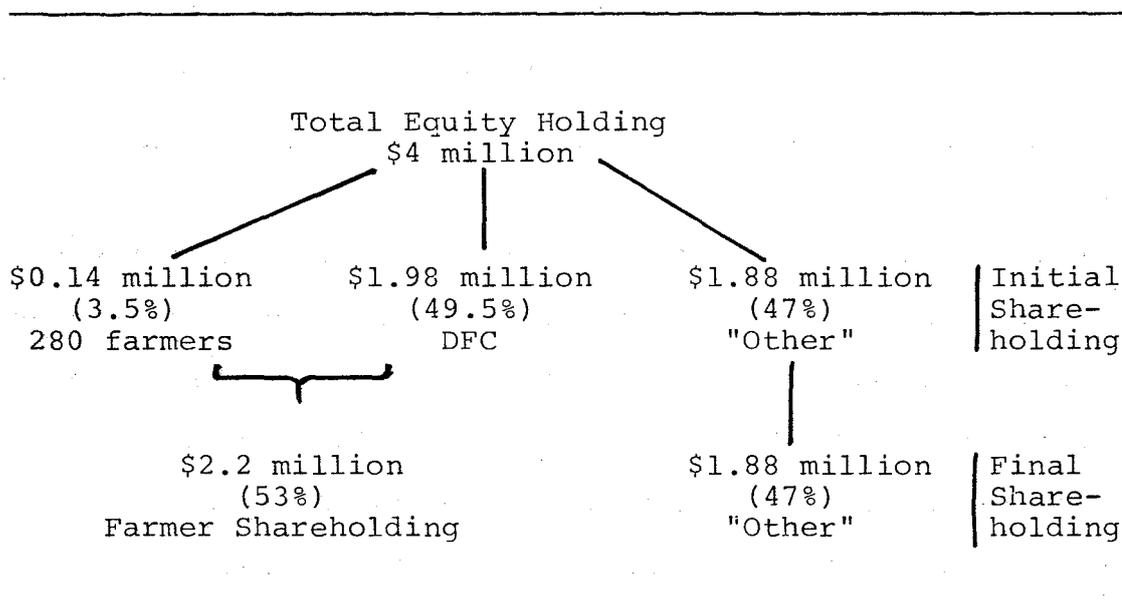
shares. It is DFC policy not to hold equity investments for longer than seven years, with the realisation of shares normally being undertaken in consultation with the Company's directors. The DFC shares could be held on behalf of farmers, in that farmer suppliers could be given first option on a specified number to be released each year, either at par or valuation. Alternatively, if farmer participation were organised on a co-operative basis, shares would be transferred from the DFC to the co-operative gradually over the seven year period.

Under these circumstances, the maximum farmer shareholding which could eventually be realised in the company depends on the amount of initial shareholding taken

up by the farmers. For instance, if the 280 farmers could initially purchase an average of 500 shares (issued at \$1.00), their maximum potential shareholding would be 53 per cent, made up as shown in Figure 5.

FIGURE 5

Financial Organisation of Equity Holding
with Farmers Taking 53 per cent
of Final Shareholding



This of course assumes that farmers uplift the right to purchase all the DFC shares offered. Further options are shown in Table 3. If initial individual farmer contributions could average \$1,500, their final equity holding could be as high as 60 per cent of the total equity.

If the DFC shareholding was offered to farmers or

a farmer co-operative in equal parcels over a seven year period, the share purchases could be financed through retention of a proportion of the gross payments made for beet delivered under contract to the processing factory. For example, in Table 3, a 49.5 per cent DFC equity holding represents 1.98 million one-dollar shares. If these were offered in equal parcels over seven years, 282,860 would become available each year. If these were offered at par, their cost would represent 10.5 per cent of the gross payments made for beet delivered to the factory that year.⁶

It is useful to also consider the situation where farmers limited their potential shareholding to one-third of the equity investment as shown in Figure 6. In this case, the average initial cash contributions would be \$500 for each farmer and DFC equity support would be limited to \$1,200,000. The DFC shares could be again offered in equal parcels over seven years, but in this case the offering of 170,000 each year would represent 6.3 per cent of the gross payout for delivered feedstock.

⁶ From Table 1, the gross payment for delivered beet each year is \$10.80/wet tonne over 250,000 tonnes, or \$2.7 million.

TABLE 3

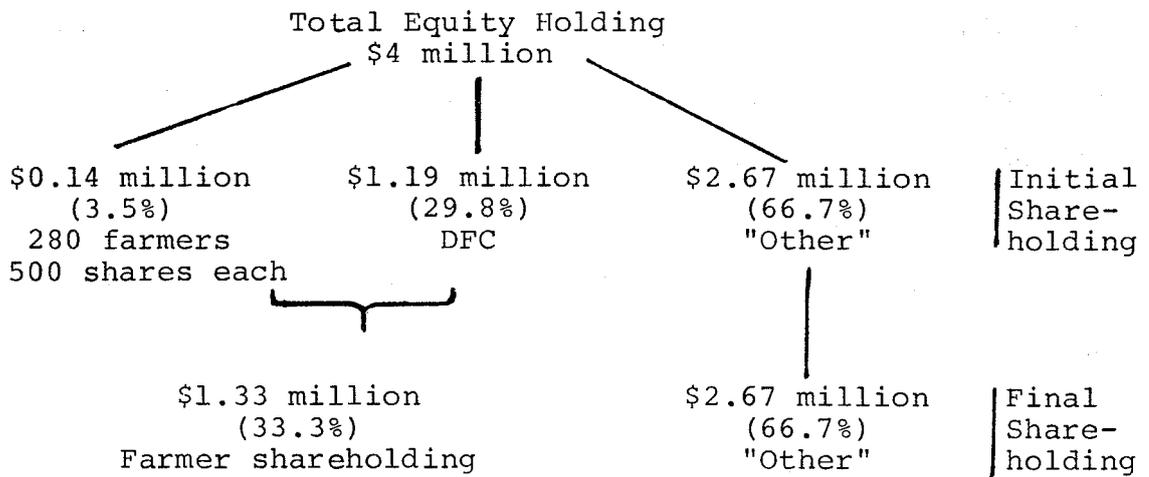
Alternative Initial Equity Holdings

Initial Equity taken up by farmers			
- individually	\$500/farmer	\$750/farmer	\$1500/farmer
- collectively	\$140,000	\$210,000	\$420,000
- % of total equity (\$4 m)	3.5	5.25	10.5
DFC Equity Holding			
- total shares	\$1,980,000	\$1,980,000	\$1,980,000
- % of total equity	49.5	49.5	49.5
Equity held by farmers and DFC ^a			
- total shares	\$2,120,000	\$2,190,000	\$2,400,000
- % of total equity	53.0	54.75	60
"Other" Equity holding			
- total shares	\$1,880,000	\$1,810,000	\$1,600,000
- %	47.0	45.25	40
Total Equity Holding	\$4,000,000	\$4,000,000	\$4,000,000

^a The DFC shares could all revert to individual farmers or a farmer co-operative, provided they uplifted all the DFC shares offered, and thus this line represents total "potential" farmer shareholding.

FIGURE 6

Financial Organisation of Equity Holding
with Farmers Taking One-third of
Final Shareholding



4. CO-OPERATIVE STRUCTURE

There are many advantages in any farmer shareholding in a beet-ethanol plant being organised on a co-operative basis, and the grouping being declared a Co-operative under The Co-operative Companies Act 1956. This engenders considerable flexibility in the capital structure of the Company. In addition, under Sections 199 and 200 of The Income Tax Act 1976, all profit distributions to members via rebates are tax deductible (compared with normal Company dividends which are taxable), and profits retained for expansion or loan redemption are also tax deductible. The next three subsections discuss each of these aspects in detail.

