Making Sense of the New 20% Qualified Business Income Deduction in the Tax Cuts and Jobs Act

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The late 2017 overhaul of the Tax Code is the first massive revision since 1986. The changes are broad, and we will focus on only one part of the bill – the new deduction bestowed upon owners of sole proprietorships, S corporations, partnerships, trusts and estates. The changes went into effect January 1, 2018 and will continue at least until December 31, 2025. Let's review the 2017 law first.

Entity Choice Under 2017 Law

If you operate a business, there are four main entity choices:

- C corporation
- Sole proprietorship
- S corporation
- Partnership, including LLCs and limited partnerships.

Owners of C corporations are subject to double taxation. When income is earned by the corporation, it is first taxed at the business level, at a top tax rate of 35% under 2017 law. When the corporation distributes income to its shareholders, the shareholders pay tax on the dividends, at a top rate of 23.8%. Thus, from a federal tax perspective, owners of C corporations pay a combined total rate on the income earned by the business of 50.47% (35% + (65% * 23.8%)).

If you do not operate as a C corporation, you are taxed at a single level. For sole proprietorships, S corporations and partnerships, when income is earned at the business level, it is generally not taxed at that level; instead, the income of the business ultimately is taxed only once and that is at the individual level.

A sole proprietor simply reports his or her income directly on Schedule C. For an S corporation or a partnership (referred to in the Section 199A Regulations as "Relevant Passthrough Entity" or RPE, the income of the business is allocated among the owners and included on the owners' returns. Owners of the business can include individuals, members of LLCs, partners of partnerships, shareholders of S corporations, trusts and estates. The business owner of an RPE pays tax on its share of the income at ordinary rates, which rise to as high as 40.8% under 2017 law (39.6% top rate plus a 1.2% phase out of itemized deductions for high earners). C corporations that own ownership interests in RPEs do not qualify for the Qualified Business Income Deduction (QBID).

Under 2017 law, the top effective tax rates paid by C corporations versus other business types were:

- 50.47% for C corporations
- 40.8% for sole proprietors, shareholders in an S corporation and partners of a partnership.

Entity Choice Under the New Law

The foundation of the Tax Cuts and Jobs Act was the reduction in the C corporation tax rate from 35% to 21%. However, Congress could not make this reduction as a stand-alone change. Such a dramatic decrease would have caused the business playing field to tilt, with sole proprietors and owners of RPEs losing much of their advantage over their corporate competitors. The effective combined rate on corporate owners would become 39.8% (21% + (79%*23.8%)), while the top rate for ordinary individual income – the rate applied to the income of sole proprietors and owners of

RPEs, whether distributed or not – would become 37% under 2018 law. This would mean the advantage of a single level of taxation would shrink from 10% to just 2.8%.

Congress' solution to this problem was to create Section 199A, a new provision of the Internal Revenue Code (IRC). Section 199A allows owners of sole proprietorships, S corporations and partnerships – as well as trusts, estates and owners of stand-alone rental properties reported on Schedule E – to take a deduction of 20% against their income from the business if they qualify. The result is to reduce the effective top rate on business income of sole proprietorships and RPEs from 40.8% under 2017 law to 29.6% under Section 199A (new 37% top rate * 20% deduction = 29.6%).

Because of the new Section 199A deduction, sole proprietors and owners of RPEs retain their competitive rate advantage over C corporations; that is, 10% under the old law and 10% under the new law (39.8% versus 29.6%).

Section 199A, however, is anything but simple, and the 20% deduction is far from guaranteed to business owners. Claiming the new deduction requires navigating confusing new limitations, definitions, thresholds and phase-ins and phase-outs.

Qualified Business Income (QBI)

QBI is defined in Section 199A(c) as the "ordinary" income – less ordinary deductions – earned from a sole-proprietorship, S corporation or partnership. Basically, QBI is the net amount of qualified items of income, gain, loss and deduction with respect to each taxpayer's Qualified Trade or Business (QTB) only if they are effectively connected with a US trade or business. Puerto Rico counts as part of the US for this purpose.

QBI does not include any wages paid to an owner of a RPE who is also an employee of an S corporation or a guaranteed payment paid to a partner. Compensation paid to an employee of a sole proprietorship or RPE who is not an owner of that RPE is not QBI to that employee because the business of being an employee is not a QTB. A self-employed person or independent contractor who is compensated for his services is a QTB, does have QBI and is eligible for the QBID.

This means that you could have two people doing the exact same job – one as an independent contractor and one as an employee – with the self-employment income of the former being considered QBI (and thus eligible for a 20% deduction), while the wages earned by the latter would not be eligible for the 20% deduction. In addition, the Regulations specifically address the issue of an employee quitting his or her job and then becoming an independent contractor for the former employer by providing – no matter what the status of the former employee may be under other provisions of the IRC – for purposes of Section 199A that person will still be considered an employee of his or her former employer.

QBI does NOT include the following items of investment income:

- short-term capital gain or loss;
- long-term capital gain or loss;
- dividend income;
- interest income on working capital;
- certain foreign personal holding company income; and
- any items of deduction or loss allocable to the foregoing.

For a shareholder or a partner in an RPE, note that QBI does not include any wages or guaranteed payments received by the owners of the RPE from the business. To illustrate, if you own 30% of an S corporation that pays you $40,000 of wages and allocates you $80,000 of income, your QBI from the S corporation is ONLY the $80,000 of income; the $40,000 of wages do not count.

If you are a shareholder in an S corporation that provides significant services and you don't pay yourself reasonable wages, the IRS may treat you as if you took reasonable wages anyway, in which case this "reasonable compensation" will not be treated as QBI.

Determining Your QBI

When beginning the process of determining the amount of your QBI deduction, start by adding all items of income and deductions on a Schedule K-1 OTHER THAN the exclusions. That's your QBI.

> NOTE: Because of a last-minute addition to the Act, the 20% deduction also applies to rental real estate. However, there are many unanswered questions about different types of rental real estate that could result in some types of rental property not qualifying for the deduction, such as property that is under a triple-net lease because such property is not subject to active management.

Once you know your QBI, calculating the 20% to get your deduction amount is not simply multiplying your QBI by 20%. This is only the first step. You must determine if there are any limitations on the amount of the deduction you may take.

Several limitations may apply – some quantitative, some business-based. Beginning with the numerical limitations, you only are entitled to deduct 20% of QBI up to a set limit. (There is a good reason for these limitations: preventing abuse of the new system. To help prevent abuse, Congress enacted W-2 limitations that exclude management fees, independent contractor fees and guaranteed payments.)

The deductible 20% of QBI limit above certain threshold amounts is the GREATER OF:

- 50% of your allocable share of the W-2 wages paid by the business

OR

- 25% of your allocable share of the W-2 wages paid by the business PLUS 2.5% of your allocable share of the UBIA of Qualified Property, which is the unadjusted basis of depreciable property immediately after acquisition of the Qualified Property.

W-2 wages are exactly that: wages paid to an employee, including an employee who is also an owner of the business, and INCLUDING any elective deferrals into a Section 401(k)-type vehicle or other deferred compensation. W-2 wages do not include items such as payments to an independent contractor or management fees. An item is not a W-2 wage for these purposes unless it shows up on a payroll tax return.

For a shareholder in an S corporation, Section 1366 and Section 1377 of the IRC require that all items of an S corporation be allocated pro-rata, on a per-share/per-day basis.

Partners in a partnership have more difficulty determining their pro-rata share of W-2 limitation because partnerships can – subject to the substantial economic effect rules of Section 704(b) of the IRC – "specially allocate" different items of income, gain, loss and deduction among their partners at different percentages. Thus, without concrete guidance, it is unclear how a partner in this situation determines its share of the W-2 wages.

Fortunately, Section 199A(f)(1) instructs that a partner's share of a partnership's W-2 wages is, quite logically, determined in the same manner as his share of the partnership's wage deduction. Thus, if you own a 20% capital stake in a partnership, but under the terms of the agreement you are allocated 80% of any depreciation and only 30% of Schedule K-1, Line 1 ordinary income, you are allocated 30% of the partnership's wage deduction via your Line1 allocation, and you are allocated only 30% of the partnership's W-2 wage expense for the purposes of these W-2 wage limitations.

If the 50% of W-2 wages limitation does not let the owners of a passthrough entity take the full 20% deduction of QBI, an alternative approach of calculating 25% of W-2 wages plus 2.5% of UBIA of

Qualified Property can be used. This second approach is helpful when the RPE does not have W-2 wages or only minimal W-2 wages but does have substantial UBIA of Qualified Property.

The determination of the UBIA of Qualified Property must be made for each trade or business by the individual or RPE that directly conducts the trade or business before applying the aggregation rules of Section 1.199A-4. In the case of Qualified Property held by an RPE, each partner's or shareholder's share of the UBIA of Qualified Property is an amount that bears the same proportion to the total UBIA of Qualified Property as the partner's or shareholder's share of tax depreciation bears to the RPE's total tax depreciation with respect to the property for the year. In the case of Qualified Property held by a partnership that does not produce tax depreciation during the year (for example, property that has been held for less than 10 years but whose recovery period has ended), each partner's share of the UBIA of Qualified Property is based on how gain would be allocated to the partners pursuant to Sections 704(b) and 704(c) if the Qualified Property were sold in a hypothetical transaction for cash equal to the fair market value of the Qualified Property. In the case of Qualified Property held by an S corporation that does not produce tax depreciation during the year, each shareholder's share of the UBIA of Qualified Property is a share of the unadjusted basis proportionate to the ratio of shares in the S corporation held by the shareholder over the total shares of the S corporation. The UBIA of Qualified Property is presumed to be zero if not determined and reported for each trade or business.

Qualified Business Income Deduction (QBID)

On paper, QBID results in a 20% deduction for passthrough entities. But who gets to take the 20% deduction?

Section 199A(a) makes clear that the deduction is available to all taxpayers other than C corporations. This certainly seems to indicate that if an S corporation or partnership has an interest in a lower-tier RPE, the upper-tier S corporation or partnership will have to determine its deduction before determining the amount of its QBI to pass through to its ultimate shareholders or partners. Section 199A(f)(4)(B) and the proposed Regulations provide how to determine the deduction in the case of tiered entities. The proposed Regulations are very helpful in many areas and, as you would expect, there are taxpayers who are winners and losers.

