

Producer Cooperatives and Membership in a Dynamic Marketplace

Iowa Women in Agriculture Conference

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Center for Agricultural and Rural Development

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DYNAMICS FACING PRODUCERS

- Changing **economics** of food production
- Changing **market scope and structure**
- Changing **consumer preferences** for foodstuffs
- Changing **tax** environment
- Changing **social** and **political cultures**

...AND CO-OPS

- Changing **producer needs**

IMPORTANT LAWS FOR CO-OPS

- Capper Volstead (1922)
- IA code Chapter 499 (1935)—producer co-ops
- IA code Chapter 501 (1996)—closed co-ops (aka “new generation)
- IA code Chapter 501A (2005)—hybrid co-op and L.L.C.

✓ **Democratic control** in the hands of producers
(production at risk requirement)

✓ **Limited capital access** members and accumulation

✓ **Special tax treatment** of co-op profits allocated to patron

IMPORTANT TAX LAWS – PART 1

Subchapter T – no changes

- Co-ops can allocate profits to patrons/members, and the income tax is paid either by the co-op or the patron/member (single taxation)
- Allocations can be “qualified” or “nonqualified”
- Minimum 20% of qualified allocation must be paid as cash in that year
- At least 50% of business must be with members

IMPORTANT TAX LAWS – PART 2

Section 199A(a) – ties back to Sec 199 DPAD

- Major changes to how taxable income is calculated at the farmer level (relies on **QBI calculation**)
- Deduction available for **pass-through organizations**: sole proprietors, partnerships, trusts, estates, LLCs, S-corporations, and cooperatives
- Deduction depends on **who you sell to**: co-op vs. not

For purposes of state income taxes, **IOWA** couples with the federal deduction on an increasing scale over the next 4 – 5 years, starting at 25%.

QBI FOR FARMERS

Calculation can be complicated, and tax professionals are awaiting guidance from the IRS, but generally...

$$\text{QBI} = \text{Net Income} - \text{Capital Gains}$$

- **Does include** PURPIM and patronage from co-op
- **Does not include** wages, interest income, dividend income, capital gains.
- Connected with a **domestic trade or business**
- Each “qualified trade or business” must be calculated separately

SEC 199A BASICS

- Deduction on “qualified business income” (QBI) for pass-through entities (non C corp)
- **Expires after 2025** (Iowa will be fully coupled just before that); note corporate tax rate of 20% is permanent)
- There are potentially two §199A deductions to calculate:
 - § 199A(a) is a farm-level deduction, depends on who the farmer sells to (co-op vs not), limited by 50% of wages + 20% of taxable income less cap gains
 - § 199A(g) is a co-op level deduction and may be passed through to co-op members

SEC 199A(a): THE FARMER-LEVEL DEDUCTION

Sales to Co-op

- 20% of QBI is initial deduction, then subtract the **smaller** of:
 - 9% of net income attributed to sale to co-op
 - 50% of W2 wages associated with sale to co-op
 - wage/capital limits apply
- **Then ADD** deduction passed through from co-op (if any)

Sales Not to Co-op

- 20% of QBI, limited by:
 - 20% of taxable income **minus capital gains**
 - wage/capital limits apply if income exceed \$157,500 / \$315,000 for single / married filing jointly.

SEC 199A(g): THE CO-OP LEVEL DEDUCTION

- **Co-ops** will calculate a deduction at their level, and **may** pass through a portion of it.
- Their deduction is 9% of QPAI attributable to patron/members, including PURPIM, limited by 50% of wages and taxable income.
- The co-op will choose how much to keep at the co-op level to offset their taxes or pass through (0% - 9%)
- A farmer's total deduction is limited by **taxable income after QBI deduction taken**

CO-OP VS NOT?

Total Deduction if selling to a co-op:

1. Sec 199A(a) deduction
 - a) If you have **no W2 wages**, your deduction will likely be 20% of QBI (on-par with selling to independent)
 - b) If you have **significant W2 wages**, your deduction will likely be 11% of QBI, and you may be disadvantaged relative to selling to an independent unless the co-op deduction is passed-through.