4.1. The Co-operative Companies Act 1956⁷

In order to be classified as a Co-operative under the Co-operative Companies Act 1956, the Company must fulfil certain requirements. The major conditions under Section 2(1) of the Act are as follows:

- (a) the activities of the Company must be such that it is included in those classes of Companies which can be declared Co-operative Companies (e.g. meat by-products marketing, lime, wine making, stock provender, fruit packing, poultry processing, cold store, meat marketing, wool processing and marketing, fertiliser supply, egg marketing, fertiliser

⁷ A copy of this Act is attached as Appendix 2.

manufacturing, fish marketing, milk marketing, and pig marketing); and

- (b) not less than three-fifths of the nominal value of the shares issued should be held by persons engaged in supplying the Company.

Although the activities of a beet-ethanol company would not be deemed as being included in those classes of Companies already listed under Section 2(1) of the Co-operative Companies Act 1956, it is likely that such a Company would be considered as embodying the basic tenets and principles for which this legislation was intended, and if this proved to be the case and not less than three-fifths of the nominal values of the shares were held by feedstock suppliers, then under Section 2(2) of the Act,

"The Governor-General may, from time to time, by order in Council, declare any class of companies to be Co-operative Companies for the purposes of this Act." - See Appendix 2.

It must be appreciated that co-operatives registered under this Act have great flexibility in managing the allocation of their shares amongst their members. Unlike normal Companies which cannot purchase their own shares, under Section 4 of the Act, a Co-operative Company may "... require or accept from any of its shareholders ... a surrender of any shares held by them in the Company ...".

These surrendered shares may either be held by the Company or reissued. In reality, therefore, the provision in the Act that feedstock suppliers should hold at least sixty per cent of the nominal value of the shares issued is not restrictive since, if the composition of feedstock suppliers changes over time, so too can the structure of the shareholding.

With a co-operatively owned beet-ethanol company, it is likely that shareholding would be linked to the area contracted for feedstock supply. In the example quoted previously and outlined in Table 1, the \$4 million equity could, for instance, be issued across the contracted area to average 16 shares/ha at \$100/share. A minimum holding of 10 shares/ha contracted would be necessary to maintain at least sixty per cent of the shareholding in the hands of feedstock suppliers. An example of this situation is provided by the contractual arrangements entered into by the American Crystal Sugar Company, a Co-operative sugar beet Company based in Minnesota.⁸ Five year supply contracts for beet are signed between the Company and the growers, in which the grower agrees to plant "not less than the number of acres of sugar beets equal to the number of preferred shares of the Company owned by (the) Grower". For beet-ethanol supply, and using the figure quoted above,

⁸ A copy of the supply contracts used by the American Crystal Sugar Company is provided in Appendix 3. At the time this Co-operative was formed, farmer participation in financing equalled \$40/ha of sugar beet planted, with a retention of \$1/ton for loan repayment.

the contracted area could be tied to a holding of 10 shares for every hectare planted.

In a situation where feedstock supply contracts are periodically negotiated, it is relatively easy to ensure that the requirement degree of shareholding is held by feedstock suppliers. This is more difficult with fertiliser co-operatives and explains why, under Section 8(2) of the Co-operative Companies Act 1956, fertiliser co-operatives may require shareholders who have not purchased fertiliser from the Company during a two year period to surrender all or part of their shares to the Company. Such a requirement should not be necessary with a beet-ethanol Company, since shareholding can be tied in with the right to supply feedstock to the plant.

One final consideration is the capital value of the shares which are surrendered or reissued each year. Generally, the market value of these shares should remain close to their nominal value since, unless qualifying assets are purchased or reserves built up, all profits would be distributed annually via rebates to co-operative members.

4.2 Profit Disbursement Through Rebates

Under Section 199 of the Income Tax Act 1976,⁹ any rebates paid to members of a Co-operative as a means of profit distribution, such payments being made within six

⁹ Appendix 4 contains a copy of the relevant Section.

months after the end of the trading period, are allowed as an extraordinary deduction from full trading profits when calculating assessable income for taxation purposes.

To quote Section 199(3),

"The Commissioner shall, in calculating the assessable income for any income year of (a mutual) association to which this Section applies, allow a deduction of ... the aggregate of the amounts of rebates ...".

This contrasts with profit distribution from Company operations where any dividend payments must be found from tax-paid income.¹⁰ In other words, where tax is assessed on Companies prior to dividend payments, tax is assessed on Co-operatives after rebates are paid to members.¹¹

However, profit disbursement via rebates which are deductible in the hands of the Co-operative only applies to profits generated by the Co-operative with respect to transactions with its members. Member transactions involve the purchase of trading stock or services from a member, or

¹⁰ Or, in some instances, from capital reserves which may have been built up from tax paid profits and/or non-taxable capital gains on, for instance, sale of property.

¹¹ Rebates which are paid are treated as assessable income in the hands of the members.

sales of stock or services to a member, including money lending or borrowing transactions but not profits which have been derived from transactions between the Co-operative and non-members, e.g. another Company.

Secondly, if trading with non-members has generated a taxable profit, the tax assessed on this profit has priority claim before any rebates are deducted from profits generated on transactions with Co-operative members.

One important point that emerges under this Section of the Act is the situation where the farmer Co-operative only holds a proportion of the shares in the beet-processing Company, rather than the processing Company being wholly owned by the Co-operative. In this case, some of the profits received by the Co-operative would be generated from its shareholding in the processing Company and, under the present interpretation, could not be disbursed to members as rebates and claimed as an extraordinary deduction by the Co-operative from assessable income. It is possible that the processing Company could be set up in such a way that a farmer Co-operative could be a part shareholder yet still receive the full benefits of a Co-operative. This would, however, need to be the subject of a separate legal interpretation.

A beet-ethanol Co-operative could, however, have some flexibility in disbursement of profits in that either

rebates could be paid or the prices paid for feedstock adjusted; both would return profits to the members, although adjustment in feedstock purchase price would naturally only benefit those farmer shareholders who held contracts in that particular year.

4.3 Primary Producer Co-operatives

In addition to the rebate deduction afforded Co-operatives under Section 199 of The Income Tax Act 1976¹², primary producer Co-operatives can, under Section 200 of this Act, claim additional deductions from assessable income for tax purposes.

The main requirements of a "Primary Producer Co-operative Company" for the purposes of Section 200 of The Income Tax Act 1976 are as follows:

- (a) registration under the Co-operative Companies Act 1956;
- (b) substantial farmer ownership - specifically, fifty or more shareholders;
- (c) at least 50 per cent of the nominal values of the allotted shares are held by or on behalf of people engaged in specified activities; and
- (d) at least 80 per cent of the total value of the

¹² Appendix 4 contains a copy of the relevant Section of The Income Tax Act, 1976.

transactions of the Company are with its shareholders in respect of what are termed "qualifying activities". Those qualifying activities are defined in the Section, and cover the collection, treatment, processing, packing, storage, distribution and marketing of most primary produce.

If the specific activities of a beet-ethanol Co-operative were not deemed to be "qualifying activities" as defined under Section 200(1), application could be made for the Governor General by Order in Council to declare such activities to be qualifying activities for the purposes of Section 200.

The tax advantages that are associated with this Section are significant. Specifically, Section 200(4,5) allows for income used to increase or decrease "qualifying assets" or "qualifying liabilities" during the year to be deducted from profits in calculating assessable income for any income year. Therefore asset expansion, purchase of new plant, or even principal loan repayment can be a fully deductible expense for primary producer Co-operatives, whereas for normal companies the money for such activities must come from tax-paid income. Furthermore, the deduction of retained profits paid into development reserves is also allowed, as long as they are actually expended on development or expansion of the Co-operative's business within three years, and as long as such deduction does not cause a

loss situation. Such flexibility allows capital for Co-operative expansion to be built up from income, rather than tax-paid profits.

While these tax advantages would accrue to a wholly-owned farmer Co-operative operating a beet-ethanol plant, the situation that would pertain to part-farmer Co-operative shareholding in the processing Company is less clear, since it could be difficult to meet the provision that at least 80 per cent of the transactions of the Company is with its shareholders in relation to "qualifying activities". As was noted in the discussion on rebates, the tax situation that would prevail for a farmer Co-operative which held only a proportion of the shares of the processing Company, requires further legal interpretation.