In addition to S corporations, partnerships, sole proprietorships, trusts and estates also can take this deduction if they own RPEs. Finally and most importantly, individuals will be able to take this deduction if they are sole proprietorships or own RPEs.

A few notes:

- The QBID is taken at the business owner's level and includes individuals, trusts and estates.
- After the business owner of a sole-proprietorship or RPE has reached a certain income level, the QBID is limited to a W-2 wage limitation or a W-2 wage and Unadjusted Basis Immediately After Acquisition of Qualified Property (UBIA of Qualified Property) limitation.
- "Qualified Property" is tangible depreciable property.
- An S corporation shareholder's share of the S corporation's wages and UBIA of Qualified Property is proportionate to the shareholder's ownership in the S corporation.
- UBIA of Qualified Property is tangible depreciable property valued at the unadjusted basis of that property immediately after the property was acquired before any depreciation is applied to the property.
- The UBIA of Qualified Property is used for the longer of the normal depreciable life of the property or ten years.

- In a partnership, the partners' share of wages is based on how the wage expenses are shared and how the shares of UBIA of Qualified Property are allocated in accordance with the partnership agreement and reported on the partners' K-1s.
- The deduction for trusts and estates is based on rules similar to those found in Section 199(d)(1)(B) and Treasury Reg. Section 1.199-5(e).
- QBI is the income generated by a QTB and QBID that reduces the taxable income of the taxpayer owner of a sole proprietorship or RPE.
- The QBID is determined without regard to preferences in the IRC.
- The QBID deduction is available for income taxes only. It is not affected by nor does it affect the Net Investment Income Tax, self-employment taxes or Alternative Minimum Tax.
- The deduction is below the line – not part of calculating adjusted gross income – but available to taxpayers who do not itemize.

Taking the QBID

Beginning January 1, 2018, anyone who generates "qualified business income" – QBI – will be entitled to take a deduction of 20% of that QBI on their tax return subject to certain limitations, thresholds, phase-ins and phase-outs.

The deduction is calculated as the SUM of the LESSER of:

- the "combined qualified business income" of the taxpayer, or
- 20% of the excess of taxable income over the sum of any net capital gain

PLUS, the LESSER of

- 20% of qualified cooperative dividends

OR

- taxable income less net capital gain.

Focusing on the first half of the calculation and leaving the "qualified cooperative dividends" section for the tax professionals, let's break down the calculation of the "sum of the lesser" language above. The deduction cannot exceed the taxpayer's taxable income less capital gain.

For "the combined qualified business income" calculation, understand that "combined qualified business income" is not income. Rather, it is a deduction generally calculated as follows:

The SUM of the LESSER of

- 20% of the taxpayer's QBI

Or the GREATER of

- 50% of W-2 wages with respect to the qualified business allocable to the taxpayer from the qualified business, OR
- 25% of W-2 wages with respect to the qualified business allocable to the taxpayer from the qualified business plus 2.5% of the UBIA of Qualified Property

PLUS

- 20% of qualified REIT dividends, which are REIT dividends other than capital gain dividends and qualified dividends (dividends from a REIT otherwise eligible for the 20% rate)

PLUS

- qualified PTP income, which is calculated by adding:
    - The passthrough items of qualified income, gain, loss and deduction from a PTP AND

- Ordinary income realized on the sale of an interest in a PTP because of the application of Section 751(a) (relating to hot assets).

If a taxpayer has QBI of less than zero from one trade or business but has overall QBI greater than zero when all of the taxpayer's trades or businesses are netted, the taxpayer must offset the net income in each trade or business that produced net income with the net loss from each trade or business that produced net loss before the taxpayer applies the limitations based on W-2 wages and UBIA. The taxpayer must apportion the net loss among the QTBs with positive QBI in proportion to the relative amounts of QBI in such QTBs. For purposes of applying the limitation based on W-2 wages and UBIA of Qualified Property, the net income with respect to each trade or business (as offset by the apportioned losses) is the taxpayer's QBI with respect to that QTB. The W-2 wages and UBIA of Qualified Property from the QTBs that produced negative QBI are not considered nor are they carried over into the subsequent year.

In the case of a partnership or S corporation, Section 199A is applied at the partner or shareholder level, but the QBID has no effect on the adjusted basis of the partner's interest in the partnership or the adjusted basis of a shareholder's stock in an S corporation or the S corporation's accumulated adjustments account.

The QBID does not reduce net earnings from self-employment or net investment income. Self-employment income and net investment income are calculated without considering QBID. In addition, for purposes of determining alternative minimum taxable income, QBI will be determined without regard to any adjustments under Sections 56 through 59.

Section 6662(a) provides a penalty for an underpayment of tax required to be shown on a tax return. A substantial understatement of income tax is that which exceeds the greater of ten % of the tax or $5,000. There is a special rule in the case of any taxpayer who claims the QBID by substituting "five percent" for "ten percent."

The proposed Regulations provide that, in determining W-2 wages, a person may take into account any W-2 wages paid by another person and reported by the other person on form W-2, with the other person as the employer listed in Box C of the W-2 if the W-2 wages were paid to common-law employees or officers of the taxpayer. The person paying the W-2 wages and reporting the W-2 wages on form W-2 is precluded from considering such wages for purposes of determining W-2 wages for that person. Taxpayers who have other persons who pay and report W-2 wages on behalf of or with respect to others can include certified professional employer organizations, statutory employers and agents. Taxpayers who otherwise qualify for the QBID are not restricted in applying the QBID merely because they use a third-party payor to pay and report wages to their employees.

If there is any addition to or improvement of UBIA of Qualified Property that previously was placed in service, such addition or improvement will be treated as separate UBIA of Qualified Property that the taxpayer made on the date of the addition or improvement, and that date will be used for determining the depreciable period of the QBID of Qualified Property.

The IRS stated in the proposed Regulations that "reasonable compensation" is limited to situations involving S corporations and the paying of compensation to shareholders of that S corporation. "Reasonable compensation" does not apply to partnerships, LLCs and sole proprietorships. Partners cannot receive wage compensation from the partnership or LLC. Wages paid by an S corporation to a shareholder do not qualify for QBI. No partner is required to take a guaranteed payment from the partnership. Guaranteed payments do not qualify as QBI.

If the "reasonable compensation" paid to a shareholder for services rendered on behalf of the S corporation is too low and the taxable income of the S corporation is too high, the IRS can increase the compensation paid to the shareholder and thus lower the taxable income of the S corporation, which will reduce the QBI available to the shareholder. Maintaining a proper balance between "reasonable compensation" and maximum QBI will be a high priority in the future. W-2 wages paid

to a shareholder factor into determining the W-2 wage limitation requirement as to whether a shareholder can maximize the QBID.

QBI does not include any guaranteed payment paid to a partner for services rendered with respect to the QTB, regardless of whether the partner is an individual or an RPE. A guaranteed payment paid by a lower-tier partnership to an upper-tier partnership retains its character as a guaranteed payment and is not included in QBI of a partner of the upper-tier partnership.

And a few notes here:

- Reasonable compensation paid by the PTP to the taxpayer, guaranteed payments paid by the PTP to the taxpayer and, to the extent provided in Regulations, payments to the taxpayer by the PTP in his or her capacity as other than a partner are not QBI.
- Wages for this purpose include cash and noncash compensation that is both taxable and nontaxable to the employee.
- W-2 wages do not include W-2 wages not properly reported on a return filed up to 60 days late with the Social Security Administration.

Carryover Loss Rules if Combined Qualified Real Estate Investment Trust (REIT) Dividends and Qualified Publicly Traded Partnership (PTP) Income is Less than Zero

The Section 199A QBI 20% deduction also applies to REIT income and PTP income. For purposes of this paper, I will not dwell on this, but it is worth noting.

If losses attributable to qualified REIT dividends and qualified PTP income are netted against QBI, these losses will affect QBI. A separate loss carryforward rule is needed to segregate an overall loss attributable to qualified REIT dividends and qualified PTP income from QBI. If a taxpayer has an overall loss after qualified REIT dividends and qualified PTP income are combined, the portion of the taxpayer's Section 199A deduction related to qualified REIT dividends and qualified PTP income is zero for that taxable year. The overall loss does not affect the amount of the taxpayer's QBI. The overall loss is carried forward and must be used to offset combined qualified REIT dividends and qualified PTP income in the succeeding taxable year(s).

Qualified Property

"UBIA of Qualified Property" is defined in the proposed Regulations of Section 199A as any tangible property, subject to depreciation (meaning inventory doesn't count), that is held by the business at the end of the year and was used – at ANY point in the year – in the production of QBI. But there's a catch: if you count the basis towards your limitation, the "depreciable period" cannot have ended prior to the last day of the year for which you wish to take the deduction.

The depreciable period starts on the date the property is placed in service and ends on the LATER OF:

- 10 years,

OR

- the last day of the last full year in the asset's "regular" depreciation period.

The basis taken into consideration is "unadjusted basis", meaning it is NOT reduced by any depreciation deductions. In fact, Section 199A requires that you take into consideration the basis of the property "immediately after acquisition" before any depreciation is taken.

Any asset that was fully depreciated prior to 2018, unless it was placed in service after 2008, will not count towards UBIA of Qualified Property. If substantial improvement or alterations are made to existing depreciable tangible property, the date used to calculate the period that the improvements

or alterations can be used for UBIA of Qualified Property begins on the date the improvements or alterations were made. This means that parts of the same tangible property will have different UBIA of Qualified Property periods.

Just as with W-2 wages, for purposes of applying the 2.5% limitation, a shareholder or partner may only take into consideration his or her allocable share of UBIA of Qualified Property.

A common question concerns whether an owner of passthrough entities can combine all his or her entities in calculating QBI and the various limitations that would apply to the 20% deduction. It appears that the 20% deduction needs to be computed with respect to each separate business owned by a taxpayer. Section 199A requires that the deduction be computed for "each" QTB. The proposed Regulations provide that a taxpayer may aggregate two or more businesses under certain situations. These aggregation requirements will be discussed in greater detail later, but note that the IRS requires information on each separate trade or business – as separate AND aggregated – to be reported.

Here are a few examples from the proposed Regulations.

