

Modified Farmer and Cooperative Deductions Under New Section 199A

Pre-2018 Law

Section 199 generally provided businesses, including farmers and agricultural cooperatives, with a deduction based on the business' income from domestic production activities. The deduction was equal to 9 percent of qualifying taxable income, but not more than 50 percent of the wages paid with respect to such domestic production activities. Under a special rule, agricultural cooperatives were permitted to determine their deduction effectively on gross sales and use the deduction to offset the cooperative's income and/or pass through some or all of the benefit to their farmer patrons.

The effect of the old section 199 benefit for farmers was dependent upon the buyer of the farmer's agricultural products. To the extent a farmer sold to independent buyers (i.e., non-cooperatives), the farmer could have generated his/her own section 199 deduction, typically capped by the 50-percent-of-wages limitation. In that case, a farmer with no employee wages would have had no section 199 deduction.

In contrast, a farmer patron who sold to the cooperative was not permitted to include the income from such sales in his/her section 199 calculation, but instead would have benefitted from the section 199 deduction passed through to him/her as a farmer patron of the cooperative. In that case, a farmer who sold to a cooperative gave up his/her individual section 199 deduction in order to claim the section 199 deduction passed through to him/her from the cooperative.

Section 199 was repealed by P.L. 115-97, which was signed into law on December 22, 2017, effective for taxable years beginning after December 31, 2017.

Current Law

Beginning in 2018 (through 2025), individual taxpayers may claim a deduction under new section 199A equal to 20 percent of qualified net business income from a partnership, S corporation, or sole proprietorship, as well as 20 percent of qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income. Special rules (described below) apply to specified cooperatives and their patrons.

Specifically, a farmer generally may claim a deduction with respect to sales of agricultural products equal to 20 percent of the net business income, subject to either a wage or wage/capital limitation in the case of taxable incomes above \$157,500 (single) and \$315,000 (married filing jointly). For farmers with taxable income below those levels, the wage and wage/capital limitation does not apply. Regardless of the income level, the deduction may not exceed 20 percent of the farmer's taxable income (excluding capital gains).

A special rule permits a farmer who sells his/her agricultural product to the cooperative to determine the deduction based on 20 percent of the gross payments received from the cooperative. Unlike the deduction described above, this 20-percent gross deduction is not

subject to the wage and wage/capital limitation. Similarly, a special rule permits the agricultural cooperative to determine its deduction based on 20 percent of the cooperative's gross income, less deductible payments to the farmer patrons (and subject to the wage or wage/capital limitation).

Under both special rules, the deduction may not exceed taxable income (excluding capital gains). These deductions may result in the farmer's and/or the cooperative's taxable income being reduced to zero, but would not create a net operating loss carryforward.

Modification

To address concerns that the current law special rules for cooperatives and their farmer patrons are creating an unintended incentive for farmers to sell their agricultural products to cooperatives, the modification to section 199A would replace the special rules described above with the following approach.

- Cooperatives would be permitted to determine their deduction based on rules substantially similar to those under old section 199, including the flexibility of retaining a portion of their deduction to offset income at the entity level and/or pass through some or all of the deduction to their farmer patrons.
- Farmers selling their agricultural products to independent buyers would continue to determine their deduction as under current law section 199A.
- Farmers selling their agricultural products to agricultural cooperatives (of which they are a patron) would be able to claim a deduction equal to 20 percent of the net business income on such sales, subject to either the wage or wage/capital limitation if the farmer has taxable income above the \$157,500/\$315,000 thresholds described above. This deduction would then be reduced by an amount equal to what the farmer would have had to forgo under old section 199 as the individual benefit had he/she sold to a cooperative (i.e., the lesser of 9 percent of the net income from the farmer's sales to the cooperative or 50 percent of wages attributed to such sales). This modified deduction, as under current law, would be limited to 20 percent of the farmer's taxable income (excluding capital gains). In addition to this modified deduction, the farmer would be able to claim the pass-through deduction from the cooperative (if any), up to the farmer's taxable income (including capital gains), after applying the farmer's individual deduction under section 199A.

115TH CONGRESS
2^D SESSION

H. R. _____

To amend the Internal Revenue Code of 1986 to modify the deduction for business income of a cooperative and its patrons.

