



Agricultural Law Press

Publisher/Editor

Robert P. Achenbach, Jr.

* * * *

Issue Contents

Bankruptcy

General

Avoidable transfers **101**

Exemptions

Tenancy by the entirety propertys **101**

Federal Estate and Gift Taxation

GSTT **101**

Portability **102**

Federal Income Taxation

Backup withholding **102**

Charitable deduction **102**

IRS notices **103**

Pension plans **103**

Proof of mailing **103**

Qualified business income deduction **103**

Quarterly interest rates **103**

Safe harbor interest rates

July 2019 **103**

Agricultural Law Digest

Volume 30, No. 13

June 28, 2019

ISSN 1051-2780

Proposed Qualified Business Income Deduction Regulations for Cooperatives

-by Robert P. Achenbach, Jr., J.D.

The IRS has issued proposed regulations providing guidance regarding the application of the qualified business interest deduction (QBID) under I.R.C. §§ 199A(a), 199A(b) (7), and 199A(g) to cooperatives and their patrons and to specified cooperatives and their patrons.¹

Rules for Patrons of cooperatives

Although the QBID is not available to cooperatives as C corporations,² non-C corporation patrons of cooperatives are eligible for QBID.³ The proposed regulations provide that patronage dividends or similar payments may be included in the patron's QBI: (1) to the extent that these payments are related to the patron's trade or business; (2) to the extent that these payments are qualified items of income, gain, deduction, or loss at the cooperative's trade or business level; (3) to the extent that these payments are not income from a specified service trade or business (SSTB),⁴ at the cooperative's trade or business level;⁵ and (4) provided the patron receives certain information from the cooperative about these payments.⁶

The proposed regulations provide that in situations in which a patron conducts a trade or business that receives patronage dividends or similar payments from a cooperative, the W-2 wages and unadjusted basis immediately after acquisition (UBIA) of qualified property considered are those of the patron's trade or business and not of the cooperative that directly conducts the trade or business from which the payments arise.⁷

To the extent a patron operating a trade or business has income directly from that business (as opposed to receiving a patronage dividend from a cooperative), the patron must follow the rules of Treas. Reg. §§ 1.199A-1 through 1.199A-6 to calculate the QBID. However, to the extent a patron receives patronage dividends or similar payments from a cooperative, the patron must follow the additional special rules and clarifications in the proposed regulations to calculate the QBID.

For these purposes, patronage dividends or similar payments include money, property, qualified written notices of allocations, and qualified per-unit retain certificates for which an exempt or nonexempt cooperative receives a deduction under I.R.C. § 1382(b), and nonpatronage distributions paid in money, property, qualified written notices of allocation as well as money or property paid in redemption of a nonqualified written notice of allocation for which an exempt cooperative receives a deduction under I.R.C. § 1382(c) (2).⁸

* Publisher and editor of the Agricultural Law Press.

The proposed regulations provide that patronage dividends or similar payments are included in calculating QBI for purposes of the patrons' QBID, provided the amounts are otherwise qualified items.⁹ A patron's QBI can include payments to patrons for which the exempt cooperative receives a deduction under I.R.C. § 1382(c) (2) in addition to payments for which the exempt cooperative receives a deduction under I.R.C. § 1382(b).¹⁰ Amounts paid under I.R.C. § 1382(c)(1) (dividends on capital stock), however, are dividends from ownership of C corporations, which are not included in QBI. Accordingly, the proposed regulations provide that patronage dividends or similar payments are considered to be generated from the trade or business the cooperative conducts on behalf of or with the patron and are characterized by the cooperative at its trade or business level.

Thus, in situations where the patron receives a distribution from a cooperative that is a patronage dividend or similar payment, the cooperative determines whether that distribution contains qualified items of income, as defined under Treas. Reg. § 1.199A-3(b) and reports that information to the patron. The cooperative must report this information regardless of whether the patron's taxable income does not exceed the threshold amount (\$315,000 in the case of joint returns and \$157,500 for all other taxpayers for any taxable year beginning before 2019).¹¹

The proposed regulations provide that the cooperative must report the amount of qualified items of income, gain, deduction, or loss in the distributions made to the patron on an attachment to or on the Form 1099-PATR, *Taxable Distributions Received From Cooperatives*, issued by the cooperative to the patron, unless otherwise provided by the instructions to the Form.¹²

