

Tilting the Playing Field: Tax Preferences for Cooperatives and Government-Owned Enterprises

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The United States tax code does not apply evenly across all types of business activity. While private corporations are subject to corporate income tax and, in many cases, double taxation of earnings, other large segments of the economy operate under special rules or enjoy complete exemptions. Cooperatives, state and local government enterprises, and federally owned corporations together account for at least \$1.4 trillion in annual commercial revenue, yet much of that activity escapes entity-level taxation. The result is a sprawling “untaxed” sector that competes directly with tax-paying firms but benefits from structural preferences written into the law.

These exemptions are not minor carveouts. In the cooperative category, credit unions hold trillions in assets and compete head-to-head with banks. State and local governments operate major commercial enterprises ranging from utilities and hospitals to liquor monopolies. At the federal level, government-owned corporations such as the US Postal Service, Amtrak, and power marketing administrations generate revenues on par with large private companies. In each case, these entities function in markets where private alternatives exist, but they are governed by rules that insulate them from the tax burdens faced by ordinary businesses. Table 1 summarizes each of these three enterprise types by tax treatment, with examples and implications for tax competition.

Recent analysis by tax policy expert Scott Hodge underscores the broader reach of this phenomenon.¹ Hodge finds that nonprofit organizations collectively earn more than \$2.8 trillion in business-related income each year, nearly all untaxed. That includes more than \$1 trillion from nonprofit hospitals alone, as well as billions in revenues from universities, insurers, sports leagues, and professional associations. By his estimates, exempting this income represents roughly \$51 billion in forgone federal revenue annually. While these figures highlight that the untaxed business sector includes large swaths of nonprofit activity that compete directly with for-profit firms, little analysis has been done on the scale of state, local government, and cooperative enterprises.

TABLE 1. Comparative tax treatment of cooperatives and government-owned enterprises in the United States

Type of Enterprise	Relevant Tax Code Sections	Entity-Level Federal Income Tax	Treatment of Earnings/Distributions	Typical Examples	Competitive Implications
Cooperatives	§ 501(c)(12), § 501(c)(14), Subchapter T (§§ 1381–1388)	Varies by type: credit unions and § 501(c)(12) utility co-ops are fully exempt; Subchapter T co-ops are partially taxed	Patronage dividends deductible at the entity level and taxed once at the member level; non-patronage income subject to corporate tax	Credit unions, Land O'Lakes, ACE Hardware affiliates, electric & telephone co-ops	Preferential: avoids double taxation; credit unions and utility co-ops often pay no federal income tax
State & Local Government Enterprises	§ 115, IRS rulings on "essential governmental functions"	Exempt from federal income tax on income derived from public utilities or essential functions	Earnings accrue to the state or local treasury; not taxed when transferred or reinvested	Public utilities, hospitals, higher education institutions, liquor stores, airports, toll roads	Structural advantage: compete with private firms without federal income tax liability; broad definition of "essential functions"
Federal Government Enterprises	Generally exempt as instrumentalities of the United States; governed by enabling statutes	Exempt from federal and state income tax (e.g., US Postal Service, Tennessee Valley Authority, Bonneville & Western Power Administrations)	Surpluses retained or returned to Treasury; not taxed	US Postal Service, Amtrak, Tennessee Valley Authority, Bonneville & Western Power Administrations	Compete with private firms (e.g., FedEx, utilities) while exempt from entity-level tax; policy-driven rather than market-driven pricing

Source: Author's representation.

The central policy question, then, is not simply whether these organizations should pay more tax, but whether the tax system should treat similar economic activity differently depending on its organizational form. From the perspective of a neutral base, such as that envisioned by Hall–Rabushka's flat tax,² the problem is inconsistency: Cooperatives and government-run enterprises enjoy exemptions or special treatment, while C-corporations bear the brunt of double taxation. Understanding the size of this untaxed sector, and the distortions it creates, is therefore essential to evaluating the fairness and efficiency of the current system.

This analysis examines the cooperative, state and local government, and federal government enterprise sectors, quantifying the revenues they generate and analyzing the preferential tax treatment they enjoy. Drawing on available data, it estimates the scale of untaxed or unequally taxed commercial activity across these entities and compares it to the treatment of private businesses subject to corporate income tax. The paper concludes by evaluating potential policy approaches, emphasizing that the ultimate goal should be neutrality across organizational forms consistent with the Hall–Rabushka tax base.

