

# SECTION 199A FAQs – APRIL 2018

Cooperatives and their members have many questions regarding the newly amended Section 199A of the tax code. The following FAQs address some of the issues that have been raised. As always, please consult your CPA or other tax advisor when implementing this new provision.

## Q: What is Section 199A?

A: Section 199A is a tax deduction that was included in the tax reform bill enacted in late December. Due to concerns that the provision would cause market disruptions, Section 199A has been amended with respect to transactions with cooperatives. The changes are retroactive to January 1.

## Q: What does Section 199A do?

A: Section 199A has two purposes:

1. It provides a 20% tax deduction for all forms of businesses except C corporations. Because (most) C corporations received a 40% rate cut – from a top rate of 35% to a top rate of 21%, Congress recognized that other forms of business should receive tax relief. The 199A deduction applies to sole proprietorships, partnerships, S corporations, LLCs, etc.
2. It provides a replacement for prior-law Section 199 for cooperatives and their members.

## Q: How does Section 199A apply to farmer cooperatives?

A: The calculation is the same as it was under prior-law Section 199 – it is 9% of the co-op's qualified production activities income (QPAI). The deduction is limited to 50% of the co-op's wages for the year that are allocable to domestic production gross receipts and may not exceed the co-op's taxable income for the year. The co-op may choose to keep all or part of the deduction at the co-op level to offset tax liabilities; the remainder may be passed through to members.

## Q: How does the Section 199A deduction work for members of farmer cooperatives?

A: Farmers who transact with a cooperative on a patronage basis will calculate their 20% deduction on income from business conducted with the co-op, and will then perform the following calculation:

Reduce the 20% deduction by the *lesser of*

- (1) 9% of qualified production activities income allocable to such sales, *or*
- (2) 50% of wages allocable to such sales.

A farmer's Section 199A deduction will then equal the Section 199A deduction passed through to him or her by the cooperative plus the modified 20% deduction.

## Q: Why is there a modification for farmers who do business with the cooperative?

A: The goal of Section 199A is to replicate prior-law section 199. Under "old" 199, the farmer would forego calculating his own 199 based on his on-farm wages, in exchange for using the co-op's calculation and the possibility that the co-op would pass through its deduction. The reduction duplicates that dynamic in order to maintain the competitive balance that existed before tax reform.

## Q: Could a farmer receive less than a 20% deduction when transacting with a cooperative?

A: Yes, if the cooperative has a low wage base relative to that of the patron or if the cooperative chooses to retain the deduction, the farmer's total deduction may be less than 20%. Again, this reflects the dynamic in effect under old law Section 199.

**Q: Could a co-op member receive a deduction in excess of 20%?**

**A:** Yes, depending on how much deduction the cooperative passes through to its members. For example, a farmer with no wages (and joint taxable income less than \$315,000) will receive a full 20% deduction on net income from sales to the cooperative, plus whatever deduction is passed through from the cooperative.

**Q: Does the definition of “qualified business income” include crop payments (Per-Unit Retains Paid in Money).**

**A:** Yes. PURPIMs were included under prior-law Section 199 and the IRS issued dozens of letter rulings affirming that treatment. The relevant language in Section 199A is identical to Section 199 and the [Technical Explanation](#) makes clear that any new regulations should be based on the Section 199 regulations.

**Q: How is the provision of supplies treated under Section 199A?**

**A:** The new law incorporates Section 199 Treasury regulations regarding supplies – namely, the definition of “agricultural or horticultural products” eligible for the deduction includes fertilizer, diesel fuel, and other supplies and products with respect to which the cooperative performs storage, handling, or other activities (see Reg. Sections 1.199-3(e)(1) and 1.199-6(f)).

**Q: What if a farmer delivers product to a cooperative, but is not entitled to share in patronage dividends and is not otherwise entitled to participate on a patronage basis?**

**A:** The farmer will receive the 20% deduction under Section 199A, but will not apply the reduction outlined above and will not be eligible for a pass-through deduction from the cooperative.

**Q: What if a farmer’s operation is a C corporation?**

**A:** C corporations are not eligible for any deduction under Section 199A. Lawmakers wanted to ensure that C corporations receive only the new, lower corporate rate, and not the additional 199A deduction. We are aware that some C corporation farms were taxed at 18% under prior law and are now taxed at 21%. [Click here for a checklist for producers considering ownership restructuring in light of this restriction.](#)

**Q: What about Section 199 deductions generated in tax years beginning before the enactment of Section 199A?**

**A:** A transition rule provides that Section 199 deductions attributable to taxable years beginning before January 1, 2018, may be utilized by taxpayers. The Technical Explanation specifies:

The proposal clarifies that the repeal of section 199 for taxable years beginning after December 31, 2017, does not apply to a qualified payment received by a patron from a specified agricultural or horticultural cooperative in a taxable year beginning after December 31, 2017, to the extent such qualified payment is attributable to qualified production activities income with respect to which a deduction is allowable to the cooperative under former section 199 for a taxable year of the cooperative beginning before January 1, 2018.

**Q: Where can I get more information on Section 199A?**

**A:** Consult your CPA or tax advisor for advice on your particular tax situation. In addition, the Joint Committee on Taxation issued a [Technical Explanation](#) of the bill and included over twenty pages on Section 199A.

**This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors for advice on calculating the individual or cooperative-level Section 199A deduction.**