Grain Cooperatives Cannot Afford to Ignore Section 199A

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The road to our present Section 199A tax deduction started back in 2004 with a tax deduction for domestic manufacturing firms. Tax specialist were able to first argue that crop producers were manufacturing firms and then extend that argument to allow cooperatives to be collectively manufacturing their member's crops. The cooperative could then retain the deduction or pass some or all of it on to the producers. Use of the old Section 199 (DPAD) varied across grain cooperatives. Some cooperatives retained all of the deduction at the cooperative level, some passed it all on and many retained a portion and passed on portion to the members. Some marketing cooperatives chose not to take DPAD at the cooperative level, arguing that it was the producer's tax credit.

During the tax reform debate the cooperative industry argued for the need to retain some similar to the existing DPAD for cooperatives. Among the many logical rationales for retaining a cooperative specific Section 199, the concept of cooperatives passing the deduction on to their members seemed to get the most traction. Perhaps that explains the structure of the revised Section 199A. The "new" Section 199A provides cooperative the opportunity to take a deduction that can be retained or passed on to members. It also includes an offsets to a farm level tax deduction if a producer markets through a cooperative.

Under the structure of Section 199A, grain cooperatives cannot afford to ignore the cooperative level deduction. Their member producers will face a potential offset to their farm level tax deduction because they marketed through the cooperative. Cooperatives can negate that effect, and in some cases increases a producer's total tax deduction, by passing through a good portion of their cooperative level deduction. That means cooperative boards will have to balance the need for the deduction at the cooperative and member level. It also means that grain cooperative must take advantage of the cooperative level deduction if they want the option of passing a portion to the producer. Just like under DPAD, obtaining a meaningful level of deduction at the cooperative level will require structuring commodity payments as Per Unit Retains Paid in Money (PURPIMs) instead of purchases.

Some of the details of Section 199A will not be apparent until the actual tax rules are finalized. What is clear is that grain marketing and other commodity marketing cooperatives cannot afford to ignore it!