Per Unit Retains and A Look Back at the Grain Glitch

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Per Unit Retains are an amount of equity deducted from a commodity payment based on the units of commodity handled. They differ from retained patronage in that they are based solely on quantity handled and not profits. Per Unit Retains originated in marketing cooperatives operating on a pooling basis. Pooling cooperatives do not purchase the commodities that they market and then pay patronage. Instead, members receive one or more volume based intermediate payments and then, when the pool is closed, the residual is distributed in proportion to volume. There is no clear dividing line between the value represented by the commodity and the value added by the cooperative's marketing and processing activities. The lack of a defined profit in a pooling cooperative prevents them from issuing patronage or creating equity through retained patronage. The payment from the cooperative to the patron is called a Per Unit Retain Paid in Money (PURPIM).

The original Section 199 Domestic Production Activities Deduction was implemented in 2005. It had a dual basis of determination, quailed business income and W-2 wages. Cooperatives were allowed to calculate their qualified business income on their income before patronage, which was logical since cooperatives who allocate all income as patronage do not have taxable income. Since pooling cooperatives did not have patronage, they were allowed to calculate their qualified business income before PURPIM payments. That gave pooling cooperatives a large qualified business income calculation but since the 50% of W-2 wage calculation was typically the binding limit on the DPAD, it made little difference. Other marketing cooperatives, such as grain marketing cooperatives, that had traditionally structured payments as commodity purchases took the lead from the pooling cooperatives and structured payments as PURPIMs.

Now here is where the "Grain Glitch" enters in. In the original Section 199A in the 2017 Tax Cuts and Jobs Act, there was a desire to provide farmers and other non-corporate business with a tax deduction because they did not benefit from the reduction in the corporate tax rate. Farmers received a deduction based on their qualified business income. Because the cooperative can be viewed as an extension of the farm, patronage was added to the definition of qualified business income. That is logical because a farmer storing grain on-farm and gaining $.05/bushel over cost from storage is really no different than a farmer storing grain in a cooperative and receiving the net gain from storage through patronage.

The language of the original Section 199A also added back PURPIMs to the patron's income calculation. This is speculation on my part, but I assume that the individuals drafting the tax code looked back at the DPAD language and, like DPAD, included both patronage and PURPIMs assuming that they were similar concepts. The original Section 199A calculation did not include a secondary limit based on the producer's W-2 wages so the ability to add back PURPIMs drastically increased the producer deduction.

The rest, as they say, is history and led to our current Section 199A with a cooperative level deduction based on the cooperative's qualified business income and W-2 wages and a separately

calculated producer offset based on the producer's qualified income and farm level W-2 wages. It is interesting to see how Per Unit Retains, which was a rather obscure aspect of the cooperative business model, came to generate so much excitement.

Maybe there is hope for obscure college professors!

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