Section 199A Implementation – Impact on NDA/Darigold

Co-op Background & Prior Section 199

The Northwest Dairy Association (NDA) is a dairy farmer-owned cooperative with farmer-owners in Washington, Idaho, Oregon, and Montana. Under the Darigold brand, the cooperative owns and operates numerous dairy manufacturing plants that process the milk produced by NDA farmers into consumer dairy products and ingredients. Darigold is a wholly owned subsidiary of NDA that joins in the filing of the cooperative's consolidated federal income tax return.

Congress created the Section 199 tax deduction for domestic manufacturing in 2004. Businesses across the economy have used the deduction. Dairy farmer cooperatives have claimed it as well and have passed the deduction back directly to their farmer-owners. Cooperatives have been able to calculate the deduction on income from wholly owned subsidiaries that join in their consolidated federal return.

Therefore, NDA has been able to include the income generated by Darigold's plants in its calculation of Section 199, as Darigold is included in NDA's consolidated tax return and its plants are processing milk produced by NDA's farmer-owners. Darigold's incorporation as a fully owned subsidiary of NDA has never prevented NDA from including the domestic manufacturing income from the processing plants in the deduction, which is of course for domestic manufacturing.

Section 199A – Replacement and Implementation

Congress repealed Section 199 in the 2017 tax law. In its place, Congress created Section 199A(g) specifically for agricultural cooperatives and enacted a revised version in 2018. While Congress made clear its intent that the deduction should operate in the same manner as the former Section 199, the Department of the Treasury's proposed rule would undermine this intent. Of great concern, the rule does not make clear that cooperatives can count income from non-cooperative subsidiaries when calculating the deduction, even those that are included in the cooperative's consolidated tax return.

This restriction clearly contradicts the law, which states that the regulations "shall be based on the regulations applicable to cooperatives and their patrons under section 199 (as in effect before its repeal)." Limiting the deduction as proposed in the rule would also impose a tax increase on the many dairy producers that market their milk through cooperatives with wholly owned subsidiaries.

Should the proposed regulation move forward as written, <u>virtually the entire Section 199 deduction that NDA takes would be wiped out</u> because the cooperative would be unable to count income generated by Darigold in the deduction. In recent years, NDA has taken a deduction totaling roughly $60 million annually, which has been passed back to its farmer-owners in direct proportion to their share of NDA's total milk volume. NDA's Washington owners receive roughly $44 million of this total, while its Idaho owners receive roughly $10 million. While the amount passed back to each producer varies, on average this would amount to a tax increase of $150,000 annually per Washington state farmer and $200,000 annually per Idaho farmer if each produced the same volume of milk.

Solution

If this issue has not been resolved in the proposed Section 199A rule, remand the rule to the Department of the Treasury with instructions to withdraw the rule and amend it to ensure that when cooperatives calculate the Section 199A(g) deduction, they can include income from non-cooperative subsidiaries that join in the cooperative's consolidated tax return. This is consistent with congressional intent in enacting the revised deduction.