Impact of Section 199A(g) on Local Grain Marketing and Farm Supply Cooperatives

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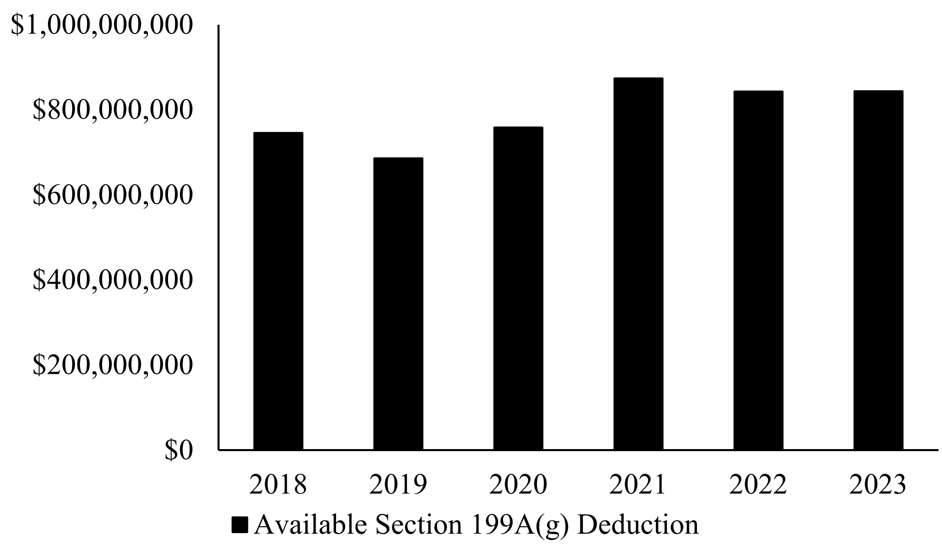
The 2017 Tax Cuts and Jobs Act made many significant changes to the Internal Revenue Code (IRC). In particular, the Act repealed the corporate alternative minimum tax and permanently reduced corporate income tax rates from a top rate of 35% to a single rate of 21%. Additionally, pass-through business entities received temporary tax relief in the form of the IRC Section 199A deduction by allowing these businesses to deduct a portion of their qualified business income. For farmer cooperatives, the deduction serves as a useful tax tool that can create substantial benefits for its farmer-owners.

The purpose of this fact sheet is to use financial data of local grain marketing and farm supply cooperatives to examine potential connections between the Section 199A(g) deduction and benefits provided to farmer-owners. Financial data used in this analysis was provided by CoBank, which was made available to the researchers per a confidentiality agreement with the cooperative names/identifiers removed for anonymity.

From 2018 to 2023, a total of 783 local grain marketing and farm supply cooperatives, hereafter farmer cooperatives, were identified as having a Section 199A(g) deduction available. The method in how the available Section 199A(g) deduction was estimated is shared in the appendix at the end of this fact sheet.

Since 2018, farmer cooperatives have experienced a steady growth in available Section 199A(g) deductions. Figure 1 shows the sum total of the deduction for the farmer cooperatives in the data set. In real terms, the deduction increased around $100 million in five years from approximately $745 million in 2018 to $845 million in 2023. The increased availability of the Section 199A(g) deduction allowed these farmer cooperatives to directly impact their farmer-owners by passing through the deduction and/or use the deduction at the cooperative level to provide more benefits to their farmer-owners such as increasing cash patronage payments and/or higher allocated equity redemptions. Or, by investing more in infrastructure, including property, plant, and equipment upgrades and additions.

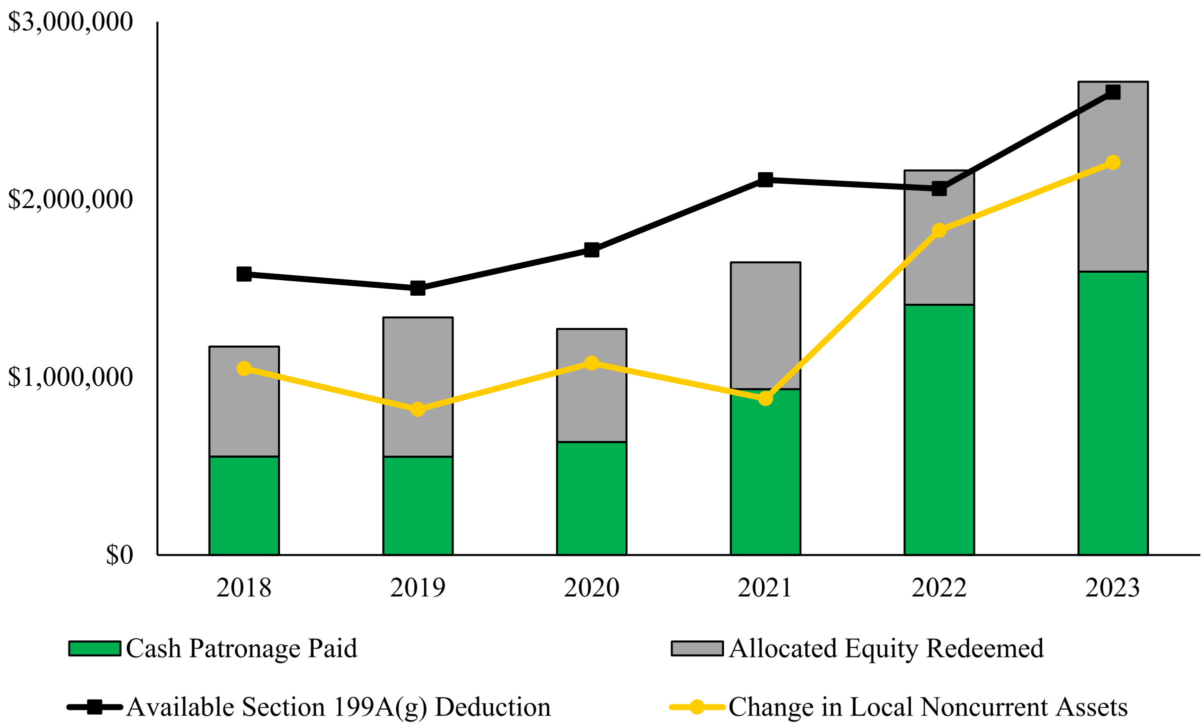
Figure 1. Sum Total of Available Section 199A(g) Deduction for Farmer Cooperatives



