

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Part 1**

[REG–107892–18]

RIN 1545–BO71

**Qualified Business Income Deduction****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** This document contains proposed regulations concerning the deduction for qualified business income under section 199A of the Internal Revenue Code (Code). The regulations will affect individuals, partnerships, S corporations, trusts, and estates engaged in domestic trades or businesses. The proposed regulations also contain an anti-avoidance rule under section 643 of the Code to treat multiple trusts as a single trust in certain cases. This document also provides notice of a public hearing on these proposed regulations.

**DATES:** Written or electronic comments must be received by October 1, 2018. Outlines of topics to be discussed at the public hearing scheduled for October 16, 2018, at 10 a.m. must be received by October 1, 2018. If no outlines of topics are received by October 1, 2018 the public hearing will be cancelled.

**ADDRESSES:** Send submissions to CC:PA:LPD:PR (REG–107892–18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–107892–18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224, or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG–107892–18). The public hearing will be held in the Auditorium, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Vishal R. Amin, Frank J. Fisher, or Wendy L. Kribell at (202) 317–6850 or Adrienne M. Mikolashek at 202–317–5279; concerning submissions of comments and outlines of topics for the public hearing, Regina Johnson at (202) 317–6901 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:****Paperwork Reduction Act**

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). The Department of the Treasury (Treasury Department) and the IRS request comment on the assumptions, methodology, and burden estimates related to this information collection. Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE-CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by October 15, 2018.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Details of the estimated collection burden can be found in Section I.J. of the Special Analyses section later in this document.

The collection of information required by this proposed regulation is in proposed § 1.199A–4 and proposed § 1.199A–6. The collection of information in proposed § 1.199A–4 is required for taxpayers that choose to aggregate two or more trades or businesses. The collection of information in proposed § 1.199A–6 is required for passthrough entities that report section 199A information to their owners or beneficiaries. It is necessary to report the information to the IRS in order to ensure that taxpayers properly report in accordance with the rules of the proposed regulations the correct amount of deduction under section

199A. The collection of information is necessary to ensure tax compliance.

The likely respondents are individuals with qualified business income from more than one trade or business as well as most partnerships, S corporations, trusts, and estates that have qualified business income.

*Estimated total annual reporting burden:* 25 million hours.

Estimated average annual burden hours per respondent will vary from 30 minutes to 20 hours, depending on individual circumstances, with an estimated average of 2.5 hours.

*Estimated number of respondents:* 10 million.

*Estimated annual frequency of responses:* annually.

*Estimated monetized burden:* Using the IRS's taxpayer compliance cost estimates, taxpayers who are self-employed with multiple businesses are estimated to have a monetization rate of \$39 per hour. Pass-throughs that issue K–1s have a monetization rate of \$53 per hour. (See “Taxpayer Compliance Costs for Corporations and Partnerships: A New Look,” Contos, et al. IRS Research Bulletin (2012) p. 5 for a description of the model.)

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

**Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under sections 199A and 643 of the Code.

*I. Section 199A*

Section 199A was enacted on December 22, 2017, by § 11011 of “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” Public Law 115–97 (TCJA), and was amended on March 23, 2018, retroactively to January 1, 2018, by § 101 of Division T of the Consolidated Appropriations Act, 2018, Public Law 115–141, (2018 Act). Section 199A applies to taxable years beginning after 2017 and before 2026.

Section 199A provides a deduction of up to 20 percent of income from a domestic business operated as a sole

proprietorship or through a partnership, S corporation, trust, or estate (section 199A deduction). The section 199A deduction may be taken by individuals and by some estates and trusts. A section 199A deduction is not available for wage income or for business income earned through a C corporation. For taxpayers whose taxable income exceeds a statutorily-defined amount (threshold amount), section 199A may limit the taxpayer's section 199A deduction based on (i) the type of trade or business engaged in by the taxpayer, (ii) the amount of W-2 wages paid with respect to the trade or business (W-2 wages), and/or (iii) the unadjusted basis immediately after acquisition (UBIA) of qualified property held for use in the trade or business (UBIA of qualified property). These statutory limitations are subject to phase-in rules based upon taxable income above the threshold amount.

