



Equity Management

Using Non-Qualified Distribution

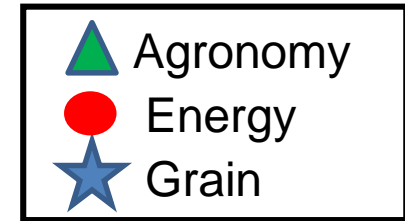
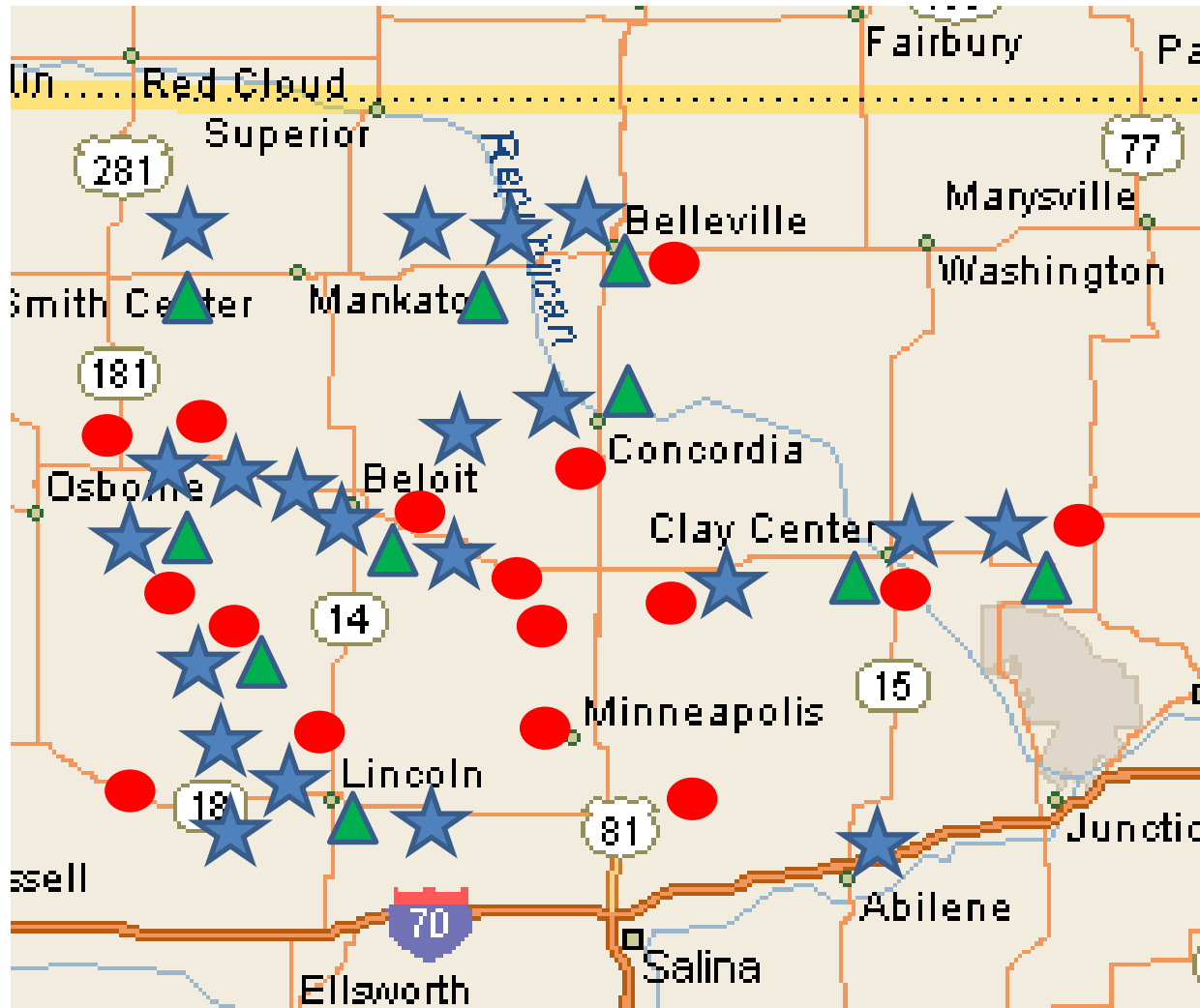


Farmway Co-op, Inc.