Note: CoBank data set was adjusted to constant 2023 dollars via the GDP implicit price deflator.

Figure 2 shows positive correlation between the available Section 199A(g) deduction and the aforementioned benefits. On average, as the available deduction to farmer cooperatives increased, the amount of money returned to farmer-owners (cash patronage paid and allocated equity redeemed) as well as capital investments (proxied by local noncurrent assets) tended to increase. In addition, the deduction is sizable because on average it has been greater than or roughly equal to the average amount of money being returned to farmer-owners of cooperatives. While other factors could be impacting these changes in Figure 2, the averages suggest that farmer cooperatives are likely using the Section 199A(g) deduction in a way that benefits their farmer-owners. Another benefit of the Section 199A(g) deduction, that is not available in the data but supported by anecdotes from cooperative leaders, is the ability of the cooperative to pass through a portion of the deduction to their farmer-owners that lowers taxes paid by farmers.

Figure 2. Average of Available Section 199A(g) Deduction, Allocated Equity Redeemed, Cash Patronage Paid, and Change in Local Noncurrent Assets for Farmer Cooperatives



Note: CoBank data set was adjusted to constant 2023 dollars via the GDP implicit price deflator.

Policymakers debating the future of Section 199A(g) should consider how farmer cooperatives are utilizing this tax deduction. This fact sheet used financial data from U.S. farmer cooperatives to illustrate potential linkages between the deduction and benefits to farmers. Additional research is being conducted to isolate the causal impacts.

With this deduction set to expire in 2025, policymakers should consider the financial impact on all farmer cooperatives and their farmer-owners when discussing the future of the Section 199A(g) deduction.

Appendix – Calculation of Available Section 199A(g) Deduction

The data set does not report the amount of Section 199A(g) deduction used by a cooperative and/or passed-through to the cooperative's farmer-owners. Therefore, the calculation of the Section 199A(g) deduction reported in this fact sheet is based on a set of assumptions that estimates the deduction available to a farmer cooperative. This appendix details how this estimate is calculated.

The Section 199A(g) deduction is limited by the lessor of two limits; 50% of W2 wages or 9% of Qualified Production Activities Income (QPAI). It is assumed that all farmer cooperatives in the data purchase grain from their patrons on a per-unit retains paid in money (PURPIM) basis. Given a cooperative is allowed to add back these PURPIMs in their QPAI calculation, the limit on the available Section 199A(g) deduction is likely 50% of W2 wages paid by the cooperative. So, the calculation of the available deduction starts with the following equation:

$$Wage\ Limit = 0.5 \times Personnel\ Expenses \times (1 - Benefits\ \%) \times Member\ Business\ \% \tag{1}$$

Multiplying *Personnel Expenses* by (1 – *Benefits %*) arrives at W2 wages. *Benefits %* is not reported in the data so this percentage is assumed to be 20%. *Member Business %* is also not reported in the data. Given the Section 199A(g) is tied to grain sales and taking discussions with cooperative leaders into account, it is assumed that member business is typically around 75%.

The next step was for the available Section 199A(g) deduction to account for grain sales and the other potential limit for the deduction, 9% of QPAI. If the cooperative had $0 grain sales, the deduction equals $0. To properly calculate QPAI, all expenses tied to the grain department are needed. As the data does not provide that information, QPAI is assumed to equal 50% of grain sales. The 9% QPAI limit will generally apply to cooperatives that have low grain sales relative to all other sales.

Finally, *Earnings Before Taxes* (*EBT*) is evaluated. If *EBT* is equal to zero or negative, then the cooperative has no available Section 199A(g) deduction. If *EBT* is less than *Wage Limit* from Equation 1, then the available deduction equals *EBT*. Conversely, if *EBT* is greater than *Wage Limit*, then the available deduction equals *Wage Limit*.

Based on these assumptions, of the 3,194 observations in the 2018 to 2023 data, 2,518 reported grain sales (78.8%). Of those observations with grain sales, 2,412 had the *Wage Limit* to determine the available Section 199A(g) deduction. Only 106 observations were limited by the 9% QPAI calculation.