Example 1

On January 5, 2012, A purchases for $1 million and places in service Real Property X in A's trade or business. A's trade or business is not an SSTB. A's basis in Real Property X under Section 1012 is $1 million. Real Property X is Qualified Property within the meaning of Section 199A(b)(6). As of December 31, 2018, A's basis in Real Property X, as adjusted under Section 1016(a)(2) for depreciation deductions under Section 168(a), is $821,550.

For purposes of Section 199A(b)(2)(B)(ii) and this Section, A's UBIA of Real Property X is its $1 million cost basis under Section 1012, regardless of any later depreciation deductions under Section 168(a) and resulting basis adjustments under Section 1016(a)(2).

Example 2.

The facts are the same as in Example 1, except that on January 15, 2019, A enters into a like-kind exchange under Section 1031 in which A exchanges Real Property X for Real Property Y. Real Property Y has a value of $1 million. No cash or other property is involved in the exchange. As of January 15, 2019, A's basis in Real Property X, as adjusted under Section 1016(a)(2) for depreciation deductions under Section 168(a), is $820,482. A's UBIA in Real Property Y is $820,482 as determined under Section 1031(d) (A's adjusted basis in Real Property X carried over to Real Property Y). Pursuant to paragraph (c)(2)(iii)(A) of this Section, Real Property Y is first placed in service by A on January 5, 2012, which is the date on which Property X was first placed in service by A.

Example 3

C operates a trade or business that is not an SSTB as a sole proprietorship. On January 5, 2011, C purchases for $10,000 and places in service Machinery Y in C's trade or business. C's basis in Machinery Y under Section 1012 is $10,000. Machinery Y is Qualified Property within the meaning of Section 199A(b)(6). Assume that Machinery Y's recovery period under Section 168(c) is ten years, and C depreciates Machinery Y under the general depreciation system by using the straight-line depreciation method, a ten-year recovery period and the half-year convention. As of December 31, 2018, C's basis in Machinery Y, as adjusted under Section 1016(a)(2) for depreciation deductions under Section 168(a), is $2,500. On January 1, 2019, C incorporates the sole proprietorship and elects to treat the newly formed entity as an S corporation for federal income tax purposes. C contributes Machinery Y and all other assets of the trade or business to the S corporation in a non-recognition transaction under Section 351. The S corporation immediately places all the assets in service.

For purposes of Section 199A(b)(2)(B)(ii) and this Section, C's UBIA of Machinery Y from 2011 through 2018 is its $10,000 cost basis under Section 1012, regardless of any later depreciation deductions under Section 168(a) and resulting basis adjustments under Section 1016(a)(2). Pursuant to paragraph (c)(3) of this Section, S corporation's UBIA of Machinery Y is determined under the applicable rules of subchapter C as of date the S corporation places it in service. Therefore, the S corporation's UBIA of Machinery Y is $2,500, the basis of the property under Section 362 at the time the S corporation places the property in service. For purposes of determining the depreciable period of Machinery Y, the S corporation's "placed in service date" will be the date C originally placed the property in service in 2011. Therefore, Machinery Y may be Qualified Property of the S corporation (assuming it continues to be used in the business) for 2019 and 2020 and will not be Qualified Property of the S corporation after 2020, because its depreciable period will have expired.

Determination of W-2 Wages and Unadjusted Basis After Acquisition of Qualified Property

The determination of W-2 wages must be made for each trade or business by the individual or RPE that directly conducts the trade or business before applying the aggregation rules of proposed Regulations Section 1.199A-4. In the case of W-2 wages paid by an RPE, the RPE must determine and report W-2 wages for each trade or business conducted by the RPE. W-2 wages are presumed to be zero if not determined and reported for each trade or business.

Qualified Trade or Business (QTB)

A QTB is a trade or business. The trade or business of being an employee is not a QTB. A Specified Service Trade or Business (SSTB) as defined in Section 199A and the proposed Regulations is not a QTB. Only a QTB may be aggregated with other QTBs if all requirements are met.

Under the proposed Regulations, aggregation of QTBs works in terms of "businesses" rather than "activities", and it appears Section 199A permits aggregating QTBs if the QTBs have substantial similarities. It levers off the existing elective grouping regime of Section 469 that applies to "activities". The proposed Regulations borrow some of the concepts from Section 469 without adopting the activity requirements in structuring its aggregation requirements for two or more QTBs.

To provide the taxpayer with the best result, it appears we need to compute the deduction for each separate business as a stand-alone QTB and recalculate as many of the QTBs that can be aggregated together as a group to determine which is the better approach. The information from both the individual calculations for each QTB and the collected calculations for the combined grouping of all the selected QTBS must be reported on the taxpayer's income tax return. Once a taxpayer has decided to aggregate several QTBs to determine the combined QBI, the taxpayer must continue that approach in succeeding years.

Notwithstanding the above, there is an exception to the W-2 limit. If taxable income for the year – not adjusted gross income, not QBI, but TAXABLE INCOME – is less than the "threshold amount" for the year, one simply can ignore the two W-2-based limitations. The "threshold amounts" for 2018 are $315,000 if married and $157,500 for all other taxpayers. These amounts will be indexed for inflation starting in 2019. Obviously, taxable income is determined WITHOUT factoring in any potential 20% deduction.

When taxable income exceeds the relevant threshold, W-2 limitations are factored in, but not all at once. W-2 limitations will be "phased in" over the next $100,000 of taxable income if married filing jointly, or $50,000 for everyone else. In the case of a married couple, for every $10,000 of taxable

income more than $315,000, the married couple will lose 10% of its QBID. For all other taxpayers, for each $5,000 in taxable income more than $157,500, the taxpayer will lose 10% QBID.

The application of this phase-in is determined at the individual, trust or estate level, which may not be where the trade or business is operated. If a partnership or an S corporation operates an SSTB, the application of the threshold does not depend on the partnership's or S corporation's taxable income but rather on the taxable income of the individual partners or shareholders.

For other than an SSTB:

- The cap does not apply to taxpayers with $315,000 or less of taxable income on a joint return ($157,500 of taxable income on all other returns).
- For taxpayers with more than $315,000 but less than $415,000 of taxable income on a joint return (more than $157,500 and less than $207,500 on all other returns), the cap does not apply BUT
- The deduction is reduced by the amount by which 20% of the taxpayer's QBI with respect to the QTB exceeds the cap multiplied by a fraction the numerator of which is the amount by which the taxpayer's taxable income exceeds $315,000 on a joint return ($157,500 on a single individual return) and the denominator of which is $100,000 ($50,000 in the case of all other returns).

Specified Service Trades or Businesses (SSTBs)

Unless an exception applies, if a trade or business is an SSTB, none of its items are to be considered for purposes of determining a taxpayer's QBI. In the case of an SSTB conducted by an entity such as a partnership or an S corporation, if it is determined that the trade or business is an SSTB, none of the income from that trade or business flowing to an owner of the entity is QBI, regardless of whether the owner participates in the specified service activity. Therefore, a direct or indirect owner of a trade or business engaged in an SSTB is treated as engaged in the SSTB for purposes of Section 199A, regardless of whether the owner is passive or active in the SSTB. None of the W-2 wages or UBIA will be considered for purposes of determining QBID.

An SSTB includes any trade or business with 50% or more common ownership (directly or indirectly) that provides 80% or more of its property or services to an SSTB. If a trade or business has 50% or more common ownership with an SSTB, to the extent that the trade or business provides property or services to the commonly owned SSTB, the portion of the property or services provided to the SSTB will be treated as an SSTB (meaning the income will be treated as income from an SSTB).

The IRS has stated that, for purposes of Section 199A, IRC Section 162(a) provides the best definition of a trade or business because there is a large body of existing case law and administrative guidance interpreting the meaning of trade or business under this Section. The proposed Regulations extend the definition of trade or business beyond IRC Section 162 in one circumstance by providing that the rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if both businesses are commonly controlled. This means that taxpayers may segregate rental property from operating businesses and have both businesses treated as QTBs that can either be kept separate or aggregated for purposes of Section 199A.

The IRS has provided a de minimis rule under which a trade or business will not be considered to be an SSTB merely because it provides a small amount of services in a specified service activity. A trade or business (determined before the application of the aggregation rules) is not an SSTB if the trade or business has gross receipts of $25 million or less and less than ten percent of the gross receipts of the trade or business is attributable to the performance of services in an SSTB. For trades or business with gross receipts greater than $25 million (in a taxable year), a trade or

business is not an SSTB if less than five percent of the gross receipts of the trade or business are attributable to the performance of services in an SSTB.

Descriptions of SSTBs

Section 199A provides an extensive list of the various types of SSTBs. Please see the separate pages at the end of this document for a breakdown of the various types of SSTBs.

Computation of Deduction for Individuals with Taxable Income Above Threshold Amount

The Section 199A deduction is determined for individuals with taxable income that exceeds the threshold amount by adding the QBI component and 20% of the combined amount of qualified REIT dividends and qualified PTP income (including the individual's share of qualified REIT dividends and qualified PTP income from RPEs). That sum is then compared to 20% of the amount by which the individual's taxable income exceeds net capital gain. The lesser of these two amounts is the individual's Section 199A deduction.

An individual with taxable income for the taxable year that exceeds the threshold amount determines the QBI component using the following computational rules, which are to be applied in the order they appear.

> (i) SSTB exclusion. If the individual's taxable income is within the phase-in range, only the applicable percentage of QBI, W-2 wages and UBIA of Qualified Property for each SSTB is considered for purposes of determining the individual's Section 199A deduction. If the individual's taxable income exceeds the phase-in range, none of the individual's share of QBI, W-2 wages or UBIA of Qualified Property attributable to an SSTB may be considered for purposes of determining the individual's Section 199A deduction.
>
> (ii) Aggregated trade or business. If an individual chooses to aggregate trades or businesses under the proposed Regulations, the individual must combine the QBI, W-2 wages and UBIA of Qualified Property of each trade or business within an aggregated trade or business prior to applying the W-2 wages and UBIA of Qualified Property limitations described in the Regulations.

