Co-ops' Nonpatronage Income Tax Treatment and Competitive Considerations

Simple indicative example: Sale of fertilizer that generates $1,000 net taxable income; related wages are $50.

		Co-op taxation on non-patronage income*	Corporations competing with Co-ops on nonpatronage activity	Charity conducting a business not related to its charitable activity (UBTI)
2017 law	$1000 net income	$1000	$1000	$1000
	Sec 199 DPAD deduction (9% taxable income, capped at 50% wages)	($25)	($25)	($25)
	Net tax at 35% rate	$341.25	$341.25	$341.25
Post 2017 law	$1000 net income	**$1000**	$1000	$1000
	Co-ops' request for Sec 199A deduction (9% taxable income, capped at 50% wages)	**($25)**	--	--
	Net tax at 21% rate	**$204.75**	$210	$210

*Patronage income not impacted; no rule change.

Two things to note:

1. The only change in relative taxation among the three taxpayers comes from the coops' current request for a 199A deduction related to nonpatronage income.

2. Like all corporate entities, co-ops are already paying substantially lower taxes today on nonpatronage income than they were in 2017 due to the 14% rate reduction. The co-ops are saying the proposed Treasury Regulations have "raised taxes on America's farmers," but how?

This is a misleading example in a Sec. 199A article the NCFC has reviewed and commented on[1]:

> Under the old rules, a farmer cooperative with 2,000 active members and 79.1 million bushels of delivery would receive a deduction of around $30 million in 2019. But under the proposed rule, the tax deduction drops to about $22.1 million. That's just under $8 million in tax deduction that the cooperative could lose, including not sharing the deduction with members. Dividing that lost deduction by the 79.1 mb equates to 10.1 cents a bushel of lost values, or $50,063 to the average farmer in the cooperative.
>
> As NCFC noted, "The proposed IRS rule would increase taxable income for these farmers by $50,000."

Let's break this down:

- Remember that the 199 and 199A deduction is limited to 50% of wages. Does it seem possible that the co-op described above is paying out $60M in wages, which is driving a $30M deduction?
- Approximately 27% of the deduction cannot be claimed, and so it must relate to nonpatronage activity. Nonpatronage activity is taxed at the co-op level, it is not passed on to farmers (even under old 199). The example suggests this change increases taxes on farmers, but in fact it only impacts tax the co-op pays (and the co-op should already be paying less tax, because its tax rate already went down from 35% to 21% as part of tax reform).

The co-op's appear to be exaggerating the numbers and making misleading statements about the impact on America's farmers.

[1] https://www.dtnpf.com/agriculture/web/ag/news/business-inputs/article/2020/03/04/co-ops-encouraged-treasury-fixing (accessed May 1, 2020)