



MDK: King

NOTE

2003 BILL

Fri
4/11
am.

Patron. Cap.

1 AN ACT relating to: retained earnings of telecommunications cooperatives.

Analysis by the Legislative Reference Bureau

Under current law, a telecommunications utility may subsidize activities that are not subject to regulation by the Public Service Commission (PSC) only with the telecommunications utility's retained earnings. For a telecommunications utility that is a telecommunications cooperative, the PSC has determined that "retained earnings" do not include the patronage capital of the telecommunications cooperative. The effective date of this determination is January 1, 2003. Patronage capital is generally understood to mean the profits of a cooperative.

This bill reverses the PSC's determination. Under this bill, the retained earnings of a telecommunications cooperative include its patronage capital. In addition, the bill specifies that retained earnings include patronage capital whether or not it is allocated to cooperative members, and regardless of its source or the manner in which it is classified in the financial statements of the cooperative.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

2 SECTION 1. 196.204 (1) of the statutes is renumbered 196.204 (1) (a).

3 SECTION 2. 196.204 (1) (b) of the statutes is created to read:

4 196.204 (1) (b) For purposes of par. (a), the retained earnings of a

5 telecommunications cooperative include the patronage capital of the

BILL

SECTION 2

1 telecommunications cooperative, whether or not the patronage capital is allocated
2 to members of the telecommunications cooperative, regardless of the source of the
3 patronage capital and regardless of the manner in which the patronage capital is
4 classified in the financial statements of the telecommunications cooperative.

5 **SECTION 3. Effective date.**

6 (1) This act takes effect retroactively to January 1, 2003. ✓

7 (END)

DRAFTER'S NOTE
FROM THE
LEGISLATIVE REFERENCE BUREAU

LRB-1464/1dn

MDK: *King*

Representative Freese:

Please review this bill to make sure that it achieves your intent. In particular, please note the following:

1. Is the analysis okay? I do not have an accounting or financial background, and I wonder whether I have described patronage capital adequately.
2. The bill is retroactively effective in order to completely negate the PSC's determination. Under this approach, it isn't necessary to specify that retained earnings include patronage capital regardless of when it is received.

Mark D. Kunkel
Senior Legislative Attorney
Phone: (608) 266-0131
E-mail: mark.kunkel@legis.state.wi.us

**DRAFTER'S NOTE
FROM THE
LEGISLATIVE REFERENCE BUREAU**

LRB-1464/1dn
MDK:kmg:rs

April 10, 2003

Representative Freese:

Please review this bill to make sure that it achieves your intent. In particular, please note the following:

1. Is the analysis okay? I do not have an accounting or financial background, and I wonder whether I have described patronage capital adequately.
2. The bill is retroactively effective in order to completely negate the PSC's determination. Under this approach, it isn't necessary to specify that retained earnings include patronage capital regardless of when it is received.

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Suggested changes in the LRB Analysis of LRB-1464/1dn

[1. Suggested changes in redlined style.]

Under current law, a telecommunications utility may subsidize non-utility ~~the~~ activities ~~that are not subject to regulation by the Public Service Commission (PSC)~~ only with the telecommunications utility's retained earnings. In 2002 the Public Service Commission determined that this provision does not apply to a telecommunication utility that is a cooperative. For a ~~telecommunications utility that is a cooperative,~~ the PSC has determined interpreted the law to mean that "retained earnings" do not include the patronage capital of the ~~telecommunications cooperative.~~ The effective date of ~~this determination-~~ this PSC decision is January 1, 2003. Patronage capital is generally understood to mean the profits revenues of a cooperative in excess of its costs, which by law are allocated and later paid to members as refunds. Cooperative revenues not derived from members are not required to be allocated to members.

This bill reverses the PSC's ~~determination,~~ decision regarding retained earnings of telecommunications cooperatives in order to restore PSC accounting procedures followed prior to 2003. Under this bill, the retained earnings of a telecommunications cooperative include its patronage capital. In addition the The bill specifies that retained earnings include patronage capital whether or not it is allocated to cooperative members, and regardless of its source or the manner in which it is classified in the financial statements of the cooperative.

[2. Revised, without redlined changes.]

Under current law, a telecommunications utility may subsidize non-utility activities only with the telecommunications utilities retained earnings. In 2002 the Public Service Commission determined that this provision does not apply to a telecommunications utility that is a cooperative. For a cooperative, the PSC interpreted the law to mean that retained earnings do not include the patronage capital of the cooperative. The effective date of this PSC decision is January 1, 2003. Patronage capital is generally understood to mean revenues of a cooperative in excess of its costs, which by law are allocated and later paid to members as refunds. Cooperative revenues not derived from members need not be allocated to members.