If an individual's QBI from at least one trade or business is less than zero, the individual must offset the QBI attributable to each trade or business that produced net positive QBI with the QBI from each trade or business that produced net negative QBI in proportion to the relative amounts of net QBI in the trades or businesses with positive QBI. The adjusted QBI is then used to make the appropriate calculations. The W-2 wages and UBIA of Qualified Property from the trades or businesses that produced net negative QBI are not considered and are not carried over to the subsequent year.

If an individual's QBI from all trades or businesses combined is less than zero, the QBI component is zero for the taxable year. This negative amount is treated as negative QBI from a separate trade or business in the succeeding taxable year of the individual. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the IRC. The W-2 wages and UBIA of Qualified Property from the trades or businesses that produced net negative QBI are not considered and are not carried over to the subsequent year.

If the combined amount of REIT dividends and qualified PTP income is less than zero, the portion of the individual's Section 199A deduction related to qualified REIT dividends and qualified PTP income is zero for the taxable year. The negative combined amount must be carried forward and used to offset the combined amount of REIT dividends/qualified PTP income in the succeeding taxable year of the individual and this Section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the IRC.

Below are examples from the proposed Regulations. In these examples, assume the following:

- All trades and businesses are QTBs
- None of the trades or businesses is an SSTB
- All the tax items associated with the trades or businesses are effectively connected to a USA trade or business
- The taxpayers report no capital gains or losses or other tax items not specified in the examples
- Total taxable income does not include QBID

Example 1

D, an unmarried individual, owns several parcels of land that D manages and that are leased to several suburban airports for parking lots. The business generated $1,000,000 of QBI in 2018. The business paid no wages and the property was not Qualified Property because it was not depreciable. After allowable deductions unrelated to the business, D's total taxable income for 2018 is $980,000. Because D's taxable income exceeds the applicable threshold amount, D's Section 199A deduction is subject to the W-2 wage and UBIA of Qualified Property limitations. D's Section 199A deduction is limited to zero because the business paid no wages and held no Qualified Property.

Example 2

Assume the same facts as in Example 1, except that D developed the land parcels in 2019, expending a total of $10,000,000 to build parking structures on each of the parcels, all of which is depreciable. During 2020, D leased the parking structures and the land to the suburban airports. D reports $4,000,000 of QBI for 2020. After allowable deductions unrelated to the business, D's total taxable income for 2020 is $3,980,000. Because D's taxable income is above the threshold amount, the QBI component of D's Section 199A deduction is subject to the W-2 wage and UBIA of Qualified Property limitations. Because the business has no W-2 wages, the QBI component of D's Section 199A deduction is limited to the lesser of 20% of the business's QBI or 2.5% of its UBIA of Qualified Property. Twenty percent of the $4,000,000 of QBI is $800,000. Two and one-half percent of the $10,000,000 UBIA of Qualified Property is $250,000. The QBI component of D's Section 199A deduction is thus limited to $250,000. D's Section 199A deduction is equal to the lesser of (i) 20% of the QBI from the business as limited ($250,000) or (ii) 20% of D's taxable income ($3,980,000 x 20% = $796,000). Therefore, D's Section 199A deduction for 2020 is $250,000.

Example 3

E, an unmarried individual, is a 30% owner of LLC, which is classified as a partnership for federal income tax purposes. In 2018, the LLC has a single trade or business and reported QBI of $3,000,000. The LLC paid total W-2 wages of $1,000,000, and its total UBIA of Qualified Property is $100,000. E is allocated 30% of all items of the partnership. For the 2018 taxable year, E reports $900,000 of QBI from the LLC. After allowable deductions unrelated to LLC, E's taxable income is $880,000. Because E's taxable income is above the threshold amount, the QBI component of E's Section 199A deduction will be limited to the lesser of (i) 20% of E's share of LLC's QBI or (ii) the greater of the W-2 wage or UBIA of Qualified Property limitations. Twenty percent of E's share of QBI of $900,000 is $180,000. The W-2 wage limitation equals 50% of E's share of the LLC's wages ($300,000) or $150,000. The UBIA of Qualified Property limitation equals $75,750, the sum of (i) 25% of E's share of LLC's wages ($300,000) or $75,000 plus (ii) 2.5% of E's share of UBIA of Qualified Property ($30,000) or $750. The greater of the limitation amounts ($150,000 and $75,750) is $150,000. The QBI component of E's Section 199A deduction is thus limited to $150,000, the lesser of (i) 20% of QBI ($180,000) and (ii) the greater of the limitations amounts ($150,000). E's Section 199A deduction is equal to the lesser of (i) 20% of the QBI from the business as

limited ($150,000) or (ii) 20% of E's taxable income ($880,000 x 20% = $176,000). Therefore, E's Section 199A deduction is $150,000 for 2018.

Example 4

F, an unmarried individual, owns a 50% interest in Z, an S corporation for federal income tax purposes that conducts a single trade or business. In 2018, Z reported QBI of $6,000,000. Z paid total W-2 wages of $2,000,000, and its total UBIA of Qualified Property is $200,000. For the 2018 taxable year, F reports $3,000,000 of QBI from Z. F is not an employee of Z and receives no wages or reasonable compensation from Z. After allowable deductions unrelated to Z and a deductible qualified net loss from a PTP of ($10,000), F's taxable income is $1,880,000. Because F's taxable income is above the threshold amount, the QBI component of F's Section 199A deduction will be limited to the lesser of (i) 20% of F's share of Z's QBI or (ii) the greater of the W-2 wage and UBIA of Qualified Property limitations. Twenty percent of F's share of QBI of $3,000,000 is $600,000. The W-2 wage limitation equals 50% of F's share of Z's W-2 wages ($1,000,000) or $500,000. The UBIA of Qualified Property limitation equals $252,500, the sum of (i) 25% of F's share of Z's W-2 wages ($1,000,000) or $250,000 plus (ii) 2.5% of E's share of UBIA of Qualified Property ($100,000) or $2,500. The greater of the limitation amounts ($500,000 and $252,500) is $500,000. The QBI component of F's Section 199A deduction is thus limited to $500,000, the lesser of (i) 20% of QBI ($600,000) and (ii) the greater of the limitations amounts ($500,000). F reported a qualified loss from a PTP and has no qualified REIT dividend. F does not net the ($10,000) loss against QBI. Instead, the portion of F's Section 199A deduction related to qualified REIT dividends and qualified PTP income is zero for 2018. F's Section is 199A deduction is equal to the lesser of (i) 20% of the QBI from the business as limited ($500,000) or (ii) 20% of F's taxable income over net capital gain ($1,880,000 x 20% = $376,000). Therefore, F's Section 199A deduction is $376,000 for 2018. F must also carry forward the $(10,000) qualified loss from a PTP to be netted against F's qualified REIT dividends and qualified PTP income in the succeeding taxable year.

Example 5 – Phase-in Range

B and C are married and file a joint individual income tax return. B is a shareholder in M, an entity taxed as an S corporation for federal income tax purposes that conducts a single trade or business. M holds no Qualified Property. B's share of the M's QBI is $300,000 in 2018. B's share of the W-2 wages from M in 2018 is $40,000. C earns wage income from employment by an unrelated company. After allowable deductions unrelated to M, B and C's taxable income for 2018 is $375,000. B and C are within the phase-in range because their taxable income exceeds the applicable threshold amount, $315,000 but does not exceed the threshold amount plus $100,000, or $415,000. Consequently, the QBI component of B and C's Section 199A deduction may be limited by the W-2 wage and UBIA of Qualified Property limitations but the limitations will be phased in.

The UBIA of Qualified Property limitation amount is zero because M does not hold Qualified Property. B and C must apply the W-2 wage limitation by first determining 20% of B's share of M's QBI. Twenty percent of B's share of M's QBI of $300,000 is $60,000. Next, B and C must determine 50% of B's share of M's W-2 wages. Fifty percent of B's share of M's W-2 wages of $40,000 is $20,000. Because 50% of B's share of M's W-2 wages ($20,000) is less than 20% of B's share of M's QBI ($60,000), B and C must determine the QBI component of their Section 199A deduction by reducing 20% of B's share of M's QBI by the reduction amount.

B and C are 60% through the phase-in range (that is, their taxable income exceeds the threshold amount by $60,000 and their phase-in range is $100,000). B and C must determine the excess amount, which is the excess of 20% of B's share of M's QBI, or $60,000, over 50% of B's share of M's W-2 wages, or $20,000. Thus, the excess amount is $40,000. The reduction amount is equal to 60% of the excess amount, or $24,000. Thus, the QBI component of B and C's Section 199A deduction is equal to $36,000, 20% of B's $300,000

share M's QBI (that is, $60,000), reduced by $24,000. B and C's Section 199A deduction is equal to the lesser of (i) 20% of the QBI from the business as limited ($36,000) or (ii) 20% of B and C's taxable income ($375,000 x 20% = $75,000). Therefore, B and C's Section 199A deduction is $36,000 for 2018.

Example 6

Assume the same facts as in Example 5, except that M was engaged in an SSTB. Because B and C are within the phase-in range, B must reduce the QBI and W-2 wages allocable to B from M to the applicable percentage of those items. B and C's applicable percentage is 100% reduced by the percentage equal to the ratio that their taxable income for the taxable year ($375,000) exceeds their threshold amount ($315,000), or $60,000, bears to $100,000. Their applicable percentage is 40%. The applicable percentage of B's QBI is ($300,000 x 40% =) $120,000, and the applicable percentage of B's share of W-2 wages is ($40,000 x 40% =) $16,000. These reduced numbers must then be used to determine how B's Section 199A deduction is limited.

B and C must apply the W-2 wage limitation by first determining 20% of B's share of M's QBI as limited by the paragraph above. Twenty percent of B's share of M's QBI of $120,000 is $24,000. Next, B and C must determine 50% of B's share of M's W-2 wages. Fifty percent of B's share of M's W-2 wages of $16,000 is $8,000. Because 50% of B's share of M's W-2 wages ($8,000) is less than 20% of B's share of M's QBI ($24,000), B and C's must determine the QBI component of their Section 199A deduction by reducing 20% of B's share of M's QBI by the reduction amount.