4.4 Co-operative Funding

Clearly, farmer participation in a beet-ethanol industry being organised on a co-operative basis has very significant advantages. The Co-operative could be financed under the systems discussed in Sections 2 and 3 of this report, with individual farmer members providing the Co-operative's capital requirement for its equity holding, either from their own personal cash resources or through Rural Bank mortgages on their properties.

Alternatively, if DFC were to take an equity holding in the plant on behalf of the Co-operative, the full

advantages of the Co-operative structure would not be realised until all the shares had been transferred. One option in this pattern is for the farmers to form a Co-operative which initially has minimal equity share (and therefore cash requirement), but contracts directly to the processing factory for the supply of feedstock including harvesting and transport. Capital requirements would be only for harvesting and transport equipment and the Co-operative could then retain a proportion of the beet payout to build up a reserve with which to gradually purchase the equity shares in the processing plant held by the DFC. The DFC holding could be transferred as funds permitted, or even transferred in total after, say, five years for part payment, security being taken over the transferred shares.

Another option is for the issue of rights to the Co-operative, which would enable the farmer group to take up a predetermined number of shares over a regulated period. These rights could be either optional or compulsory. Such a system does mean, however, that other parties fund and probably retain their respective shares of the total amount of initial equity required, and while this may attract certain institutional lenders, it does not appear consistent with DFC policy on equity holding.

APPENDIX 1

THE ROLE OF THE DEVELOPMENT
FINANCE CORPORATION OF NEW ZEALAND

In its role as a development bank, DFC's approach to all financing proposals is to determine initially whether the project has sound developmental features and secondly, to determine whether it is commercially viable.

Development features upon which special emphasis is placed include:

- (a) projects based on the processing of primary products or indigenous resources for export;
- (b) projects which assist the balance of payments situation, (e.g. import substitution projects);
- (c) projects which assist the development of engineering and technical skills;
- (d) projects situated in designated Regional Development areas;
- (e) overseas projects where there are identifiable benefits to New Zealand;
- (f) other projects which materially contribute to New Zealand's economic development.

When appraising the commercial viability of a project, particular importance is placed on:

Equity ratio. DFC's normal criterion is that shareholders funds and advances represent approximately 40 per cent of the total liabilities. A lower percentage however, may be acceptable in the short term if it can be demonstrated that the ratio will exceed 40 per cent within a reasonable period.

Projected cash flow. The project must be able to generate an annual cash flow sufficient to fully service all debt commitments as well as provide a level of return appropriate for the risk and for the investment involved.

D.F.C.'s approach to financing is project orientated. It, accordingly, devotes more time to evaluating and determining the commercial merits of a project than do other traditional banking sources. An in-depth analysis of each project is undertaken to identify and evaluate the key issues such as capital cost, supply, production, marketing, together with the relevant long term financial projections. In a major project DFC's involvement is therefore extensive and continues through all stages of the project.

Adequate security is also necessary although DFC tends to place greater emphasis on the future viability of the project rather than the security available. With major

projects DFC generally takes a debenture over the company with reasonable priority to other lenders and where appropriate the covenants of the shareholders.

As a development bank DFC adopts a flexible approach to project financing, placing emphasis on the need to establish the financing package most appropriate for the project concerned. Generally this will involve a combination of the financial facilities offered by DFC. For ease of reference the financing facilities considered for a beet-ethanol project are reviewed in the following order:

Pre Production Finance,
Suspensory Loan Finance,
Commercial Finance Facilities.

(a) Pre Production Assistance

(i) Investigation and Establishment Grants.

The grant scheme is aimed to encourage a more intensive commercial examination of opportunities in regional development areas, South Canterbury being one such area. Grants of up to \$10,000 are provided under the Government's Regional Development assistance as partial reimbursement of actual expenses incurred on commercial feasibility studies. Applications are channelled through the local Regional Development Council.

(ii) Applied Technology Programme. DFC

administers on behalf of the Government the Applied Technology Programme. The programme provides financial assistance to projects with strong technological innovations to ensure adequate financial support is available through to the commercial stage of development. Financial assistance under this programme is normally limited to 50 per cent of the project's research and development costs with assistance available in the following forms:

Commencement Grants for setting up initial research and development facilities (e.g. pre production test procedures in a laboratory). A limit of \$50,000 p.a. over three years is set for any one company.

Project Grants for applied research and development projects mainly to cover materials, wages salaries and overhead expenses. A limit of \$10,000 p.a. per project is set for any one company.

Investment Finance for all forms of pre commercial development programmes. No set limit applies to individual projects with each considered on its merits, although the normal amount is less than \$50,000 or less than half the total costs involved. Repayment is on a royalty basis and

hence contingent upon the success of the project.

It is also noted that the DFC has specialist staff who are able to advise on licensing agreements, patents and other technical aspects.

(b) Suspensory Loan Assistance

DFC administers the Suspensory Loan scheme on behalf of the Government, providing financial assistance specifically for projects situated in Government designated regional development areas, South Canterbury being one such area. Under this scheme a project with strong developmental features can qualify for the following assistance:

(i) Regional Development Suspensory Loan.

A Suspensory Loan may be provided for up to 30 per cent of total expenditure on plant and equipment or alternatively buildings, or up to 20 per cent of the joint cost of plant, equipment and buildings. The Suspensory Loan is interest free and converts to a grant provided that the assets financed continue to be used for the purpose for which the loan was approved and remain in the region for the five years following the date of the drawdown. Applications are routed through the Department of Trade and Industry.

The maximum value of a Suspensory Loan for any

one project is \$100,000 with assistance over this level subject to Ministerial approval. Some projects involving up to \$1 million have been approved.

(ii) "Pioneer Status" Suspensory Loan.

This scheme provides financial assistance for projects which introduce new forms of commercial resource development in priority regions. Emphasis is placed on the further processing of renewable resources, introduction of new forms of manufacturing and processing, and the application of new technologies to existing industries.

Assistance is generally based on 10 per cent of the project cost with a maximum suspensory loan of \$50,000. The Suspensory Loan converts to a grant on a similar basis to the Regional Development Suspensory Loan.

(c) Commercial Finance Facilities

(i) Equity Investment.

Equity participation by DFC is considered only where a further equity contribution is necessary to create a proper balance between shareholders' funds and long term debt finance (i.e. an equity ratio of 40 per cent). DFC equity support is however always limited to a level below 50 per cent of the total equity

investment of the project.

The type of equity finance selected is dependent on the particular financing package for a project and could, for example, be in the form of ordinary shares. It is DFC's policy not to hold equity investments for a term longer than seven years with the realisation of the shares normally undertaken in consultation with the company's directors.

Current fixed dividend rate for cumulative preference shares is 9 per cent.

(ii) Term Loan.

Term Loan finance for land, buildings, plant and machinery can be provided by DFC for periods in the range of 5 to 15 years. The term is normally set with reference to the economic life of the assets financed and the forecast cash flow to be generated by the project. A feature of DFC term loans is the repayment holiday allowed during the most sensitive phases of the project: the installation, start up, and learning phases. Repayment holidays of up to two years may be provided, or longer where special circumstances exist. If a repayment holiday of two years is provided, the remaining payments are made over the next 13 years of the 15 year term loan.

Interest rates are determined by DFC's borrowing costs with the present rate in the region of 13.75 - 14.75 per cent per annum. It is noted that companies granted high priority status accorded by the Department of Trade and Industry receive a preferential interest rate ranging up to one per cent lower than would otherwise be the case.

(iii) Off Shore Loans.

DFC is active in the international inter-bank markets and is able through international commercial and investment banks to arrange off shore finance facilities. Such loans are subject to consent from the Reserve Bank of New Zealand. To obtain protection from adverse currency movements it is advisable, though not essential, that foreign exchange cover is taken. This can be provided within certain limits by the Reserve Bank of New Zealand.

Typically, loan agreements involving off shore finance provide for a five to seven year commitment on an interest rollover basis for periods generally of three or six months. Market economics normally restrict DFC's ability to fund off shore loans to no less than \$500,000.

The interest rate payable comprises DFC's cost

of funds plus a margin determined by the borrower's credit worthiness.

(iv) Local Capital Market.

