How Much Section 199A Should We Pass On?

Phil Kenkel
Bill Fitzwater Cooperative Chair

Sometime there are great questions with no simple answers. An example of that is the question of how much Section 199A deduction a cooperative needs to pass on to keep their members equivalent with farmers marketing through non-cooperative firms. The first difficulty in answering the question is that the effect is unique for each producer. Producers marketing through cooperatives face a possible offset (reduction) to another deduction that they would otherwise have available. The producer's offset is the lessor of 9% of the producers qualified business income or 50% of the producers W-2 wages. The W-2 wage calculation is typically the binding constraint. Because of that, the tax effect of marketing through a cooperative depends on the producer's W-2 wages. Producers with no W-2 wages face no offset.

Many cooperative managers and directors have contacted me asking for a thumb rule as to how much of the cooperative deduction they need to pass on. An over simplified version of the tax situation is as follows: The cooperative has a deduction equal to 50% of their W-2 wages and the producer wages an offset equal to 50% of their farming W-2 wages. I can hear cooperative auditors cringing at that description and I should point out that there can be adjustments for non-member business, farm supply versus commodity labor and other issues.

Still that basic description illustrates how one can come up with a thumb rule of how much Section 199A a marketing cooperative should pass on. The cooperative's deduction is 50% of their W-2 wages. In you divide that number by the units of the commodity marketed (be that bushels of grain, hundredweight of milk or boxes of tomatoes) who have the cooperative's deduction per unit. For example if the cooperative had $300,000 of wages and handled 1m bushels of wheat, they would have $.30 wages per bushel and 50% of that would be $.15/bushel. Next if you determine the W-2 wages of the typical producers on a per unit basis. For example if the producer had $3 wages/acre and a yield of 30 bushels/acre, their W-2 wages are $.10/bushel and 50% of that is $.05/bushel. In that example, we can see that the cooperative needs to pass on 30% ($.05) of their Section 199A deduction to keep that representative member equivalent.

That thumb rule approach, like all thumb rules is an oversimplification. It does illustrate the concept of determining the Section 199A pass through needed to keep producers equivalent. One can work through those calculations for any marketing cooperative; the only thing that changes is the units by which the commodity volume are measured. A cooperative marketing multiple commodities would obviously have to calculate as a weighted average.

I would write more about this but when it comes to typing up thumb rules, I am all thumbs!

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