IN THE HOUSE OF REPRESENTATIVES

M _____ introduced the following bill; which was referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to modify the deduction for business income of a cooperative and its patrons.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. MODIFICATION OF DEDUCTION FOR QUALI-**
4 **FIED BUSINESS INCOME OF A COOPERATIVE**
5 **AND ITS PATRONS.**

6 (a) DEDUCTION FOR QUALIFIED PRODUCTION AC-
7 TIVITIES INCOME.—

8 (1) IN GENERAL.—Subsection (g) of section
9 199A of the Internal Revenue Code of 1986 is
10 amended to read as follows:

1 “(g) DEDUCTION FOR INCOME ATTRIBUTABLE TO
2 DOMESTIC PRODUCTION ACTIVITIES OF SPECIFIED AGRI-
3 CULTURAL OR HORTICULTURAL COOPERATIVES.—

4 “(1) ALLOWANCE OF DEDUCTION.—

5 “(A) IN GENERAL.—In the case of a tax-
6 payer which is a specified agricultural or horti-
7 cultural cooperative, there shall be allowed as a
8 deduction an amount equal to 9 percent of the
9 lesser of—

10 “(i) the qualified production activities
11 income of the taxpayer for the taxable
12 year, or

13 “(ii) the taxable income of the tax-
14 payer for the taxable year.

15 “(B) LIMITATION.—

16 “(i) IN GENERAL.—The deduction al-
17 lowable under subparagraph (A) for any
18 taxable year shall not exceed 50 percent of
19 the W-2 wages of the taxpayer for the tax-
20 able year.

21 “(ii) W-2 WAGES.—For purposes of
22 this subparagraph, the W-2 wages of the
23 taxpayer shall be determined in the same
24 manner as under subsection (b)(4) (with-
25 out regard to subparagraph (B) thereof

1 and after application of subsection (b)(5)),
2 except that such wages shall not include
3 any amount which is not properly allocable
4 to domestic production gross receipts for
5 purposes of paragraph (3)(A).

6 “(C) TAXABLE INCOME OF COOPERATIVES
7 DETERMINED WITHOUT REGARD TO CERTAIN
8 DEDUCTIONS.—For purposes of this subsection,
9 the taxable income of a specified agricultural or
10 horticultural cooperative shall be computed
11 without regard to any deduction allowable
12 under subsection (b) or (c) of section 1382 (re-
13 lating to patronage dividends, per-unit retain
14 allocations, and nonpatronage distributions).

15 “(2) DEDUCTION ALLOWED TO PATRONS.—

16 “(A) IN GENERAL.—In the case of any eli-
17 gible taxpayer who receives a qualified payment
18 from a specified agricultural or horticultural co-
19 operative, there shall be allowed as a deduction
20 for the taxable year in which such payment is
21 received an amount equal to the portion of the
22 deduction allowed under paragraph (1) to such
23 cooperative which is—

24 “(i) allowed with respect to the por-
25 tion of the qualified production activities

1 income to which such payment is attrib-
2 utable, and

3 “(ii) identified by such cooperative in
4 a written notice mailed to such taxpayer
5 during the payment period described in
6 section 1382(d).

7 “(B) LIMITATION BASED ON TAXABLE IN-
8 COME.—The deduction allowed to any taxpayer
9 under this paragraph shall not exceed the tax-
10 able income of the taxpayer determined without
11 regard to the deduction allowed under this
12 paragraph and after taking into account any
13 deduction allowed to the taxpayer under sub-
14 section (a) for the taxable year.

15 “(C) COOPERATIVE DENIED DEDUCTION
16 FOR PORTION OF QUALIFIED PAYMENTS.—The
17 taxable income of a specified agricultural or
18 horticultural cooperative shall not be reduced
19 under section 1382 by reason of that portion of
20 any qualified payment as does not exceed the
21 deduction allowable under subparagraph (A)
22 with respect to such payment.

23 “(D) ELIGIBLE TAXPAYER.—For purposes
24 of this paragraph, the term ‘eligible taxpayer’
25 means—

1 “(i) a taxpayer other than a corpora-
2 tion, or

3 “(ii) a specified agricultural or horti-
4 cultural cooperative.

5 “(E) QUALIFIED PAYMENT.—For purposes
6 of this section, the term ‘qualified payment’
7 means, with respect to any eligible taxpayer,
8 any amount which—

9 — “(i) is described in paragraph (1) or
10 (3) of section 1385(a),

11 “(ii) is received by such taxpayer from
12 a specified agricultural or horticultural co-
13 operative, and

14 “(iii) is attributable to qualified pro-
15 duction activities income with respect to
16 which a deduction is allowed to such coop-
17 erative under paragraph (1).