This bill reverses the PSC's decision regarding retained earnings of telecommunications cooperatives in order to restore PSC accounting procedures followed prior to 2003. Under this bill, the retained earnings of a telecommunications cooperative include its patronage capital. The bill specifies that retained earnings include patronage capital whether or not it is allocated to cooperative members, and regardless of its source or the manner in which it is classified in the financial statements of the cooperative.

0.9. cell. services

not collect

GLC don't have retained earnings

ch. 185.45

for purposes of 196.204

For the purposes of 196.204 accounted PC treated the same as RE and

treated to patronage capital same as RE of a Corp

decisions RE doesn't fit PC

new accounting category removed from RE into

Kunkel, Mark

From: Warren Day [warren.day@wfcmac.coop]
Sent: Wednesday, April 23, 2003 2:27 PM
To: mark.kunkel@legis.state.wi.us; ruthann.nelson@wfcmac.coop
Subject: Friese's PSC bill

Mark, thanks again for your time this morning. Here are some citations to law regarding non-member sourced income to the cooperative. Recall that in your analysis, you stated that "patronage capital is generally understood to mean..." I feel it is important to clarify that the co-op literally does not have profits - and to further state that some of the excess revenues may not be allocated and paid out (until ultimate liquidation.) The co-op can elect to allocate, however. See s.185.45(4)(a). (Non-member sourced income comes from sources like rents from non-utility subsidiaries, rents form real property, interest, dividends, royalties, gains from the sale of non-utility property.)

For some authority on this, see 26 IRC 1382 (c)(2)(A) (Internal Revenue Code) which refers to non-patronage sources. That part is cross-referenced in s.1385(a)(2). Section 1382 defines what "income" of the co-op is exempt from tax when allocated and "paid" to members. Another reference is in s. 1388(a)(3)(A) of the code, which defines patronage, and the manner in which members are notified and assigned the income by the cooperative.

There is also the reference to the concept of non-patronage revenue in Wis Stat. 185.45(4)(a) which permits the co-op board of directors to determine what portion of net proceeds may be credited to "unallocated surplus".

Mark, regarding the "accounting procedures" reference in the analysis: Would it work to say in the first paragraph that the "PSC stipulated new accounting procedures (only) for telecommunications cooperatives that has the effect of removing patronage capital from retained earnings for the purposes of 196.204" This is awkward, but is an accurate description of the PSC order that took effect on January 1. Thanks.
Warren Day

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value at time of issuance are not taxable to cash-basis member when received where decision to retain funds in the business rested solely with the directors. *Car-penter v Commissioner* (1953) 20 TC 603, aff'd (1955, CA5 Fla) 219 F2d 635, 55-1 USTC ¶ 9259, 46 AFTR 1743 and acq.

"Retain" or revolving fund certificates issued by tax exempt cooperative to patrons are not taxable un-

less they have fair market value; certificates redeem-able and transferable only at discretion of directors, whose policy was to sharply limit transfers and who had not redeemed a certificate issued after 1943, had no ascertainable fair market value. *Howey v Commis-sioner* (1954) TC Memo 1954-19, RIA TC Memo ¶ 54125, 13 CCH TCM 399.

[§ 1386, 1387. Reserved for future use.]

PART III. DEFINITIONS; SPECIAL RULES

Sec.

1388. Definitions; special rules.

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Amendments:

In 1962, P.L. 87-834, added Part III and item 1388.

§ 1388. Definitions; special rules.

(a) **Patronage dividend.** For purposes of this subchapter, the term "patronage dividend" means an amount paid to a patron by an organization to which part I of this subchapter applies—

- (1) on the basis of quantity or value of business done with or for such patron,
- (2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and
- (3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

Such term does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions.

(b) **Written notice of allocation.** For purposes of this subchapter, the term "written notice of allocation" means any capital stock, revolving fund certificate, retain certificate, certificate of indebtedness, letter of advice, or other written notice, which discloses to the recipient the stated dollar amount allocated to him by the organization and the portion thereof, if any, which constitutes a patronage dividend.

(c) **Qualified written notice of allocation.** (1) **Defined.** For purposes of this subchapter, the term "qualified written notice of allocation" means—

(A) a written notice of allocation which may be redeemed in cash at its stated dollar amount at any time within a period beginning on the date such written notice of allocation is paid and ending not earlier than 90 days from such date, but only if the distributee receives written notice of the right of redemption at the time he receives such written notice of allocation; and

(B) a written notice of allocation which the distributee has consented, in the manner provided in paragraph (2), to take into account at its stated dollar amount as provided in section 1385(a).