Businesses Operating as Cooperatives

Cooperatives are a distinctive form of enterprise in which any surplus is returned to members (typically suppliers, consumers, or employees) rather than to outside shareholders. The tax code provides a range of exemptions and special rules, which generally place these organizations at an advantage compared to private businesses. The most important class of cooperatives is credit unions, which are exempt from entity-level taxation under sections 501(c)(1) and 501(c)(14) of the tax code. With around 144 million members and \$2.4 trillion in assets, credit unions compete directly with commercial banks while operating outside of the corporate income tax system.³

Other significant exemptions apply to utility-style cooperatives. For example, telephone and electrical cooperatives organized under the Rural Electrification Act are exempt so long as at least 85 percent of their income comes from member business. These organizations provide services indistinguishable from those of private-sector utilities, but their net earnings generally escape entity-level taxation. By contrast, private electric or telecom companies are taxed on all income at corporate rates, creating a structural preference in favor of cooperative ownership.

The tax treatment of other cooperatives is governed by the tax code's Subchapter T, which covers consumer, producer, purchasing, and employee-owned cooperatives. These businesses, ranging from Welch's and Land O'Lakes to ACE Hardware affiliates, can deduct "patronage earnings" that are allocated back to members, whether in cash or through qualified written notices. Those amounts are taxed only once, at the member level, avoiding the double taxation that applies to corporate dividends. Nonpatronage earnings, however, are generally subject to corporate-level tax and then taxed again when distributed, and price reductions to members escape taxation altogether.

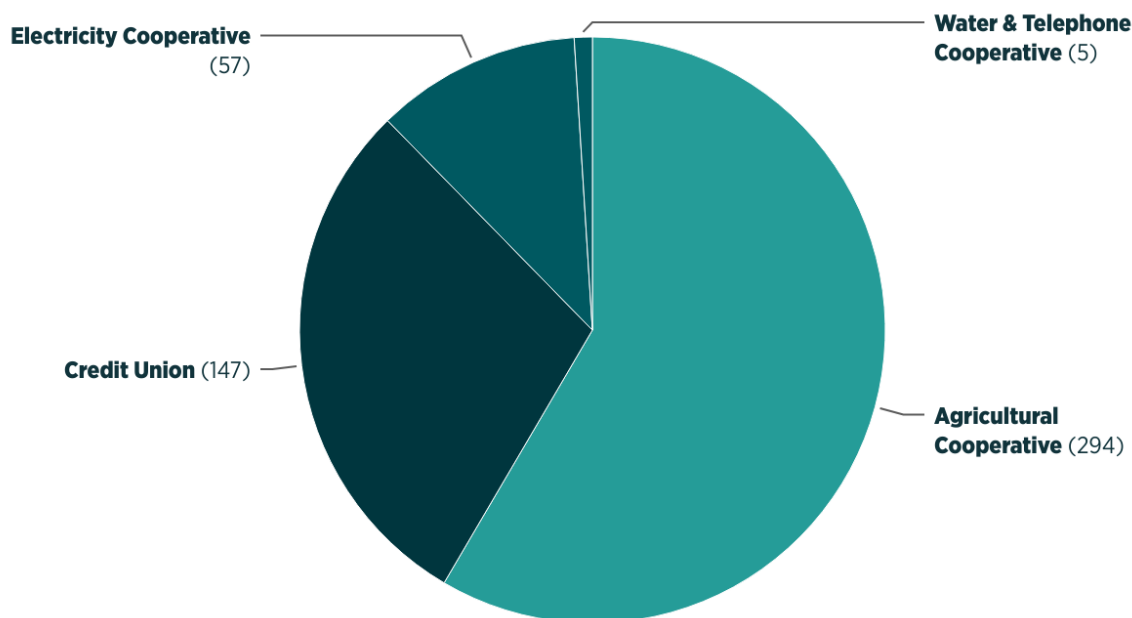
Taken together, the tax system treats cooperatives more favorably than comparable businesses in the private sector, particularly when cooperatives derive most of their income from member business. Credit unions and utility cooperatives often face no entity-level tax at all, while Subchapter T cooperatives achieve effective pass-through treatment for their core earnings. This places the cooperative sector in the broader category of "untaxed" or "lightly taxed" business activity and underscores the significant preferential status cooperatives enjoy relative to private firms subject to the corporate income tax.