18 “(3) QUALIFIED PRODUCTION ACTIVITIES IN-
19 COME.—For purposes of this subsection—

20 “(A) IN GENERAL.—The term ‘qualified
21 production activities income’ for any taxable
22 year means an amount equal to the excess (if
23 any) of—

1 “(i) the taxpayer’s domestic produc-
2 tion gross receipts for such taxable year,
3 over

4 “(ii) the sum of—

5 “(I) the cost of goods sold that
6 are allocable to such receipts, and

7 “(II) other expenses, losses, or
8 deductions (other than the deduction
9 allowed under this subsection), which
10 are properly allocable to such receipts.

11 “(B) ALLOCATION METHOD.—The Sec-
12 retary shall prescribe rules for the proper allo-
13 cation of items described in subparagraph (A)
14 for purposes of determining qualified produc-
15 tion activities income. Such rules shall provide
16 for the proper allocation of items whether or
17 not such items are directly allocable to domestic
18 production gross receipts.

19 “(C) SPECIAL RULES FOR DETERMINING
20 COSTS.—

21 “(i) IN GENERAL.—For purposes of
22 determining costs under subclause (I) of
23 subparagraph (A)(ii), any item or service
24 brought into the United States shall be
25 treated as acquired by purchase, and its

1 cost shall be treated as not less than its
2 value immediately after it entered the
3 United States. A similar rule shall apply in
4 determining the adjusted basis of leased or
5 rented property where the lease or rental
6 gives rise to domestic production gross re-
7 ceipts.

8 “(ii) EXPORTS FOR FURTHER MANU-
9 FACTURE.—In the case of any property de-
10 scribed in clause (i) that had been exported
11 by the taxpayer for further manufacture,
12 the increase in cost or adjusted basis
13 under clause (i) shall not exceed the dif-
14 ference between the value of the property
15 when exported and the value of the prop-
16 erty when brought back into the United
17 States after the further manufacture.

18 “(D) DOMESTIC PRODUCTION GROSS RE-
19 CEIPTS.—

20 “(i) IN GENERAL.—The term ‘domes-
21 tic production gross receipts’ means the
22 gross receipts of the taxpayer which are
23 derived from any lease, rental, license, sale,
24 exchange, or other disposition of any agri-
25 cultural or horticultural product which was

1 manufactured, produced, grown, or ex-
2 tracted by the taxpayer (determined after
3 the application of paragraph (4)(B)) in
4 whole or significant part within the United
5 States. Such term shall not include gross
6 receipts of the taxpayer which are derived
7 from the lease, rental, license, sale, ex-
8 change, or other disposition of land.

9 “(ii) RELATED PERSONS.—

10 “(I) IN GENERAL.—The term
11 ‘domestic production gross receipts’
12 shall not include any gross receipts of
13 the taxpayer derived from property
14 leased, licensed, or rented by the tax-
15 payer for use by any related person.

16 “(II) RELATED PERSON.—For
17 purposes of subclause (I), a person
18 shall be treated as related to another
19 person if such persons are treated as
20 a single employer under subsection (a)
21 or (b) of section 52 or subsection (m)
22 or (o) of section 414, except that de-
23 terminations under subsections (a)
24 and (b) of section 52 shall be made
25 without regard to section 1563(b).

1 “(4) SPECIFIED AGRICULTURAL OR HORTI-
2 CULTURAL COOPERATIVE.—For purposes of this sec-
3 tion—

4 “(A) IN GENERAL.—The term ‘specified
5 agricultural or horticultural cooperative’ means
6 an organization to which part I of subchapter
7 T applies which is engaged—

8 “(i) in the manufacturing, production,
9 growth, or extraction in whole or signifi-
10 cant part of any agricultural or horti-
11 cultural product, or

12 “(ii) in the marketing of agricultural
13 or horticultural products.

14 “(B) APPLICATION TO MARKETING CO-
15 OPERATIVES.—A specified agricultural or horti-
16 cultural cooperative described in subparagraph
17 (A)(ii) shall be treated as having manufactured,
18 produced, grown, or extracted in whole or sig-
19 nificant part any agricultural or horticultural
20 product marketed by the specified agricultural
21 or horticultural cooperative which its patrons
22 have so manufactured, produced, grown, or ex-
23 tracted.

24 “(5) DEFINITIONS AND SPECIAL RULES.—

1 “(A) SPECIAL RULE FOR AFFILIATED
2 GROUPS.—

3 “(i) IN GENERAL.—All members of an
4 expanded affiliated group shall be treated
5 as a single corporation for purposes of this
6 subsection.