The DFC, through its involvement in the local capital market, is able to advise on various forms of debt issuance. DFC has, for example, issued its own debenture stock, secured beared notes, and floating rate notes, as well as participating in the role of co-managing for other local debt issuance.

(v) Guarantees.

DFC can provide guarantees to enable development projects to utilise the funds of other lending institutions at an advantageous interest rate, where without a guarantee the security offered would be unacceptable. Guarantees may be used to support most financial transactions with the most common relating to mortgage, term loans and bank overdraft guarantees. A guarantee is particularly applicable for projects where large amounts of capital equipment will be imported as most countries offer a buyer's credit scheme whereby foreign buyers can obtain generous credit terms at favourable interest rates.

The guarantee fee varies between one and two per cent per annum depending on the amount guaranteed, degree of risk, and the term for which guarantee

is required.

(vi) Commercial Bill Facility.

Where appropriate Commercial Bill assistance may also be provided for working capital or as bridging finance pending the arrangement of longer term advances.

(vii) Leasing.

Leasing is a flexible form of financing which can cover not only building, plant and equipment, but also an entire production facility. Where the amount is substantial DFC can arrange syndicated or leveraged lease packages to suit the financing requirements of the particular project. The terms of a lease can also be structured to meet the project's cash flow, for example, payment set to coincide with a project's seasonal cash flow peaks. Normally the residual value of a lease would equate with the tax written down value of the assets or production facility.

Lease interest rates can vary considerably depending on the terms and conditions of the lease package involved.

[WITH AMENDMENTS INCORPORATED]

CO-OPERATIVE COMPANIES

REPRINTED AS ON 1 APRIL 1979

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THE CO-OPERATIVE COMPANIES ACT 1956

1956, No. 18

An Act to consolidate and amend certain enactments relating to co-operative companies [19 October 1956]

1. Short Title and commencement—(1) This Act may be cited as the Co-operative Companies Act 1956.

(2) This Act shall come into force on the 1st day of January 1957.

2. Interpretation—(1) In this Act, unless the context otherwise requires,—

"Articles" has the same meaning as in the Companies Act 1955:

"Company" means a company incorporated under the Companies Act 1955 or under any former Companies Act:

"Co-operative company" means a co-operative egg

marketing company, or a co-operative fertiliser manufacturing company, or a co-operative fish marketing company, or a co-operative milk marketing company, or a co-operative pig marketing company; and includes such other classes of companies as are from time to time declared by the Governor-General by Order in Council to be co-operative companies for the purposes of this Act:

"Co-operative egg marketing company" means a company the principal object of which is the marketing or the treatment and marketing of eggs supplied to the company by its shareholders, and of the shares issued by which not less than three-fifths in nominal value are held by persons engaged in supplying eggs to the company:

["Co-operative fertiliser manufacturing company" means a company the principal object of which is the manufacture of fertilisers for the use of its shareholders:]

"Co-operative fish marketing company" means a company the principal object of which is the treatment for human consumption, or the marketing, of fish supplied to the company by its shareholders, and of the shares issued by which not less than three-fifths in nominal value are held by persons engaged in supplying fish to the company:

"Co-operative milk marketing company" means a company the principal object of which is the treatment or the marketing of milk supplied to the company by its shareholders, and of the shares issued by which not less than three-fifths in nominal value are held by persons engaged in supplying milk to the company:

"Co-operative pig marketing company" means a company the principal object of which is the treatment for human consumption of pigs supplied to the company by its shareholders and the marketing of the produce, and of the shares issued by which not less than three-fifths in nominal value are held by persons engaged in supplying pigs to the company:

"Fertiliser" has the same meaning as in [the Fertilisers Act 1960]:

"Minister" means the Minister of Justice:

"Pig" includes any portion of the carcass of a pig:

"Principal object", in relation to any company, means

the principal business that the company for the time being carries on, notwithstanding that it may have authority to carry on any other business:

“Registrar” means the Registrar of Companies under the Companies Act 1955.

(2) The Governor-General may from time to time, by Order in Council, declare any class of companies to be co-operative companies for the purposes of this Act.

Cf. 1933, No. 49, s. 2; 1939, No. 39, s. 13 (3); 1944, No. 30, s. 95 (4); 1950, No. 7, s. 2; 1955, No. 26, s. 2

“Co-operative company”: For classes of companies declared to be co-operative companies, see

S.R. 1965/160, co-operative meat by-products marketing companies,
S.R. 1966/45, co-operative lime companies,
S.R. 1966/144, co-operative wine-making companies,
S.R. 1969/147, co-operative stock provender companies,
S.R. 1970/19, co-operative fruit packing companies,
S.R. 1973/202, co-operative poultry processing companies,
S.R. 1975/236, co-operative cold store companies,
S.R. 1976/321, co-operative meat marketing companies,
S.R. 1979/19, co-operative wool processing or marketing companies,
S.R. 1979/20, co-operative fertiliser supply companies,

and for further definition of this term, see S.R. 1960/14. As to an application of the term, see s. 35 (4) of the Inland Revenue Department Act 1974.

“Co-operative fertiliser manufacturing company”: This definition was substituted for the original definition by s. 2 of the Co-operative Companies Amendment Act 1977.

“Co-operative milk marketing company”: For the liability of these companies to income tax, see s. 202 of the Income Tax Act 1976.

“Co-operative pig marketing company”: For the liability of these companies to income tax, see s. 203 of the Income Tax Act 1976.

“Fertiliser”: The Fertilisers Act 1960, being the corresponding enactment in force at the date of this reprint, has been substituted for the repealed Fertiliser Act 1927.

As to co-operative freezing companies, see the Co-operative Freezing Companies Act 1960.

3. Registration of co-operative company—(1) A co-operative company may at any time, on application to the Registrar, and on payment of a fee of **[\$10]**, become registered as such under this Act.

(2) The Registrar shall issue to the company when so registered a certificate of registration under this Act, and that certificate shall be conclusive evidence of the validity of the registration.

(3) No application for registration under this Act shall be made unless registration under this Act is provided for by the articles of the company or by a special resolution of the company.

(4) Every application for the registration of a company under this Act shall be accompanied by a statutory declaration, made by one or more directors of the company, that the company is a co-operative company within the meaning of this Act

(5) Any registration of a company under this Act may at any time be cancelled by the Registrar if he is of opinion that the company is not or has ceased to be a co-operative company within the meaning of this Act, and upon the cancellation being notified to the company the company shall cease to be registered under this Act.

Cf. 1933, No. 49, s. 3; 1939, No. 39, s. 13 (4); 1944, No. 30, s. 95 (1); 1950, No. 7, s. 3; 1955, No. 26, s. 3

In subs. (1) the expression “\$10” was substituted for the expression “\$2” (as substituted by s. 7 of the Decimal Currency Act 1964 for the words “one pound”) by s. 2 of the Co-operative Companies Amendment Act 1976.

4. Surrender of shares—It shall be lawful for any company registered under this Act to require or accept from any of its shareholders, in accordance with the provisions hereinafter contained, a surrender of any shares held by them in the company, and to pay for the shares so surrendered out of the assets of the company in manner hereinafter provided.

Cf. 1933, No. 49, s. 4; 1939, No. 39, s. 13 (4); 1944, No. 30, s. 95 (1); 1950, No. 7, s. 3; 1955, No. 26, s. 3

5. Reissue of surrendered shares—Any shares so surrendered may be reissued by the company to any person in the same manner as if they had not been previously issued.

Cf. 1933, No. 49, s. 5; 1939, No. 39, s. 13 (4); 1944, No. 30, s. 95 (1); 1950, No. 7, s. 3; 1955, No. 26, s. 3

6. Surrendered shares not to exceed one-fifth of issued shares—(1) The number of shares so surrendered to the company and not reissued shall not at any time exceed one-fifth of the total number of shares issued by the company exclusive of the said shares so surrendered and not reissued.

(2) Every director of the company who accepts, authorises, or consents to the surrender of any share in breach of the provisions of this section commits an offence, and shall be liable on summary conviction to a fine not exceeding **[\$100]** in respect of every share so unlawfully surrendered.

