**Some Simple Math on Retaining Profits**

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Sometimes we over complicate things. Cooperative have three choices as to how to retain funds: qualified revolving equity, nonqualified revolving equity and unallocated retained earnings. That choice has nothing to do with the decision on the amount of cash retained. The board should first decide how much cash the cooperative needs. After making that decision, they can decide which method of retaining funds will be most beneficial to the member. When analyzing the choices there are just three elements: the cash payments in the current period and the equity redemption year, the taxes in each year and length of the revolving period.

Once we know the cash payments, tax rates and revolving period we can calculate the present value of the after tax distributions to the member. That sounds complicated but it is not. If the cooperative distributes 50% cash and 50% qualified stock with a 15-year revolving period, the present value of their distribution is $39. That amount comes from the cash the member receives in the current period ($50), minus the taxes they pay in the current period ($35) plus the present value of the $50 they will receive in 15 years ($24, assuming a 5% rate).

With those two simple adjustments, one for taxation and one for timing, we can easily compare profit retention choices. In keeping with our first point, the cash patronage percentage should be adjusted to keep the cooperative's cash flow equivalent across the choices. I have a spreadsheet on my website that makes the conversion for you. At current tax rates, the member's benefit is $39 if profits are retained as qualified equity, $42 if profits are retained as nonqualified equity and $20 if profits are retained as unallocated retained earnings. All of those choices leave the cooperative with exactly $50 in cash. If the cooperative retains part of the Section 199A deduction the present after tax value of the nonqualified distribution jumps to $48.

Those simple numbers help simplify thinking about the choices. Why consider nonqualified revolving equity? Because members might prefer $48 to $39! Why not retain funds as unallocated retained earnings? Because members end up with $20 instead of $48! There may be other rationales for building retained earnings but the effect on member return is easy to see.

If you think your members would prefer qualified revolving patronage, tell them to put $48 in an envelope. I will meet them at your cooperative and trade them for an envelope with $39 in it. I hope you have a lot of members because I will make that trade all day long!

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