Such term does not include any written notice of allocation which is paid as part of a patronage dividend or as part of a payment described in section 1382(c)(2)(A), unless 20 percent or more of the amount of such patronage dividend, or such payment, is paid in money or by qualified check.

(2) **Manner of obtaining consent.** A distributee shall consent to take a written notice of allocation into account as provided in paragraph (1)(B) only by—

(A) making such consent in writing,

(B) obtaining or retaining membership in the organization after—

(i) such organization has adopted (after October 16, 1962) a bylaw providing that membership in the organization constitutes such consent, and

(ii) he has received a written notification and copy of such bylaw, or

(C) if neither subparagraph (A) nor (B) applies, endorsing and cashing a qualified check, paid as a part of the patronage dividend or payment of which such written notice of allocation is also a part, on or before the 90th day after the close of the payment period for the taxable year of the organization for which such patronage dividend or payment is paid.

(3) **Period for which consent is effective.** (A) General rule. Except as provided in subparagraph (B)—

nonqualified per-unit retain certificates, as defined in section 1388(i) with respect to marketing occurring during such taxable year; or

(4) in money or other property (except per-unit retain certificates) in redemption of a nonqualified per-unit retain certificate which was paid as a per-unit retain allocation during the payment period for the taxable year during which the marketing occurred.

For purposes of this title, any amount not taken into account under the preceding sentence shall, in the case of an amount described in paragraph (1) or (2), be treated in the same manner as item of gross income and as a deduction therefrom, and in the case of an amount described in paragraph (3) or (4), be treated as a deduction in arriving at gross income.

(c) **Deduction for nonpatronage distributions, etc.** In determining the taxable income of an organization described in section 1381(a)(1), there shall be allowed as a deduction (in addition to other deductions allowable under this chapter)—

- (1) amounts paid during the taxable year as dividends on its capital stock; and
- (2) amounts paid during the payment period for the taxable year—

(A) in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation) on a patronage basis to patrons with respect to its earnings during such taxable year which are derived from business done for the United States or any of its agencies or from sources other than patronage, or

(B) in money or other property (except written notices of allocation) in redemption of a nonqualified written notice of allocation which was paid, during the payment period for the taxable year during which the earnings were derived, on a patronage basis to a patron with respect to earnings derived from business or sources described in subparagraph (A).

(d) **Payment period for each taxable year.** For purposes of subsections (b) and (c)(2), the payment period for any taxable year is the period beginning with the first day of such taxable year and ending with the fifteenth day of the ninth month following the close of such year. For purposes of subsections (b)(1) and (c)(2)(A), a qualified check issued during the payment period shall be treated as an amount paid in money during such period if endorsed and cashed on or before the 90th day after the close of such period.

(e) **Products marketed under pooling arrangements.** For purposes of subsection (b), in the case of a pooling arrangement for the marketing of products—

- (1) the patronage shall (to the extent provided in regulations prescribed by the Secretary) be treated as patronage occurring during the taxable year in which the pool closes, and
- (2) the marketing of products shall be treated as occurring during any of the taxable years in which the pool is open.

(f) **Treatment of earnings received after patronage occurred.** If any portion of the earnings from business done with or for patrons is includible in the organization's gross income for a taxable year after the taxable year during which the patronage occurred, then for purposes of applying paragraphs (1) and (2) of subsection (b) to such portion the patronage shall, to the extent provided in regulations prescribed by the Secretary, be considered to have occurred during the taxable year of the organization during which such earnings are includible in gross income.

(g) **Use of completed crop pool method of accounting. (1) In general.** An organization described in section 1381(a) which is engaged in pooling arrangements for the marketing of products may compute its taxable income with respect to any pool opened prior to March 1, 1978, under the completed crop pool method of accounting if—

(A) the organization has computed its taxable income under such method for the 10 taxable years ending with its first taxable year beginning after December 31, 1976, and

(B) with respect to the pool, the organization has entered into an agreement with the United States or any of its agencies which includes provisions to the effect that—

(i) the United States or such agency shall provide a loan to the organization with the products comprising the pool serving as collateral for such loan,

(ii) the organization shall use an amount equal to the proceeds of such loan to make price support advances to eligible producers (as determined by the United States or such agency), to defray costs of handling, processing, and storing such products, or to pay all or part of any administrative costs associated with the price support program,

(iii) an amount equal to the net proceeds (as determined under such agreement) from the sale or exchange of the products in the pool shall be used to repay such loan until such loan is repaid in full (or all the products in the pool are disposed of), and

(iv) the net gains (as determined under such agreement) from the sale or exchange of such products shall be distributed to eligible producers, except to the extent that the United States or such agency permits otherwise.