Section 199A also allows individuals and some trusts and estates (but not corporations) a deduction of up to 20 percent of their combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income, including qualified REIT dividends and qualified PTP income earned through passthrough entities. This component of the section 199A deduction is not limited by W-2 wages or UBIA of qualified property.

The section 199A deduction is the lesser of (1) the sum of the combined amounts described in the prior two paragraphs or (2) an amount equal to 20 percent of the excess (if any) of taxable income of the taxpayer for the taxable year over the net capital gain of the taxpayer for the taxable year.

Additionally, section 199A(g) provides that specified agricultural or horticultural cooperatives may claim a special entity-level deduction that is substantially similar to the domestic production activities deduction under former section 199.

Finally, the statute expressly grants the Secretary authority to prescribe such regulations as are necessary to carry out the purposes of section 199A (section 199A(f)(4)), and provides specific grants of authority with respect to: The treatment of acquisitions, dispositions, and short-tax years (section 199A(b)(5)); certain payments to partners for services rendered in a non-partner capacity (section 199A(c)(4)(C)); the allocation of W-2 wages and UBIA of qualified property (section 199A(f)(1)(A)(iii)); restricting the allocation of items and wages under section 199A and such reporting requirements as the Secretary determines appropriate (section

199A(f)(4)(A)); the application of section 199A in the case of tiered entities (section 199A(f)(4)(B)); preventing the manipulation of the depreciable period of qualified property using transactions between related parties (section 199A(h)(1)); and determining the UBIA of qualified property acquired in like-kind exchanges or involuntary conversions (section 199A(h)(2)).

## II. Section 643

Part I of subchapter J of chapter 1 of the Code provides rules related to the taxation of estates, trusts, and beneficiaries. For various subparts of part I of subchapter J, sections 643(a), 643(b), and 643(c) define the terms *distributable net income (DNI)*, *income*, and *beneficiary*, respectively. Sections 643(d) through 643(i) (other than section 643(f)) provide additional rules. 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 the tax imposed by chapter 1 of the Code. Section 643(f) further provides that, for these purposes, spouses are treated as a single person.

## Explanation of Provisions

The purpose of these proposed regulations is to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding the application of section 199A. These proposed regulations contain six substantive sections, §§ 1.199A-1 through 1.199A-6, each of which provides rules relevant to the calculation of the section 199A deduction. Additionally, the proposed regulations would establish anti-abuse rules under section 643(f) to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax, including abuse of section 199A. This Explanation of Provisions describes each of the proposed regulation sections in turn.

### I. Proposed § 1.199A-1: Operational Rules

Section 1.199A-1 of the proposed regulations (proposed § 1.199A-1) provides guidance on the determination of the section 199A deduction. For simplicity, the proposed regulations use the term *individual* when referring to an individual, trust, estate, or other person eligible to claim the section 199A deduction. The term *relevant passthrough entity (RPE)* is used to

describe passthrough entities that directly operate the trade or business or pass through the trade or business' items of income, gain, loss, or deduction from lower-tier RPEs to the individual.

Proposed § 1.199A-1(b) contains definitions applicable for section 199A and §§ 1.199A-1 through 1.199A-6. Proposed § 1.199A-1(c) provides guidance on the computation of the section 199A deduction for individuals with taxable income at or below the threshold amount. Proposed § 1.199A-1(d) provides guidance on the computation of the section 199A deduction for individuals with taxable income above the threshold amount, including individuals with taxable income within a phase-in range above the threshold amount. Proposed § 1.199A-1(e) provides special rules related to the section 199A deduction.

#### A. Defined Terms

Defined terms in proposed § 1.199A-1(b) include aggregated trade or business, applicable percentage, phase-in range, qualified business income (QBI), QBI component, qualified PTP income, qualified REIT dividends, reduction amount, RPE, specified service trade or business (SSTB), threshold amount, total QBI amount, UBIA of qualified property, and W-2 wages.