The Size of the Cooperative Sector

According to the latest available data (Q2 2025), the nearly 4,400 credit unions operating in the United States receive about \$147 billion annually in collective gross income.⁴ That figure is essentially the top-line "revenue" measure for credit unions, although the National Credit Union Administration (NCUA) uses slightly different terminology. Agricultural cooperatives generated \$289 billion in total sales and \$5 billion in services and other operating income in 2023 for a total combined revenue of \$294 billion.⁵ Meanwhile, electricity cooperatives reported roughly \$57 billion in total revenue, according to 2023 data from the Energy Information Administration (EIA).⁶

In addition to these larger cooperative organizations, smaller cooperatives, such as water and telephone cooperatives, typically serve rural communities. Data from the IRS Exempt Organizations Business Master File (EO-BMF) indicate that water cooperative revenues total about \$3.9 billion, while telephone cooperatives generate about \$1.2 billion.⁷ These should be interpreted as lower bounds: The EO-BMF captures 501(c)(12) exempt parent entities and reports Form 990 revenue at the EIN level, not on a consolidated basis. In the telephone sector especially, a substantial share of activity has migrated to broadband and related services that are often

FIGURE 1. Revenues (\$billions) generated by businesses operating as cooperatives (latest data)



Note: Credit union, telephone cooperative, and water cooperative data are for 2024. Agricultural cooperative and electricity cooperative data are for 2023.

Sources: National Credit Union Administration, *Quarterly Credit Union Data Summary 2025 Q2*; United States Department of Agriculture, *Agricultural Cooperative Statistics, 2023 (Service Report 87)*, Table 3; US Energy Information Administration (EIA), *Electric Sales, Revenue, and Average Price*, October 10, 2024, Table T10.

booked in taxable subsidiaries or affiliates outside the EO-BMF. Moreover, legacy wireline voice service has contracted markedly since the mid-2000s, so today’s “telephone-only” revenue base is naturally smaller than historical survey totals.

Figure 1 breaks down revenue sources into four different cooperative organization types. Almost 60 percent of cooperative revenue is from agricultural cooperatives, 30 percent from credit unions, and the remaining 12 percent from electricity, water, and telephone cooperatives. The total revenue from the cooperative sector is roughly \$503 billion.

Since the Congressional Budget Office (CBO) last analyzed cooperative revenues in 2002, the sector has expanded dramatically. At that time, the combined revenues of electricity cooperatives (\$37 billion), credit unions (\$36.3 billion), telephone cooperatives (\$2.2 billion), and water cooperatives (\$1.5 billion) amounted to just over \$77 billion.⁸ By 2023, those same categories had grown by 171 percent relative to their 2002 levels, far outpacing the 70 percent increase in consumer prices and even exceeding the 156 percent growth of the overall economy during the same period.⁹ This means that cooperatives have not only kept pace with inflation and national economic expansion but have grown as a share of total economic activity.

Businesses Owned by State and Local Governments

Under Section 115 of the federal tax code, state and local governments do not pay federal income tax on the net income they earn from operating public utilities or carrying out what are deemed “essential governmental functions.” In practice, the IRS has interpreted this exemption broadly, giving state and local governments the ability to run enterprises that look and act much like private businesses, but are not subject to the same tax obligations.

The most familiar state and local enterprises are electric, water, and gas utilities, which mirror services widely provided in the private sector. Other enterprises, such as sewer systems and garbage collection, operate in markets where private providers exist but are less common. Beyond utilities, governments are active in transportation businesses such as parking garages, ferry services, ports, and airports, as well as in recreation through facilities like swimming pools, golf courses, and even hotels. States likewise participate in a range of other commercial ventures, including running lotteries and earning rental income from government-owned commercial real estate.