(2) **Completed crop pool method of accounting defined.** For purposes of this subsection, the term "completed crop pool method of accounting" means a method of accounting under which gain or loss is computed separately for each crop year pool in the year in which the last of the products in the pool are disposed of.

- (1) the tax for the taxable year computed with such deduction; or
 (2) an amount equal to—
 (A) the tax for the taxable year computed without such deduction, minus
 (B) the decrease in tax under this chapter for any prior taxable year (or years) which would result solely from treating such nonqualified written notices of allocation or nonqualified per-unit retain certificates as qualified written notices of allocation or qualified per-unit retain certificates (as the case may be).
- (b) **Special rules.** (1) If the decrease in tax ascertained under subsection (a)(2)(B) exceeds the tax for the taxable year (computed without the deduction described in subsection (a)) such excess shall be considered to be a payment of tax on the last day prescribed by law for the payment of tax for the taxable year, and shall be refunded or credited in the same manner as if it were an overpayment for such taxable year.
- (2) For purposes of determining the decrease in tax under subsection (a)(2)(B), the stated dollar amount of any nonqualified written notice of allocation or nonqualified per-unit retain certificate which is to be treated under such subsection as a qualified written notice of allocation or qualified per-unit retain certificate (as the case may be) shall be the amount paid in redemption of such written notice of allocation or per-unit retain certificate which is allowable as a deduction under section 1382(b)(2) or (4), or (c)(2)(B) for the taxable year.
- (3) If the tax imposed by this chapter for the taxable year is the amount determined under subsection (a)(2), then the deduction described in subsection (a) shall not be taken into account for any purpose of this subtitle other than for purposes of this section.

HISTORY; ANCILLARY LAWS AND DIRECTIVES**Amendments:**

In 1966, P.L. 89-809, Sec. 211(a), included per-unit retain certificates in the heading of Sec. 1383 and subsecs. (a) and (b)(2). . . . reference to 1382(b)(4) was added in subsecs. (a) and (b)(2), effective for per-unit retain allocations made during tax. yrs. of an organization described in Code Sec. beginning after 4/30/66, with respect to products delivered during such years. See note at end of Code Sec. 1382.

In 1962, P.L. 87-834, Sec. 17, added Code Sec. 1383, effective as provided in Sec. 17(c) of this Act, reproduced in note following Code Sec. 1381.

CROSS REFERENCES

Taxation of farmers' cooperatives, 26 USCS § 521.
 Returns regarding patronage dividends, 26 USCS § 6044.

RESEARCH GUIDE**Am Jur:**

34 Am Jur 2d, Federal Taxation (2002) § 20184.

[§ 1384. Reserved for future use.]

PART II. TAX TREATMENT BY PATRONS OF PATRONAGE DIVIDENDS AND PER-UNIT RETAIN ALLOCATIONS

Sec.

1385. Amounts includible in patron's gross income.

HISTORY; ANCILLARY LAWS AND DIRECTIVES**Amendments:**

In 1966, P.L. 89-809, added to Part II "and per-unit retain allocations".

In 1962, P.L. 87-834, added Part II and item 1385.

§ 1385. Amounts includible in patron's gross income.

(a) **General rule.** Except as otherwise provided in subsection (b), each person shall include in gross income—

- (1) the amount of any patronage dividend which is paid in money, a qualified written notice of allocation, or other property (except a nonqualified written notice of allocation), and which is received by him during the taxable year from an organization described in section 1381(a),
- (2) any amount, described in section 1382(c)(2)(A) (relating to certain nonpatronage distributions by tax-exempt farmers' cooperatives), which is paid in money, a qualified written notice of allocation, or other property (except a nonqualified written notice of allocation), and which is received by him during the taxable year from an organization described in section 1381(a)(1), and

Kunkel, Mark

From: Warren Day [warren.day@wfcmac.coop]
Sent: Monday, April 28, 2003 9:43 AM
To: Kunkel, Mark
Subject: Re: Analysis

Mark, this version looks just fine. Thank you. I assume you can/will go ahead and jacket for Rep. Freese. Thanks again. Warren Day

Kunkel, Mark wrote:

> Here is a new version of the analysis that eliminates "nonprofit".