2. **PLUS** Sec 199A(g) deduction: member's portion of the co-op's DPAD-like pass-through, calculated from the co-op's QPAI, including PURPIM

WHAT THIS IMPLIES



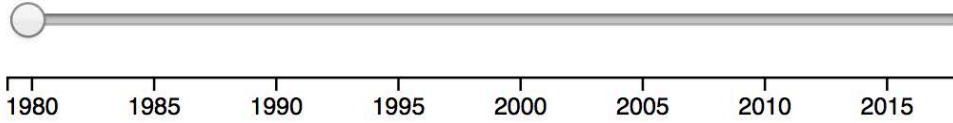
- The choice of who to sell to will depend on more than price
- Co-ops may use non-qualified allocations to still allocate when taxable income is down—members don't understand this
- Member characteristics complicate things (org., wages, likely tax bracket)
- Will impact equity redemption periods and capital accumulation
- Tax differential matters less as income declines.

CONSOLIDATION

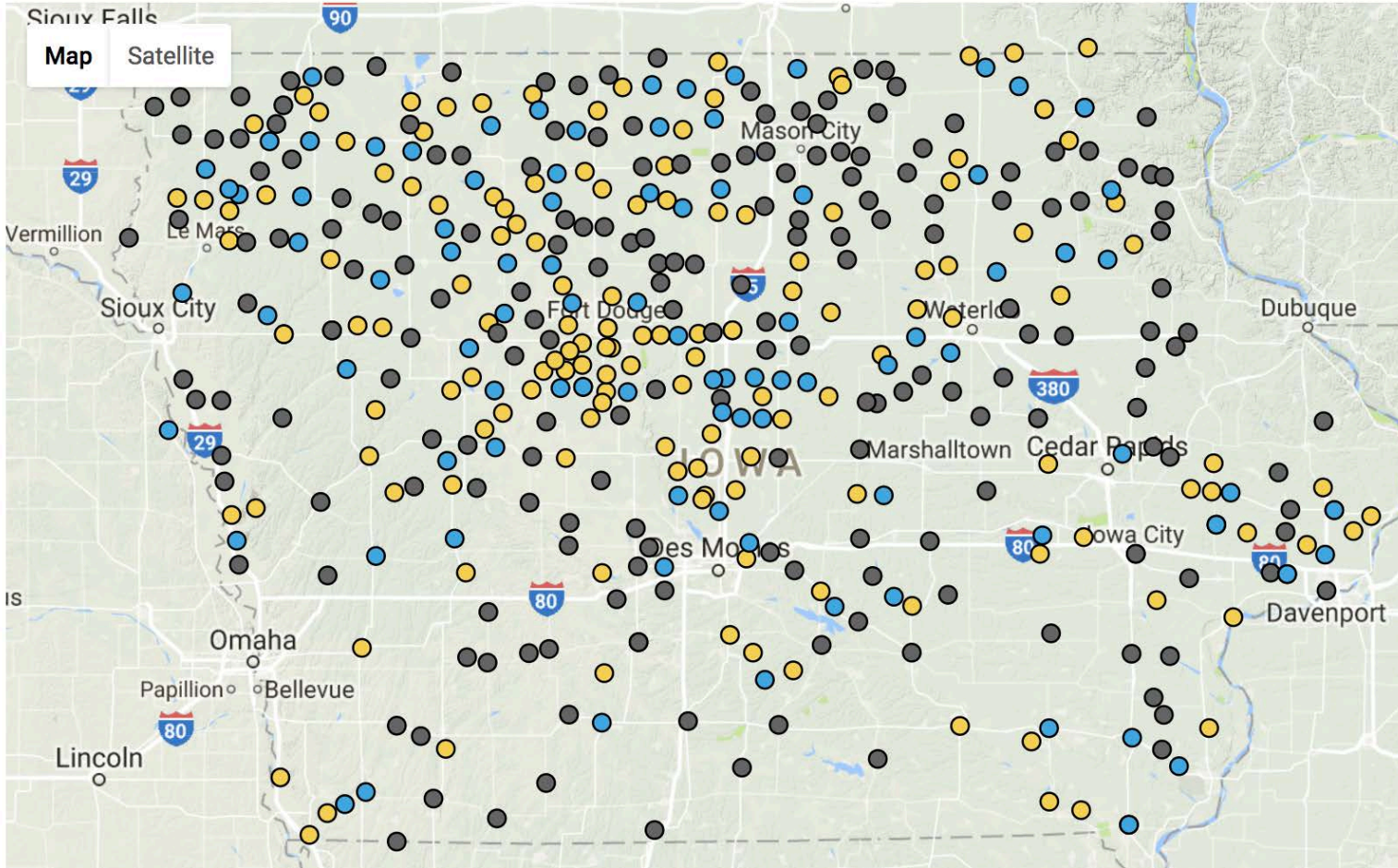
TRENDS AND IMPACTS



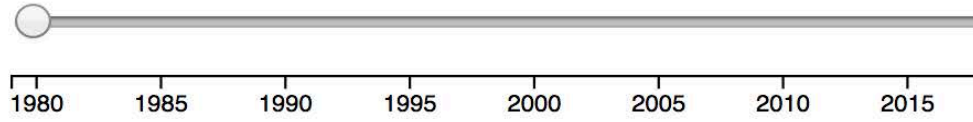
Location of Co-ops in Iowa at 1979






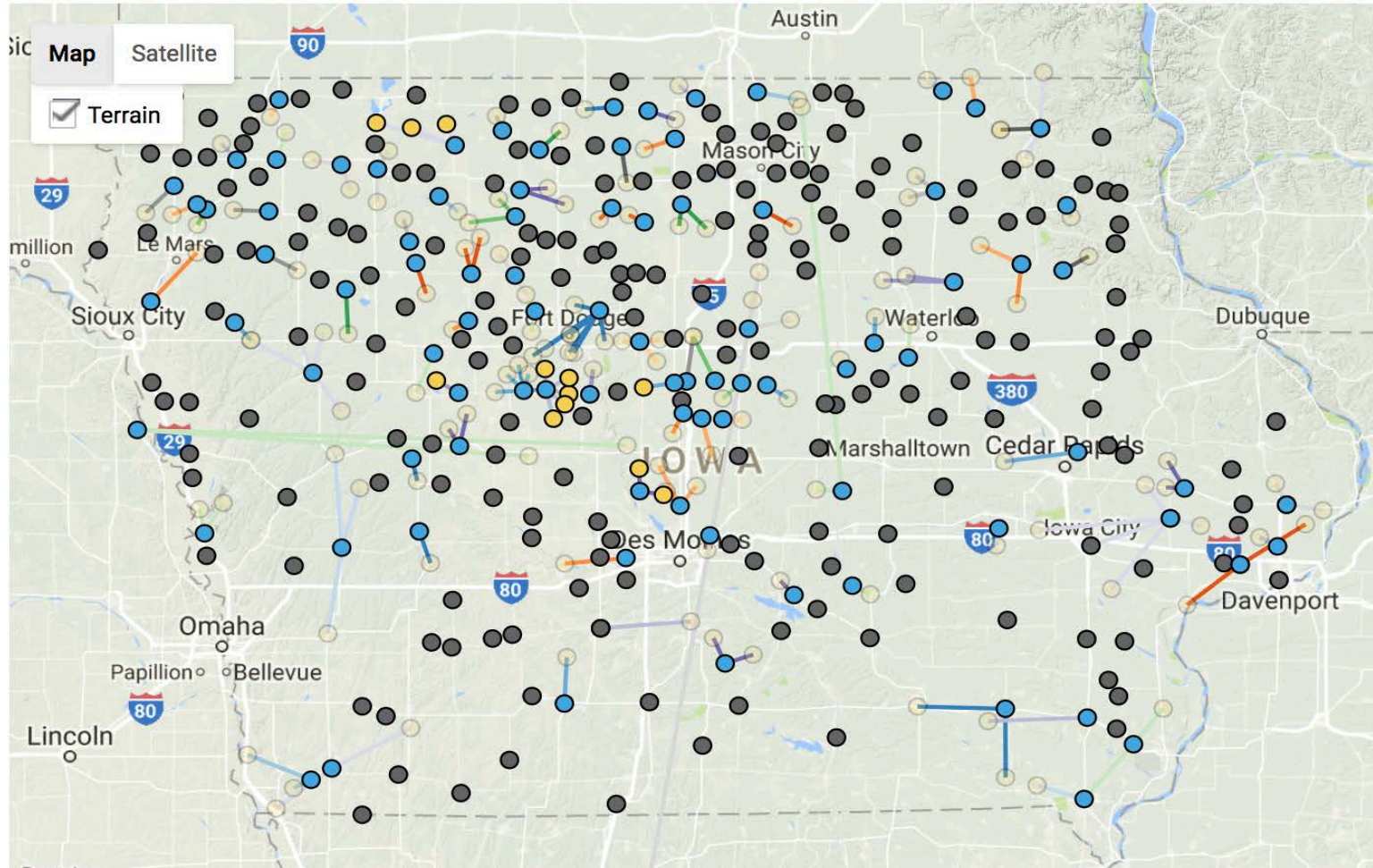
- CO-op Headquarter
- CO-op Branches
- Single Location Co-op



