Rural Maryland Council

50 Harry S. Truman Parkway • Annapolis, MD 21401
Office: 410-841-5772 • Voice: 410-841-5761 • TTY: 800-735-2258
Email: rmc.mda@maryland.gov Website: www.rural.maryland.gov

***Susan O'Neill**, Chair* ***Charlotte Davis**, Executive Director*

POSITION STATEMENT
SENATE BILL 85- Corporations and Associations - Limited Worker Cooperative Associations - Authorization
(Maryland Limited Cooperative Association Act)
Senate Judicial Proceeding Committee
February 7, 2024

The Rural Maryland Council **SUPPORTS** Senate Bill 85- Corporations and Associations - Limited Worker Cooperative Associations - Authorization (Maryland Limited Cooperative Association Act). The bill authorizes the formation of a limited worker cooperative association.

While Maryland statute recognizes the formation of cooperatives such as electric cooperatives and housing cooperatives, it does not specifically authorize worker cooperatives. Cooperatives are often a solution to many rural challenges to make up for a lack of population density and create economies of scale. As rural Maryland's population is aging, transitioning to the next generation is of concern particularly aging business owners and farmers. As these aging owners wish to retire, converting to a worker-owned cooperative could retain needed businesses and jobs in areas desperate in need.

There are ***Seven Cooperative Principles:***

- **Voluntary and Open Membership**
- **Democratic Member Control**
- **Member Economic Participation**
- **Autonomy and Independence**
- **Education, Training and Information**
- **Cooperation among Cooperatives**
- **Concern for Community**

Worker cooperatives are value-driven businesses that put the worker and community benefits as the core of their purpose. More than half of worker cooperatives in the United States today were designed to improve low-wage jobs and build wealth in communities most directly affected by inequality, helping vulnerable workers build skills and earning potential, household income and assets.

Worker cooperatives are different from Employee Stock Ownership Plans (ESOPs) as outlined below in the attached chart created with information from ESOP Partners. An ESOP is a federally-regulated employee benefit plan that gives ownership interest to workers by allocating shares from the ESOP trust. A worker cooperative is a member-owned business entity in which worker-owners have a controlling interest, and who elect the governing body on a one-member-one-vote basis.

This legislation will support the retention and creation of jobs across the State. The Rural Maryland Council requests a favorable report of SB 85.

The Rural Maryland Council (RMC) is an independent state agency governed by a nonpartisan, 40-member board that consists of inclusive representation from the federal, state, regional, county, and municipal governments, as well as the for-profit and nonprofit sectors. We bring together federal, state, county, and municipal government officials as well as representatives of the for-profit and nonprofit sectors to identify challenges unique to rural communities and to craft public policy, programmatic or regulatory solutions.

	Worker Coop	ESOP
Ownership	Workers become direct owners of the company. In a worker co-op, worker-owners have a controlling ownership interest. That is to say, worker-owners make up more than 50% of the total combined voting power of all classes of stock of the corporation.	The ESOP trust is the legal owner of the block of the corporation's shares (up to 100% of the company) for the benefit of current and future employees. ESOP employees accrue share allocations while working and typically receive the value of their share allocations, most often in cash, at retirement or separation from service.
Voting Rights	Every worker-owner has one equal voting right. Worker-owners may or may not choose to elect a board of directors, or delegate accountabilities to working groups. These structures can depend on the size of the business.	Employee-owners may or may not have voting rights, as determined and articulated in plan documents. The ESOP-appointed trustee serves on behalf of employee-owners, in most cases. Democratic governance is neither required nor prohibited
Employee Eligibility	Criteria for member eligibility in a worker co-op is articulated in governing documents and can include: • Minimum work tenure • Hours worked per year • Buy-in payment • Being voted in by current members All workers who meet eligibility criteria may become cooperative members, but are not required to.	At a minimum, ESOPs are required to cover a substantial percentage of non-highly compensated employees who are at least 21 years old and who have completed one year of service. Certain employees may be excluded from ESOP participation. ESOP eligibility requirements are subject to IRS nondiscrimination testing, and are articulated in plan documents.
Payment of Dividends to Employee-Owners	In a worker cooperative, a majority of allocated earnings (i.e. the portion of net income designated as surplus) or losses go to worker-members on a **patronage** basis as described in the co-op's governing documents.	Not all ESOPs choose to pay dividends, but they may. Dividend payments for an **ESOP-owned C corporation** may be tax deductible under IRC Section 404(k)(2).
Taxes	A cooperative pays income taxes on its profits, and worker-owners must be paid "reasonable" salaries subject to payroll taxes (rather than pay whole salaries as patronage dividends to avoid payroll taxes). Allocation of profits to patronage dividends allows the cooperative to have worker-owners take on some of the tax responsibility as individuals. The 20% federal pass through deduction creates a tax break.	The ESOP-owned portion of an S-corporation is not subject to federal income tax. So a 100% ESOP-owned S corporation pays $0 in federal income taxes. An ESOP-owned C corporation can benefit from the tax deductions mentioned above.
Financing	In most cases, workers each contribute a buy-in amount (i.e. each purchases a voting share), and the cooperative secures a loan for the rest of the sale price. Member equity is rarely enough to cover the sale price. Seller notes are commonly part of the sale structure.	Leveraged ESOP sales often involve a combination of lender and seller financing. Employees do not "buy into" plan participation. Non-leveraged (at sale) ESOPs are rare, but in those cases, the company would contribute the cash to the ESOP, and the ESOP would purchase company shares.