Proposed § 1.199A-1(b) also defines trade or business for purposes of section 199A and proposed §§ 1.199A-1 through 1.199A-6. Neither the statutory text of section 199A nor the legislative history provides a definition of trade or business for purposes of section 199A. Multiple commenters stated that section 162 is the most appropriate definition for purposes of section 199A. Although the term trade or business is defined in more than one provision of the Code, the Department of the Treasury (Treasury Department) and the IRS agree with commenters that for purposes of section 199A, section 162(a) provides the most appropriate definition of a trade or business. This is based on the fact that the definition of trade or business under section 162 is derived from a large body of existing case law and administrative guidance interpreting the meaning of trade or business in the context of a broad range of industries. Thus, the definition of a trade or business under section 162 provides for administrable rules that are appropriate for the purposes of section 199A and which taxpayers have experience applying and therefore defining trade or business as a section 162 trade or business will reduce compliance costs, burden, and administrative complexity.

The proposed regulations extend the definition of trade or business for purposes of section 199A beyond section 162 in one circumstance. Solely for purposes of section 199A, the rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if the rental or licensing and the other trade or business are commonly controlled under proposed § 1.199A-4(b)(1)(i). It is not uncommon that for legal or other non-tax reasons taxpayers may segregate rental property from operating businesses. This rule allows taxpayers to aggregate their trades or businesses with the associated rental or intangible property under proposed § 1.199A-4 if all of the requirements of proposed § 1.199A-4 are met. In addition, this rule may prevent taxpayers from improperly allocating losses or deductions away from trades or businesses that generate income that is eligible for a section 199A deduction.

#### *B. Computation of the Section 199A Deduction for Individuals With Taxable Income Below the Threshold Amount*

##### 1. Basic Computational Rules

An individual with income attributable to one or more domestic trades or businesses, other than as a result of owning stock of a C corporation or engaging in the trade or business of being an employee, and with taxable income (before computing the section 199A deduction) at or below the threshold amount, is entitled to a section 199A deduction equal to the lesser of (i) 20 percent of the QBI (generally defined as the net amount of qualified items of income, gain, deduction, and loss with respect to a qualified trade or business of the taxpayer) from the individual's trades or businesses plus 20 percent of the individual's combined qualified REIT dividends and qualified PTP income or (ii) 20 percent of the excess (if any) of the individual's taxable income over the individual's net capital gain. Proposed § 1.199A-1(c) contains guidance on calculating the amount of the deduction in these circumstances. If an individual's combined QBI is negative or combined qualified REIT dividends and PTP income is less than zero, proposed § 1.199A-1(c)(2) provides rules for the carryover of the losses.

##### 2. Carryover Loss Rules for Negative Total QBI Amounts

If an individual has multiple trades or businesses, the individual must calculate the QBI from each trade or business and then net the amounts. Section 199A(c)(2) provides that, for

purposes of section 199A, if the net QBI with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year. Proposed § 1.199A-1(c)(2)(i) repeats this rule and provides that the section 199A carryover rules do not affect the deductibility of the losses for purposes of other provisions of the Code.

##### 3. Carryover Loss Rules if Combined Qualified REIT Dividends and Qualified PTP Income is Less Than Zero

One commenter stated it was not clear whether, if a taxpayer has an overall loss from combined qualified REIT dividends and qualified PTP income (because a loss from a PTP exceeds REIT dividends and PTP income), the negative amount should be netted against any net positive QBI (regardless of source), or whether the negative amount should be segregated and subject to its own loss carryforward rule distinct from but analogous to the QBI loss carryforward rule. Section 199A contemplates that qualified REIT dividends and qualified PTP income are computed and taken into account separately from QBI and should not affect QBI. If overall losses attributable to qualified REIT dividends and qualified PTP income were netted against QBI, these losses would affect QBI. Therefore, a separate loss carryforward rule is needed to segregate an overall loss attributable to qualified REIT dividends and qualified PTP income from QBI. Additionally, commenters have expressed concern that losses in excess of income could create a negative section 199A deduction, a result incompatible with the statute. Accordingly, proposed § 1.199A-1(c)(2)(ii) provides that if an individual has an overall loss after qualified REIT dividends and qualified PTP income are combined, the portion of the individual's section 199A deduction related to qualified REIT dividends and qualified PTP income is zero for the taxable year. In addition, the overall loss does not affect the amount of the taxpayer's QBI. Instead, such overall loss is carried forward and must be used to offset combined qualified REIT dividends and qualified PTP income in the succeeding taxable year or years for purposes of section 199A.

