Water and Agriculture Tax Reform Act

A proposal to reform section 501(c)(12) to improve efficiency and economic vitality of irrigation and water companies

For 150 years, mutual ditch, irrigation, and water companies have installed vital infrastructure used for irrigation and for serving homes and businesses across the West. Congress has long recognized the important role these companies serve and the financial challenges they face. In 1926, Congress adopted a provision in the tax code that provides a tax-exemption for these companies if certain requirements are met. This provision has been critical to western communities for the past 95 years. During this time, however, aging infrastructure and a recent informal interpretation by the IRS have pointed to the need to update this section of the tax code to ensure that it continues to operate well.

This WATER Act addresses two challenges inherent in 501(c)(12) of the tax code:

85-15 Test –

Section 501(c)(12) provides that in order to qualify as tax-exempt, a mutual ditch, irrigation, or water company must receive at least 85 percent of its income from its members. While well intentioned and effective in the early 1900s, over the past thirty years this 85-percent requirement has presented significant challenges to many irrigation and water companies in the West. The cost of maintaining and operating aging water infrastructure has skyrocketed and has made it impossible for many of these companies to operate solely on member income. As companies have been unable to meet the 85-percent test, many have been forced to put off critical infrastructure improvements, while a number of others have lost their tax-exempt status.

Further, as populations have increased in western states, water has become increasingly scarce for cities, agriculture, and other uses. Many local and state efforts have responded to this challenge by promoting reuse of water and water leasing to improve water use efficiency. The 85-percent requirement impedes these efforts since generating non-member income through water reuse or leasing can jeopardize a company's tax-exempt status.

The legislation would address these challenges by permitting a greater percentage of non-member income to be received by these companies provided that the proceeds are used for the operations, maintenance and capital improvements of the irrigation, ditch, and water systems.

Membership Voting Requirements –

The language of Section 501(c)(12) has also created issues about what types of mutual ditch, irrigation, and water companies should qualify as tax-exempt organizations. Historically, mutual ditch, irrigation, and water companies have been corporate entities that issue stock to their shareholders. The greater the number of shares owned by a member, the greater the volume of water he or she receives. Furthermore, a shareholder who owns more shares owes proportionally larger assessments to the corporation. As such, mutual ditch, irrigation, and water companies frequently operate on a **one-share, one-vote basis** and have done so since prior to the adoption of Section 501(c)(12).

Although these companies have operated in this manner for over 100 years, the IRS has informally indicated that these companies must now operate on a **one-shareholder, one-vote basis** if they want to maintain their tax-exempt status. Pursuing this position would strip the tax-exemption of mutual ditch, irrigation, and water companies in most western states.

The legislation addresses this issue by indicating that companies will not jeopardize their tax-exempt status if they continue to operate on a one-share, one-vote basis in accordance with state law.

By excluding certain types of income from the 85-percent member income test and clarifying that the historical corporate structure for these entities is acceptable, Congress can help irrigation, ditch and water companies stay in business while at the same time helping to address the ongoing drought in the West. Further, by requiring that the proceeds from the sale of water be used exclusively for operations and maintenance, Congress can ensure that this income is reinvested in western water infrastructure, helping to create jobs and improve water efficiency.