

**DESCRIPTION OF H.R. 519,
THE “WATER AND AGRICULTURE TAX REFORM ACT OF 2017”**

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
on June 21, 2018

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION



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INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of H.R. 519, the “Water and Agriculture Tax Reform Act of 2017,” on June 21, 2018. The bill modifies the tax exemption requirements for mutual ditch and irrigation companies under section 501(c)(12).¹ This document,² prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

¹ All section references herein are to the Internal Revenue Code of 1986, as amended (herein “Code”), unless otherwise stated.

² This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 519, the “Water and Agriculture Tax Reform Act of 2017,”* (JCX-39-18), June 20, 2018. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

A. Modify Tax Exemption Requirements for Mutual Ditch or Irrigation Companies

Present Law

Section 501(c)(12) describes certain mutual or cooperative organizations that are exempt from Federal income tax under section 501(a), namely: (1) benevolent life insurance associations of a purely local character; (2) mutual ditch or irrigation companies; (3) mutual or cooperative telephone companies; and (4) like organizations to any of the foregoing types of organizations.³ In 1967, the IRS interpreted the reference to “like organizations” to include mutual or cooperative electric companies and water companies, and such mutual or cooperative electric companies and water companies have been treated as within section 501(c)(12).⁴

In general, 85 percent or more of the income of these entities must consist of amounts collected from members for the sole purpose of meeting losses and expenses of the organization.⁵ The 85-percent test is applied on a year-by-year basis. If an organization fails to satisfy the test for a year, it does not qualify for exemption for that particular year; it may, however, continue to qualify for exemption for any year for which the 85-percent test is satisfied. The Code provides certain exceptions to the 85-percent-of-income requirement for mutual and cooperative telephone and electric companies.⁶

The Service generally requires that mutual or cooperative organizations described in section 501(c)(12) be democratically controlled, meaning that election of officers is conducted on a one-member, one-vote basis, with all meetings having a quorum of members in attendance or voting by proxy.⁷

Description of Proposal

First, in the case of a mutual ditch or irrigation company (or a like organization to a mutual ditch or irrigation company), the 85-percent-of-income requirement is applied without taking into account income received or accrued: (1) from the sale, lease, or exchange of fee or other interests in real property, including interests in water; (2) from the sale or exchange of stock in a mutual ditch or irrigation company (or in a like organization to a mutual ditch or irrigation company) or contract rights for the delivery or use of water; or (3) from the investment of proceeds from sales, leases, or exchanges under (1) or (2) above.

³ Sec. 501(c)(12)(A).

⁴ Rev. Rul. 67-265, 1967-2 C.B. 205.

⁵ Sec. 501(c)(12)(A); Treas. Reg. sec. 1.501(c)(12)-1(a).

⁶ Secs. 501(c)(12)(B)-(H).

⁷ Internal Revenue Manual sec. 7.25.12.5 (citing *Puget Sound Plywood, Inc. v. Commissioner*, 44 T.C. 305 (1966), acq. 1966-2 C.B. 6).

Notwithstanding the foregoing, any income described in (1), (2), or (3) above that is distributed or expended for expenses (other than for operations, maintenance, and capital improvements) of the mutual ditch or irrigation company (or of the like organization to a mutual ditch or irrigation company, as the case may be), shall be treated as nonmember income in the year in which it is distributed or expended. For this purpose, expenses (other than for operations, maintenance, and capital improvements) include expenses for the construction of conveyances designed to deliver water outside of the system of the mutual ditch or irrigation company or of the like organization.

Second, in the case of a mutual ditch or irrigation company (or a like organization to a mutual ditch or irrigation company), where State law provides that such an organization may be organized in a manner that permits voting on a basis that is pro rata to share ownership on corporate governance matters, the organization's eligibility for tax exemption is determined without taking into account whether each of its member shareholders has one vote on corporate governance matters per share held in the organization. Nothing in this rule shall be construed to create any inference about the requirements of section 501(c)(12) for organizations other than mutual ditch or irrigation companies.

Effective Date

The proposal is effective for taxable years beginning after the date of enactment.

B. Estimated Revenue Effect of the Proposal

Fiscal Years													
[Millions of Dollars]													
<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2018-23</u>	<u>2018-28</u>	
[1]	-3	-3	-4	-4	-4	-4	-4	-4	-4	-4	-18	-39	

NOTE: Details do not add to totals due to rounding.

[1] Loss of less than \$500,000.