Impacts of Section 199A and Profit Distribution on Representative Corn and Soybean Marketing Cooperative

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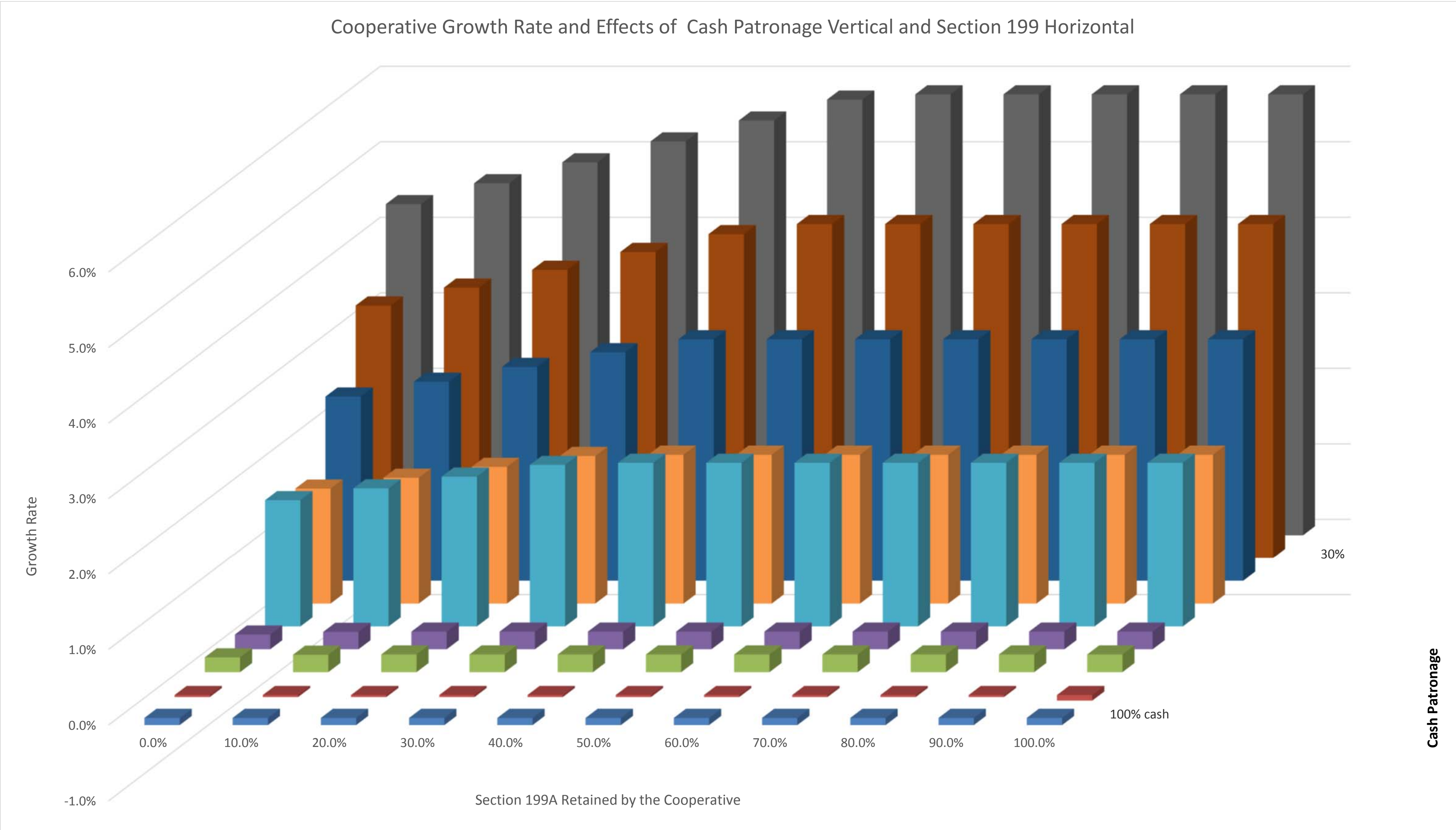
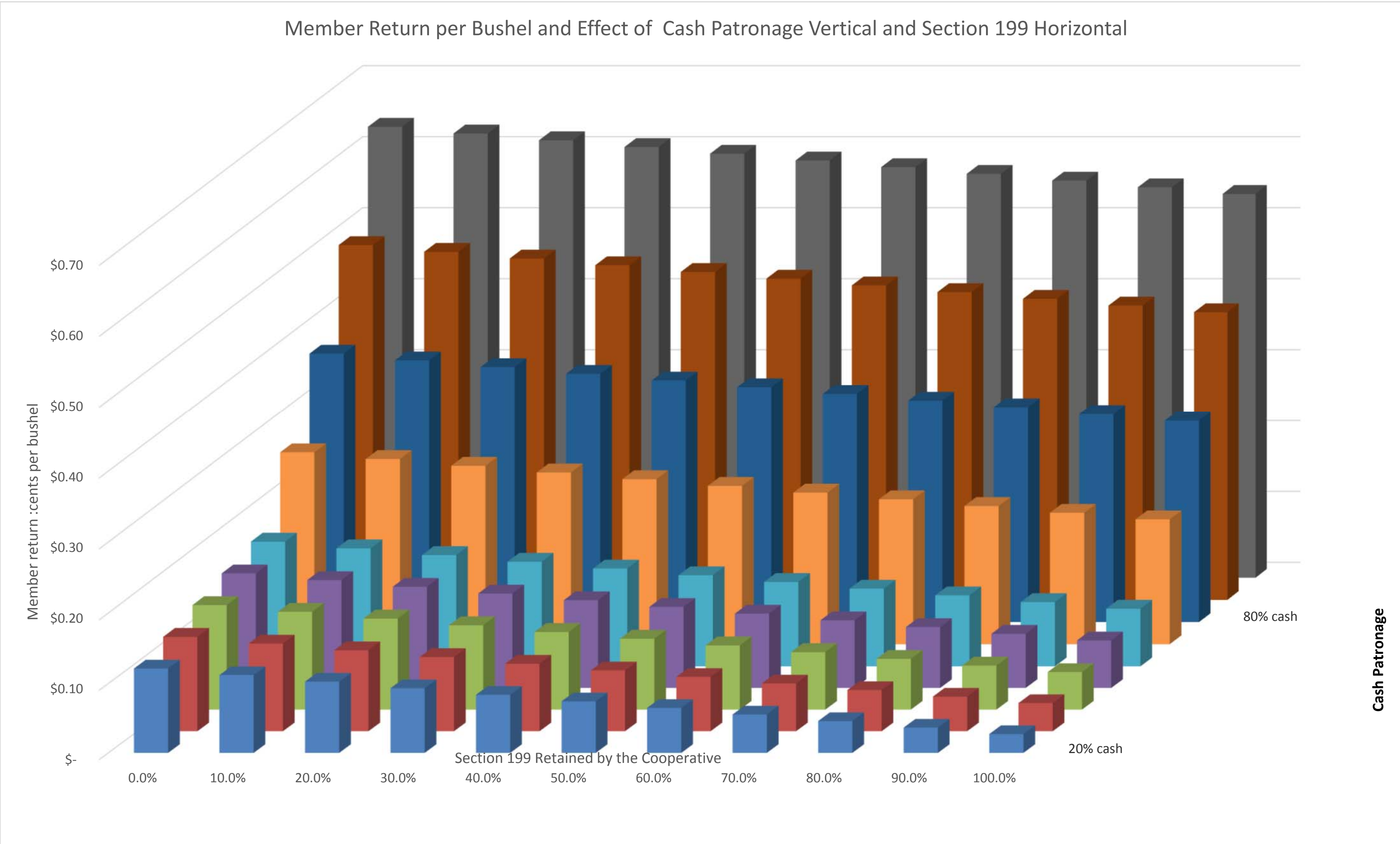
Background and Assumptions