B and C are 60% through the phase-in range (that is, their taxable income exceeds the threshold amount by $60,000 and their phase-in range is $100,000). B and C must determine the excess amount, which is the excess of 20% of B's share of M's QBI, as adjusted in the first paragraph of this example or $24,000, over 50% of B's share of M's W-2 wages, as adjusted in the first paragraph, or $8,000. Thus, the excess amount is $16,000. The reduction amount is equal to 60% of the excess amount or $9,600. Thus, the QBI component of B and C's Section 199A deduction is equal to $14,400, 20% of B's share M's QBI of $24,000, reduced by $9,600. B and C's Section 199A deduction is equal to the lesser of 20% of the QBI from the business as limited ($14,400) or 20% of B's and C's taxable income ($375,000 x 20% = $75,000). Therefore, B and C's Section 199A deduction is $14,400 for 2018.

Example 7

F, an unmarried individual, owns as a sole proprietor 100% of three trades or businesses, Business X, Business Y, and Business Z. None of the businesses hold Qualified Property. F does not aggregate the trades or businesses under Section1.199A-4. For taxable year 2018, Business X generates $1 million of QBI and pays $500,000 of W-2 wages with respect to the business. Business Y also generates $1 million of QBI but pays no wages. Business Z generates $2,000 of QBI and pays $500,000 of W-2 wages with respect to the business. F also has $750,000 of wage income from employment with an unrelated company. After allowable deductions unrelated to the businesses, F's taxable income is $2,722,000.

Because F's taxable income is above the threshold amount, the QBI component of F's Section 199A deduction is subject to the W-2 wage and UBIA of Qualified Property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold Qualified Property, therefore only the 50% of W-2 wage limitation must be calculated. Because QBI from each business is positive, F applies the limitation by determining the lesser of 20% of QBI and 50% of W-2 wages for each business. For Business X, the lesser of 20% of QBI ($1,000,000 x 20% = $200,000) and 50% of Business X's W-2 wages ($500,000 x 50% = $250,000) is $200,000. Business Y pays no W-2 wages. The lesser of 20% of Business Y's QBI ($1,000,000 x 20% = $200,000) and 50% of its W-2 wages (zero) is zero.

For Business Z, the lesser of 20% of QBI ($2,000 x 20% = $400) and 50% of W-2 wages ($500,000 x 50% = $250,000) is $400.

F must then combine the amounts determined in the second paragraph of this example and compare that sum to 20% of F's taxable income. The lesser of these two amounts equals F's Section 199A deduction. The total of the combined amounts in the second paragraph is $200,400 ($200,000 + 0 + 400). Twenty percent of F's taxable income is $544,400 ($2,722,000 x 20%). Thus, F's Section 199A deduction for 2018 is $200,400.

Example 8

Assume the same facts as in Example 7, except that F aggregates Business X, Business Y, and Business Z under the rules of Section1.199A-4.

Because F's taxable income is above the threshold amount, the QBI component of F's Section 199A deduction is subject to the W-2 wage and UBIA of Qualified Property limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis. None of the businesses holds Qualified Property, therefore only the W-2 wage limitation must be calculated. F applies the limitation by determining the lesser of 20% of the QBI from the aggregated businesses, which is $400,400 ($2,002,000 x 20%) and 50% of W-2 wages from the aggregated businesses, which is $500,000 ($1,000,000 x 50%). F's Section 199A deduction is equal to the lesser of $400,400 and 20% of F's taxable income ($2,722,000 x 20% = $544,400). Thus, F's Section 199A deduction for 2018 is $400,400.

Example 9

Assume the same facts as in Example 7, except that for taxable year 2018, Business Z generates a loss that results in ($600,000) of negative QBI and pays $500,000 of W-2 wages. After allowable deductions unrelated to the businesses, F's taxable income is $2,120,000. Because Business Z had negative QBI, F must offset the positive QBI from Business X and Business Y with the negative QBI from Business Z in proportion to the relative amounts of positive QBI from Business X and Business Y. Because Business X and Business Y produced the same amount of positive QBI, the negative QBI from Business Z is apportioned equally among Business X and Business Y. Therefore, the adjusted QBI for each of Business X and Business Y is $700,000 ($1 million plus 50% of the negative QBI of $600,000). The adjusted QBI in Business Z is $0, because its negative QBI has been fully apportioned to Business X and Business Y.

Because F's taxable income is above the threshold amount, the QBI component of F's Section 199A deduction is subject to the W-2 wage and UBIA of Qualified Property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold Qualified Property, therefore only the 50% of W-2 wage limitation must be calculated. For Business X, the lesser of 20% of QBI ($700,000 x 20% = $140,000) and 50% of W-2 wages ($500,000 x 50% = $250,000) is $140,000. Business Y pays no W-2 wages. The lesser of 20% of Business Y's QBI ($700,000 x 20% = $140,000) and 50% of its W-2 wages (zero) is zero.

F must combine the amounts determined in the preceding paragraph and compare the sum to 20% of taxable income. F's Section 199A deduction equals the lesser of these two amounts. The combined amount from the preceding paragraph is $140,000 ($140,000 + $0) and 20% of F's taxable income is $424,000 ($2,120,000 x 20%). Thus, F's Section 199A deduction for 2018 is $140,000. There is no carryover of any loss into the following taxable year for purposes of Section 199A.

Example 10

Assume the same facts as in Example 9 of this paragraph (d)(4), except that F aggregates Business X, Business Y, and Business Z.

Because F's taxable income is above the threshold amount, the QBI component of F's Section 199A deduction is subject to the W-2 wage and UBIA of Qualified Property limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis. None of the businesses holds Qualified Property, therefore only the W-2 wage limitation must be calculated. F applies the limitation by determining the lesser of 20% of the QBI from the aggregated businesses ($1,400,000 x 20% = $280,000) and 50% of W-2 wages from the aggregated businesses ($1,000,000 x 50% = $500,000), or $280,000. F's Section 199A deduction is equal to the lesser of $280,000 and 20% of F's taxable income ($2,120,000 x 20% = $424,000). Thus, F's Section 199A deduction for 2018 is $280,000. There is no carryover of any loss into the following taxable year for purposes of Section 199A.

Example 11

Assume the same facts as in Example 7, except that Business Z generates a loss that results in ($2,150,000) of negative QBI and pays $500,000 of W-2 wages with respect to the business in 2018. Thus, F has a negative combined QBI of ($150,000) when the QBI from all of the businesses are added together ($1 million plus $1 million minus the loss of ($2,150,000)). Because F has a negative combined QBI for 2018, F has no Section 199A deduction with respect to any trade or business for 2018. Instead, the negative combined QBI of ($150,000) carries forward and will be treated as negative QBI from a separate trade or business for purposes of computing the Section 199A deduction in the next taxable year. None of the W-2 wages carry forward. However, for income tax purposes, the $150,000 loss may offset F's $750,000 of wage income (assuming the loss is otherwise allowable under the IRC).

In taxable year 2019, Business X generates $200,000 of net QBI and pays $100,000 of W-2 wages with respect to the business. Business Y generates $150,000 of net QBI but pays no wages. Business Z generates a loss that results in ($120,000) of negative QBI and pays $500 of W-2 wages with respect to the business. F also has $750,000 of wage income from employment with an unrelated company. After allowable deductions unrelated to the businesses, F's taxable income is $960,000. Pursuant to paragraph (d)(2)(iii)(B) of Section 199A, the ($150,000) of negative QBI from 2018 is treated as arising in 2019 from a separate trade or business. Thus, F has overall net QBI of $80,000 when all trades or businesses are taken together ($200,000 plus $150,000 minus $120,000 minus the carryover loss of $150,000). Because Business Z had negative QBI and F also has a negative QBI carryover amount, F must offset the positive QBI from Business X and Business Y with the negative QBI from Business Z and the carryover amount in proportion to the relative amounts of positive QBI from Business X and Business Y. Because Business X produced 57.14% of the total QBI from Business X and Business Y, 57.14% of the negative QBI from Business Z and the negative QBI carryforward must be apportioned to Business X, and the remaining 42.86% allocated to Business Y. Therefore, the adjusted QBI in Business X is $45,722 ($200,000 minus 57.14% of the loss from Business Z ($68,568), minus 57.14% of the carryover loss ($85,710). The adjusted QBI in Business Y is $34,278 ($150,000, minus42.86% of the loss from Business Z ($51,432) minus one third of the carryover loss ($64,290)). The adjusted QBI in Business Z is $0, because its negative QBI has been apportioned to Business X and Business Y.

Because F's taxable income is above the threshold amount, the QBI component of F's Section 199A deduction is subject to the W-2 wage and UBIA of Qualified Property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold Qualified Property, therefore only the 50% of W-2 wage limitation must be calculated. For Business X, 20% of QBI is $9,144 ($45,722 x 20%) and 50% of W-2 wages is $50,000 ($100,000 x 50%), so the lesser amount is $9,144. Business Y pays no W-2 wages. Twenty percent of Business Y's QBI is $6,856 ($34,278 x 20%) and 50% of its W-2 wages (zero) is zero, so the lesser amount is zero.

F must then compare the combined amounts determined in the preceding paragraph to 20% of F's taxable income. The Section 199A deduction equals the lesser of these amounts. F's combined amount from the preceding paragraph is $9,144 ($9,144 plus zero) and 20% of F's taxable income is $192,000 ($960,000 x 20%). Thus, F's Section 199A deduction for 2019 is $9,144. There is no carryover of any negative QBI into the following taxable year for purposes of Section 199A.

Example 12

Assume the same facts as in Example 11, except that F aggregates Business X, Business Y, and Business Z under the rules of Section1.199A-4. For 2018, F's QBI from the aggregated trade or business is ($150,000). Because F has a combined negative QBI for 2018, F has no Section 199A deduction with respect to any trade or business for 2018. Instead, the negative combined QBI of ($150,000) carries forward and will be treated as negative QBI from a separate trade or business for purposes of computing the Section 199A deduction in the next taxable year. However, for income tax purposes, the $150,000 loss may offset taxpayer's $750,000 of wage income (assuming the loss is otherwise allowable under the IRC).

In taxable year 2019, F will have QBI of $230,000 and W-2 wages of $100,500 from the aggregated trade or business. F also has $750,000 of wage income from employment with an unrelated company. After allowable deductions unrelated to the businesses, F's taxable income is $960,000. F must treat the negative QBI carryover loss ($150,000) from 2018 as a loss from a separate trade or business for purposes of Section 199A. This loss will offset the positive QBI from the aggregated trade or business, resulting in an adjusted QBI of $80,000 ($230,000 - $150,000).