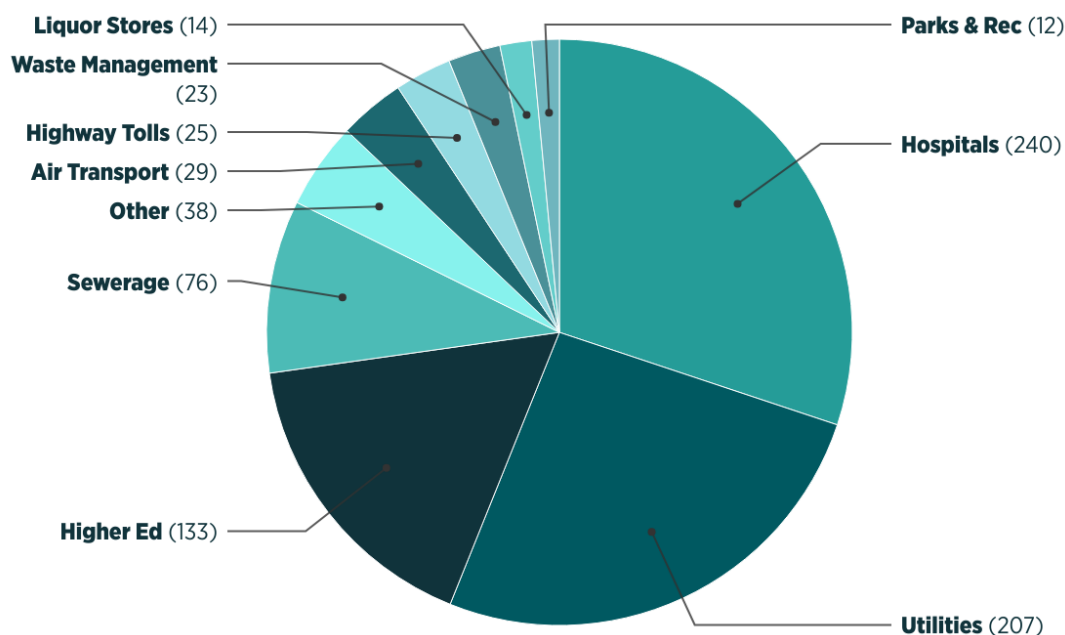
Some enterprises are created by states and localities mainly as revenue-raising tools rather than to compete in open markets. Liquor stores are the clearest case: They are established as legal monopolies, and the income they generate functions more like a substitute for excise taxes than as traditional business profit. In practice, a state gains revenue by barring private competitors and keeping consumer payouts lower than they would be in a competitive market. The same effect could be achieved if the state allowed private liquor sales but imposed a tax on them. In that case, the tax revenue would not be subject to federal taxation. By parity of reasoning, the appropriate federal treatment of state-run liquor stores would be to tax only the portion of their receipts equivalent to the normal profit a private retailer would earn.

The Size of the State and Local Enterprise Sector

The state and local sector received a total of \$207 billion in sales revenue in fiscal year 2023 from operating water, electric, and gas utilities.¹⁰ All of that revenue arose from sales. However, utilities are not the largest revenue raiser for state and local commercial enterprises—that comes from service fees charged by operating hospitals, which receive \$240 billion. Public colleges raise the third largest revenue volume, \$133 billion, from commercial activities including tuition and fees, financial investments, residence halls, food services, and other sales and service revenues. Figure 2 breaks down these revenue sources for 2023 by type of state and local enterprise.

The combined revenue (\$797 billion) of state and local government enterprises accounts for 16.5 percent of the total revenue raised by the state and local government sector. If those activities’ share of state and local net value added is proportional to their share of total revenue, the value added by state and local entities that might be performing tasks comparable to those in the for-profit sector is \$354 billion.¹¹ That figure represents 1.3 percent of net domestic product.

FIGURE 2. Revenues (\$billions) generated by business enterprises run by state and local governments (2023)



Note: “Other” includes revenues raised from parking facilities, port facilities, natural resources, housing and community development, and miscellaneous commercial activities.

Source: US Census Bureau, “Annual Survey of State and Local Finance (2023)” (dataset), last revised July 31, 2025, <https://www.census.gov/data/datasets/2023/econ/local/public-use-datasets.html>.

Since the CBO last examined state and local government enterprise revenues in 2002, this sector has also grown substantially. At that time, revenues totaled \$287 billion across utilities (\$93.4 billion), hospitals (\$65.6 billion), higher education (\$61.4 billion), waste management (\$11.2 billion), air transport (\$12.3 billion), parks and recreation (\$7 billion), highway tolls (\$6 billion), and liquor stores (\$5.1 billion).¹² By 2023, those same categories had expanded to \$797 billion, an increase of 178 percent over two decades. The evidence shows that state and local government enterprises have not only scaled in absolute terms but have also become a more significant presence within the broader economy.