Cf. 1933, No. 49, s. 6; 1939, No. 39, s. 13 (4); 1944, No. 30, s. 95 (1); 1950, No. 7, s. 3; 1955, No. 26, s. 3

In subs. (2) the expression “\$100” was substituted for the words “fifty pounds” by s. 7 of the Decimal Currency Act 1964.

7. Shareholder may surrender shares—(1) In any case not provided for in the following provisions of this section a company registered under this Act may in its discretion, subject to the provisions of section 6 of this Act, accept the surrender of any shares from any shareholder who agrees to

(2) The personal representative of a deceased shareholder of a company registered under this Act may surrender to the company any shares held by the deceased shareholder in the company, and, subject to the provisions of section 6 of this Act, the company shall accept that surrender.

(3) Where any shareholder of a company which is registered under this Act, and of which the principal object includes the treatment or marketing of any goods supplied to the company by its shareholders,—

(a) Has not supplied any such goods to the company during the immediately preceding period of 5 years; or

(b) In a case where the goods are produced on farm land, has disposed of all farm land owned by him (whether in fee simple or as lessor or licensee) situated within the area of supply of the company,—

he may surrender to the company any shares held by him in the company, and, subject to the provisions of section 6 of this Act, the company shall accept that surrender.

(4) Where any shareholder of a company which is registered under this Act, and of which the principal object includes the sale of any goods to the shareholders of the company,—

(a) Has not purchased any such goods from the company during the immediately preceding period of 5 years; or

(b) In a case where those goods are for use on or in connection with farm land, has disposed of all farm land owned by him (whether in fee simple or as lessee or licensee) situated within the area of supply of the company,—

he may surrender to the company any shares held by him in the company, and, subject to the provisions of section 6 of this Act, the company shall accept that surrender.

(5) In subsections (3) and (4) of this section the term “area of supply”, in relation to any company, means the area from time to time declared by the Minister, by notice in the *Gazette*, to be the area of supply of that company for the purposes of this section.

Cf. 1933, No. 49, s. 7; 1939, No. 39, s. 13 (4); 1944, No. 30, s. 95 (1); 1950, No. 7, s. 3; 1955, No. 26, s. 4

8. Compulsory surrender of shares—(1) Any company registered under this Act (not being a co-operative fertiliser manufacturing company) may at any time (subject to any

restrictions or conditions imposed by its articles and to section 6 of this Act) require any shareholder to surrender to the company the shares held by him in the company, or so many of them as the company thinks fit.

(2) Any co-operative fertiliser manufacturing company registered under this Act may at any time (subject to any restrictions or conditions imposed by its articles and to section 6 of this Act) require any shareholder who has not purchased fertiliser from the company during the period of 2 years immediately preceding the passing of the resolution referred to in subsection (3) of this section to surrender to the company the shares held by him in the company, or so many of them as the company thinks fit.

(3) No demand for the surrender of any shares shall be made under the authority of this section except pursuant to a resolution of the shareholders of the company.

(4) On the expiration of one month after a written notice of any such resolution has been received by the shareholder, the shares so to be surrendered by him shall be deemed to have been duly surrendered.

Cf. 1933, No. 49, s. 8; 1939, No. 39, s. 13 (4); 1944, No. 30, s. 95 (1); 1950, No. 7, s. 3; 1955, No. 26, s. 5

9. Consideration for surrender of shares—There shall be payable to every shareholder whose shares are surrendered under this Act out of the assets of the company by way of consideration for that surrender—

(a) Where the surrender is under subsection (1) of section 8 of this Act, the amount paid up or deemed to be paid up on the shares so surrendered, together with interest on that amount at the rate of 5 percent per annum, calculated from the end of the preceding financial year of the company to the date of the surrender;

(b) In any other case, the value of the shares so surrendered, to be agreed upon by the company and the shareholder, or in default of agreement to be fixed by arbitration under the Arbitration Act 1908, and this section shall be deemed to be a submission within the meaning of that Act.

Cf. 1933, No. 49, ss. 7, 8 (1); 1939, No. 39, s. 13 (4); 1944, No. 30, s. 95 (1); 1950, No. 7, s. 3; 1955, No. 26, s. 6

10. Limiting application of Companies Act 1955—(1) Except where this Act expressly provides to the contrary, the foregoing provisions of this Act shall take effect notwith-

standing anything in the Companies Act 1955 or in any rule of law or in the memorandum or articles of any company.

(2) The following provisions of the Companies Act 1955 shall not apply to a co-operative company which is registered under this Act or the articles of which provide for its registration under this Act, namely:

- (a) Section 90, which relates to the duties of companies with respect to the issue of share certificates;
- (b) Section 184, which relates to restrictions on the appointment or advertisement of directors;
- (c) Section 185, which relates to the share qualifications of directors.

Cf. 1933, No. 49, ss. 4, 9; 1939, No. 39, s. 13 (4); 1944, No. 30, s. 95 (1); 1950, No. 7, s. 3; 1955, No. 26, s. 8

11. Use of word "co-operative" in name of co-operative company—(1) Any company entitled to be registered under this Act as a co-operative company may be registered under the Companies Act 1955 by a name which includes the word "co-operative".

(2) If at any time after a company is so registered under the Companies Act 1955 or under any former Companies Act it ceases to be entitled to be registered under this Act, or its registration under this Act is cancelled, subsection (1) of this section shall cease to apply to the company, and sections 31 and 32 of the Companies Act 1955 shall apply accordingly.

Cf. 1933, No. 49, s. 10; 1939, No. 39, s. 13 (5), (6); 1944, No. 30, s. 95 (2), (3); 1950, No. 7, s. 4; 1955, No. 26, s. 7

12. Repeals and savings—(1) The enactments specified in the Schedule to this Act are hereby repealed.

(2) Without limiting the provisions of the Acts Interpretation Act 1924, it is hereby declared that the repeal of any provision by this Act shall not affect any document made or any thing whatsoever done under the provision so repealed or under any corresponding former provision, and every such document or thing, so far as it is subsisting or in force at the time of the repeal and could have been made or done under this Act, shall continue and have effect as if it had been made or done under the corresponding provision of this Act and as if that provision had been in force when the document was made or the thing was done.

SCHEDULE

ENACTMENTS REPEALED

1933, No. 49—The Co-operative Companies Act 1933.

1939, No. 39—The Statutes Amendment Act 1939: Section 13.

1950, No. 7—The Co-operative Egg Marketing Companies Act 1950.

1955, No. 26—The Co-operative Fertiliser Manufacturing Companies Act 1955.

1955, No. 63—The Companies Act 1955: So much of the Fifteenth Schedule as relates to the Co-operative Fertiliser Manufacturing Companies Act 1955.

A reference to the Milk Act 1944: Section 95, was omitted by s. 71 (1) of the Milk Act 1967.

THE CO-OPERATIVE COMPANIES AMENDMENT ACT 1976

1976, No. 82

An Act to amend the Co-operative Companies Act 1956

[10 December 1976]

1. Short Title and commencement—(1) This Act may be cited as the Co-operative Companies Amendment Act 1976, and shall be read together with and deemed part of the Co-operative Companies Act 1956 (hereinafter referred to as the principal Act).

(2) This Act shall come into force on the 1st day of January 1977.

2. This section amended s. 3 (1) of the principal Act.

THE CO-OPERATIVE COMPANIES AMENDMENT ACT 1977

1977, No. 148

An Act to amend the Co-operative Companies Act 1956

[23 December 1977]

1. Short Title—This Act may be cited as the Co-operative Companies Amendment Act 1977, and shall be read together with and deemed part of the Co-operative Companies Act 1956 (hereinafter referred to as the principal Act).

