Modified Farmer and Cooperative Deductions
Under New Section 199A

Pre-2018 Law

Section 199 generally provided businesses, including farmers and agricultural cooperatives, with a deduction based on the business’ income from domestic production activities. The deduction was equal to 9 percent of qualifying taxable income, but not more than 50 percent of the wages paid with respect to such domestic production activities. Under a special rule, agricultural cooperatives were permitted to determine their deduction effectively on gross sales and use the deduction to offset the cooperative’s income and/or pass through some or all of the benefit to their farmer patrons.

The effect of the old section 199 benefit for farmers was dependent upon the buyer of the farmer’s agricultural products. To the extent a farmer sold to independent buyers (i.e., non-cooperatives), the farmer could have generated his/her own section 199 deduction, typically capped by the 50-percent-of-wages limitation. In that case, a farmer with no employee wages would have had no section 199 deduction.

In contrast, a farmer patron who sold to the cooperative was not permitted to include the income from such sales in his/her section 199 calculation, but instead would have benefitted from the section 199 deduction passed through to him/her as a farmer patron of the cooperative. In that case, a farmer who sold to a cooperative gave up his/her individual section 199 deduction in order to claim the section 199 deduction passed through to him/her from the cooperative.

Section 199 was repealed by P.L. 115-97, which was signed into law on December 22, 2017, effective for taxable years beginning after December 31, 2017.

Current Law

Beginning in 2018 (through 2025), individual taxpayers may claim a deduction under new section 199A equal to 20 percent of qualified net business income from a partnership, S corporation, or sole proprietorship, as well as 20 percent of qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income. Special rules (described below) apply to specified cooperatives and their patrons.

Specifically, a farmer generally may claim a deduction with respect to sales of agricultural products equal to 20 percent of the net business income, subject to either a wage or wage/capital limitation in the case of taxable incomes above $157,500 (single) and $315,000 (married filing jointly). For farmers with taxable income below those levels, the wage and wage/capital limitation does not apply. Regardless of the income level, the deduction may not exceed 20 percent of the farmer’s taxable income (excluding capital gains).

A special rule permits a farmer who sells his/her agricultural product to the cooperative to determine the deduction based on 20 percent of the gross payments received from the cooperative. Unlike the deduction described above, this 20-percent gross deduction is not
subject to the wage and wage/capital limitation. Similarly, a special rule permits the agricultural cooperative to determine its deduction based on 20 percent of the cooperative’s gross income, less deductible payments to the farmer patrons (and subject to the wage or wage/capital limitation).

Under both special rules, the deduction may not exceed taxable income (excluding capital gains). These deductions may result in the farmer’s and/or the cooperative’s taxable income being reduced to zero, but would not create a net operating loss carryforward.

**Modification**

To address concerns that the current law special rules for cooperatives and their farmer patrons are creating an unintended incentive for farmers to sell their agricultural products to cooperatives, the modification to section 199A would replace the special rules described above with the following approach.

- Cooperatives would be permitted to determine their deduction based on rules substantially similar to those under old section 199, including the flexibility of retaining a portion of their deduction to offset income at the entity level and/or pass through some or all of the deduction to their farmer patrons.

- Farmers selling their agricultural products to independent buyers would continue to determine their deduction as under current law section 199A.

- Farmers selling their agricultural products to agricultural cooperatives (of which they are a patron) would be able to claim a deduction equal to 20 percent of the net business income on such sales, subject to either the wage or wage/capital limitation if the farmer has taxable income above the $157,500/$315,000 thresholds described above. This deduction would then be reduced by an amount equal to what the farmer would have had to forgo under old section 199 as the individual benefit had he/she sold to a cooperative (i.e., the lesser of 9 percent of the net income from the farmer’s sales to the cooperative or 50 percent of wages attributed to such sales). This modified deduction, as under current law, would be limited to 20 percent of the farmer’s taxable income (excluding capital gains). In addition to this modified deduction, the farmer would be able to claim the pass-through deduction from the cooperative (if any), up to the farmer’s taxable income (including capital gains), after applying the farmer’s individual deduction under section 199A.