#### *C. Computation of the Section 199A Deduction for Individuals With Taxable Income Above the Threshold Amount*

Proposed § 1.199A-1(d) addresses the calculation of the section 199A deduction for individuals with taxable

income above the threshold amount. All of the rules relating to the REIT/PTP component of the section 199A deduction applicable to individuals with taxable income at or below the threshold amount also apply to individuals with taxable income above the threshold amount. The QBI component of the section 199A deduction, however, is subject to limitations for individuals with taxable income exceeding the threshold amount. These limitations include the exclusion or reduction of items from an SSTB and limitations based on the W-2 wages of the trade or business or a combination of the W-2 wages and the UBIA of qualified property. Proposed § 1.199A-1(d) provides guidance on the application of these limitations.

Proposed § 1.199A-1(d)(2)(i) addresses the limitation or exclusion from QBI for SSTBs. SSTBs are specified service trades or businesses as defined in section 199A(d)(2) and proposed § 1.199A-5 (see part V. of the Explanation of Provisions). If an individual's taxable income is above the threshold amount but within the phase-in range then the individual must calculate an applicable percentage that limits the QBI, W-2 wages, and UBIA of qualified property from an SSTB that are used to calculate the individual's section 199A deduction. If the individual's taxable income is above the phase-in range, then no amount of QBI, W-2 wages, or UBIA of qualified property from an SSTB can be used by the individual in calculating the individual's section 199A deduction.

Proposed § 1.199A-1(d)(iv) addresses the limitations on QBI based on W-2 wages and UBIA of qualified property. An individual must determine the W-2 wages and the UBIA of qualified property attributable to each trade or business contributing to the individual's combined QBI under the rules of proposed § 1.199A-2. The W-2 wages and UBIA of qualified property amounts are compared to QBI in order to determine an individual's QBI component for each trade or business.

After determining the QBI for each trade or business, the individual must compare 20 percent of that trade or business' QBI to the alternative limitations for that trade or business. The limitation to which the 20 percent of QBI is compared is the greater of 50 percent of the W-2 wages attributable to the trade or business or 25 percent of those W-2 wages plus 2.5 percent of the UBIA of qualified property for that trade or business. If 20 percent of the QBI of the trade or business is greater than the relevant alternative limitation, the QBI component is limited in the calculations

under the proposed regulations to the amount of the alternative limitation. If an individual's taxable income is within the phase-in range and 20 percent of QBI is greater than either of the limitation amounts, the individual's QBI component for the trade or business is instead equal to 20 percent of QBI reduced by the reduction amount as described in proposed § 1.199A-1(d)(iv)(B).

One commenter noted that, if combined QBI from all of an individual's trades or businesses is greater than zero, but the individual's QBI from one or more trades or businesses is less than zero, the mechanics of how the loss should be offset against the QBI income for purposes of calculating the section 199A deduction are unclear. How such a loss is allocated matters in situations in which an individual has taxable income above the threshold amount and more than one trade or business with positive QBI. The commenter suggested that a "netting" approach best reflects Congress's intent, and that the absence of a netting approach would lead to inconsistent and counterintuitive results that Congress did not intend. The Treasury Department and the IRS agree that a netting approach is contemplated by the carryforward rule of section 199A(c)(2) and is necessary to ensure results consistent with the intent of section 199A. Accordingly, proposed § 1.199A-1(d)(iii) provides that, if an individual has QBI of less than zero from one trade or business, but has overall QBI greater than zero when all of the individual's trades or businesses are taken together, then the individual 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 individual applies the limitations based on W-2 wages and UBIA of qualified property. The individual must apportion the net loss among the trades or businesses with positive QBI in proportion to the relative amounts of QBI in such trades or businesses. Then, for purposes of applying the limitation based on W-2 wages and UBIA of qualified property, the net gain or income with respect to each trade or business (as offset by the apportioned losses) is the taxpayer's QBI with respect to that trade or business. The W-2 wages and UBIA of qualified property from the trades or businesses which produced negative QBI are not taken into account for purposes of proposed § 1.199A-1(d) and are not carried over into the subsequent year. The Treasury Department and the IRS

request comments on the approach described above.

