Strategic Decisions Involving Section 199A

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While Section 199A, which was part of the 2017 Tax Cuts and Job Act, has faded from the news, many questions remain as to the exact implementation and guidance. Despite the saying that "the devil is in the details" it is useful for cooperative CEO and board members to take a high level look at the basic structure of the new tax provision. That "30,000 foot" view of Section 199A reveals some key strategic questions for boards and managers.

Section 199A allows a cooperative to take a tax deduction at the cooperative level. The cooperative can pass on all or part of that deduction to their patrons. Producers who operate pass thru entities (partnerships, proprietorships. LLCs and S-corps) get a deduction under a separate part of Section 199A. Producers who market through a cooperative could face an offset to that deduction and the offset is independent of the amount (if any) of Section 199A pass through from the cooperative. A producer's advantage or disadvantage by marketing thru a cooperative depends on the balance of the pass thru from the cooperative and their farm level deduction offset. Both the cooperative's deduction and the producer's offset are independently impacted by W-2 wages at the cooperative and farm level.

Before focusing on the details, cooperative boards need to consider their strategy toward Section 199A. At one end of the spectrum, the board could focus on the amount of deduction needed by the cooperative and pass on any balance. That strategy could concentrate on profit distribution, re-examining cash patronage levels and perhaps taking a closer look at non-qualified stock. The board could then consider how much tax deduction the cooperative needed and pass on the remainder.

At the other end of the spectrum, the cooperative board could identify a target member group and focus on keeping their tax situation equivalent with non-cooperative producers. Under that strategy, the board concentrates on what level of pass through the members need and keep any remainder at the cooperative. The cooperative's remaining deduction would affect the cooperative's tax payment and influence cash and stock patronage options.

There has always been a lot of moving parts within the cooperative value package. Section 199A has perhaps put marketing cooperatives more squarely in the tax deduction business. Before you dig into the details, take a moment to consider your strategy. If you don't want the tail to wag the dog the first step is determining what is the tail and what is the dog!

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