- Founded April 7, 1911
- Headquartered in Beloit, Kansas
- 38 locations and 22 fueling sites across 9 Kansas counties
- Three Core Services
 - Grain
 - Agronomy
 - Petroleum Energy
- Sales Average \$535,000,000 to \$570,000,000



Farmway Co-op, Inc.



Joint Partnerships

- 50% Owner of AGMark LLC
- 20% Owner of Concordia Terminal LLC
- Norkan Fertilizer Terminal, Concordia
- Flint Hills Grain Partnership in Abilene

Farmway Co-op, Inc.

- 12 Board Members
- 2 Associate Board Members
- 150 Full-time Employees
- More than 8,000 Members
- 4,462 Voting Members



Distributing Net Income

- Patronage & Non-Patronage Income
 - My Focus will be on Patronage Income

Patronage Income may be distributed as

1. Allocated Patronage Refunds to Patrons
2. Unallocated Retained Earnings.
3. Dividends on Selected Equity Classes
4. Income taxes based on the taxability of the first three choices


Subchapter T of the IRS code

- Specifies Tax Treatment of Patronage Refund Allocations
- May be cash or non-cash(allocated retained)
- May be either “qualified” or “non-qualified”

Qualified Allocations

- Patron agrees to include the entire amount of the distribution in his taxable income for the current fiscal year
- Cooperative can exclude that amount from its taxable income
 - Cash Patronage is qualified and needs to be at least 20% of the total qualified allocation
 - Qualified retained patronage placed in equity account eventually refunded through equity redemption program


Non-qualified Allocation

- Most relevant in discussions about retained patronage distributions
 - Patron does not include the nonqualified distribution in their taxable income
 - Cooperative does not exclude the distributed earnings from its taxable income
 - Nonqualified retained earnings are credited to patron equity accounts
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Farmway Policy on non-qualified retained earnings

- Treated just like qualified retained revolving funds
- Named non-qualified equity paid out
 - Estates
 - Year of allocation
- When equity is redeemed the cooperative receives an income tax deduction
- Patron must include redeemed amount in taxable income

Why deal with Non-qualified?

- Bonus Depreciation
 - Section 199 Domestic Production Activity Deduction (DPAD)
 - Provides tax benefits to cooperatives so taxable income can be created at the cooperative level.
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History

\$00,000 omitted

Fiscal Year	Revolving Equity	Memberships	Unallocated Retained Earnings	Nonqualified Equity
2007	12.1	1	5.3	n/a
2008	12.6	1.1	7.8	n/a
2009	13	1.1	10.8	n/a
2010	17.9	1.2	14.4	n/a
2011	18	1.2	18.7	n/a
2012	17.2	1.2	20.9	5.5
2013	16.5	1.2	21.5	8.3
2014	15.9	1.2	21.9	9.8