Because F's taxable income is above the threshold amount, the QBI component of F's Section 199A deduction is subject to the W-2 wage and UBIA of Qualified Property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold Qualified Property, therefore only the 50% of W-2 wage limitation must be calculated. For the aggregated trade or business, the lesser of 20% of QBI ($80,000 x 20% = $16,000) and 50% of W-2 wages ($100,500 x 50% = $50,250) is $16,000. F's Section 199A deduction equals the lesser of these amounts ($16,000) and 20% of F's taxable income ($960,000 x 20% = $192,000). Thus, F's Section 199A deduction for 2019 is $16,000. There is no carryover of any negative QBI into the following taxable year for purposes of Section 199A.

Aggregation Rules for QTBs

The proposed Regulations incorporate the rules under IRC Section 162 for determining whether a QTB exists. A taxpayer can have more than one QTB.

The IRS has received comments requesting that the Regulations provide that taxpayers be permitted to group or "aggregate" QTBs using the grouping rules described in Section 1.469-4 ("Grouping Rules"). The Grouping Rules set forth guidance for grouping a taxpayer's trade or business activities and rental activities for purposes of applying the passive activity loss and credit limitation rules of Section 469. Section 469 uses the term "activities" to determine the application of the limitation rules. In contrast, Section 199A applies to trades or businesses. By focusing on activity, the Grouping Rules may be both under- and over-inclusive in determining what activities give rise to a QTB.

Section 469 is a loss-limitation rule used to prevent taxpayers from sheltering passive losses with nonpassive income. The Section 199A deduction is not based on the level of a taxpayer's involvement in the QTB (both active and passive owners of a QTB may be entitled to a QBID).

An additional problem with relying on the Grouping Rules is that these rules may require including an SSTB to be grouped with non-SSTBs. Thus, the Grouping Rules are not appropriate

for determining QTBs. Multiple QTBs may be operated as a single trade or business. Multiple trades or businesses may be structured this way for various legal, economic or other non-tax reasons.

The fact that businesses are operated across entities raises the question of whether, in defining QTBs for QBID, aggregation or disaggregation of entities should be permitted or required either at the entity level or the owner's level. Allowing taxpayers to aggregate trades or businesses offers taxpayers a means of combining their trades or businesses for purposes of applying the W-2 wage and UBIA limitations and potentially maximizing the QBID.

If aggregation is not permitted, taxpayers could be forced to incur costs to restructure solely for tax purposes. Additionally, business and non-tax law requirements may not permit many taxpayers to restructure their operations. Section 199A permits the aggregation of separate trades or businesses provided certain requirements are satisfied. Aggregation is permitted but is not required.

Aggregation may only occur if a taxpayer can demonstrate that the requirements are satisfied.

First, each trade or business must itself be a trade or business.

Second, the same person or group of persons must directly or indirectly own a majority interest in each of the businesses to be aggregated for most of the taxable year in which the items attributable to each trade or business are included in income. All the items attributable to the trades or businesses must be reported on returns with the same taxable year (not including short years). The proposed Regulations provide rules allowing for family attribution. Because the proposed Regulations look to a group of persons, non-majority owners may benefit from the common ownership and be permitted to aggregate.

Third, none of the aggregated trades or businesses can be an SSTB.

Fourth, individuals and trusts must establish that the trades or businesses meet at least two of three factors. These factors demonstrate that the businesses are in fact part of a larger, integrated trade or business. These factors are that the businesses:

(1) provide products and services that are the same (for example, a restaurant and a food truck) or they provide products and services that are customarily provided together (for example, a gas station and a car wash);
(2) share facilities or share significant centralized business elements (for example, common personnel, accounting, legal, manufacturing, purchasing, human resources or information technology resources); or
(3) are operated in coordination with, or reliance on, other businesses in the aggregated group (for example, supply chain interdependencies).

A few notes regarding aggregation:

- A taxpayer is permitted to aggregate trades or businesses operated directly and trades or businesses operated through RPEs. Individual owners of the same RPEs are not required to aggregate in the same manner.
- A taxpayer directly engaged in a trade or business must compute QBI, W-2 wages and UBIA for each trade or business before applying the aggregation rules. If an individual has aggregated two or more trades or businesses, the combined QBI, W-2 wages and UBIA for all aggregated trades or businesses are used for purposes of applying the W-2 wage and UBIA limitations.
- An RPE must provide its owners with information regarding QBI, W-2 wages and UBIA attributable to its trades or businesses.
- The proposed Regulations require that, once multiple trades or businesses are aggregated into a single aggregated trade or business, taxpayers must consistently report the

aggregated group in subsequent tax years. The Regulations provide for situations in which the aggregation rules are no longer met as well as for when a newly created or acquired trade or business can be added to an existing aggregated group. The Regulations provide reporting and disclosure requirements for taxpayers who choose to aggregate, including identifying information about each trade or business that constitutes a part of the aggregated trade or business.

- The Commissioner may disaggregate trades or businesses if a taxpayer fails to make the required aggregation disclosure.
- In determining ownership, a taxpayer is considered as owning the interest in each trade or business owned, directly or indirectly, by or for the individual's spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and the individual's children, grandchildren and parents.

Here are additional examples from the proposed regulations. Except as otherwise specified in the examples, a single letter denotes an individual taxpayer. Assume:

- The taxpayer is a United States citizen
- All individuals and RPEs use a calendar taxable year
- There are no ownership changes during the taxable year
- All trades or businesses satisfy the requirements under Section 162
- All tax items are effectively connected to a trade or business within the United States within the meaning of Section 864(c) and
- None of the trades or businesses is an SSTB within the meaning of Section1.199A-5.

Example 1

A wholly owns and operates a catering business and a restaurant through separate disregarded entities. The catering business and the restaurant share centralized purchasing to obtain volume discounts and a centralized accounting office that performs all the bookkeeping, tracks and issues statements on all the receivables and prepares the payroll for each business. A maintains a website and print advertising materials that reference both the catering business and the restaurant. A uses the restaurant kitchen to prepare food for the catering business. The catering business employs its own staff and owns equipment and trucks that are not used or associated with the restaurant.

Because the restaurant and catering business are held in disregarded entities, A will be treated as operating each of these businesses directly and thereby satisfies paragraph (b)(1)(i) of this Section. Under paragraph (b)(1)(v), A satisfies the following factors: (1) paragraph (b)(1)(v)(A) is met as both businesses offer prepared food to customers; and (2) paragraph (b)(1)(v)(B) is met because the two businesses share the same kitchen facilities in addition to centralized purchasing, marketing and accounting. Having satisfied paragraph (b)(1)(i)-(v), A may treat the catering business and the restaurant as a single trade or business for purposes of applying Section199A-1(d).

Example 2

Assume the same facts as in Example 1, but the catering and restaurant businesses are owned in separate partnerships and A, B, C, and D each own a 25% interest in the capital and profits of each of the two partnerships. A, B, C, and D are unrelated.

Because under paragraph (b)(1)(i) A, B, C, and D together own more than 50% of the capital and profits in each of the two partnerships, they may each treat the catering business and the restaurant as a single trade or business for purposes of applying Section1.199A-1(d).

Example 3

W owns a 75% interest in S1, an S corporation, and a 75% interest in the capital and profits of PRS, a partnership. S1 manufactures clothing and PRS is a retail pet food store. W manages S1 and PRS.

W owns more than 50% of the stock of S1 and more than 50% of the capital and profits of PRS thereby satisfying paragraph (b)(1)(i). Although W manages both S1 and PRS, W is not able to satisfy the requirements of paragraph (b)(1)(v) as the two businesses do not provide goods or services that are the same or customarily offered together, there are no significant centralized business elements, and no facts indicate that the businesses are operated in coordination with, or reliance upon, one another. W must treat S1 and PRS as separate trades or businesses for purposes of applying Section1.199A-1(d).

Example 4

E owns a 60% interest in the capital and profits of each of four partnerships (PRS1, PRS2, PRS3 and PRS4). Each partnership operates a hardware store. A team of executives oversees the operations of all four of the businesses and controls the policy decisions involving the business. Human resources and accounting are centralized for the four businesses. E reports PRS1, PRS3 and PRS4 as an aggregated trade or business under paragraph (b)(1) and reports PRS2 as a separate trade or business. Only PRS2 generates a net taxable loss.

E owns more than 50% of the capital and profits of each partnership thereby satisfying paragraph (b)(1)(i). Under paragraph (b)(1)(v), the following factors are satisfied: (1) paragraph (b)(1)(v)(A) because each partnership operates a hardware store; and (2) paragraph (b)(1)(v)(B) because the businesses share accounting and human resource functions. E's decision to aggregate only PRS1, PRS3, and PRS4 into a single trade or business for purposes of applying Section1.199A-1(d) is permissible. The loss from PRS2 will be netted against the aggregate profits of PRS1, PRS3 and PRS4 pursuant to Section1.199A-1(d)(2)(iii).

Example 5

Assume the same facts as Example 4, and that F owns a 10% interest in the capital and profits of PRS1, PRS2, PRS3 and PRS4.

Because under paragraph (b)(1)(i) E owns more than 50% of the capital and profits in the four partnerships, F may aggregate PRS 1, PRS2, PRS3 and PRS4 as a single trade or business for purposes of applying Section1.199A-1(d), provided that F can demonstrate that the ownership test is met by E.

Example 6

D owns 75% of the stock of S1, S2 and S3, each of which is an S corporation. Each S corporation operates a grocery store in a separate state. S1 and S2 share centralized purchasing functions to obtain volume discounts and a centralized accounting office that performs all the bookkeeping, tracks and issues statements on all the receivables and prepares the payroll for each business. S3 is operated independently from the other businesses.

D owns more than 50% of the stock of each S corporation, thereby satisfying paragraph (b)(1)(i). Under paragraph (b)(1)(v), the grocery stores satisfy paragraph (b)(1)(v)(A) because they are in the same trade or business. Only S1 and S2 satisfy paragraph (b)(1)(v)(B) because of their centralized purchasing and accounting offices. D is only able to show that the requirements of paragraph (b)(1)(v)(B) are satisfied for S1 and S2; therefore, D only may

aggregate S1 and S2 into a single trade or business for purposes of Section1.199A-1(d). D must report S3 as a separate trade or business for purposes of applying Section1.199A-1(d).