2. This section amended s. 2 (1) of the principal Act.

APPENDIX III
FIVE YEAR AGREEMENT

Between _____ Grower
AND
AMERICAN CRYSTAL SUGAR COMPANY
(Company)

1. Grower agrees to prepare land for, plant, block, thin, cultivate, harvest and deliver the seasons of 1978, 1979, 1980, 1981 and 1982, not less than the number of acres of sugarbeets equal to the number of preferred shares of the Company owned by Grower with respect to any crop year, unless acreage controls are placed on the production of sugarbeets during any one year this agreement is in force or underplant is directed by Company. Land to be used for sugarbeet production, beet seed prices, cultural and harvest practice requirements and other supplemental matters shall be specified annually prior to March 1 by annual contract, supplemental to this agreement.
2. The total price per net ton of beets to be paid to Grower by Company shall be based on the average sugar content of the beets delivered by Grower to Company and the average net selling price as hereinafter defined, received by Company, for sugar sold from the Minnesota, and North Dakota factories operated by the Company during the twelve month period beginning on September 1 of each year, as set forth in the following tabulation:

Table with columns: Average Net Selling Price Per Cwt. Sugar, and 13 columns of sugar percentages (19.0 to 13.0). Rows list various price points from 25.00 down to 10.00.

Intermediate average net selling prices and sugar contents shall be in the same relative proportion as reflected in the interval in which such intermediate average net selling prices or sugar contents occur. If average net selling prices or sugar contents are higher or lower than shown in the foregoing tabulation, the price to be paid for such beets shall be increased or decreased proportionately, using the immediately succeeding or preceding intervals, as the case may be, as the basis for calculation.

The average net selling price shall be determined by deducting from the gross sales price all such charges and expenditures as are regularly and customarily deducted from such gross sales price of sugar in accordance with Company's system of accounting heretofore established to determine the average net selling price from sugar sold, after deducting also all excise, sales, and other taxes or charges either now or heretofore imposed directly or indirectly on, or arising out of, the production, possession, holding for sale, sale, or shipment of such sugar; or on all or any part of the proceeds of such sales. Company will make a deduction from the gross selling price of sugar sold and delivered during the above specified period for factory site bulk sugar facilities owned by Company, such deduction not to exceed the prevailing rates charged by public warehouses in the sales area of Company's Minnesota and North Dakota factories for the storage of sugar in 100 pound bags. After the costs of such bulk sugar storage facilities, including improvements thereto, have been fully recovered, such deduction shall be limited to taxes, insurance, maintenance and operating costs properly applicable thereto. The determination of the average net selling price shall be audited by an independent Public Accountant not connected with the Company.

3. Settlement shall be made in three payments, as follows:
(a) The initial payment shall be made on or about November 15. Such initial payment shall not exceed an amount per ton of beets delivered based upon sixty percent of Company's estimate of the final average net selling price per cwt. of sugar. Any qualified and/or nonqualified per unit retains, within the meaning of that term as used in the United States Internal Revenue Code set by the Board of Directors may be deducted from this initial payment or any subsequent payment.

(b) An adjustment payment shall be made on or about April 15. Such adjustment payment shall not exceed an amount which will bring the adjustment payment plus the initial payment to an amount per ton of beets delivered based upon eighty percent of Company's estimate of the final average net selling price per cwt. of sugar.

(c) Final payment shall be made on or about September 30 and shall not exceed an amount which will bring the final payment plus all previous payments to an amount per ton of beets delivered based upon the final average net selling price per cwt. of sugar.

The aggregate payments to growers with respect to sugarbeets delivered during any crop year shall not be such as to create a loss to the Company for Federal Income Tax purposes with respect to business done with members and accordingly, the net selling price may be reduced to eliminate such member business loss, in which case any payment subsequent to the initial payment to growers may be reduced. Should such reduction be anticipated, the final payment may be made in two installments, the second of which will be made subsequent to September 30, but in no event later than 15 days after the completion and acceptance of the report of the Company's Independent Public Accountants on the audit of the Company's financial statements as of its last fiscal year end.

4. DELIVERY OF BEETS SHALL BE MADE BY GROWER AT SUCH TIMES, IN SUCH QUANTITIES AND TO SUCH RECEIVING STATIONS AS MAY BE DESIGNATED BY THE COMPANY. Title and all risk of loss to said beets shall be and remain with Grower until title and risk of loss passes to Company when Grower completes delivery according to Company's Operational and Agricultural Regulations and Policies. All growers shall be credited with a hauling allowance of not less than \$50 per ton mile based on the trucking mileage as established by Company from the grower's field to the designated factory receiving station. If Grower has more than one field, the average distance from all fields, weighted by acreage, shall be established by Company and used as the mileage for all Grower's fields. On beets delivered to a factory receiving station by Grower, the hauling allowance will be paid to Grower with his initial beet payment. On beets delivered to outside stations the hauling allowance will serve as a credit to the Grower against the freight from his outside station to the closest factory receiving station calculated at the average ton mile rate paid the commercial haulers for hauling from the outside receiving stations to the closest factory receiving station ("Commercial Ton Mile Rate"), and Growers shall be charged with the excess of the freight at such rate over the credit less the rate for transporting beets from factory yard piles to the wet hopper, which charge to Grower shall be a deduction from his initial beet payment. In calculating the Commercial Ton Mile Rate, the ton mile rate for each outside station shall be weighted by the acreage for that outside station. The above hauling allowance shall be in lieu of all other hauling allowances and freight charges.

5. In no event shall Company be liable to Grower for partial or complete failure of crop or for any injury or damage to beets.

6. Seed to be planted by Grower shall be purchased from Company. The price of all such seed shall be set by the Board of Directors. Company shall use due care in endeavoring to supply Grower with pure seed of high germinating quality, but it is expressly agreed that COMPANY DOES NOT WARRANT EXPRESSLY OR IMPLIEDLY ITS FITNESS, MERCHANTABILITY, OR OTHER QUALITY, and it is also expressly agreed that Company does not guarantee a crop.

7. In lieu of amortizing the capital costs of Company's Moorhead, Minnesota Research Center through an appropriate uniform charge on each pound of seed sold to each shareholder-grower, the Company may make an annual charge uniformly to each shareholder-grower of not to exceed \$2.00 on each preferred share held. After the capital costs (including subsequent additions and improvements) and interest thereon of the Research Center have been fully recovered, taking into account all such amortization charges paid by non shareholder-growers, no further amortization charge will be made.

8. Grower agrees to abide by the Articles of Incorporation and the Bylaws of Company and to abide by Company's Operational and Agricultural Regulations and Policies and agrees that he shall use no poisonous chemical or other substance in a manner which could result in any residue in or on beets grown for Company under this agreement or in any sugar or by-products produced from such beets beyond the limits permitted by law or governmental regulation.

Grower will harvest and deliver to the Company all beets grown by him under this contract. All beets delivered hereunder shall be properly topped at the base of the bottom leaf and free from excess dirt, stones, trash, and other foreign substances of any kind which might interfere with handling and processing at the Company's factories. All beets shall be subject to a proper standard deduction for tare. A distinct evidence of leaf scar is to be left after top tare is taken. In determining tare, beets with a diameter of three inches or less shall be topped straight across at the base of the bottom leaf and beets over three inches in diameter shall be trimmed up at a thirty degree angle from the base of bottom leaf. Tare determination and sugar percentage shall be determined at tare/sugar laboratories operated by the Company. There shall be deducted from the gross weight of beets delivered hereunder, before net tons are determined, Grower's share of the weight, as determined by Company weighing, of all dirt, stones, trash, and other foreign substances shaken or otherwise captured from the beets of all growers as they are delivered at Grower's beet receiving station, the Grower's share being the proportion which the gross tons of beets delivered by the Grower bears to the total gross tons delivered by all growers. The beets shall be protected from sun and frost after removal from the ground, including beets that are loaded on trucks.

Company has the option of rejecting any diseased, frozen or damaged beets, beets less than 12% sugar, or less than 80% purity, beets which, in Company's opinion, are not suitable for the manufacture of sugar, beets as to which, in Company's opinion, the terms and conditions of this agreement, Company's Operational and Agricultural Regulations and Policies have not been properly complied with or for any other bona fide reason.

Grower agrees to destroy on or before August 15, all acres of sugarbeets planted in excess of that authorized by the Company.