7 “(ii) PARTNERSHIPS OWNED BY EX-
8 PANDED AFFILIATED GROUPS.—For pur-
9 poses of paragraph (3)(D), if all of the in-
10 terests in the capital and profits of a part-
11 nership are owned by members of a single
12 expanded affiliated group at all times dur-
13 ing the taxable year of such partnership,
14 the partnership and all members of such
15 group shall be treated as a single taxpayer
16 during such period.

17 “(iii) EXPANDED AFFILIATED
18 GROUP.—For purposes of this subsection,
19 the term ‘expanded affiliated group’ means
20 an affiliated group as defined in section
21 1504(a), determined—

22 “(I) by substituting ‘more than
23 50 percent’ for ‘at least 80 percent’
24 each place it appears, and

1 “(II) without regard to para-
2 graphs (2) and (4) of section 1504(b).

3 “(iv) ALLOCATION OF DEDUCTION.—
4 Except as provided in regulations, the de-
5 duction under paragraph (1) shall be allo-
6 cated among the members of the expanded
7 affiliated group in proportion to each mem-
8 ber’s respective amount (if any) of quali-
9 fied production activities income.

10 “(B) SPECIAL RULE FOR COOPERATIVE
11 PARTNERS.—In the case of a specified agricul-
12 tural or horticultural cooperative which is a
13 partner in a partnership, rules similar to the
14 rules of subsection (f)(1) shall apply for pur-
15 poses of this subsection.

16 “(C) TRADE OR BUSINESS REQUIRE-
17 MENT.—This subsection shall be applied by
18 only taking into account items which are attrib-
19 utable to the actual conduct of a trade or busi-
20 ness.

21 “(D) UNRELATED BUSINESS TAXABLE IN-
22 COME.—For purposes of determining the tax
23 imposed by section 511, this section shall be ap-
24 plied by substituting ‘unrelated business taxable
25 income’ for ‘taxable income’ each place it ap-

1 appears in this section (other than this subpara-
2 graph).

3 “(E) SPECIAL RULE FOR COOPERATIVE
4 WITH OIL RELATED QUALIFIED PRODUCTION
5 ACTIVITIES INCOME.—

6 “(i) IN GENERAL.—If a specified agri-
7 cultural or horticultural cooperative has oil
8 related qualified production activities in-
9 come for any taxable year, the amount oth-
10 otherwise allowable as a deduction under
11 paragraph (1) shall be reduced by 3 per-
12 cent of the least of—

13 “(I) the oil related qualified pro-
14 duction activities income of the coop-
15 erative for the taxable year,

16 “(II) the qualified production ac-
17 tivities income of the cooperative for
18 the taxable year, or

19 “(III) taxable income.

20 “(ii) OIL RELATED QUALIFIED PRO-
21 Duction ACTIVITIES INCOME.—For pur-
22 poses of this subparagraph, the term ‘oil
23 related qualified production activities in-
24 come’ means for any taxable year the
25 qualified production activities income

1 which is attributable to the production, re-
2 fining, processing, transportation, or dis-
3 tribution of oil, gas, or any primary prod-
4 uct thereof (within the meaning of section
5 927(a)(2)(C), as in effect before its repeal)
6 during such taxable year.

7 “(6) REGULATIONS.—The Secretary shall pre-
8 scribe such regulations as are necessary to carry out
9 the purposes of this subsection, including regulations
10 which prevent more than 1 taxpayer from being al-
11 lowed a deduction under this subsection with respect
12 to any activity described in paragraph (3)(D)(i).
13 Such regulations shall be based on the regulations
14 applicable to cooperatives and their patrons under
15 section 199 (as in effect before its repeal).”.

16 (2) CONFORMING AMENDMENTS.—

17 (A) Sections 63(b)(3), 63(d)(3),
18 199A(e)(1), and 6662(d)(1)(C) of such Code
19 are each amended by striking “the deduction”
20 and inserting “any deduction”.

21 (B) The last sentence of section 62(a) of
22 such Code and section 172(d)(8) of such Code
23 are each amended by striking “The deduction”
24 and inserting “Any deduction”.

1 (C) Section 199A(e)(1) of such Code is
2 amended by striking “Taxable income” and in-
3 serting “Except as otherwise provided in sub-
4 section (g)(2)(B), taxable income”.

5 (D) Section 613(a) of such Code is amend-
6 ed by striking “the deduction under section
7 199A” and inserting “any deduction under sec-
8 tion 199A”.