#### *D. Special Rules*

Proposed § 1.199A-1(e) incorporates special rules contained in sections 199A and 6662. Section 199A(f)(1) provides that in the case of a partnership or S corporation, section 199A is applied at the partner or shareholder level. The proposed regulations provide that the section 199A deduction has no effect on the adjusted basis of the partner's interest in the partnership. With respect to S corporations, the section 199A deduction has no effect on the adjusted basis of a shareholder's stock in an S corporation or the S corporation's accumulated adjustments account.

The proposed regulations provide that the deduction under section 199A does not reduce net earnings from self-employment under section 1402 or net investment income under section 1411. Therefore, both sections 1402 and 1411 are calculated as though there is no section 199A deduction.

Section 199A(f)(1)(C) provides that if in the case of a taxpayer with QBI from within the Commonwealth of Puerto Rico, if such income is taxable under section 1 for a taxable year, then for purposes of determining QBI of such individual for such taxable year, the term "United States" shall include the Commonwealth of Puerto Rico. Proposed § 1.199A-1(e)(3) repeats this statutory language.

Section 199A(f)(2) provides that for purposes of determining alternative minimum taxable income under section 55, QBI shall be determined without regard to any adjustments under sections 56 through 59. To clarify that the section 199A deduction does not result in individuals being subject to the alternative minimum tax, proposed § 1.199A-1(e)(4) provides that, for purposes of determining alternative minimum taxable income under section 55, the deduction allowed under section 199A(a) for a taxable year shall be equal in amount to the deduction allowed under section 199A(a) in determining taxable income for that taxable year.

Section 6662(a) provides a penalty for an underpayment of tax required to be shown on a return. Under section 6662(b)(2), the penalty applies to the portion of any underpayment that is attributable to a substantial understatement of income tax. Section 6662(d)(1) defines substantial understatement of income tax, which is generally an understatement that exceeds the greater of 10 percent of the tax required to be shown on the return or \$5,000. Section 6662(d)(1)(C) provides a special rule in the case of any

taxpayer who claims the deduction allowed under section 199A for the taxable year, which requires that section 6662(d)(1)(A) is applied by substituting "5 percent" for "10 percent." Proposed § 1.199A-1(e)(5) cross-references this rule.

Section 199A(b)(7) provides that in the case of any qualified trade or business of a patron of a specified agricultural or horticultural cooperative, the amount determined under section 199A(b)(2) with respect to such trade or business shall be reduced by the lesser of (A) 9 percent of so much of the qualified business income with respect to such trade or business as is properly allocable to qualified payments received from such cooperative, or (B) 50 percent of so much of the W-2 wages with respect to such trade or business as are so allocable. Proposed § 1.199A-1(e)(6) repeats this statutory language.

## **II. Proposed § 1.199A-2: Determination of W-2 Wages and the UBIA of Qualified Property**

As described in part I.C. of this Explanation of Provisions, if an individual's taxable income exceeds the threshold amount, section 199A(b)(2)(B) imposes a limit on the section 199A deduction based on the greater of either (i) the W-2 wages paid, or (ii) the W-2 wages paid and UBIA of qualified property attributable to a trade or business. This part of this Explanation of Provisions describes the rules in proposed § 1.199A-2 regarding the determination of W-2 wages and UBIA of qualified property.

### *A. W-2 Wages Attributable to a Trade or Business*

The W-2 wage rules of proposed § 1.199A-2 generally follow the rules under former section 199. Section 199, which was repealed by the TCJA, provided for a deduction with respect to certain domestic production activities and contained a W-2 wage limitation similar to the one in section 199A. The legislative text of the W-2 wage limitation in section 199A is modeled on the text of former section 199, and both taxpayers and the IRS have developed experience in applying those W-2 wage rules for over a decade. The regulations under former section 199 provided rules to determine W-2 wages, which provide a useful starting point in developing the W-2 wage rules under section 199A, including rules on the definition of W-2 wages, wages paid by persons other than the common-law employer, and methods for calculating W-2 wages.