Specified Service Trade or Business

The proposed regulations clarify that a patron (whether the patron is a relevant passthrough entity (RPE) or an individual) must determine whether the trades or businesses it directly conducts are SSTBs.¹³ The proposed regulations also provide that in the case of a patron's trade or business that receives patronage dividends or similar payments distributed from a cooperative, the cooperative must determine whether the distributions from the cooperative include items of income, gain, deduction, and loss from an SSTB directly conducted by the cooperative, and whether such items are qualified items with respect to such SSTB. The cooperative must report to the patron the amount of qualified items of income, gain, deduction, and loss from an SSTB directly conducted by the cooperative. The patron then determines if the distribution may be included in the patron's QBI depending on the patron's taxable income and the statutory phase-in and threshold amounts. Because the cooperative may not know whether the patron's taxable income exceeds the threshold amount, the cooperative must report this information to all patrons.¹⁴

Determination of W-2 Wages and UBIA of Qualified Property

I.R.C. § 199A(f)(1)(A)(2)(iii) requires that S corporations and partnerships allocate W-2 wages and UBIA of qualified property to their owners in accordance with each owner's applicable share;¹⁵ however, I.R.C. § 199A does not provide a similar rule for cooperatives.

The proposed regulations provide that patrons directly conducting trades or businesses that receive patronage dividends or similar payments from a cooperative calculate the W-2 wage and UBIA of qualified property limitations at the patron level

based on the patrons' trades or businesses, without any regard to the cooperative's W-2 wages or UBIA of qualified property.¹⁶

Special Rules for Patrons of Specified Cooperatives¹⁷

Because patrons of specified cooperatives may be eligible to take both an I.R.C. § 199A(a) and I.R.C. § 199A(g) deduction, I.R.C. § 199A(b)(7) provides that if a trade or business of a patron of a specified cooperative receives qualified payments¹⁸ from a specified cooperative that are included in the patron's QBI, the patron must reduce its I.R.C. § 199A(a) deduction by the lesser of (i) 9 percent of so much of the QBI with respect to such trade or business that is properly allocable to qualified payments from the specified cooperative, or (ii) 50 percent of so much of the patrons' W-2 wages¹⁹ with respect to such trade or business as are so allocable.²⁰

The proposed regulations provide an allocation method for items of QBI attributable to more than one trade or business. That allocation method also applies to patrons with multiple trades or businesses.²¹

Under a transition rule, the repeal of former I.R.C. § 199 (the domestic production activity deduction) for taxable years beginning after December 31, 2017 does not apply to former I.R.C. § 199 qualified payments received by a patron from specified cooperatives in a taxable year beginning after December 31, 2017, to the extent such qualified payments are attributable to qualified production activities income (QPAI) with respect to which a deduction is allowable to the specified cooperatives under former I.R.C. § 199 for a taxable year of the specified cooperatives beginning before January 1, 2018.²² Such qualified payments remain subject to former I.R.C. § 199, and any deduction under former I.R.C. § 199 allocated by the specified cooperatives to their patrons related to such qualified payments may be deducted by such patrons in accordance with former I.R.C. § 199. In addition, no deduction is allowed under I.R.C. § 199A(a) and (g) with respect to such qualified payments.

The proposed regulations provide that the cooperative must identify in a written notice to its patrons that an I.R.C. § 199A(a) deduction cannot be claimed for qualified payments that otherwise would constitute QBI in the patron's trade or business in a taxable year in which the qualified payments remain subject to former I.R.C. § 199.²³

Steps for Calculating I.R.C. § 199A(g) Deduction for Specified Cooperatives

The proposed regulations²⁴ provide four required steps to determine the amount of a nonexempt specified cooperative's I.R.C. § 199A(g) deduction and provides rules to determine the amount of an exempt specified cooperative's I.R.C. § 199A(g) deduction.

The first step requires nonexempt specified cooperatives to identify the gross receipts and related deductions (other than a deduction under I.R.C. § 199A(g)) that are from patronage sources and from nonpatronage sources.