9 (b) MODIFICATIONS RELATED TO PAYMENTS FROM
10 COOPERATIVES.—

11 (1) REPEAL OF SPECIAL DEDUCTION FOR
12 QUALIFIED COOPERATIVE DIVIDENDS.—Subsection
13 (a) of section 199A of such Code is amended to read
14 as follows:

15 “(a) ALLOWANCE OF DEDUCTION.—In the case of a
16 taxpayer other than a corporation, there shall be allowed
17 as a deduction for any taxable year an amount equal to
18 the lesser of—

19 “(1) the combined qualified business income
20 amount of the taxpayer, or

21 “(2) an amount equal to 20 percent of the ex-
22 cess (if any) of—

23 “(A) the taxable income of the taxpayer
24 for the taxable year, over

1 “(B) the net capital gain (as defined in
2 section 1(h)) of the taxpayer for such taxable
3 year.”.

4 (2) REPEAL OF RULE EXCLUDING QUALIFIED
5 COOPERATIVE DIVIDENDS FROM QUALIFIED BUSI-
6 NESS INCOME.—

7 (A) IN GENERAL.—Section 199A(c)(1) of
8 such Code is amended by striking “, qualified
9 cooperative dividends,”.

10 (B) CONFORMING AMENDMENTS.—

11 (i) Section 199A(c)(3)(B) of such
12 Code is amended—

13 (I) by striking “investment” in
14 the matter preceding clause (i), and

15 (II) by adding at the end of
16 clause (ii) the following: “Any amount
17 described in section 1385(a)(1) shall
18 not be treated as described in this
19 clause.”.

20 (ii) Section 199A(e) of such Code is
21 amended by striking paragraph (4) and by
22 redesignating paragraph (5) as paragraph
23 (4).

24 (3) REDUCTION OF QUALIFIED BUSINESS IN-
25 COME WITH RESPECT TO INCOME RECEIVED FROM

1 COOPERATIVES.—Section 199A(b) of such Code is
2 amended by adding at the end the following new
3 paragraph:

4 “(7) SPECIAL RULE WITH RESPECT TO INCOME
5 RECEIVED FROM COOPERATIVES.—In the case of any
6 qualified trade or business of a patron of a specified
7 agricultural or horticultural cooperative, the amount
8 determined under paragraph (2) with respect to
9 such trade or business shall be reduced by the lesser
10 of—

11 “(A) 9 percent of so much of the qualified
12 business income with respect to such trade or
13 business as is properly allocable to qualified
14 payments received from such cooperative, or

15 “(B) 50 percent of so much of the W-2
16 wages with respect to such trade or business as
17 are so allocable.”

18 (c) APPLICATION OF SECTION 199 TO CERTAIN
19 QUALIFIED PAYMENTS PAID AFTER 2017.—Subsection
20 (c) of section 13305 of Public Law 115–97 is amended
21 to read as follows:

22 “(c) EFFECTIVE DATES.—

23 “(1) IN GENERAL.—Except as provided in para-
24 graph (2), the amendments made by this section

1 shall apply to taxable years beginning after Decem-
2 ber 31, 2017.

3 “(2) TRANSITION RULE FOR QUALIFIED PAY-
4 MENTS OF PATRONS OF COOPERATIVES.—

5 “(A) IN GENERAL.—The amendments
6 made by this section shall not apply to a quali-
7 fied payment received by a taxpayer from a
8 specified agricultural or horticultural coopera-
9 tive in a taxable year of the taxpayer beginning
10 after December 31, 2017, which is attributable
11 to qualified production activities income with
12 respect to which a deduction is allowable to the
13 cooperative under section 199 of the Internal
14 Revenue Code of 1986 (as in effect before the
15 amendments made by this section) for a taxable
16 year of the cooperative beginning before Janu-
17 ary 1, 2018. Any term used in this subpara-
18 graph which is also used in section 199 of such
19 Code (as so in effect) shall have the same
20 meaning as when used in such section.

21 “(B) COORDINATION WITH SECTION
22 199A.—No deduction shall be allowed under sec-
23 tion 199A of such Code for any qualified pay-
24 ment to which subparagraph (A) applies.”.

25 (d) EFFECTIVE DATE.—

1 (1) IN GENERAL.—Except as otherwise pro-
2 vided in this subsection, the amendments made by
3 this section shall take effect as if included in section
4 11011 of Public Law 115–97.

5 (2) APPLICATION OF SECTION 199 TO CERTAIN
6 QUALIFIED PAYMENTS PAID AFTER 2017.—The
7 amendment made by subsection (c) shall take effect
8 as if included in section 13305 of Public Law 115–
9 97.