The Treasury Department and the IRS have received comments concerning

whether amounts paid to workers who receive Forms W-2 from third party payors (such as professional employer organizations, certified professional employer organizations, or agents under section 3504) that pay these wages to workers on behalf of their clients and report wages on Forms W-2, with the third party payor as the employer listed in Box c of the Forms W-2, may be included in the W-2 wages of the clients of third party payors. In order for wages reported on a Form W-2 to be included in the determination of W-2 wages of a taxpayer, the Form W-2 must be for employment by the taxpayer. The regulations under former section 199, specifically § 1.199-2(a)(2), addressed this issue, providing that, since employees of the taxpayer are defined in the regulations as including only common law employees of the taxpayer and officers of a corporate taxpayer, taxpayers may take into account wages reported on Forms W-2 issued by other parties provided that the wages reported on the Forms W-2 were paid to employees of the taxpayer for employment by the taxpayer.

Proposed § 1.199A-2(b)(2)(ii) provides a rule for wages paid by a person other than the common law employer that is substantially similar to the rule in § 1.199-2(a)(2). Specifically, 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 Forms W-2 with the other person as the employer listed in Box c of the Forms W-2, provided that the W-2 wages were paid to common law employees or officers of the person for employment by the person. In such cases, the person paying the W-2 wages and reporting the W-2 wages on Forms W-2 is precluded from taking into account such wages for purposes of determining W-2 wages with respect to that person. Persons that pay and report W-2 wages on behalf of or with respect to others can include certified professional employer organizations under section 7705, statutory employers under section 3401(d)(1), and agents under section 3504. Under this rule, persons who otherwise qualify for the deduction under section 199A are not limited in applying the deduction merely because they use a third party payor to pay and report wages to their employees. However, with respect to individuals who taxpayers assert are their common law employees for purposes of section 199A, taxpayers are reminded of their duty to file returns and apply the tax law on a consistent basis.

Unlike former section 199, the W-2 wage limitation in section 199A applies separately for each trade or business. Accordingly, proposed § 1.199A-2 provides that, in the case of W-2 wages that are allocable to more than one trade or business, the portion of the W-2 wages allocable to each trade or business is determined to be in the same proportion to total W-2 wages as the deductions associated with those wages are allocated among the particular trades or businesses. Section 199A(b)(4) also requires that to be taken into account, W-2 wages must be properly allocable to QBI. W-2 wages are properly allocable to QBI if the associated wage expense is taken into account in computing QBI.

Additionally, proposed § 1.199A-2(b)(4) restates the rule of section 199A(f)(1)(A)(iii), which provides that, in the case of a trade or business conducted by an RPE, a partner's or shareholder's allocable share of wages must be determined in the same manner as the partner's allocable share or a shareholder's pro rata share of wage expenses.

Consistent with section 199A(b)(5) and the legislative history of the TCJA, which direct the Secretary to provide rules for applying the W-2 wage limitation in cases in which the taxpayer acquires, or disposes of, a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business during the year, proposed § 1.199A-2(b)(2)(iv)(B) provides rules that apply in the case of an acquisition or disposition of a trade or business. See Joint Explanatory Statement of the Committee of Conference, 38. Specifically, proposed § 1.199A-2(b)(2)(iv)(B)(1) provides that, in the case of an acquisition or disposition of a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business that causes more than one individual or entity to be an employer of the employees of the acquired or disposed of trade or business during the calendar year, the W-2 wages of the individual or entity for the calendar year of the acquisition or disposition are allocated between each individual or entity based on the period during which the employees of the acquired or disposed of trade or business were employed by the individual or entity, regardless of which permissible method is used for reporting predecessor and successor wages on Form W-2. For this purpose, the period of employment is determined consistently with the principles for determining whether an individual is an

employee described in proposed § 1.199A-2(b).

A notice of proposed revenue procedure, Notice 2018-64, 2018-35 IRB \_\_\_\_, which provides three methods for calculating W-2 wages is being issued concurrently with this notice of proposed rulemaking. The three methods in the notice are substantially similar to the methods provided in Rev. Proc. 2006-47, 2006-2 C.B. 869, for purposes of calculating "paragraph (e)(1) wages" (that is, wages described in § 1.199-2(e)(1) issued under former section 199). The first method (the unmodified Box method) allows for a simplified calculation while the second and third methods (the modified Box 1 method and the tracking wages method) provide for greater accuracy.

#### *B. The UBIA of Qualified Property*

Section 199A(b)(2)(B)(ii) provides an alternative deduction limitation based on 25 percent of W-2 Wages with respect to the qualified trade or business and 2.5 percent of the UBIA of qualified property. Proposed § 1.199A-2 restates the statutory definitions under the qualified property rules, and provides additional guidance.