Major Federal Government Enterprises

Several of the most significant federal government enterprises generate large revenues from activities virtually indistinguishable from those of private firms. The largest of these is the US Postal Service (USPS), which collected roughly \$79.5 billion in 2024 from the sale of postage, shipping, and related services.¹³ Although USPS retains a legal monopoly over first-class mail, most of its revenue now comes from package delivery, where it competes directly with private carriers such as UPS and FedEx. In the energy sector, the Tennessee Valley Authority (TVA) earned \$12.3 billion in 2024 from the sale of electricity to wholesale and retail customers across the Southeast.¹⁴ Similarly, the Bonneville Power Administration (BPA) earned \$4.6 billion from the sale of hydroelectric

power generated by federally owned dams in the Pacific Northwest, while the Western Area Power Administration (WAPA) recorded \$1.4 billion from power marketing operations in its region.¹⁵

Another high-profile federal enterprise is Amtrak, the National Railroad Passenger Corporation, which earned \$2.5 billion in passenger fares and related revenues in its most recent fiscal year.¹⁶ Amtrak directly competes with airlines, buses, and private vehicles for intercity travel, yet unlike its competitors, it operates as a federally chartered corporation with unique subsidies and exemptions. Taken together, these enterprises represent over \$100 billion in annual revenues from purely commercial activity. They illustrate that, at the federal level as at the state and local level, governments are active players in markets that otherwise would be the domain of private business.

The scale of these federal enterprises underscores the central issue: Governments at every level can and do operate businesses that mirror private firms in form but not in governance. Whether in energy, transportation, communications, or recreation, these entities generate large streams of commercial revenue while benefiting from legal privileges and tax exemptions that private firms do not enjoy. The question, then, is not only about the size of this untaxed business sector but also about the incentives under which it operates.

Tax Treatment of Untaxed Enterprises

The evidence assembled in this analysis shows that a very large share of economic activity in the United States takes place outside the reach of the corporate income tax. Cooperatives, state and local government enterprises, and federally owned corporations collectively generate around \$1.4 trillion in annual revenues, often in markets where private firms compete under far heavier tax burdens (table 2). The expansion of these sectors since the early 2000s underscores how significant the untaxed or preferentially taxed portion of the economy has become.

Simply subjecting government-owned and -operated enterprises to federal income taxation would not resolve the distortions they create in the marketplace. The core problem lies in their organizational structure: Unlike private corporations, they lack shareholders who press managers to operate efficiently, maximize profits, and either distribute surpluses as dividends or reinvest them productively. Without that disciplining force, public enterprises often allocate resources for political rather than economic reasons, expanding services or setting prices in ways that private firms would not. Even if they paid federal taxes, these incentives would remain unchanged. Because these entities' structures are determined by state and local laws, the real solution is to rethink their governance model, not simply to adjust their tax treatment.

As with government-owned enterprises, the more appropriate policy solution for cooperatives may not be simply to alter their tax treatment but to reconsider whether their preferential exemptions are warranted in markets where they compete directly with private firms, ensuring a more neutral tax base across organizational forms.

TABLE 2. Cooperatives and government-owned enterprises generate \$1.4 trillion in annual revenue

Sector	Subgroup	Revenues	Notes/Comments
Cooperatives	Agricultural Cooperatives	\$294 billion	2023 Data
	Credit Unions	\$147 billion	2024 Data
	Electricity Cooperatives	\$57 billion	2023 Data
	Water Cooperatives	\$3.9 billion	2024 Data
	Telephone Cooperatives	\$1.2 billion	2024 Data
State and Local Government	Hospitals	\$240 billion	2023 Data
	Utilities	\$207 billion	2023 Data
	Higher Education	\$133 billion	2023 Data
	Sewerage	\$76 billion	2023 Data
	Highway Tolls	\$25 billion	2023 Data
	Waste Management	\$23 billion	2023 Data
	Liquor Stores	\$14 billion	2023 Data
	Parks and Recreation	\$12 billion	2023 Data
	Other	\$38 billion	2023 Data
Federal Government	United States Postal Service	\$79.5 billion	2024 Data
	Tennessee Valley Authority	\$12.3 billion	2024 Data
	Bonneville Power Administration	\$4.6 billion	2024 Data
	Amtrak	\$2.5 billion	2024 Data
	Western Area Power Administration	\$1.4 billion	2024 Data
Total		\$1,374.8 billion	

Sources: National Credit Union Administration, *Quarterly Credit Union Data Summary 2025 Q2*, September 5, 2025; United States Department of Agriculture, *Agricultural Cooperative Statistics, 2023 (Service Report 87)*, Table 3; US Energy Information Administration (EIA), *Electric Sales, Revenue, and Average Price*, October 10, 2024, Table T10; Internal Revenue Service, *Exempt Organizations Business Master File Extract (EO BMF)*, September 9, 2025; US Census Bureau, "Annual Survey of State and Local Finance (2023)," (dataset), last revised July 31, 2025, <https://www.census.gov/data/datasets/2023/econ/local/public-use-datasets.html>; United States Postal Service, "US Postal Service Reports Fiscal Year 2024 Results," November 14, 2024; Tennessee Valley Authority, *FY 2026 Budget Details and Management Agenda and FY 2024 Annual Performance Report*, May 2025; Bonneville Power Administration, *2024 Annual Report*, November 18, 2024; Western Area Power Administration, *Annual Report FY 2024 Statistical Appendix*; Amtrak, *FY 2024 Company Profile*.