The second step is for nonexempt specified cooperatives to identify patronage gross receipts that qualify as domestic production gross receipts (DPGR).²⁵

The third step is for nonexempt specified cooperatives to calculate qualified production activities income (QPAI) from only their patronage DPGR.²⁶

The fourth step is for nonexempt specified cooperatives to

calculate their I.R.C. § 199A(g) deduction, which is equal to 9 percent of the lesser of QPAI or taxable income, and subject to the W-2 wage limitation.²⁷

An exempt specified cooperative is required to perform steps two through four twice, first using only its patronage gross receipts and related deductions and second using only its nonpatronage gross receipts and related deductions.²⁸

Rules for Passing I.R.C. § 199A(g) Deduction to Patrons

Once a specified cooperative calculates the I.R.C. § 199A(g) deduction, it may pass on the deduction to patrons who are eligible taxpayers, defined as (i) a patron that is other than a C corporation or (ii) a patron that is a specified cooperative. The proposed regulations provide that a specified cooperative that receives an I.R.C. § 199A(g) deduction as an eligible taxpayer can take the deduction only against patronage gross income and related deductions, or pass on the deduction to its patrons that are eligible taxpayers.²⁹ The proposed rules do not allow an exempt specified cooperative to pass through any of the I.R.C. § 199A(g) deduction attributable to nonpatronage activities because no QPAI is attributable to any qualified payments.

Cooperative as a Partner in a Partnership

The proposed rules provide that a partnership must separately identify and report on the Schedule K-1 issued to its partner, unless otherwise provided by the instructions to the form, the specified cooperative's allocable share of gross receipts and related deductions.³⁰ This allows the specified cooperative partner to apply the four steps³¹ required to calculate its patronage I.R.C. § 199A(g) deduction (or patronage and nonpatronage I.R.C. § 199A(g) deductions in the case of an exempt specified cooperative).

Domestic Production Gross Receipts (DPGR)

The proposed regulations do not allow a specified cooperative to pass through to a C corporation any of the I.R.C. § 199A(g) deduction of the specified cooperative attributable to the disposition of such agricultural or horticultural products.³² This is because, under I.R.C. § 199A(g)(2)(D), taxpayers taxed as C corporations are not eligible to claim a I.R.C. § 199A(g) deduction from the specified cooperative.

The proposed regulations provide guidance on the allocation of costs to DPGR,³³ including rules for allocating a taxpayer's COGS, as well as other expenses, losses, and deductions properly allocable to DPGR.

Wage Limitation

The proposed regulations provide guidance regarding the W-2 wage limitation on the I.R.C. § 199A(g) deduction.³⁴ A Notice of a proposed revenue procedure, which proposes a draft revenue procedure providing three proposed methods that specified cooperatives may use for calculating W-2 wages, is being issued concurrently with this notice of proposed rulemaking and is discussed below.³⁵

Under the proposed regulations, W-2 wages for the purpose of the wage limitation in I.R.C. § 199A(g) are generally determined in a manner that is similar to the manner in which W-2 wages are determined for the purpose of the deduction under I.R.C. § 199A(a) with three significant differences.³⁶ First, I.R.C. § 199A(g)(1)(B)(ii) provides that W-2 wages are determined without regard to I.R.C. § 199A(b)(4)(B), which excludes from the definition amounts not properly allocable to QBI for purposes of I.R.C. § 199A(c)(1). Second, W-2 wages under I.R.C. § 199A(g) do not include any

amount that is not properly allocable to DPGR. Third, W-2 wages under I.R.C. § 199A(g) do not generally include any remuneration paid for services in the commonwealth of Puerto Rico and other United States territories.

Proposed Expanded Affiliated Group Rules

The proposed regulations provide guidance on the application of I.R.C. § 199A(g) to an expanded affiliated group (EAG) under I.R.C. § 199A(g)(5)(A)(iii) that includes a specified cooperative.³⁷ Unlike the former I.R.C. § 199 deduction, the I.R.C. § 199A(g) deduction is limited to specified cooperatives. The proposed regulations provide that, in the case of nonexempt specified cooperatives, attribution between the members of an EAG is allowed provided the DPGR and related deductions are patronage. In the case of exempt specified cooperatives, attribution is allowed in all events because exempt specified cooperatives are allowed to take a separate I.R.C. § 199A(g) deduction on both their patronage and nonpatronage income.

