

# AGRICULTURAL PRODUCERS TO MARKET THROUGH COOPERATIVES

*Agricultural Alert*  
February 21, 2018

The Tax Cuts and Jobs Act, signed into law on December 22, 2017, should provide powerful new tax benefits for many agricultural businesses in 2018. Farm operations organized as C corporations, whose 2017 earnings were taxed at federal rates as high as 35 percent, will now be subject to a new 21 percent corporate rate. Passthroughs (S corporations, LLCs, partnerships, and sole proprietorships) previously taxed at federal rates of up to 39.6 percent, are now subject to a top rate of 37 percent. Some passthroughs will also be entitled to a business income deduction of up to 20 percent, reducing their effective federal rate to as low as 29.6 percent.

As the following will explain, producers organized as passthroughs, who market through cooperatives, may benefit even more from the business income deduction.

New Code section 199A generally entitles certain passthroughs to take a deduction of up to 20 percent of net business income. Ultimately, Congress intended the new passthrough business income deduction under Code section 199A to be a similar, but more broadly applicable, replacement for the Domestic Productions Activity Deduction (“DPAD”).

Under the old DPAD, passthroughs were generally entitled to a deduction equal to a percentage of net business income. More specifically, that deduction was equal to nine percent of a net figure: qualified domestic production gross receipts, less cost of goods sold and other directly related expenses.

The passthrough deduction under new Code section 199A is computed in a similar fashion. The new deduction is roughly up to 20 percent of qualified business income (“QBI”), or “the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer.”

A new 199A provision entitles producers to take a much larger deduction by marketing through *cooperatives*—a deduction equal to 20 percent of gross sales. Under new Code section 199A, passthroughs are entitled to take a deduction equal to 20 percent of qualified cooperative dividend income (“QCDI”). The definition of QCDI includes per unit retains paid in money from cooperatives. Per unit retains, however, are *gross* payments cooperatives make to member producers. Thus, the new statute entitles producers to a much larger deduction equal to 20 percent of *gross* income sourced through cooperatives.

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To illustrate the difference: suppose a producer (single, taxed as a sole proprietorship) anticipates generating \$300,000 in gross grain sales in 2018. After incurring \$200,000 of farm expenses, he will earn \$100,000 of net income. If the producer markets his grain through an independent elevator, then under section 199A, he should have \$100,000 of QBI and be entitled to a deduction equal to 20 percent of that amount, \$20,000, producing net taxable income of \$80,000.

Alternatively, if that same farmer markets his grain through a cooperative, the farmer will generate \$300,000 in per unit retains. Under section 199A, he should have \$300,000 of QCDI and be entitled to a deduction equal to 20 percent of QCDI instead—**resulting in a much larger deduction, \$60,000, and producing net taxable income of only \$40,000.**

On January 12, the United States Department of Agriculture issued a statement referring to the difference as “unintended” and in need of a solution. On February 15, House Ways and Means Chairman Kevin Brady stated that the issue “needs to be corrected ASAP.” Also in February, however, House Agriculture Committee Ranking Member Collin Peterson stated he hoped for a change but “wouldn’t bet on it.”

Many Senators anticipate a change to come in the next omnibus budget bill intended to avoid a government shutdown past March 23. However, there currently seem to be differing views on what the change or solution should be. Unless a change occurs soon, this provision could place pressure on large corporations and independent elevators to consider becoming cooperatives before the end of 2018.

We will continue to monitor these developments and the impact it has on agribusiness, especially if the U.S. Treasury releases much anticipated guidance. Please contact one of the members of Hodgson Russ’ Tax and Agriculture Practice Groups for more information on the new TCJA or to discuss its specific effect on your business.