A New Dimension of Member Diversity

Phil Kenkel
Bill Fitzwater Cooperative Chair

Mature cooperatives are always challenged to meet the needs of a diverse membership. Cooperative leaders are used to considering differences in age and time perspective, farm size, services required and even interest in being involved with the cooperative. Tax reform has created another possible area of member heterogeneity and that dimension relates to farm level W-2 wages. Under Section 199A producers, marketing through a cooperative face a tax disadvantage (reduction in a pass through credit that would otherwise be available) and that offset is limited by their farm level W-2 wages. The offset is independent of the amount of Section 199A deduction passed on by the cooperative or the patronage distribution. This creates diversity across the membership as to whether members are advantaged, or disadvantaged relative to producers marketing through non-cooperatives.

Some farm tax advisors have encouraged producers to project their Section 199A situation and consider marketing only a portion of their commodities through a cooperative or do business with the cooperative on a non-patronage basis. I do not know the calculus of that advice but one would think it assumes that potential tax disadvantage is greater than the Section 199A pass through and patronage distribution. All of that creates another dimension of member diversity for the board to consider.

It would appear difficult for the cooperative to create a structure to address the different tax situations. As mentioned producers with higher W-2 wages could limit their patronage transactions with the cooperative. That is a poor solution because those producers, who could be the very large producers that the cooperative is striving to attract and maintain, are not benefiting from the cooperative. A dangerous solution, but one I have heard proposed, is to provide select members the option of more favorable prices in lieu of patronage. That creates a host of problems including the fact that those customers are not building ownership in the cooperative and neither are they sharing risk.

The best solution may be to stick to your knitting and strive for efficiency and profitability. When profits are available retain the necessary portion in a form providing ownership value (allocated equity) and structure the distribution to maximize member benefit (cash and nonqualified revolving equity). The rationale for any producer (regardless of W-2 wage situation) for doing business with the cooperative should be the overall value package. Cooperative leaders just need to insure that they have a package of prices, services, patronage, revolving equity payments and Section 199A pass through that outshines the value package of any non-cooperative firm.

Who says you don’t have a challenge for the new year!