New IRS Proposed Revenue Procedure

The IRS has issued a Notice³⁸ which contains a proposed revenue procedure providing computational guidance on methods and appropriate sources of data for calculating W-2 wages for purposes of I.R.C. § 199A(g) and Prop. Treas. Reg. §§ 1.199A-8 through 1.199A-12 discussed above. The proposed revenue procedure provides three methods for calculating W-2 wages for purposes of I.R.C. § 199A(g)(1)(B)(i), which limits the amount of the deduction available to specified agricultural or horticultural cooperatives under I.R.C. § 199A(g)(1)(A) to 50 percent of the specified cooperative's W-2 wages for the taxable year.³⁹

Unmodified Box Method. Under the Unmodified Box method, W-2 wages are calculated by taking, without modification, the lesser of—The total entries in Box 1; or the total entries in Box 5 of all Forms W-2 filed with SSA by the Specified Cooperative with respect to employees of the Specified Cooperative for employment by the Specified Cooperative.

Modified Box 1 Method. Under the Modified Box 1 method, the specified cooperative makes modifications to the total entries in Box 1 of Forms W-2 filed with respect to employees of the specified cooperative. W-2 wages under this method are calculated as follows—(1) total the amounts in Box 1 of all Forms W-2 filed with SSA by the specified cooperative with respect to employees of the specified cooperative for employment by the specified cooperative; (2) subtract from the total in (1) amounts included in Box 1 of Forms W-2 that are not wages for federal income tax withholding purposes, including amounts that are treated as wages for purposes of income tax withholding under I.R.C. § 3402(o) (for example, supplemental unemployment compensation benefits within the meaning of *Rev. Rul. 90-72, 1990-2 C.B. 211*); and (3) add to the amount obtained after paragraph (1) the total of the amounts that are reported in Box 12 of Forms W-2 with respect to employees of the specified cooperative for employment by the specified cooperative and that are properly coded D, E, F, G, or S.

Tracking Wages Method. Under the tracking wages method, the specified cooperative actually tracks total wages subject to federal income tax withholding and makes appropriate modifications. W-2 wages under this method are calculated as follows—(1) total the amounts of wages subject to federal income tax withholding that are paid to employees of the specified cooperative for employment

by the specified cooperative and that are reported on Forms W-2 filed with SSA by the specified cooperative for the calendar year; and (2) add to the amount obtained in (1) of this section the total of the amounts that are reported in Box 12 of Forms W-2 with respect to employees of the specified cooperative for employment by the specified cooperative and that are properly coded D, E, F, G, or S.

The proposed revenue procedure also contains directions for specified cooperatives with short tax years.

ENDNOTES

¹ REG-118425-18, 84 Fed. Reg. 28668 (June 19, 2019). The proposed regulations are organized into six sections: Prop. Treas. Reg. §§ 1.199A-7 through 1.199A-12.

² I.R.C. § 199A(a).

³ Treas. Reg. § 1.199A-1(a)(2) provides that, for purposes of applying the rules of Treas. Reg. §§ 1.199A-1 through 1.199A-6, a reference to an individual includes a reference to a trust (other than a grantor trust) or an estate to the extent that the QBID is determined by the trust or estate under the rules of Treas. Reg. § 1.199A-6. The proposed regulations apply this same usage of the term individual.

⁴ See definition of SSTB in I.R.C. § 199A(d)(2).

⁵ Except as permitted by the threshold rules, see Treas. Reg. § 1.199A-5(a)(2).

⁶ See Prop. Treas. Reg. § 1.199A-7(c)(3), (d)(3).

⁷ Prop. Treas. Reg. § 1.199A-7(e).

⁸ See Harl and Achenbach, *Agricultural Law*, Ch. 135 (taxation of cooperatives) (2019).

⁹ Treas. Reg. § 1.199A-7(c). To be otherwise qualified, these amounts must be qualified items of income, gain, deduction, and loss under I.R.C. § 199A(c)(3).

¹⁰ Treas. Reg. § 1.199A-7(c).

¹¹ See Rev. Proc. 2018-57, I.R.B. 2018-49, 827.

¹² Prop. Treas. Reg. § 1.199A-7(c)(3).

¹³ Prop. Treas. Reg. § 1.199A-7(d).

