Tax Reform and Cash Patronage

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I received an interesting question the other day as to how the Tax Cuts and Jobs Act of 2017 and the accompanying Section 199A provision might affect the cash patronage rates of marketing cooperatives. That led me to think through the tax and cash flow implications. Most marketing cooperatives have a portion of non-member business. The reduction in the corporate tax rate therefore reduces the cooperative's tax payment. If the cooperative's objective were to hold its cash flow constant and maximize the member's immediate benefit, the lower corporate tax rate would allow the cooperative to increase cash patronage slightly. On the other hand, most producers now enjoy a new tax deduction because their farming organization is organized as a pass through entity. If the cooperative's objective is to hold the patron's after tax benefit constant, they could slightly reduce the cash patronage rate, creating more funds for infrastructure investment and equity retirement.

Tax reform could also encourage cooperatives to re-evaluate nonqualified distributions. When distributing nonqualified stock the cooperative can reduce the cash patronage rate and keep its cash flow equivalent. Depending on their tax rate, the member may have an equivalent or even higher after tax cash flow since they are not paying taxes on the stock portion. Cooperatives now face a lower corporate tax rate and many will retain a portion of the Section 199A deduction. That allows for less of an adjustment in cash patronage rates in transitioning to nonqualified stock, while keeping the cooperative's cash flow constant.

It is difficult to determine how tax reform might affect cash patronage rates. On the one hand, the cooperative might be a position to pay out a little higher rate while at the same time one could argue that the member is held harmless at a slightly lower rate. Some cooperatives pay a similar percentage each year and might simply hold the rate constant. Other cooperatives might take this opportunity to transition to nonqualified distributions and after considering their Section 199A retention, adjust cash patronage accordingly.

Tax reform has created some new decisions for marketing cooperatives such as the strategy for Section 199A. It has also created an opportunity to re-evaluate some old decisions like cash patronage rates.

8-20-2018