##### 1. General Definition of UBIA of Qualified Property

Proposed § 1.199A-2(c)(1) restates the definition of qualified property in section 199A(b)(6)(A), which provides that "qualified property" means tangible property of a character subject to depreciation that is held by, and available for use in, a trade or business at the close of the taxable year, and which is used in the production of QBI, and for which the depreciable period has not ended before the close of the taxable year. Proposed § 1.199A-2(c)(2) also restates the definition of depreciable period in section 199A(b)(6)(B), which provides that "depreciable" period means the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of (a) the date 10 years after that date, or (b) the last day of the last full year in the applicable recovery period that would apply to the property under section 168(c), regardless of the application of section 168(g).

Because the applicable recovery period under section 168(c) of the property is not changed by any additional first-year depreciation deduction allowable under section 168, proposed § 1.199A-2(c)(2)(ii) also clarifies that the additional first-year depreciation deduction allowable under section 168 (for example, under section 168(k) or section 168(m)) does not affect

the applicable recovery period under section 168(c).

Proposed § 1.199A-2(c)(3) provides a definition of UBIA. The Treasury Department and the IRS believe that existing general principles used to define “unadjusted basis” in § 1.263(a)-3(h)(5) provide a reasonable basis for an administrable rule that is appropriate for the purposes of section 199A and that their use will reduce compliance costs, burden, and administrative complexity because taxpayers have experience applying them. In addition, the Treasury Department and the IRS believe that “immediately after acquisition” means as of the date the property is placed in service because section 199A provides that “qualified property” must be used in the production of QBI. In order to be used in the production of QBI, the qualified property necessarily must be placed in service. Determining UBIA as of the date the property is placed in service ensures consistency between purchased and produced qualified property, and reduces compliance costs, burden, and administrative complexity because taxpayers are already required to determine that amount. Accordingly, proposed § 1.199A-2 provides that the term “UBIA” means the basis as determined under section 1012 or other applicable sections of chapter 1, including subchapter O (relating to gain or loss on dispositions of property), subchapter C (relating to corporate distributions and adjustments), subchapter K (relating to partners and partnerships), and subchapter P (relating to capital gains and losses). UBIA is determined without regard to any adjustments described in section 1016(a)(2) or (3), any adjustments for tax credits claimed by the taxpayer (for example, under section 50(c)), or any adjustments for any portion of the basis for which the taxpayer has elected to treat as an expense (for example, under sections 179, 179B, or 179C). Therefore, for purchased or produced qualified property, UBIA generally will be its cost under section 1012 as of the date the property is placed in service. For qualified property contributed to a partnership in a section 721 transaction and immediately placed in service, UBIA generally will be its basis under section 723. For qualified property contributed to an S corporation in a section 351 transaction and immediately placed in service, UBIA generally will be its basis under section 362. Further, for property inherited from a decedent and immediately placed in service by the heir, the UBIA generally will be its fair market value at the time of the

decedent’s death under section 1014. However, proposed § 1.199A-2(c)(3) provides that UBIA does reflect the reduction in basis for the percentage of the taxpayer’s use of property for the taxable year other than in the taxpayer’s trade or business.

#### 2. Partnership Special Basis Adjustments

After the enactment of the TCJA, the Treasury Department and the IRS received comments requesting guidance as to whether partnership special basis adjustments under sections 734(b) or 743(b) constitute qualified property for purposes of section 199A. Treating partnership special basis adjustments as qualified property could result in inappropriate duplication of UBIA of qualified property (if, for example, the fair market value of the property has not increased and its depreciable period has not ended). Accordingly, proposed § 1.199A-2(c)(1)(iii) provides that partnership special basis adjustments are not treated as separate qualified property.

#### 3. Property Transferred With a Principal Purpose of Increasing Section 199A Deduction

Qualified property includes depreciable property used during the taxable year in the production of QBI and held by, and available for use in, the trade or business at the close of the taxable year. However, it would be inconsistent with the purposes of section 199A to permit trades or businesses to transfer or acquire property at the end of the year merely to manipulate the UBIA of qualified property attributable to the trade or business. Therefore, pursuant to the authority granted to the Secretary under section 199A(f)(4), proposed § 1.199A-2(c)(1)(iv) provides that property is not qualified property if the property is acquired within 60 days of the end of the taxable year and disposed of within 120 days without having been used in a trade or business for at least 45 days prior to disposition, unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was a purpose other than increasing the section 199A deduction.

