



TaxNewsFlash

United States



No. 2019-329
June 25, 2019

KPMG report: Section 199A implications for cooperatives; initial impressions of proposed regulations

The Consolidated Appropriations Act, 2018 (Pub. L. No. 115-141) included changes to section 199A concerning the application of a new deduction for certain cooperatives and grain companies.

[Proposed regulations](#) [PDF 382 KB] (39 pages) from the U.S. Treasury Department and IRS provide guidance to implement the statutory revisions. The proposed regulations (REG-118425-18) were published in the Federal Register on June 19, 2019.

Background

As enacted in Pub. L. No. 115-97, section 199A generally provides a deduction for qualifying income of certain noncorporate owners of some pass-through entities and sole proprietorships. The Consolidated Appropriations Act attempted to address certain concerns raised within the agricultural industry, and (effective for tax years beginning after December 31, 2017) section 199A was modified to:

- Restore prior-law section 199 treatment for specified agricultural and horticultural cooperatives under new section 199A(g)
- Allow eligible patrons to claim a deduction passed through from a specified agricultural and horticultural cooperative
- Revise the patron-level deduction to 20% of taxable income or qualified business income (in line with all other non-corporate taxpayers), with limitations for patrons (e.g., farmers) with high taxable incomes or capital gains, and further modifications for patrons who enter into transactions with a cooperative

Overview of proposed regulations

The proposed regulations are extensive and address a number of topics that:

- Provide rules for cooperatives and their patrons under section 199A(a) (the deduction for qualified business income)
- Provide rules for the section 199A(g) deduction for income attributable to domestic production activities of specified agricultural or horticultural cooperatives
- Define domestic production gross receipts (DPGR) for purposes of section 199A(g)
- Provide rules for allocation of cost of goods sold (COGS) and other deductions to DPGR for purposes of section 199A(g)
- Provide rules for the determination of the W-2 wage limitation for purposes of section 199A(g)
- Define expanded affiliated groups for purposes of section 199A(g)
- Define “patronage” and “nonpatronage” for purposes of section 1388
- Remove final regulations under former section 199 and withdraw proposed regulations under former section 199

The new regulations are proposed to be effective for tax years beginning after the date of publication of a Treasury decision adopting them as final regulations in the Federal Register. The preamble indicates that taxpayers may rely on the proposed regulations in their entirety before their finalization.

KPMG observation

The regulations are extensive and rely significantly on existing regulations under section 199A (in the case of section 199A(a)) and under section 199 (in the case of section 199A(g)). Since they are specific to cooperatives, there are a number of special rules with implications for eligibility, computations, and compliance. Treasury and the IRS have requested comments; it is possible that modifications could be made accordingly prior to finalization of the regulations.

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