

Who can claim a DPAD?

IRS decision makes Domestic Production Activity Deductions more confusing.



Editor's note: Kent Vickre and Dwight Raab write a tax and finance column for each issue of Pioneer GrowingPoint® magazine. Vickre is state coordinator of the Iowa Farm Business Association. Raab is state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.



Last tax season, many growers were surprised when their co-ops started reporting grain sales as “per-unit retains payments in money” (PURPIM) on 1099-PATR forms. As a result, many producers had no grain sales to report on their tax return (Schedule F), and the co-ops — not the growers — claimed the Domestic Production Activity Deduction (DPAD) on that grain.

The impact on farming operations is confusing. In this article, we'll cover some changes and offer some basic answers. Among the questions the 1099-PATR forms raised last year were:

1. What is the amount reported on the 1099-PATR in Box 3 (Per-Unit Retain Allocations)?
2. Can I deduct the amount listed on the 1099-PATR in Box 6 (Domestic Production Activities Deduction)?
3. What tax consequences will this have for me?

The changes cooperatives made in their 1099 reporting

were due to several IRS private letter rulings regarding this deduction. After the IRS reviewed one cooperative's membership agreement, the tax agency said the payments cooperatives make to members for delivered grain qualify as advanced PURPIM. Because of these letter rulings, cooperatives started to claim the DPAD themselves and changed their 1099-PATR reporting.

This led to more questions, such as:

- What is the Domestic Production Activity Deduction (DPAD)?
- How is it calculated?
- How much can I claim?

To answer these questions, we have to take a closer look at the IRS Code (I.R.C. § 199), specifically how it applies to agricultural commodities. The most thorough explanation of DPAD appears in an article by Phillip E. Harris¹ and Roger A. McEowen.² We've summarized their explanation and

updated the percentages for the 2010 tax year.

The legal background

I.R.C. § 199 allows taxpayers to claim a deduction on their income tax return based on their net income from most production activities in the United States. The DPAD is limited to the lesser of:

- 9 percent of the qualified production activities income (QPAI)
- 9 percent of the entity's taxable income without regard for I.R.C. § 199 (modified adjusted gross income for individual taxpayers)
- 50 percent of Form W-2 wages paid during the year by the taxpayer

How to figure QPAI

QPAI equals domestic production gross receipts (DPGR) reduced by the sum of the following:

- Cost of goods sold (CGS) allocable to DPGR
- Other deductions and expenses directly allocable to DPGR
- And a share of other deductions and expenses not directly allocable to DPGR or another class of income.

Observation: QPAI for many farmers is the sum of their net income reported on Schedule F (Form 1040), Profit or Loss from Farming and net gain from sale of raised livestock reported on Form 4797, Sales of Business Property. However, there are exceptions to this general rule.

DPGR: DPGR are receipts that come from the lease, rental, license, sale, exchange or other disposition of qualifying production property that's manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States.³ Qualifying activities include cultivating soil, raising livestock and fishing as well as storage, handling and other processing (other than transportation) of ag products.⁴

Wages: For many farmers, the 50 percent of wages limitation is the major limiting factor for DPAD. Many farmers have little or no paid labor. In addition, wages which require no withholding can't be used as "Form W-2 wages."⁵ Thus, wages paid in commodities, wages paid for agricultural labor to the proprietor's child under age 18 or


to a child under age 18 who is the child of any partner and compensation paid in the form of nontaxable fringe benefits are not included in Form W-2 wages.

Note: For tax years beginning after May 17, 2006, only the wages allocable to DPGR are qualified wages for the 50 percent of wages limitation.

Figuring the DPAD

The DPAD calculations themselves are complicated. Let's focus on how they affect you:

- If you sell grain to a cooperative where you are a member and your cooperative membership agreement characterizes payments to members as PURPIM, your cooperative will include the grain income in its DPAD deduction. The cooperative either can use the deduction on its tax return OR pass this deduction through to its members. How the cooperative decides to handle the deduction affects both the 1099-PATR and how you report it on your personal tax return. See "Explanation of 1099-PATR sections."
- If you sold your grain to a non-cooperative or you're not a member, you can use your grain sales in your own DPAD calculation deduction. Your grain sales will be included on your Schedule F, line 4, "Sales of livestock, produce, grains, and other products you raised."

For more details regarding this deduction, I suggest you review the article "Domestic Production Activity Deduction for Members of a Cooperative." It's posted on the Center for Agricultural Law and Taxation (CALT) at www.calt.iastate.edu. Look under "News & Updates" then select the February 2010 articles. This eight-page article is dated Feb. 19, 2010. It has a question-and-answer section that addresses many issues producers raise. You may want to address these questions with your tax professional or accountant. 

¹ Department of Agricultural and Applied Economics, University of Wisconsin-Madison.

² Leonard Dolezal Professor in Agricultural Law, Iowa State University, Ames, Iowa, and director of the ISU Center for Agricultural Law and Taxation.

³ I.R.C. § 199(c)(4).

⁴ Treas. Reg. § 1.199-3(e)(1).

⁵ See Rev. Proc. 2006-22, 2006-22 I.R.B. 1033.

Explanation of 1099-PATR sections

1099-PATR, Box 3 — The amount in Box 3 is the amount the cooperative paid you as a PURPIM (based on your membership agreement). This would be reported on your Schedule F, Line 5a, "Cooperative distributions (Form(s) 1099-PATR" and Line 5b, "Taxable amount."

1099-PATR, Box 6 — The amount in Box 6 is the cooperative's deduction they elect to pass through. This amount should be reported on Form 8903, "Domestic Production Activities Deduction," line 21. If the cooperative decides to pass the DPAD deduction through to its members based on their patronage, the deduction on the member's tax return is not limited by the member's adjusted gross income on Form W-2 wages. 