Patronage Dividends Demystified

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The Patronage Dividend

The patronage dividend is the distribution of a percentage of the net income attributed to the purchases by owners in a given fiscal year. This distribution applies to net profits from owner sales only, sometimes called eligible profits. No profit–no dividend. Profits on non-owner sales cannot be distributed to owners and will be taxed.

Patronage refunds, whether distributed or retained, reduce the co-op's tax obligations and keep more money circulating in the local economy. Since the IRS allows the co-op to retain up to 80 percent of the allocation, the retained portion provides a tax-free and interest-free way to capitalize the business.

The amount of the dividend varies from year to year based on how much profit the co-op made from owner purchases and the need to fund any upcoming projects. A patronage dividend distribution is not guaranteed—the store has to make a profit. The decision determining how much of that net owner income to allocate as dividend and distribute to owners is made by the cooperative's board of directors.

The more you shop and the more all owners shop, increases the net profit from owner sales and more is distributed to the ownership. All owners get the same percentage. The percentage the Co-op holds back (retains) from distribution stays in the Co-op.

The patronage distribution is a refund, a return on a percentage of your patronage – a patronage dividend – not a return on an owner's equity investment. Co-op ownership will not fund your retirement. It is an investment in Co-op ownership and all things cooperative.

How The Patronage Dividend Is Determined

How much of the eligible profits should be allocated?

> The board, with input from accountant services and the Finance Committee, determine the percentage of eligible profit that will be allocated to patronage dividends. To ensure adequate reserve and to minimize tax obligations, eligible profits are usually allocated to patronage and unless there is a compelling reason not to, it is recommended that 100% of those eligible profits be allocated. The board allocated 100% of eligible profits for patronage dividends for the Fiscal Year Ending September 30, 2014.

What percentage of the allocated profits will be distributed?

> The board then determines the percentage of patronage dividend that will be distributed to ownership. The minimum amount of distribution, required by IRS is 20%. The distribution percentage could depend on cash needs, capital investment needs, balance sheet strength, fair return to owners, owners needs and expectations, and building capital. The board determined to distribute 30% of dividend to ownership for FY2014.

What is the method of distribution?

The board also determines the method of distribution In our case, the dividend is returned to the ownership in the form of a gift card which can be exchanged for a cash payment, used to purchase product, or be given back to the store for equity assistance and capital improvements. Determination of the minimum amount of funds that will be distributed.

Most cooperatives apply a minimum dividend amount that they will process based on costs of labor, materials and postage. For instance, anyone who would receive under $2 could be cut out of further processing. This does mean that the cooperative will pay tax on those earnings of owners who would have received under $2. For FY2014 the board determined that any distribution less than $2 will not be distributed and the related profits not allocated.

Patronage Dividend Primer (produced by Cooperative Grocer and the CDS Consulting Co-op)