9. It is agreed that the amount charged for all beet seed purchased from Company by Grower hereunder, any Research Center amortization charge, and all advances made to Grower by Company on account of the crop to be grown hereunder, for fertilizer, insecticides, herbicides, machinery, labor and/or equipment, including advances or payments made to Grower or any member of his immediate family for labor performed on said crop, and advances for any other purpose, and any and all other indebtedness owing by Grower to Company, whether due or not, shall constitute a debt from Grower to Company which Company shall have the right to collect as in the case of any other contractual obligation. Company shall have the right, at its option, to treat any such amounts, advances or indebtedness as part payment for beets grown and delivered under this agreement. Any such amounts, advances, or indebtedness which are due and payable or which hereafter may become due and payable from Grower to Company shall be, become and remain a first and prior lien on the crop of sugarbeets to be grown hereunder and shall be deducted by Company from any initial or subsequent payments from Company to Grower which shall become due hereunder, or from any subsequent beet contract between Company and Grower. The Grower agrees to repay the Company, not later than November 15 of the year in which advanced, all such advances made by Company to Grower or on his behalf, together with interest thereon at a uniform rate to each Grower as may be set by Company, but not to exceed eight percent (8%) per annum.

10. Fire, strikes, accidents, acts of God, and the public enemy, or other causes beyond the control of the parties which prevent Grower from the performance of this agreement or Company from utilizing the beets contracted for in the manufacture of sugar therefrom, shall excuse the respective parties hereto from the performance of this agreement.

11. Grower agrees that, in connection with the growing of beets under this agreement, he will comply with all applicable federal, state, and local laws and ordinances including those pertaining to child labor, and with all regulations or rulings relating to any such laws and ordinances issued by any duly authorized governmental authority. Grower agrees to settle with labor at a rate which shall not be less than the rate determined by applicable law or regulation.

12. It is understood and agreed that if any governmental authority shall establish any restriction, allotment or quota upon the growing, production or processing of beets, or the output, transportation or sale of beet sugar, then Company may reduce to the extent which it deems necessary the acreage of beets herein contracted for, and shall be obligated to purchase beets only from such reduced acreage.

13. Grower herewith specifically consents to the provisions of the Company's Bylaws with respect to the tax treatment to him of patronage and unit retains as therein expressed and specifically agrees that any qualified distributions with respect to the patronage of the Company and any qualified unit retains charged him by the Company will be taken into account by him as income at the respective stated dollar amounts thereof in the manner provided in 26 U.S.C. 1385 and will be reported by him as income in the taxable year in which written notices of allocation or retention are received by him.

14. This agreement shall be binding upon Grower, his heirs, legal representatives, and assigns, and upon Company, its successors and assigns, and shall not be transferable by Grower without the written consent of Company, or its successors and assigns.

15. Company reserves the right to alter any provisions of this agreement provided any such alteration is first approved at any regular or special meeting at which a quorum is registered as being present or represented by mail vote, by a majority of the shareholders so present or represented by mail vote, where the notice of such meeting contains a statement of the proposed alteration.

16. No agent of Company has the authority to change, waive, or modify any of the terms or provisions of this agreement.

Dated this _____ day of _____, 19____

Grower
AMERICAN CRYSTAL SUGAR COMPANY

By _____

APPENDIX IV

Extract from
The Income Tax Act 1976
(Reprinted as on 1 April 1979)
pp. 362-375

*Mutual Associations and Companies***199. Profits of mutual associations in respect of transactions with members—**(1) For the purposes of this section—

“Association” includes any body or association of persons, whether incorporated or not:

“Rebate” means any payment to its members by an association, being a payment by way of distribution of profits of the association, the distribution being made not later than 6 months after the end of the association’s trading period in respect of which the payment is made.

(2) Where in any income year an association enters into transactions with its members, or with its members and other persons, any profit or surplus arising in that income year from those transactions which would be included in the profits or gains of the association if the transactions were not of a mutual character shall be deemed to be profits or gains arising from those transactions and, subject to the deduction allowed under

subsection (3) of this section, to be assessable income of the association derived in that income year (such an association being referred to in this section as an association to which this section applies).

(3) The Commissioner shall, in calculating the assessable income for any income year of an association to which this section applies, allow a deduction of the lesser of—

(a) The aggregate of the amounts of rebates, being rebates which—

(i) Are paid by the association to its members in respect of their transactions with the association in that income year, being transactions which are taken into account in calculating that assessable income; and

(ii) Are calculated by reference to the amounts of those transactions, whether or not, in any case, any rebate is limited or reduced by reference to the amount of the share or interest of a member in the capital of the association:

(b) The amount of profits attributable to those transactions as determined by the Commissioner after taking into account, in the computation of such profits, the aggregate of any amounts allocated to those transactions under subsection (4) (b) of this section.

(4) For the purpose of making his determination under subsection (3) (b) of this section, the Commissioner may—

(a) Apportion any expenditure or loss (being expenditure or loss that is deductible under this Act) incurred by the association in the said income year, in such manner as he considers appropriate, between the transactions referred to in paragraph (a) (i) of that subsection and the transactions (being transactions that are taken into account in calculating the said assessable income) in that income year with persons other than its members:

(b) Apportion between those respective classes of transactions, in such manner as he considers just and reasonable, or attribute to one such class to the exclusion of the other, any deduction, being a deduction allowed to the association in that income year under any of sections 112, 119 to 123, 154, and 156 of this Act.

(5) Where, in relation to an association to which this section applies and to an income year, the aggregate of the amounts of rebates referred to in subsection (3) (a) of this section in respect of that income year exceeds the amount determined by the Commissioner under subsection (3) (b) of this section in respect of that income year, that excess shall, to the extent to which it is attributable to deductions (being deductions referred to in subsection (4) (b) of this section) allowed to the association in that income year, be carried forward and deducted from or set off against the assessable income derived by the association in the income year next succeeding that income year (that next succeeding income year being referred to in this subsection as the year of claim) so far as that income extends:

Provided that the amount so deducted or set off shall not exceed the amount, if any, by which the amount determined by the Commissioner under subsection (3) (b) of this section in respect of the year of claim exceeds the amount of the deduction allowed under the said subsection (3) to the association in the year of claim.

(6) Where any rebate or part of a rebate paid to any member by an association to which this section applies is paid in respect of any transactions which are of such a nature that any payments in respect thereof by that member to the association or, as the case may be, by the association to that member would be taken into account in calculating the assessable income of that member, that rebate, or, as the case may be, that part of a rebate, shall form part of the assessable income (otherwise than as a dividend) of that member:

Provided that where that rebate or, as the case may be, that part of a rebate exceeds so much as is attributable thereto of the deduction allowed under subsection (3) of this section, the amount of the excess shall be deemed to be a dividend within the meaning of section 4 of this Act derived by that member.

(7) Nothing in this section shall affect the extent of the exemption from income tax of any co-operative company to which section 201 or section 202 or section 203 of this Act is applicable.

(8) For the purposes of this section, a rebate shall be deemed to have been paid to a person when it has been credited in account or otherwise dealt with in his interest or on his behalf.

(9) Where a rebate or part of a rebate is satisfied—

- (a) By the issue of fully paid-up or partly paid-up shares in an association (being a company) to which this section applies; or
- (b) By giving credit in respect of the whole or part of the amount unpaid on any shares in any such association,—

that rebate or part of a rebate shall be deemed not to be a bonus issue within the meaning of section 3 of this Act.

(10) Every reference in this section to transactions as being transactions of an association with its members or transactions of members of an association with the association and as being, in either case, transactions that are taken into account in calculating the assessable income of the association shall be taken as a reference to transactions of any one or more of the following classes, namely:

- (a) The purchase or other acquisition by the association of trading stock (as defined in section 85 (1) of this Act) from a member of the association, whether that trading stock is sold or otherwise disposed of by the association to a member of the association or to any other person:
- (b) The sale or other disposition by the association of trading stock (as so defined) to a member of the association, whether that trading stock was purchased or otherwise acquired from a member of the association or from any other person:
- (c) The supply of any services by a member of the association to the association:
- (d) The supply of any services by the association to a member of the association:
- (e) The borrowing by the association of money from a member of the association to the extent to which that money is applied in lending money to a member or members of the association:
- (f) The lending by the association of money to a member of the association.