¹⁴ Prop. Treas. Reg. § 1.199A-7(d)(3) provides that the cooperative must report to the patron the amount of SSTB income, gain, deduction, and loss in distributions that is qualified with respect to any SSTB directly conducted by the cooperative on an attachment to or on the Form 1099-PATR (or any successor form) issued by the cooperative to the patron, unless otherwise provided by the instructions to the Form. If the cooperative does not report the amount on or before the due date of the Form 1099-PATR, then only the amount that a cooperative reports as qualified items of income, gain, deduction, and loss under Prop. Treas. Reg. § 1.199A-7(c)(3) may be included in the patron's QBI, and the remaining amount of distributions from the cooperative that may be included in the patron's QBI is presumed to be zero.

¹⁵ Treas. Reg. § 1.199A-6 contains additional information regarding these reporting requirements.

¹⁶ Prop. Treas. Reg. § 1.199A-7(e).

¹⁷ Specified cooperative is defined in Prop. Treas. Reg. § 1.199A-8(a)(2) as "... a cooperative to which Part I of subchapter T of chapter 1 of subtitle A of the Internal Revenue Code (Code) applies and which—(A) Manufactures, produces, grows, or extracts (MPGE) in whole or significant part within the United States any agricultural or horticultural product, or (B) Is engaged in the marketing of agricultural or horticultural products that have

been MPGE in whole or significant part within the United States by the patrons of the cooperative.”

¹⁸ As defined in I.R.C. § 199A(g)(2)(e) and Prop. Treas. Reg. § 1.199A-8(d)(2)(ii).

¹⁹ See I.R.C. § 199A(b)(4), (7). The proposed rules provide a safe harbor allocation method for patrons with taxable income not exceeding the threshold amounts set forth in 199A(e)(2) to determine how to calculate the I.R.C. § 199A(b)(7) reduction. The proposed regulations require the specified cooperative to report the amount of such qualified payments on an attachment to or on the Form 1099-PATR, (or any successor form) issued by the cooperative to the patron, unless otherwise provided by the instructions to the Form.

²⁰ Prop. Treas. Reg. § 1.199A-7(f)(3).

²¹ Prop. Treas. Reg. § 1.199A-7(f)(2). The patron must allocate those items using a reasonable method based on all the facts and circumstances.

²² See Pub. L. 115-97, title I, § 13305(c), 131 Stat. 2054, 2126 (2017), as amended by Pub. L. 115-141, div. T, § 101(c), 132 Stat. 348, 1151 (2018), providing a transitional rule for qualified payments of patrons of cooperatives.

²³ Prop. Treas. Reg. §§ 1.199A-7(h)(3), 1.199A-8(h)(3). The cooperative must report this information on an attachment to or on the Form 1099-PATR (or any successor form) issued by the cooperative to the patron, unless otherwise provided by the instructions to the Form.

²⁴ Prop. Treas. Reg. § 1.199A-8.

²⁵ See Prop. Treas. Reg. § 1.199A-9 for additional information on DPGR.

²⁶ See Prop. Treas. Reg. § 1.199A-10 for additional information.

²⁷ See Prop. Treas. Reg. § 1.199A-11 for additional information.

²⁸ Prop. Treas. Reg. § 1.199A-8. An exempt specified cooperative cannot combine, merge, or net patronage and nonpatronage items at any step in determining its patronage I.R.C. § 199A(g) deduction and its nonpatronage I.R.C. § 199A(g) deduction.

²⁹ Prop. Treas. Reg. § 1.199A-8.

³⁰ Prop. Treas. Reg. § 1.199A-8(f).

³¹ See Prop. Treas. Reg. § 1.199A-8.

³² See Prop. Treas. Reg. § 1.199A-9. The proposed regulations incorporate the rules from Treas. Reg. § 1.199-1(d)(1) through (3) and (e), issued under former I.R.C. § 199, as applicable.

³³ Prop. Treas. Reg. § 1.199A-10. The proposed regulations are based on and follow former Treas. Reg. § 1.199-4.

³⁴ Prop. Treas. Reg. § 1.199A-11.

³⁵ Notice 2019-27, I.R.B. 2019-16, discussed below.

³⁶ Prop. Treas. Reg. § 1.199A-11.

³⁷ Prop. Treas. Reg. § 1.199A-12.

³⁸ Notice 2019-27, I.R.B. 2019-16.

³⁹ The three methods in this Notice are substantially similar to the methods provided in Rev. Proc. 2006-47, 2006-2 C.B. 869, used to calculate W-2 wages for purposes of the I.R.C. § 199 deduction and provided in Rev. Proc. 2019-11, 2019-09 for QBID.