The Cooperative's Role in Pooling Tax Deductions

Phil Kenkel
Bill Fitzwater Cooperative Chair

In my last newsletter article I discussed the revised Section 199A deduction. As you may recall Section 199A now creates a deduction at the cooperative level which can be retained or passed on to the producer. Producers marketing to a cooperative potentially face a reduction in a farm level deduction. My analysis based on "typical" grain cooperatives and grain producers indicated the cooperative needed to pass on 75% of their Section 199A deduction to hold the member harmless, not considering patronage or 40% if patronage is factored in. That conclusion is highly dependent on the level of the producer's W-2 wages.

On a more general level, Section 199A is institutionalizing the structure of pooling producer's tax deductions at the cooperative level. That structure really began with the previous Section 199 (Domestic Production Activities Deduction) which began in 2005. Marketing cooperatives were able to use DPAD because they were assumed to be collectively producing (manufacturing) their member's commodities. The structure of the revised Section 199A brings this concept of tax deduction pooling into sharper focus. Cooperative producers will see the balancing act between any possible loss of farm level deduction and possible pass through of the deduction calculated at the cooperative level.

The cooperative business model is formulated around the concept of pooling. Members of a marketing cooperative decide to collectively handle, store and market their commodities. The cooperative business model has also long recognized the need to balance the need for resources at the cooperative level and the member's need for returns. The balance of cash and retained patronage reflects those competing needs. Cooperative boards, and one would hope, cooperative members, understand the need to keep a portion of the profits in the cooperative. Those retained profits are funding the cooperative's ability to collectively handle and market the member's commodities. There is no one size fits all answer for the balance of cash and retained patronage.

Board members and CEOs of marketing cooperatives now have the additional challenge of balancing the retention of distribution of the Section 199A deduction. Many have been doing this for some time, but that aspect of the cooperative's role in pooling tax deductions has flown beneath the radar for many producers. Just like patronage, there will be no one size fits all solution. Passing on more deduction benefits producers in the short run (assuming they have taxable income) while retaining a greater share of the deduction allows the cooperative to invest to benefit the members later. A familiar balancing act but perhaps a new communication challenge.

I'll expand on this issue in my next newsletter. If you would like a copy of my latest fact sheet "Impact of Section 199A on Grain Producers" drop me an email at phil.kenkel@okstate.edu