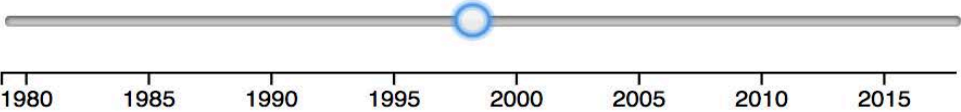
Network of Iowa Co-ops in Iowa at 1979



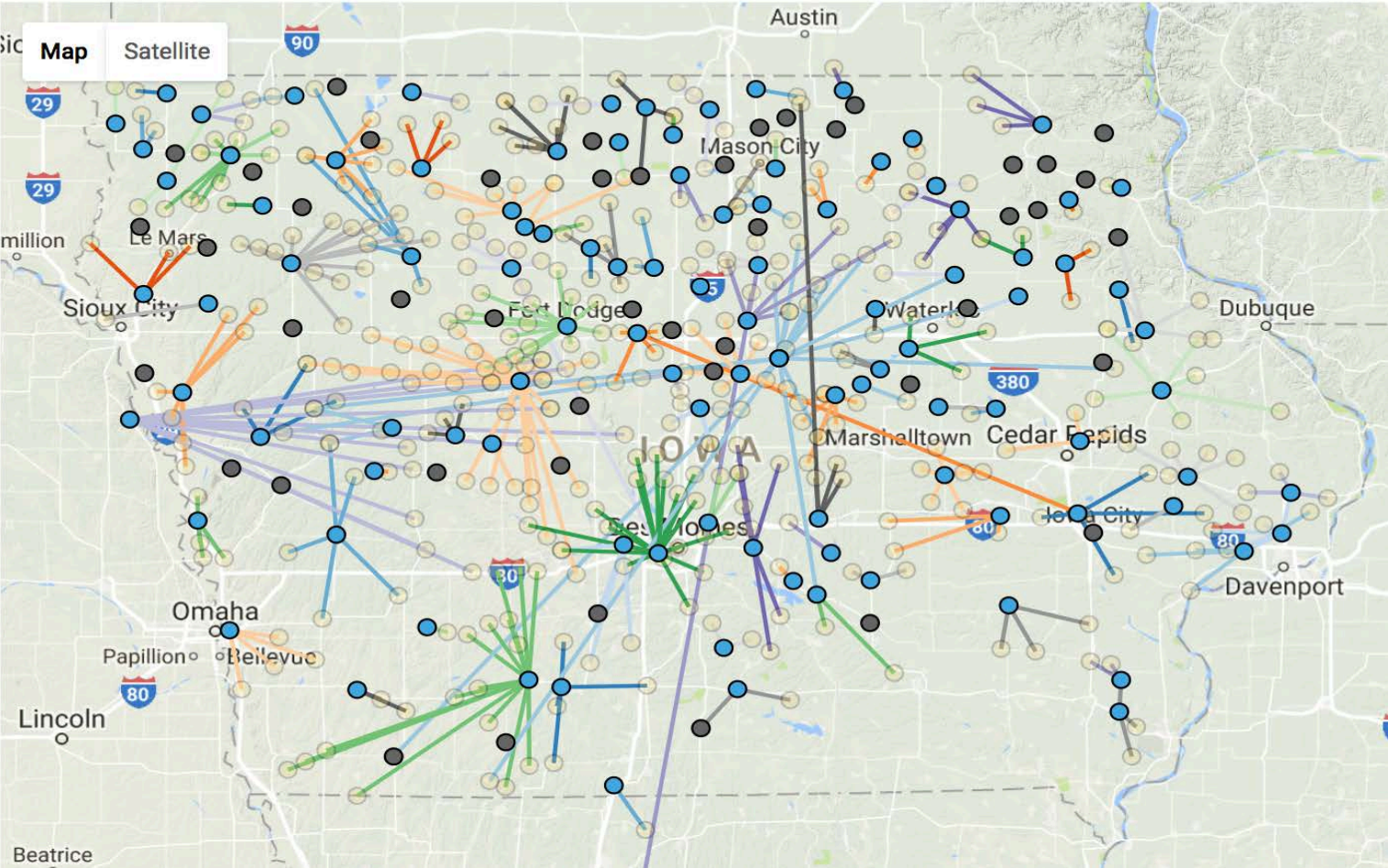
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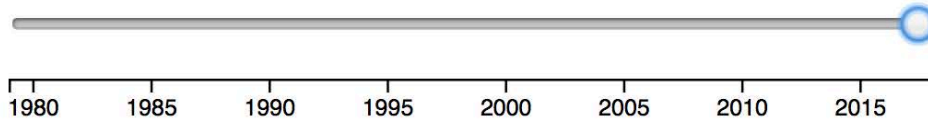
Network of Iowa Co-ops in Iowa at 1998