2011

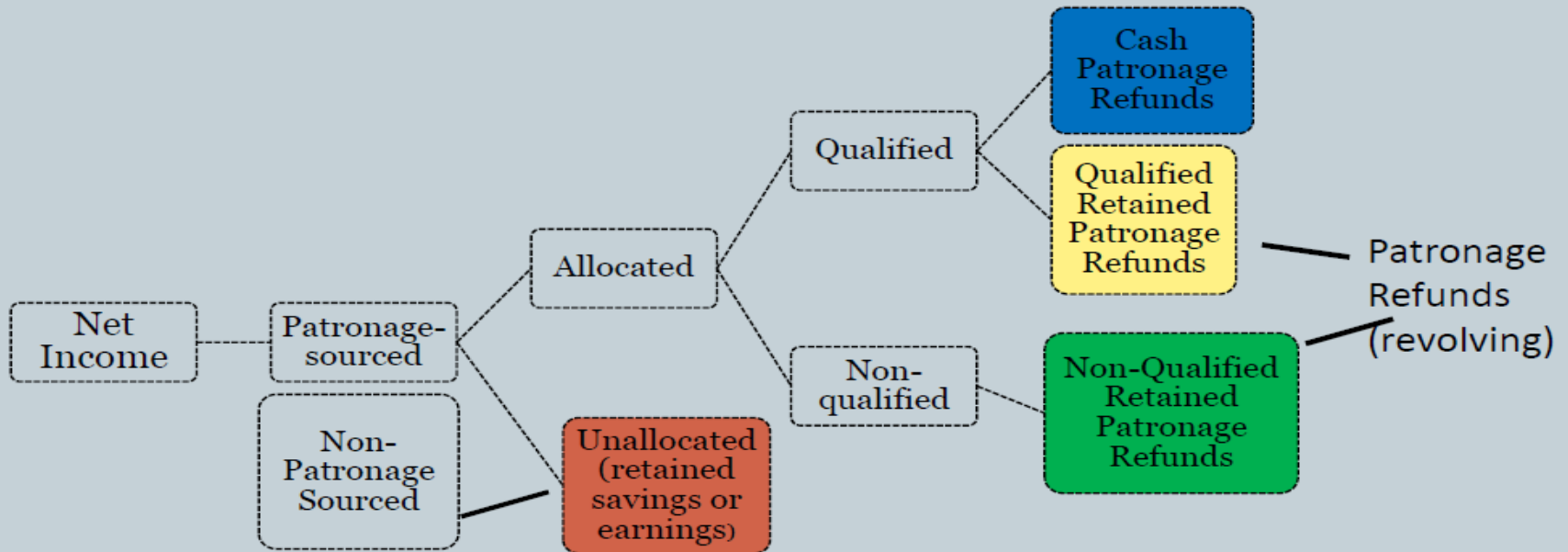
Named Equities(Revolving Fund)	Unallocated Retained Earnings
\$18,038,096	\$18,767,390

Board became concerned about the Unallocated Retained Earnings were more than the Patrons Named Equity



Simplified Representation of Income Distribution Choices in a Cooperative

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Explanation to members

- Letter to producer members
- Newsletter
- Annual meeting
- Cash flow example

Patrons Impact of Nonqualified

\$1000 patronage

Qualified Cash	Qualified Revolving
\$200	\$800
\$350 Tax	
\$(150) cash flow	\$800

\$1000 patronage

Qualified Cash	Nonqualified Retained
\$200	\$800
\$ 70 tax	
\$130 + cash flow	\$800

