

Executive Summary

NCFC Comments to Treasury and IRS on Proposed Regulations under Section 199A

Overview: Section 199A, as created by the Tax Cuts and Jobs Act of 2017 (TCJA), provided a significant benefit to patrons of farmer cooperatives relative to other farmers. To address this perceived market imbalance, Congress amended section 199A to essentially restore the operation of former section 199 (which was repealed in 2017 by the TCJA) for farmer cooperatives and their patrons.

Under the 2018 amendments, as under former section 199, a cooperative calculates a section 199A(g) deduction equal to 9% of its modified income (limited to 50% of wages), and may either retain or pass through any portion of this deduction to patrons. A patron claims a section 199A(a) deduction equal to 20% of all net farm income (whether or not from a cooperative), plus any deduction passed through from the cooperative, and makes an adjustment to eliminate double counting of the deduction. The recently proposed Treasury regulations attempt to provide guidance on these 2018 amendments. However, in many cases the proposed regulations provide rules that are different, and less favorable, than the rules applicable to former section 199. The NCFC comment letter points out these instances and makes recommendations for the final regulations.

Specific issues: The following summarizes significant issues addressed in the NCFC letter.

Treatment of nonpatronage activity. Farmer cooperatives calculated their former section 199 deduction with respect to all their qualified activity, whether patronage or nonpatronage. The proposed regulations limit the cooperative's section 199A(g) to patronage activity only. There is no basis for this Treasury position.

Changes to subchapter T. The proposed regulations modify longstanding rules regarding the definition of patronage income and the use of patronage deductions against nonpatronage income (and vice versa). These rules are unnecessary and create confusion in well-settled areas of cooperative taxation.

Use of book method. The proposed regulations seem to require amounts paid to patrons to be determined and reported under tax accounting principles. Previously, cooperatives could choose to make such determinations under book or tax income principles.

Methods of allocation. Section 199A, like former section 199, requires several allocations of income and deduction between qualified and nonqualified activity. Prior law provided flexibility as to the methods used for such allocations. The proposed regulations provide

somewhat inflexible standards regarding the use of such methods, and restrict the ability to change methods.

Corporate patrons. A patron structured as a corporation is not allowed to claim the section 199A(g) deduction passed through to it. The NCFC letter seeks clarity that it is not the cooperative's responsibility to determine the corporate status of its patrons.

Reporting requirements. The proposed regulations, and a draft IRS Form 1099-PATR, require increased reporting of the amount and nature of payments to patrons. The NCFC letter questions the need for such reporting, seeks clarity on the determination of amounts required to be reported, and suggests that a cooperative should be able to elect out of section 199A(g) to ease compliance.

Definition of agricultural and horticultural products. The section 199A(g) deduction relates only to income from the disposition of agricultural and horticultural products. The proposed regulations define such products pursuant to the Cooperative Marketing Act of 1926. NCFC believes no definition is necessary and referencing a non-tax statute is inappropriate.

Definition of supplies. Agricultural and horticultural products includes farm supplies. The NCFC letter makes specific recommendations as to the types of, and the types of activities with respect to, supplies that qualify for the section 199A(g) deduction.

Intangible property. Under the proposed regulations, the exploitation of intangible property does not qualify for the section 199A(g) deduction. The NCFC letter seeks clarity that certain common licensing transactions do not run afoul of this prohibition.

Partnerships. The proposed regulations should clarify that if a cooperative is a partner in a partnership, all the partnership items relevant to the section 199A(g) deduction flow up to the cooperative.

Complex organizational structures. The proposed regulations do not fully, and at times inappropriately, address complex organizational structures involving a cooperative. For example, unlike former section 199, the proposed regulations do not take into account the activity of controlled non-cooperative subsidiaries in the determination of the cooperative's section 199A(g) deduction.

Effective date. It is unclear whether the proposed regulation will take effect for taxable years *ending* after or *beginning* after the publication of the final regulations. NCFC recommends the latter date.