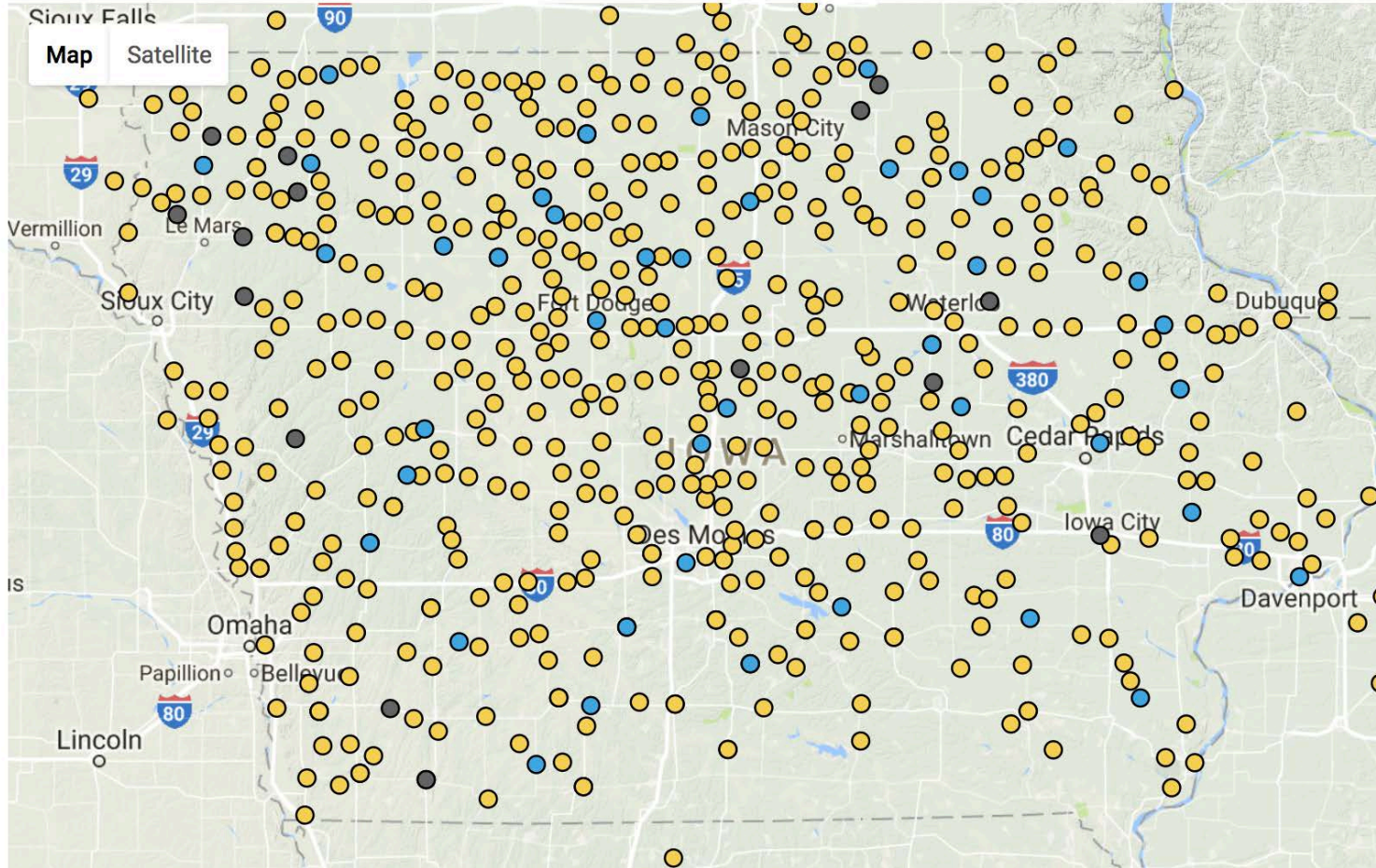
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