

Farm Accounting Issues**Cooperative Transactions****Distributions**

Cooperatives (Co-op) distribute a portion of earnings to their owner members and report these transactions on Form 1099-PATR. The distributions may be classified as patronage dividends or per unit retains.

Patronage Dividends

- Allocated on the basis of member patron's quantity of business based on the cooperative's net earnings
- Issued in portions of cash and stock allocations, both taxable to the recipient at the time of issuance
- Accounted as income with stock portion as investment in an asset

Per Unit Retains

- Allocated by the co-op based on the coop's products marketed for the patron rather than on earnings
- May be qualified, taxable in the year of allocation, or nonqualified which are not taxable to the patron until the certificate is redeemed or sold with zero cost basis on Schedule F or Form 4835

Cooperative distributions related to patron's capital purchases decrease the basis of the capital asset and are not taxable income

Losses from the sale or redemption of patronage stock allocations are Schedule F or Form 4835 transactions but gains above stated amounts may be capital gains or interest income

Domestic Production Activities Deduction (DPAD)

- IRC Section 199 allows for a deduction of 6% of qualified production activities income in 2009, limited to 6% of taxable income and 50% of Form W-2 social security wages
- Cooperatives calculate the DPAD at the entity level and can elect to pass the deduction through to their member patrons which are not limited to the member's wages paid
- Co-ops do not have to consider their payments to members as deductions of their taxable income or qualified domestic income for the DPAD pass through

- Recent letter rulings allow some marketing co-ops, depending on their member agreements, to consider the payments made to their members for commodities as per unit retain payments
- Results in significantly higher potential for the domestic production activities deduction

Form 1099-PATR may classify commodities sold through a cooperative as per unit retains which require this payment to be reported on Schedule F/Form 4835 as a cooperative transaction rather than as commodities sold.

Cooperative fiscal years seldom coincide with the producer member's tax year.

Farm producers often sell commodities to both cooperatives and non co-op businesses requiring an additional calculation of the producer's qualified production activities income (QPAI)

CRP and the Self-Employment Tax

Whether Conservation Reserve Program (CRP) payments are subject to self-employment (SE) tax has been contentious for many years. In Revenue Ruling 60-32 the IRS concluded that land diversion program payments were subject to SE tax if the participant was otherwise materially participating in a farm operation, but that the payments to set aside the land were exempt from SE tax if received by a landlord or other non-farming participant. In two later non-binding authorities IRS has taken nearly opposite positions. In 1988 Private Letter Ruling 8822064 held that a retired farmer who places land in the CRP program was not subject to SE tax. But in a more recent Chief Counsel Memo, CCA 200325002, the IRS determined that both active farmers and retirees or investors were subject to SE tax on CRP.

For active farmers, the holdings have contradictory also. A Tax Court decision, *Wuebker v. Com*, concluded that an active farmer receiving CRP was not subject to the SE tax. This decision was later reversed in Sixth Circuit as it was held that CRP payments were subject to SE tax because the contract required duties such as tillage to plant a grass crop, seeding, fertilizing and weed control. This jurisdictional court affected only Sixth Circuit states, the other states being subject to the national Tax Court opinion.

In Notice 2006-108, issued December 5, 2006, the IRS reiterated their position that CRP rental payments are earnings from self employment for both actively engaged farmers individuals not otherwise actively engaged in farming who enroll land in the CRP and arrange for a others perform the CRP contractual obligations. The IRS indicated that it intended to issue a revenue ruling which, to date, has not occurred. Nevertheless, the IRS, in its administrative audit program, relies on this notice, stating that it "sets forth the applicable Internal Revenue Service Tax law and other authorities supporting this position."

The IRS has commenced a national examination program being administered out of Bismarck, ND, attempting to impose self-employment tax on individuals who received CRP payments in 2006 and 2007, and has mailed deficiency notices to taxpayers.

The 2008 Farm Bill, PL 110-246, excluded Conservation Reserve Program payments from self employment tax for those receiving regular benefits or disability benefits from Social Security. This law was effective for 2008 and beyond but is silent regarding CRP payments to operating farmers and landowners not retired or drawing Social Security benefits. The Committee Report to this legislation states that “the treatment of conservation reserve payments received by other taxpayers is not changed.”

The IRS examinations for 2006-07 continue and prior rulings remain their operating guidelines for CRP payments made to recipients who are not drawing benefits from Social Security. The IRS argues that their position that CRP payments were earnings subject to self-employment tax was correct or the Farm Bill provision would not have been necessary. Furthermore, by specially excluding some payments, the Farm Bill implies that others are subject to self-employment tax. Landowners not retired remain the most vulnerable to IRS challenges. These owners can argue that CRP or not subject to self-employment tax because they generally have no agreement to materially participate in the farm operation and they do not materially participate in farming but IRS may be determined to subject their CRP payments to self-employment tax.

QPAI Calculation

XXX CO-OP Sales as Per Unit Retains

125,000

Schedule F

Commodity sales	500,000	
Other qualified income	<u>50,000</u>	
Gross Income		550,000
Qualified Expenses		<u>475,000</u>
Net Farm Income		75,000

Producer Domestic Production Gross Receipts

550,000
-125,000
425,000

Producer Directly Allocable Deductions

Operator Share Qualified Income	425,000	
Operator Gross Income	550,000	
		0.7727
Qualified Expenses	475,000	
	<u>0.7727</u>	367,045

Producer Qualified Production Activities Income

425,000
-367,045
QPAI 57,955

Producer W-2 Wages	50,000	
	<u>0.7727</u>	
Qualified Wages		38,636

