An Update on the Impact of Tax Reform on Agricultural Cooperatives

Phil Kenkel
Bill Fitzwater Cooperative Chair

Economics has been termed “the dismal science.” It therefore goes against my training to write anything positive. That makes it a struggle to describe the impact of tax reform on agricultural cooperatives, because it is basically all good! The outcome is a tribute both to our state and national cooperative councils and the apparent positive reputation of agricultural cooperatives among legislators.

The Tax Reform and Jobs Act of 2017 had several provisions that impacted agricultural cooperatives. First, it reduced the corporate income tax from 35% to 21%. That reduces the cooperatives tax on non-member profits. It also means that a cooperative does not have to reduce the cash patronage rate as much, if it wished to issue non-qualified stock while maintaining its cash flow. Tax reform also gives members a 20% deduction on qualified (cash and qualified stock) distributions. Finally while the Domestic Production Activities Deduction (DPAD or Section 199) was repealed a new Section 199A was created.

Section 199A provides two potential tax credits, one for cooperative member, and one for the cooperative which are determined separately. The cooperative credit cannot be passed through to the member. Unlike the previous treatment under DPAD, Section 199A appears to apply to both marketing and farm supply cooperatives and can offset potential taxes on both member and non-member based profits.

What does this mean for cooperative members? Consider Cooperative A, a cooperative that did not use DPAD and retained patronage as qualified stock. They can continue to issue cash and qualified equity while increasing the cash patronage rate slightly because of lower non-member based taxes. They can further increase member return by retaining profits as non-qualified equity. Their members are potentially better off under tax reform.

Cooperative B previously used DPAD to eliminate the taxation from member profits. The can use the new Section 199A and increase member return. The member benefit comes indirectly from the reduced corporate tax rate and directly from the 20% deduction on their cash patronage. Again the best choice for the member is to retain funds as non-qualified equity but the members benefit regardless of the profit distribution choice. Again, their members are better off under tax reform.

Finally Cooperative C, did not use DPAD but now chooses to take the Section 199A at the cooperative level. Their members of are much better off, particularly if their cooperative distributes profits in a combination of cash and non-qualified stock.

All of those positive conclusions come without even considering the member’s potential benefit from the Section 199A deduction at the member level. That farm level benefit only accrues to producers patronizing a cooperative so there has never been a better time to be a cooperative member!

More details of the impact of Tax Reform on agricultural cooperatives are available in a newly revised fact sheet which describes the research from my financial simulator.. You can access the fact sheet on the OACC website or email me at phil.kenkel@okstate/edu. If your board would like a presentation on tax reform and profit distribution alternatives, give me a shout. Note that you always consult a tax professional on the implications for your specific situation.

I am continuing to analyze this issue and if I can find any dismal aspects, I promise to highlight them in future newsletters!