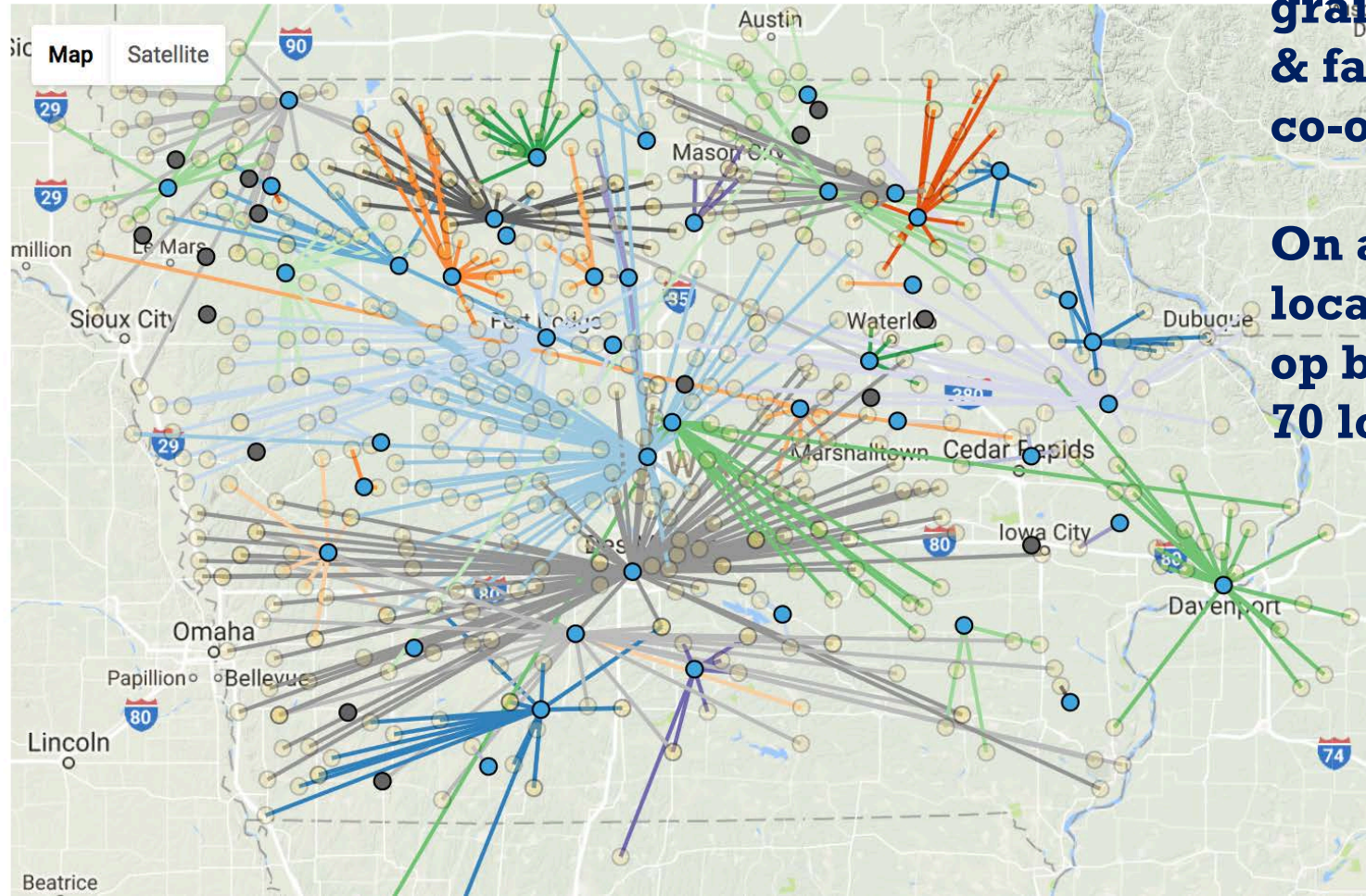
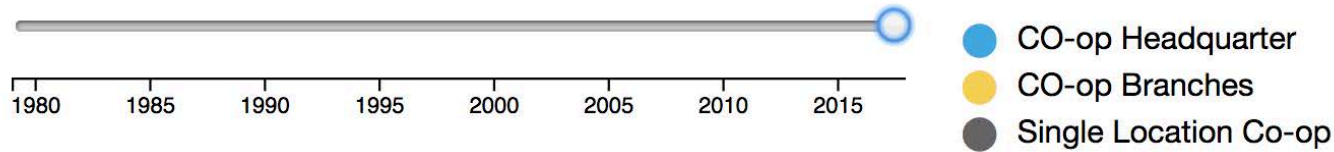
Location of Co-ops in Iowa at 2018



