

Balance Sheet Goals and Section 199A

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As I have been discussing, Section 199A creates another level of decision for cooperative boards. Before getting lost in the details of retaining or distributing tax credits and profits it is good to examine your overall strategy. On part of that strategy is how much emphasis you place on keeping most members equivalent or better off from a tax standpoint. The second strategy question is whether you want to use any tax savings to push more cash to the producer, or are trying to keep your cash distributions somewhat constant.

That brings up the balance sheet related aspects of your Section 199A strategy. One key question is your goals for total equity. The board needs to decide if the current level of debt to equity is acceptable. If major investment in infrastructure is needed then additional equity must also be generated. The next strategical question is your goal and attitude toward unallocated equity. Cooperatives need a “cushion fund” of unallocated equity (retained earnings) to absorb a possible loss without a stock write down. On the other hand unallocated equity dilutes the principle of “member benefit” since the profits retained as unallocated are never redeemed to the member. Retained earnings also dilutes the principle of “member owner” since the member only has a collective but not an individual ownership of the unallocated retained earnings.

Each board needs to develop a philosophy as to how much unallocated retained earnings is enough and how much is too much. The key is to manage the balance sheet and not let tactical decisions like Section 199A drive the debt/equity ratio or the percentage of allocated equity. All of the moving parts of the cooperative financial model are inter-connected. Non-qualified stock can be part of a strategy to reduce the member’s taxation and at the same time a means to build and retain allocated equity. Once your strategy is in place the tactics become easier to sort out.

The balance sheet is clearly part of the board’s balancing act!