>

> Under current law, a telecommunications utility is allowed to subsidize nonutility activities only with the telecommunications utility's retained earnings. Before 2003, the Public Service Commission (PSC) required a telecommunications utility that is a cooperative to follow accounting procedures that, for purposes of this law, treated the cooperative's patronage capital in the same manner as the retained earnings of other telecommunications utilities. Patronage capital is generally understood to mean the revenues of a cooperative that exceed its costs. In a decision effective January 1, 2003, the PSC interpreted the meaning of "retained earnings" for purposes of this law so that it does not include the patronage capital of a cooperative.

>

> This bill reverses the PSC's decision and, as a result, restores the accounting procedures that were in effect before 2003. Under the bill, the retained earnings of a telecommunications utility that is a cooperative include its patronage capital. The bill specifies that retained earnings include patronage capital whether or not it is allocated to cooperative members, and regardless of its source or the manner in which it is classified in the financial statements of the cooperative.

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Tomorrow
4/2 9 AM

O-note

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been
per n

2003 BILL

INSERT A

1 **AN ACT to renumber 196.204 (1); and to create 196.204 (1) (b) of the statutes;**
2 **relating to: retained earnings of telecommunications cooperatives.**

Analysis by the Legislative Reference Bureau

Under current law, a telecommunications utility may subsidize activities that are not subject to regulation by the Public Service Commission (PSC) only with the telecommunications utility's retained earnings. For a telecommunications utility that is a telecommunications cooperative, the PSC has determined that "retained earnings" do not include the patronage capital of the telecommunications cooperative. The effective date of this determination is January 1, 2003. Patronage capital is generally understood to mean the profits of a cooperative.

This bill reverses the PSC's determination. Under this bill, the retained earnings of a telecommunications cooperative include its patronage capital. In addition, the bill specifies that retained earnings include patronage capital whether or not it is allocated to cooperative members, and regardless of its source or the manner in which it is classified in the financial statements of the cooperative.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

3 **SECTION 1.** 196.204 (1) of the statutes is renumbered 196.204 (1) (a).

4 **SECTION 2.** 196.204 (1) (b) of the statutes is created to read:

2003-2004 DRAFTING INSERT
FROM THE
LEGISLATIVE REFERENCE BUREAU

LRB-1464/2ins
MDK:.....

1

INSERT A:

Under current law, a telecommunications utility is allowed to subsidize nonutility activities only with the telecommunications utility's retained earnings. Before 2003, the Public Service Commission (PSC) required a telecommunications utility that is a cooperative to follow accounting procedures that, for purposes of this law, treated the cooperative's patronage capital in the same manner as the retained earnings of other telecommunications utilities. Patronage capital is generally understood to mean the revenues of a cooperative that exceed its costs. In a decision effective January 1, 2003, the PSC interpreted the meaning of "retained earnings" for purposes of this law so that ~~it does~~ not include the patronage capital of a cooperative.

This bill reverses the PSC's decision and, as a result, restores the accounting procedures that were in effect before 2003. Under the bill, the retained earnings of a telecommunications utility that is a cooperative include its patronage capital. The bill specifies that retained earnings include patronage capital whether or not it is allocated to cooperative members, and regardless of its source or the manner in which it is classified in the financial statements of the cooperative.

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here

**DRAFTER'S NOTE
FROM THE
LEGISLATIVE REFERENCE BUREAU**

LRB-1464/2dn

MDK: j....

kmj

Representative Freese:

This version of the bill is identical to the previous version, except that the analysis is revised.

Mark D. Kunkel
Senior Legislative Attorney
Phone: (608) 266-0131
E-mail: mark.kunkel@legis.state.wi.us

**DRAFTER'S NOTE
FROM THE
LEGISLATIVE REFERENCE BUREAU**

LRB-1464/2dn
MDK:kmg:pg

April 28, 2003

Representative Freese:

This version of the bill is identical to the previous version, except that the analysis is revised.

Mark D. Kunkel
Senior Legislative Attorney
Phone: (608) 266-0131
E-mail: mark.kunkel@legis.state.wi.us

Emery, Lynn

From: Richard, Rob
Sent: Friday, August 15, 2003 2:07 PM
To: LRB.Legal
Subject: Draft review: LRB 03-1464/2 Topic: Retained earnings of telephone cooperatives

It has been requested by <Richard, Rob> that the following draft be jacketed for the ASSEMBLY:

Draft review: LRB 03-1464/2 Topic: Retained earnings of telephone cooperatives