- CO-op Headquarter
- CO-op Branches
- Single Location Co-op



Network of Iowa Co-ops in Iowa at 2018



Approximately 50 grain marketing & farm supply co-ops today

On average, 12 locations per co-op but as large as 70 locations

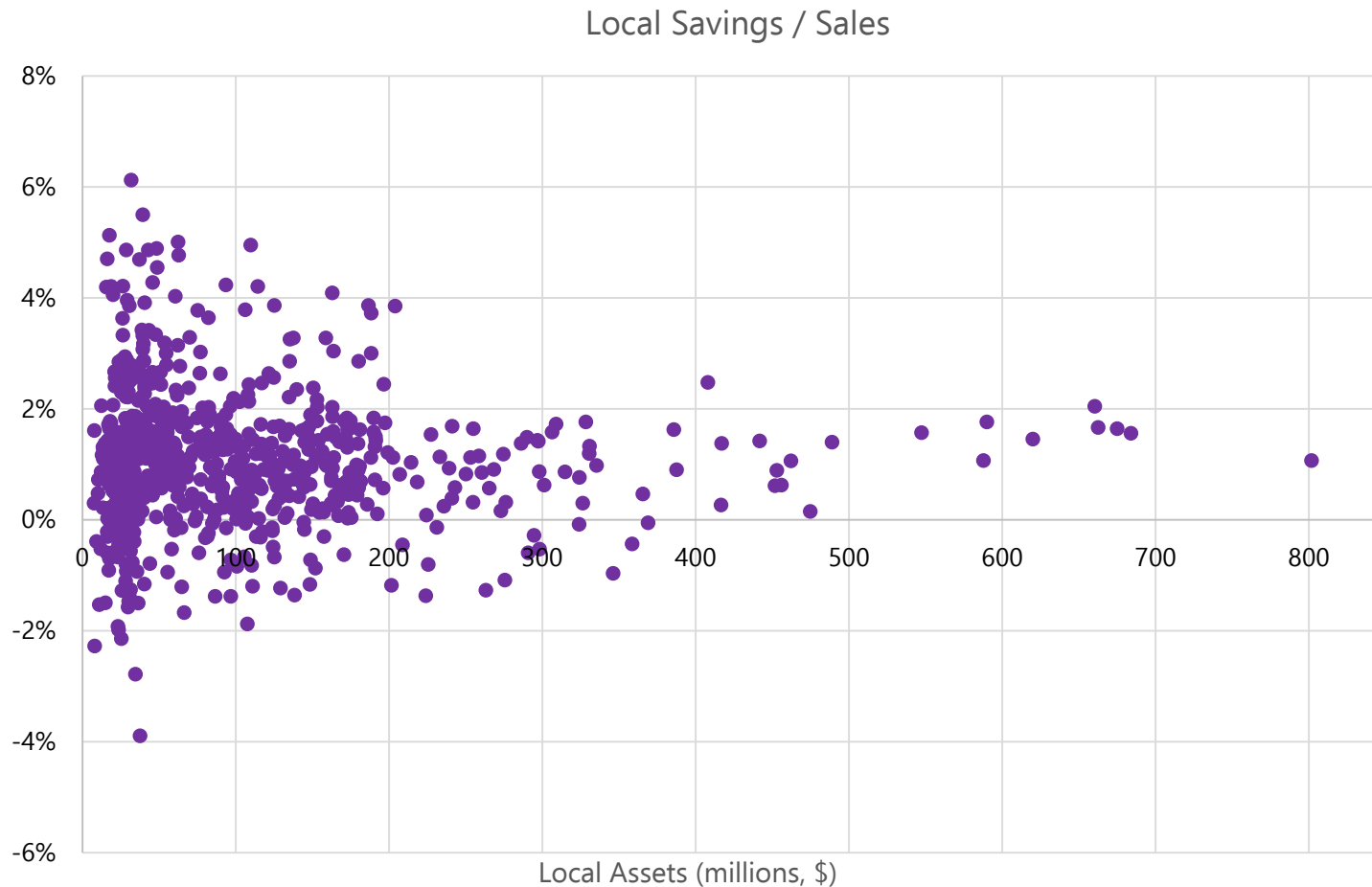
Consolidation Observations








- **Drivers**

- ✓ Access to strategic assets
- ✓ Succession and retention, access to talented GM
- ✓ Enhanced operational efficiency
- ✓ Access to capital
- ✓ Market protection for producers
- ✓ Everyone else is doing it

Profitability metrics are not enhanced by more sales alone



Has consolidation allowed co-ops to achieve purported efficiencies? (Correlations with Assets \$)

- Profit margin 
- Return on sales 
- Return on assets 
- Return on equity 
- Asset Turnover **(-0.17 to -0.21)**
- Operational exp. **(-0.17 to - 0.27)**
- Labor exp. efficiency **(0.19 – 0.26)**
- Members' share of total equity 
- Members' share of local equity **(-0.17 to -0.21)**

Competitive Environment

- Co-ops are price takers
- Significant competition
- Co-ops unable to eliminate redundant assets
- A survey of Iowa landowners shows that approximately 45% of landowners use a co-op to some degree for marketing, custom services, or to purchase inputs; equates to approximately 33% of land (acres).
- Market share of co-ops is falling according to USDA data

What I Hear Farmers Saying

- “The co-op is just another big business.”
- “It’s not my co-op anymore.”
- “I’m not the type of farmer the co-op cares about.”

Consolidation – the act of it – is fundamentally putting at odds members’ values and perceptions with leaderships’ values and perceptions.



The Times They Are A Changin'

Cooperative formation and reformation occurs during periods of:

- *Social and political unrest*
- *Distrust of institutions*
- *Imbalances in market power*
- *Gaps in markets*

Are Cooperatives Relevant?

“A co-operative is an autonomous association of persons united voluntarily to meet their **common economic, social and cultural** needs and aspirations through a jointly owned and democratically-controlled enterprise.”

- *International Cooperative Alliance*







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THANK YOU!