Co-ops' Nonpatronage Income Tax Treatment and Competitive Considerations

Co-ops are seeking to change current law section 199A as it relates to non-patronage income via regulations. In the lead-up to the passage of the Tax Cuts and Jobs Act, Agricultural Co-ops succeeded in having the Senate insert a provision addressing issues Co-ops had related to the 199A tax deduction. However, after the TCJA was passed, and the Co-op language was fully evaluated, it was clear that the legislative language skewed the competitive balance in the agriculture industry in favor of Co-ops. Congressional leaders acknowledged soon after tax reform that they did not intend to create this competitive imbalance (referred to as the "Grain Glitch"). The House and Senate tax-writing committees worked with the Co-ops and the private grain companies to fix the Grain Glitch in early 2018. All parties involved in the subsequent negotiations agreed to language that was adopted by Congress and signed into law in the spring of 2018.

In June of 2019, the Treasury Department issued proposed regulations that implement the Grain Glitch fix and maintain the economic balance that existed prior to tax reform. However, Co-ops with significant non-patronage income are now lobbying to change the proposed 199A regulations. If these Co-ops convince Treasury to modify the proposed regulations, the final regulations will skew the competitive balance in the agricultural marketplace toward these Co-ops contrary to the plain intent of the statute. The proposed regulations should not be altered.

What is the issue? Co-ops want 199A Deductions on their non-patronage, non-core "corporate" business activities

- Co-ops were originally organized to provide independent family farms with a mechanism to get their harvests to market economically (i.e., their patronage or "core" business); but, over time, some Co-ops also started to operate non-patronage, "non-core" businesses that provide products beyond their co-op members (e.g., a chain of branded fuel stations open to the general public, or offering financial services to non-patrons).

- Longstanding tax policy taxes the Co-ops' two business activities differently:

  - Income earned from a Co-op's core, patronage activities generally is not taxed at the Co-op level, but instead such income flows through to the Co-op members—like a partnership. This income continues to enjoy 199A deductions after tax reform and after the Grain Glitch fix.

  - Income earned from non-core, non-patronage activity is taxed at the level of the Co-op, just like a taxable corporation, and at the same prevailing corporate tax rate. With respect to its non-core, non-patronage business income, a Co-op is treated just like any other U.S. corporation. Even a charity that conducts unrelated business activity is taxed at the corporate rate.

  - Now, the Co-ops are seeking to change Treasury's proposed regulations that treat their non-core, non-patronage income similarly to corporate income in the same manner that the law treats their core, patronage income and allow 199A deductions. The law does not contemplate this second benefit for non-core, non-patronage income, and this result would not reflect the intent of Congress.

The table below shows how the proposed Treasury regulations preserve the pre-tax reform parity among similarly situated taxpayers with respect to non-core, non-patronage activities and how the Co-ops' position on these activities creates an unfair advantage.

	Co-op taxation		Corporations competing with Co-ops on noncore activity	Charity conducting a business not related to its charitable activity (UBTI)	All corporate income treated equally?
	Income from core activity (*patronage income*)	Income from noncore activity (*nonpatronage income*)			
Prior to tax reform	Pass through;199 deduction allowed	35%; 199 deduction allowed	35%; 199 deduction allowed	35%; 199 deduction allowed	Yes
Proposed Treasury Regulations	Pass through;199A deduction allowed	21%	21%	21%	Yes
Co-ops' anticompetitive request	Pass through;199A deduction allowed	**21%; 199A deduction allowed**	**21%**	**21%**	**No. Co-ops get preferential treatment**

By seeking to modify Treasury's proposed regulations, Co-ops are trying to pay a lower tax rate than their private competitors—and even charities doing business--on activities that are not related to those conducted on a cooperative basis with farmer patrons. Paying a lower tax rate on non-core business activities permits Co-ops to subsidize their core businesses, giving Co-ops a competitive advantage over other agricultural market participants. Reject the Co-ops' request and support Treasury's 199A regulation.