Example 7

Assume the same facts as Example 6 except each store is independently operated and S1 and S2 do not have centralized purchasing or accounting functions.

Although the stores provide the same products and services within the meaning of paragraph (b)(1)(v)(A), D cannot show that another factor under paragraph (b)(1)(v) is present. Therefore, D must report S1, S2 and S3 as separate trades or businesses for purposes of applying Section1.199A-1(d).

Example 8

G owns 80% of the stock in S1, an S corporation and 80% of the capital and profits in LLC1 and LLC2, each of which is a partnership for federal tax purposes. LLC1 manufactures and supplies all the widgets sold by LLC2. LLC2 operates a retail store that sells LLC1's widgets. S1 owns the real property leased to LLC1 and LLC2 for use by the factory and retail store. The entities share common advertising and management.

G owns more than 50% of the stock of S1 and more than 50% of the capital and profits in LLC1 and LLC2, thus satisfying paragraph (b)(1)(i). LLC1, LLC2 and S1 share significant centralized business elements and are operated in coordination with, or in reliance upon, one or more of the businesses in the aggregated group. G can treat the business operations of LLC1 and LLC2 as a single trade or business for purposes of applying Section1.199A-1(d). S1 is eligible to be included in the aggregated group because it leases property to a trade or business within the aggregated trade or business as described in Section1.199A-1(b)(13) and meets the requirements of paragraph (b)(1).

Example 9

Same facts as Example 8, except G owns 80% of the stock in S1 and 20% of the capital and profits in each of LLC1 and LLC2. B, G's son, owns a majority interest in LLC2, and M, G's mother, owns a majority interest in LLC1. B does not own an interest in S1 or LLC1, and M does not own an interest in S1 or LLC2.

Under the rules in paragraph (b)(3), B and M's interest in LLC2 and LLC1, respectively, are attributable to G and G is treated as owning a majority interest in LLC2 and LLC; G thus satisfies paragraph (b)(1)(i). G may aggregate his interests in LLC1, LLC2 and S1 as a single trade or business for purposes of applying Section1.199A-1(d). Under paragraph (b)(3) of this Section, S1 is eligible to be included in the aggregated group because it leases property to a trade or business within the aggregated trade or business as described in Section1.199A-1(b)(13) and meets the requirements of paragraph (b)(1).

Example 10

F owns a 75% interest and G owns a 5% interest in the capital and profits of five partnerships (PRS1-PRS5). H owns a 10% interest in the capital and profits of PRS1 and PRS2. Each partnership operates a restaurant and each restaurant separately constitutes a trade or business for purposes of Section 162. G is the executive chef of all the restaurants and as such he creates the menus and orders the food supplies.

F owns more than 50% of capital and profits in the partnerships, thereby satisfying paragraph (b)(1)(i). Under paragraph (b)(1)(v), the restaurants satisfy paragraph (b)(1)(v)(A) because they are in the same trade or business, and paragraph (b)(1)(v)(B) is satisfied as G is the executive chef of all the restaurants and the businesses share a centralized function for ordering food and supplies. F can show the requirements under paragraph (b)(1) are satisfied as to all the restaurants. Because F owns a majority interest in each of the partnerships, G

can demonstrate that paragraph (b)(1)(i) is satisfied. G can also aggregate all five restaurants into a single trade or business for purposes of applying Section1.199A-1(d). H, however, only owns an interest in PRS1 and PRS2. Like G, H satisfies paragraph (b)(1)(i) because F owns a majority interest. H can, therefore, aggregate PRS1 and PRS2 into a single trade or business for purposes of applying Section1.199A-1(d).

Example 11

H, J, K, and L own interests in PRS1 and PRS2, each a partnership, and S1 and S2, each an S corporation. H, J, K and L also own interests in C, an entity taxable as a C corporation. H owns 30%, J owns 20%, K owns 5%, L owns 45% of each of the five entities. All the entities satisfy 2 of the 3 factors under paragraph (b)(1)(v). For purposes of Section 199A, the taxpayers report the following aggregated trades or businesses: H aggregates PRS1 and S1 together and aggregates PRS2 and S2 together; J aggregates PRS1, S1 and S2 together and reports PRS2 separately; K aggregates PRS1 and PRS2 together and aggregates S1 and S2 together; and L aggregates S1, S2, and PRS2 together and reports PRS1 separately. C cannot be aggregated.

Under paragraph (b)(1)(i), because H, J, and K together own a majority interest in PRS1, PRS2, S1, and S2, H, J, K, and L are permitted to aggregate under paragraph (b)(1). Further, the aggregations reported by the taxpayers are permitted but not required for each of H, J, K, and L. C's income is not eligible for the Section 199A deduction and it cannot be aggregated for purposes of applying Section1.199A-1(d).

Example 12

L owns 60% of the profits and capital interests in PRS1, a partnership, a business that sells non-food items to grocery stores. L also owns 55% of the profits and capital interests in PRS2, a partnership, which owns and operates a distribution trucking business. The predominant portion of PRS2's business is transporting goods for PRS1.

L is able to meet (b)(1)(i) as the majority owner of PRS1 and PRS2. Under paragraph (b)(1)(v), L is only able to show the operations of PRS1 and PRS2 are operated in reliance of one another under paragraph (b)(1)(v)(C). For purposes of applying Section1.199A-1(d), L must treat PRS1 and PRS2 as separate trades or businesses.

Example 13

C owns a majority interest in a sailboat racing team and owns an interest in PRS1, which operates a marina. PRS1 is a trade or business under Section 162, but the sailboat racing team is not a trade or business within the meaning of Section 162.

C has only one trade or business for purposes of Section 199A and, therefore, cannot aggregate the interest in the racing team with PRS1 under paragraph (b)(1).

Example 14

Trust wholly owns LLC1, LLC2, and LLC3. LLC1 operates a trucking company that delivers lumber and other supplies sold by LLC2. LLC2 operates a lumber yard and supplies LLC3 with building materials. LLC3 operates a construction business. LLC1, LLC2, and LLC3 have a centralized human resources department, payroll, and accounting department.

Because Trust owns 100% of the interests in LLC1, LLC2, and LLC3, Trust satisfies paragraph (b)(1)(i). Trust can also show that it satisfies paragraph (b)(1)(v)(B) as the trades or businesses have a centralized human resources department, payroll, and accounting department. Trust also can show is meets paragraph (b)(1)(v)(C) as the trades or businesses are operated in coordination, or reliance upon, one or more in the aggregated group. Trust can aggregate LLC1, LLC2, and LLC3 for purposes of applying Section1.199A-1(d).

RPEs

Section 199A provides computational and reporting rules for RPEs necessary for individuals who own interests in RPEs to calculate their Section 199A deduction.

Once a trade or business is determined to be a SSTB, it remains an SSTB and cannot be aggregated with other trades or businesses. A trade or business conducted by a taxpayer, such as a sole proprietorship, disregarded entity or grantor trust, will have its status determined as an SSTB by its owner.

There are four computational rules an RPE must use to determine the items necessary for taxpayers who own interests in the RPE to calculate their Section 199A deductions. The RPE must:

First, determine if it is engaged in one or more trades or businesses.

Second, apply the rules to determine the QBI for each trade or business engaged in directly.

Third, apply the rules to determine the W-2 wages and UBIA of Qualified Property for each trade or business engaged in directly.

Fourth, determine whether it has any qualified REIT dividends earned directly or through another RPE or REIT. The RPE must also determine the net amount of qualified PTP income earned directly or indirectly through investments in PTPs.

Reporting Rules for RPEs

An RPE must separately identify and report on the Schedule K-1 (issued to its owners for any trade or business engaged in directly by the RPE) each owner's allocable share of QBI, W-2 wages and UBIA of Qualified Property attributable to each such trade or business and whether any of the trades or businesses is an SSTB.

An RPE must report on an attachment to the Schedule K-1 any QBI, W-2 wages, UBIA of Qualified Property or SSTB determinations reported to it by any RPE in which the RPE owns a direct or indirect interest. The RPE must also report each owner's allocated share of any qualified REIT dividends or qualified PTP income or loss received by the RPE (including through another RPE).

If an RPE fails to separately identify or report on the Schedule K-1 (or any attachments thereto) issued to an owner any items, the owner's share (and the share of any upper-tier indirect owner) of positive QBI, W-2 wages and UBIA of Qualified Property attributable to trades or businesses engaged in by that RPE will be presumed to be zero.

Multiple Trusts Anti-Abuse Rule

IRC Section 643(f) grants the Secretary authority to treat two or more trusts as a single trust for purposes of subchapter J if (1) the trusts have substantially the same grantors and substantially the same primary beneficiaries and (2) a principal purpose of such trusts is the avoidance of tax.

Conclusion

There are winners and losers under Section 199A – it presents a special set of challenges for taxpayers and their tax preparation professionals. With careful planning, proper structuring and aggregation of related trades or businesses, taxpayers can ensure that they receive the maximum deduction and the lowest possible income tax rate when their income is connected to a Qualified Trade or Business.

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Abbreviations and Definitions

IRC = Internal Revenue Code
PTP = Publicly Traded Partnership
QBI = Qualified Business Income
QBID = Qualified Business Income Deduction
QTB = Qualified Trade or Business
REIT = Real Estate Investment Trust
RPE = Relevant Passthrough Entity
SSTB = Specified Service Trade or Business
UBIA of Qualified Property = Unadjusted Basis Immediately After Acquisition of Qualified Property

SSTB Categories

Health – Paragraph (b)(2)(ii)

The Health SSTB category is informed by the definition of "health" under Section 448 and provides that the term "performance of services in the field of health" means the provision of medical services by physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists and other similar healthcare professionals who provide medical services directly to a patient. The performance of services in the field of health does not include the provision of services not directly related to a medical field, even though the services may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.

Law – Paragraph (b)(2)(iii)

The Law SSTB is based on the ordinary meaning of "services in the field of law" and provides that the term "performance of services in the field of law" means the provision of services by lawyers, paralegals, legal arbitrators, mediators and similar professionals in their capacity as such. The performance of services in the field of law does not include the provision of services that do not require skills unique to the field of law, for example, the provision of services by printers, delivery services or stenography services.