- Representative Corn and Soybean Marketing Cooperative created from information from Co-metrics.
- Price, volume, margin and expense information based on a 7 year time series of financial information from a cooperative determined to be representative. Maintenance, depreciation, insurance and property taxes model as percent of fixed assets and accounts receivable, inventory and regional patronage model as percent of farm supply sales.
- Simulation program developed at Oklahoma State University used to create a 30 year set of pro-forma financial statements with modeling of revolving equity payments.
- The selected cooperative distributed profits as 50% retained earnings, 25% cash and 25% qualified stock and used an age of patron equity program.
- The simulations were focused on various combinations of cash and nonqualified equity. A 20 year age of stock revolving fund was used for the baseline with 10, 15 and 25 year revolving programs also modeled.

More Assumptions and Comments

- The maximum Section 199A credit available to the cooperative was limited to 50% of the W-2 wages associated with the commodities marketed. That was operationalized by adjusting the total personnel expense by the ratio of grain sales to total sales (62%) and the assumption that taxes and benefits were 30% of total personnel expense.
- The cooperative currently has a ratio of allocated equity to total equity of 35%. If the existing profit distribution structure was maintained allocated equity would be less than 25% of total equity within 10 years. At 50% cash and 50% nonqualified the ratio of allocated equity to total equity increases to 48% over that 10 year time period.


Cooperative Growth Rate and Effects of Cash Patronage Vertical and Section 199 Horizontal
Growth Rate
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
-1.0%
0.0%
10.0%
20.0%
30.0%
40.0%
50.0%
60.0%
70.0%
80.0%
90.0%
100.0%
Section 199A Retained by the Cooperative
30%
100% cash
Cash Patronage



Member Return per Bushel and Effect of Cash Patronage Vertical and Section 199 Horizontal
Member return :cents per bushel
$0.70
$0.60
$0.50
$0.40
$0.30
$0.20
$0.10
$-
Section 199 Retained by the Cooperative
0.0%
10.0%
20.0%
30.0%
40.0%
50.0%
60.0%
70.0%
80.0%
90.0%
100.0%
80% cash
20% cash
Cash Patronage

Summary of Patronage and Section 199A Retention Impacts

- At 50% cash patronage the cooperative growth rate increases from 1.5% with 0% Section 199A retained to 2% at 30% Section 199A retained. At that cash patronage level the cooperative gets no benefit from retaining more than 30% of the Section 199A deduction
- Cash patronage has the largest impact on the cooperative's growth rate changing it from 0% at 100% cash to 5.5% at 20% cash. At cash patronage levels above 70% the cooperative has negative growth.
- At 50% cash patronage the member's benefit increases from $.07/bushel when the cooperative retains 100% of the Section 199A to $.16/bushel when the cooperative passes on 100% of the Section 199A deduction
- Cash patronage also has the largest impact on the member's return increasing it from $.03/bushel at 20% cash to $.64/bushel at 100% cash although 100% cash patronage is clearly not feasible

Why nonqualified

- In the representative cooperative at 50% cash and 50% nonqualified equity, annual equity retirements are $.027/bushel and cash patronage is $.098/bushel. Equity retirement payments are 25% of member return. If the cooperative retains profits as unallocated retained earnings they are reducing member return by approximately 25%. Retaining profits as unallocated equity does not make sense.
- At 50% cash patronage and 50% nonqualified equity the member's IRR from the cooperative is 15.8%. At 50% cash and 50% qualified it falls to 9.95%. Retaining profits as qualified equity does not make sense.
- The typical corn and soybean producers needs 36% of the cooperative's Section 199A deduction to be equivalent with a producer marketing through a non cooperative. Even at 20% cash patronage the cooperative only needs to retain 50% of the Section 199A deduction. The representative cooperative can retain sufficient Section 199A to offset the tax effect of non-qualified while still keeping their members equivalent. Retaining profits as nonqualified equity dominates the other alternatives.