Cf. 1954, No. 67, s. 145; 1968, No. 4, s. 26; 1973, No. 30, s. 28; 1974, No. 129, s. 17 (6); 1976, No. 43, s. 29 (4) (c).

As to trading stock valuation adjustment, see s. 167A (2) (b) of this Act.

200. **Primary producer co-operative companies**—(1) For the purposes of this section—

“Primary producer co-operative company”, in relation to any income year, means a company (not being a company to which section 201 or section 202 or section 203 of this Act applies)—

(a) Which is registered under the Co-operative Companies Act 1956 or the Co-operative Freezing Companies Act 1960; and

(b) Which has 50 or more shareholders; and

(c) Not less than 60 percent in nominal value of the allotted shares of which are held by or on behalf of persons engaged in carrying on the business of—

(i) Animal husbandry (including poultry-keeping and bee-keeping); or

(ii) Growing fruit, vegetables, or other crop producing plants; or

(iii) Horticulture; or

(iv) Viticulture; or

(v) Fishing (within the meaning of section 109 of this Act); or

(vi) Fish farming pursuant to a licence issued under the Freshwater Fish Farming Regulations 1972; or

(vii) Rock oyster farming or mussel farming; and

(d) Which carries on as its sole or principal activity any one or more qualifying activities; and

(e) Not less than 80 percent of the total value of the transactions of which are transactions with its shareholders in relation to qualifying activities:

“Qualifying activities”, in relation to any co-operative company and to any income year, means—

(a) The collection, treatment, processing, packing, storage, distribution, or marketing of produce, being dairy produce, wool, eggs, poultry, products and by-products of bees, fruit, grain, seeds, flowers, market garden produce, or fish (including shellfish and crustaceans), supplied by its shareholders; or

(b) The slaughtering of stock supplied by its shareholders, and the processing, storage, or marketing of any products thereof; or

(c) The making of wine or other potable liquor from grapes supplied by its shareholders; or

(d) The production or distribution of fertilisers, lime, or stock food for use by its shareholders; or

(e) The topdressing of land used in the carrying on of any farming or agricultural business by its shareholders; or

(f) Such other activities involving transactions with its shareholders as may from time to time be declared by the Governor-General by Order in Council to be qualifying activities for the purposes of this section:

“Qualifying assets”, in relation to any co-operative company and to any income year, means any land, building, plant, machinery, equipment, or trading stock used by that company wholly or principally for the purpose of carrying on the qualifying activities of the company and such other assets or class of assets (being assets used in connection with qualifying activities) as may be determined by the Commissioner, either generally or in any particular case:

“Qualifying liability”, in relation to any co-operative company and to any income year, means any loan, having a fixed term of one year or more, which has been applied in acquiring, erecting, or installing any qualifying assets, any other loan, having a fixed term of one year or more, which has been applied in repaying any qualifying liability, and such other liability (being a liability incurred in connection with qualifying assets) as may be determined by the Commissioner:

“Transaction”, in relation to any co-operative company and to any income year, means—

(a) Where the qualifying activities of the company involve the acceptance of produce from its shareholders, the purchase or other acquisition by the company of produce, being trading stock (as defined in section 85 of this Act), whether the trading stock is sold or otherwise disposed of by the company to a shareholder or to any other person; or

(b) Where the qualifying activities of the company involve the supply of trading stock or services to its shareholders, the sale or other disposition of trading stock (as so defined), whether the trading

stock was purchased or otherwise acquired from a shareholder or from any other person, or the supply of services.

(2) Where, in relation to any co-operative company and to any income year, the Commissioner is satisfied that the value of the transactions of the company in that income year with its shareholders in relation to the qualifying activities of the company would have been 80 percent of the total value of the transactions of the company in that income year if it were not for the fulfilling by the company of its statutory obligations, or abnormal trading conditions, or other extraordinary circumstances affecting the company in that income year, he may, in his discretion, determine, in relation to that company and to that income year, such lower percentage as he thinks just for the purposes of paragraph (e) of the definition of the term "primary producer co-operative company" in subsection (1) of this section.

(3) For the purposes of subsection (1) of this section, shares held in one co-operative company by or on behalf of another co-operative company shall be deemed to be held by the shareholders of the last-mentioned company.

(4) In calculating the assessable income of any primary producer co-operative company for any income year, the Commissioner shall allow, in addition to any deduction allowed under section 199 of this Act, a deduction of the amount of the profits derived by that company from the carrying on of its qualifying activities in that income year to the extent to which he is satisfied, having regard to any increase or decrease during that income year in the value of the qualifying assets of that company or in the amount of its qualifying liabilities and to such other factors as he considers equitable, that those profits have been applied or appropriated for the purposes of the development or expansion of its qualifying activities:

Provided that the amount of any deduction allowed under this subsection shall not exceed the amount which would, apart from this subsection, have been the amount of the assessable income of the company for that income year.

(5) For the purposes of determining whether there has been any increase or decrease in the qualifying assets of any primary producer co-operative company, the amount of any profits of the primary producer co-operative company derived from the carrying on of its qualifying activities in any income

year, which is appropriated by that company during or within 6 months after the end of that income year for the purposes of the development or expansion of its qualifying activities, shall be deemed to be a qualifying asset to the extent to which the Commissioner is satisfied that the amount will be expended for such purposes not later than the end of the third income year following that income year.

(6) Where in any income year any primary producer co-operative company sells or otherwise disposes of any qualifying asset (other than trading stock), such amount as the Commissioner considers to be equitable in respect of the proceeds of that sale or other disposition, having regard to any deduction allowed under this section in relation to that qualifying asset and the extent to which the proceeds of sale has been applied or appropriated for the purposes of the development or expansion of its qualifying activities, shall be deemed to be assessable income derived by that company in that income year.

(7) Where in any income year any primary producer co-operative company ceases to be a primary producer co-operative company, such amount as the Commissioner considers equitable in respect of the qualifying assets of that company, having regard to any deductions allowed under this section in relation to those qualifying assets, shall be deemed to be assessable income derived by that company in that income year.

(8) Where in any income year there is paid to a shareholder of a co-operative company—

- (a) On the surrender of any of his shares in that company, any amount in excess of the paid-up value of those shares; or
- (b) On the winding up of that company, any amount in excess of the paid-up value of his shares in that company,—

so much of the excess as the Commissioner considers to be attributable to any increase in the value of the assets of the company caused by the application or appropriation by that company of any amount in respect of which a deduction has been allowed under subsection (4) of this section shall be deemed to be assessable income derived by that shareholder in that income year.

(9) For the purposes of this section—

- (a) Where any company, being an industrial and provident society registered under the Industrial

and Provident Societies Act 1908, has resolved to register under the Co-operative Companies Act 1956 or under the Co-operative Freezing Companies Act 1960 and the Commissioner is satisfied that it is in the process of doing so, the company shall be deemed for the purposes of this section to be registered under the appropriate Act:

(b) For the purpose of determining whether any company, being an industrial and provident society to which paragraph (a) of this subsection applies, meets the requirements of the term "primary producer co-operative company" in subsection (1) of this section—

(i) Any reference in subsections (1) and (3) of this section to the holding of allotted shares in a co-operative company shall be deemed to be a reference to membership of an industrial and provident society:

(ii) Any reference in subsections (1) and (3) of this section to shareholders in a co-operative company shall be deemed to be a reference to members of an industrial and provident society:

(iii) The reference in subsection (3) of this section to the holding of shares in a co-operative company by or on behalf of another co-operative company shall be deemed to be a reference to membership of an industrial and provident society by a co-operative company, or the holding of shares in a co-operative company by or on behalf of an industrial and provident society, or the membership of an industrial and provident society by another industrial and provident society, as the case may be.

(10) Every reference in this section to an income year shall, where a co-operative company furnishes a return of income under section 15 of this Act for an accounting year ending with an annual balance date other than the 31st day of March, be deemed to be a reference to the accounting year corresponding with that income year, and in every such case, this section shall, with any necessary modifications, apply accordingly.

Cf. 1954, No. 67, s. 145A; 1975, No. 115, s. 16

As to trading stock valuation adjustment, see s. 167A (2) (b) of this Act.

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