Accounting – Paragraph (b)(2)(iv)

This SSTB is based on the ordinary meaning of "accounting" and provides that the term "performance of services in the field of accounting" means the provision of services by accountants, enrolled agents, return preparers, financial auditors and similar professionals in their capacity as such. Provision of services in the field of accounting is not limited to services requiring state licensure as a certified public accountant (CPA). The aim of this Paragraph is to capture the common understanding of accounting, which includes tax return and bookkeeping services, even though the provision of such services may not require the same education, training or mastery of accounting principles as a CPA. The field of accounting does not include payment processing and billing analysis.

Actuarial Science – Paragraph (b)(2)(v)

This SSTB is based on the ordinary meaning "actuarial science" and provides that the term "performance of services in the field of actuarial science" means the provision of services by actuaries and similar professionals in their capacity as such. The field of actuarial science does not include the provision of services by analysts, economists, mathematicians and statisticians not engaged in analyzing or assessing the financial costs of risk or uncertainty of events.

Performing Arts – Paragraph (b)(2)(vi)

The Performing Arts SSTB is informed by the definition of "performing arts" under Section 448 and provides that the term "performance of services in the field of the performing arts" means the performance of services by individuals who participate in the creation of performing arts, such as actors, singers, musicians, entertainers, directors and similar professionals performing services in their capacity as such. The performance of services in the field of performing arts does not include the provision of services that do not require skills unique to the creation of performing arts, such as the maintenance and operation of equipment or facilities for use in the performing arts. The performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public.

Consulting – Paragraph (b)(2)(vii)

The Consulting SSTB is informed by the definition of "consulting" under Section 448 and provides that the term "performance of services in the field of consulting" means the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems. Consulting includes providing advice and counsel regarding advocacy with the intention of influencing decisions made by a government or governmental agency and all attempts to influence legislators and other government officials on behalf of a client by lobbyists and other similar professionals performing services in their capacity as such. The performance of services in the field of consulting does not include the performance of services other than advice and counsel, such as sales or economically similar services or the provision of training and educational courses. For purposes of the preceding sentence, the determination of whether a person's services are sales or economically similar services will be based on all the facts and circumstances of that person's business. Such facts and circumstances include, for example, the way the taxpayer is compensated for the services provided. Performance of services in the field of consulting does not include the performance of consulting services embedded in, or ancillary to, the sale of goods or performance of services on behalf of a trade or business that is otherwise not an SSTB (such as typical services provided by a building contractor) if there is no separate payment for the consulting services.

Additionally, the IRS is aware of the concern noted by commenters that in certain kinds of sales transactions it is common for businesses to provide consulting services in connection with the purchase of goods by customers. For example, a company that sells computers may provide customers with consulting services relating to the setup, operation and repair of the computers, or a contractor who remodels homes may provide consulting prior to remodeling a kitchen. Proposed Section1.199A-5(c) provides a de minimis rule, under which a trade or business is not an SSTB if less than ten percent of the gross receipts (5% if the gross receipts are greater than $25 million) of the trade or business are attributable to the performance of services in a specified service activity. However, this de minimis rule may not provide sufficient relief for certain trades or business that provide ancillary consulting services. The Treasury Department and the IRS believe that if a trade or business involves the selling or manufacturing of goods, and such trade or business provides ancillary consulting services that are not separately purchased or billed, then such trades or businesses are not in a trade or business in the field of consulting. Accordingly, Section1.199A-5(b)(2)(vii) provides that the field of consulting does not include consulting that is embedded in, or ancillary to, the sale of goods if there is no separate payment for the consulting services.

Athletics – Paragraph (b)(2)(viii)

The field of Athletics is not listed in Section 448(d)(2), and there is little guidance on its meaning as used in Section 1202(e)(3)(A). However, commenters noted, and the IRS agrees, that among the services specified in Section 199A(d)(2)(A) the field of athletics is most similar to the field of performing arts. Accordingly, Section1.199A-5(b)(2)(viii) provides that the term "performance of services in the field of athletics" means the performances of services by individuals who participate

in athletic competition such as athletes, coaches and team managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, skiing, snowboarding, track and field, billiards and racing. The performance of services in the field of athletics does not include the provision of services that do not require skills unique to athletic competition, such as the maintenance and operation of equipment or facilities for use in athletic events. Similarly, the performance of services in the field of athletics does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of athletic events to the public.

Financial Services – Paragraph (b)(2)(ix)

Commenters requested guidance as to whether financial services include banking. These commenters noted that Section 1202(e)(3)(A) includes the term financial services but that banking in separately listed in Section 1202(e)(3)(B), which suggests that banking is not included as part of financial services in Section 1202(e)(3)(A). The Treasury Department and the IRS agree with such commenters that this suggests that financial services should be more narrowly interpreted here.

Therefore, Section1.199A-5(b)(2)(ix) limits the definition of financial services to services typically performed by financial advisors and investment bankers and provides that the field of financial services includes the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans, the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructurings (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as the client's agent in the issuance of securities and similar services. This includes services provided by financial advisors, investment bankers, wealth planners and retirement advisors and other similar professionals but does not include taking deposits or making loans.

Brokerage Services – Paragraph (b)(2)(x)

This Section uses the ordinary meaning of "brokerage services" and provides that the field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in Section 475(c)(2)) for a commission or fee. This includes services provided by stock brokers and other similar professionals but does not include services provided by real estate agents and brokers or insurance agents and brokers.

Investing and Investment Management – Paragraph (b)(2)(xi)

This Section uses the ordinary meaning of "investing and investment management" and provides that any trade or business that involves the "performance of services that consist of investing and investment management" means a trade or business that earns fees for investment, asset management services or investment management services including providing advice with respect to buying and selling investments. The performance of services that consist of investing and investment management would include a trade or business that receives either a commission, a flat fee or an investment management fee calculated as a percentage of assets under management. The performance of services of investing and investment management does not include directly managing real property.

Trading – Paragraph (b)(2)(xii)

This Section provides that any trade or business involving the "performance of services that consist of trading" means a trade or business of trading in securities, commodities or partnership interests. Whether a person is a trader is determined considering the relevant facts and circumstances. Factors that have been considered relevant to determining whether a person is a trader include the source and type of profit generally sought from engaging in the activity regardless of whether the activity is being provided on behalf of customers or for a taxpayer's own account, including the source and type of profit that is associated with engaging in the activity regardless of whether that

person trades for the person's own account, for the account of others or any combination thereof. A taxpayer, such as a manufacturer or a farmer, who engages in hedging transactions as part of their trade or business of manufacturing or farming is not considered to be engaged in the trade or business of trading commodities.

See Endicott v. Commissioner, T.C. Memo 2013-199; Nelson v. Commissioner, T.C. Memo 2013-259, King v. Commissioner, 89 T.C. 445 (1987). A person that is a trader under these principles will be treated as performing the services of trading for purposes of Section 199A(d)(2)(B).

Dealing in Securities (as defined in Section 475(c)(2)), Partnership Interests or Commodities (as defined in Section 475(e)(2)) – Paragraph (b)(2)(xiii)

For purposes of Section1.199A-5(b)(2)(xiii), the "performance of services that consist of dealing in securities (as defined in Section 475(c)(2))" means regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business. For purposes of the preceding sentence, a taxpayer that regularly originates loans in the ordinary course of a trade or business of making loans but engages in no more than negligible sales of the loans is not dealing in securities for purposes of Section 199A(d)(2). See Section1.475(c)-1(c)(2) and (4) for the definition of negligible sales.

For purposes of Section1.199A-5(b)(2)(xiii), "the performance of services that consist of dealing in partnership interests" means regularly purchasing partnership interests from and selling partnership interests to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign or otherwise terminate positions in partnership interests with customers in the ordinary course of a trade or business.

For purposes of Section1.199A-5(b)(2)(xiii), "the performance of services that consist of dealing in commodities (as defined in Section 475(e)(2))" means regularly purchasing commodities from and selling commodities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign or otherwise terminate positions in commodities with customers in the ordinary course of a trade or business.

Section 199A(d)(2)(B) provides that an SSTB also includes any trade or business that involves the performance of services that consist of investing and investment management, trading or dealing in securities (as defined in Section 475(c)(2)), partnership interests or commodities (as defined in Section 475(e)(2)). This rule does not appear in Section 1202(e)(3)(A) or Section 448(d)(2).

Section 475(c)(2) provides a detailed list of interests treated as securities, including stock in a corporation; ownership interests in widely held or publicly traded partnerships or trusts; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidences of an interest in, or derivative financial instruments in any of the foregoing securities or any currency, including any option, forward contract, short position, or any similar financial instruments; and certain hedges with respect to any such securities.

Section 475(e)(2) provides a similarly detailed list of property treated as a commodity, including any commodity that is actively traded (within the meaning of Section 1092(d)(1)) or any notional principal contract with respect to any such commodity, evidences of an interest in or derivative financial instruments in any of the foregoing commodities, and certain hedges with respect to any such commodities.

Any Trade or Business Where the Principal Asset of Such Trade or Business is the Reputation or Skill of One or More of its Employees or Owners as Defined in Paragraph (b)(2)(xiv)

The IRS believes that the "reputation or skill" clause as used in Section 199A was intended to describe a narrow set of trades or businesses, not otherwise covered by the enumerated specified services, in which income is received based directly on the skill and/or reputation of employees or owners. Additionally, the Treasury Department and the IRS believe that "reputation or skill" must be

interpreted in a manner that is both objective and administrable. Thus, Section1.199A-5(b)(2)(xiv) limits the meaning of the "reputation or skill" clause to fact patterns in which the individual or RPE is engaged in the trade or business of: (1) receiving income for endorsing products or services, including an individual's distributive share of income or distributions from an RPE for which the individual provides endorsement services; (2) licensing or receiving income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity, including an individual's distributive share of income or distributions from an RPE to which an individual contributes the rights to use the individual's image; or (3) receiving appearance fees or income (including fees or income to reality performers performing as themselves on television, social media, or other forums, radio, television, and other media hosts, and video game players).