2014


**Named
Equities(Revolving
Fund & Nonqualified
Retained)**

\$25,833,986

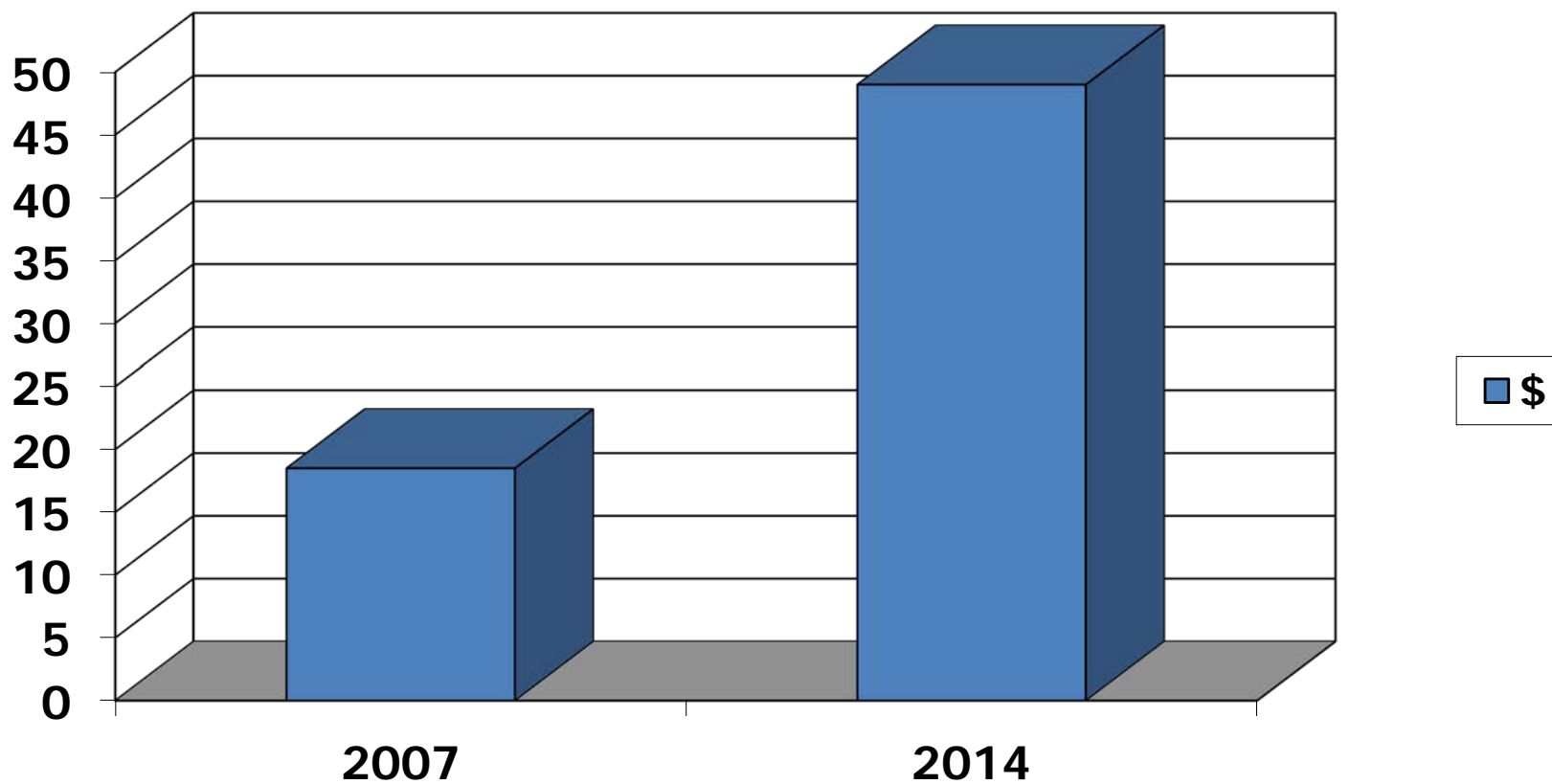
**Unallocated Retained
Earnings**

\$21,922,720

Cooperative Advantages

- Patron Perception
 - Positive cash flow with non-qualified retained earnings
 - Balance Sheet Management
 - Easier to budget profit distribution, equity management, and asset investment because there are no mandatory cash patronage requirements. It provides flexibility in matching equity redemption with budget
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Owners' Equity



Information for this presentation was gleaned from:

- David Barton
 - Professor and Director Emeritus, Arthur Capper Cooperative Center, Kansas State University
 - Michael Boland
 - E. Fred Koller Professor in Agribusiness Management, University of Minnesota
 - Phil Kenkel
 - Bill Fitzwater Cooperative Chair, Oklahoma State University
 - Dennis Gardiner
 - Gardiner Thompson, Certified Public Accountants, Des Moines, Iowa
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