From the perspective of a neutral tax base, the appropriate policy solution is not to devise special taxes for cooperatives or government-owned enterprises, but to ensure that all organizations competing in commercial markets face the same treatment under the tax code. In this sense, the single-level taxation of Subchapter T cooperatives is already closer to the Hall–Rabushka ideal, whereas the absence of tax for credit unions and the double taxation of C-corporations represent opposite departures from neutrality. Under a flat tax such as Hall–Rabushka, that would mean eliminating preferential exemptions for cooperatives and taxing state and local enterprises on the same basis as private businesses, while recognizing that governance reforms may be necessary to address the inefficiencies inherent in public ownership.

Ultimately, the aim is not to penalize cooperatives or government enterprises, but to ensure that similar activities are treated consistently regardless of ownership form. A tax system that minimizes distortions and allocates resources according to market signals rather than legal privileges is essential for long-run growth and neutrality. By highlighting the size, scope, and special treatment of the untaxed sector, this paper underscores the need to restore neutrality as a guiding principle of tax policy.

About the Author

Jack Salmon is a research fellow at the Mercatus Center at George Mason University, where he focuses on economic and fiscal policy, with an emphasis on federal budgets, taxation, economic growth, and institutional analysis. His research and commentary have been featured in a variety of outlets, including *The Hill*, *Business Insider*, *RealClearPolicy*, *National Review*, the American Institute for Economic Research, and *Reason* magazine. Salmon has provided expert analysis before Congress on the risks of debt accumulation, deficit spending, and inflation. Prior to rejoining Mercatus, he served as director of policy research at Philanthropy Roundtable, where he researched issues impacting the charitable sector and philanthropic freedom. Originally from the United Kingdom, Salmon earned his Master of Arts in political economy from King’s College London in 2015.

Notes

1. Scott Hodge, “Nonprofit Businesses and the Leaky Bucket of US Tax Policy” (Mercatus Policy Brief, Mercatus Center at George Mason University, October 2025).
2. Robert E. Hall and Alvin Rabushka, *The Flat Tax* (Hoover Institution Press, 2007).
3. National Credit Union Administration, *Quarterly Credit Union Data Summary 2025 Q2*, September 5, 2025.
4. National Credit Union Administration, *Quarterly Credit Union Data Summary 2025 Q2*.
5. United States Department of Agriculture, *Agricultural Cooperative Statistics, 2023 (Service Report 87)*, Table 3.
6. US Energy Information Administration (EIA), *Electric Sales, Revenue, and Average Price*, October 10, 2024, Table T10.
7. Internal Revenue Service, *Exempt Organizations Business Master File Extract (EO-BMF)*, September 9, 2025.

8. Congressional Budget Office (CBO), *Taxing the Untaxed Business Sector*, July 2005.
9. The CBO analysis did not include agricultural cooperatives. This comparison excludes those figures for consistency.
10. US Census Bureau, “Annual Survey of State and Local Finance (2023)” (dataset), last revised July 31, 2025, <https://www.census.gov/data/datasets/2023/econ/local/public-use-datasets.html>.
11. Gross value added of state and local governments is sourced from “Financial Accounts of the United States - Z.1, Table S.8.a,” Board of Governors of the Federal Reserve System, updated September 11, 2025. <https://www.federalreserve.gov/releases/z1/>.
12. CBO, *Taxing the Untaxed Business Sector*.
13. United States Postal Service, “US Postal Service Reports Fiscal Year 2024 Results,” November 14, 2024.
14. Tennessee Valley Authority, *FY 2026 Budget Details and Management Agenda and FY 2024 Annual Performance Report*, May 2025.
15. Bonneville Power Administration, *2024 Annual Report*, November 18, 2024; Western Area Power Administration, *Annual Report FY 2024 Statistical Appendix*.
16. Amtrak, *FY 2024 Company Profile*.