#### 4. Like-Kind Exchanges and Involuntary Conversions

Section 199A does not provide rules to determine UBIA for qualified property in the case of an exchange of property under section 1031 (like-kind exchange) or involuntary conversion under section 1033. However, section 199A(h)(2) specifically instructs the Secretary to do so. The Treasury

Department and the IRS believe that existing general principles used for like-kind exchanges and involuntary conversions under § 1.168(i)-(6) provide a useful analogy for administrable rules that are appropriate for the purposes of section 199A and that their use will reduce compliance costs, burden, and administrative complexity because taxpayers have experience applying them. Accordingly, proposed § 1.199A-2(c)(2)(iii) generally follows the rules of § 1.168(i)-6 to provide that qualified property that is acquired in a like-kind exchange, as defined in § 1.168(i)-6(b)(11), or in an involuntary conversion, as defined in § 1.168(i)-6(b)(12), is treated as replacement Modified Accelerated Cost Recovery System (MACRS) property as defined in § 1.168(i)-6(b)(1) whose depreciable period generally is determined as of the date the relinquished property was first placed in service. Accordingly, subject to one exception, proposed § 1.199A-2(c)(2)(iii) provides that, for purposes of determining the depreciable period, the date the exchanged basis in the replacement qualified property is first placed in service by the trade or business is the date on which the relinquished property was first placed in service by the individual or RPE and the date the excess basis in the replacement qualified property is first placed in service by the individual or RPE is the date on which the replacement qualified property was first placed in service by the individual or RPE. As a result, the depreciable period under section 199A for the exchanged basis of the replacement qualified property will end before the depreciable period for the excess basis of the replacement qualified property ends.

The exception is that proposed § 1.199A-2(c)(2)(iii)(C) provides that, for purposes of determining the depreciable period, if the individual or RPE makes an election under § 1.168(i)-6(i)(1) (the election not to apply § 1.168(i)-6), the date the exchanged basis and excess basis in the replacement qualified property are first placed in service by the trade or business is the date on which the replacement qualified property is first placed in service by the individual or RPE, with UBIA determined as of that date. In this case, the depreciable periods under section 199A for the exchanged basis and the excess basis of the replacement qualified property will end on the same date.

Thus, unless the exception applies, qualified property acquired in a like-kind exchange or involuntary conversion will have two separate placed in service dates under the

proposed regulations: For purposes of determining the UBIA of the property, the relevant placed in service date will be the date the acquired property is actually placed in service; for purposes of determining the depreciable period of the property, the relevant placed in service date generally will be the date the relinquished property was first placed in service. The proposed regulations contain an example illustrating these rules.

#### 5. Other Nonrecognition Transactions

The Treasury Department and the IRS have received comments requesting guidance on the application of the qualified property rules to nonrecognition transfers involving transferred basis property within the meaning of section 7701(a)(43) (transferred basis transactions). For example, taxpayers and practitioners requested guidance on how to determine the depreciable period of the property if a partnership conducts a trade or business and qualified property is contributed to that trade or business in a nonrecognition transfer under section 721(a). Also of relevance in the context of non-recognition transfers, section 199A(h)(1) grants the Secretary anti-abuse authority to apply rules similar to the rules under section 179(d)(2) (which can restrict the expensing of certain assets in transferred basis transactions) to prevent the manipulation of the depreciable period of qualified property using transactions between related parties.

The Treasury Department and the IRS believe that existing general principles used for transferred basis transactions under § 168(i)(7) provide a useful analogy for administrable rules that are appropriate for the purposes of section 199A and that their use will reduce compliance costs, burden, and administrative complexity because taxpayers have experience applying them. Accordingly, proposed § 1.199A-2(c)(2)(iv) provides that, for purposes of determining the depreciable period, if an individual or RPE (the transferee) acquires qualified property in a transaction described in section 168(i)(7)(B), the transferee determines the date on which the qualified property was first placed in service using a two-step approach. First, for the portion of the transferee's UBIA of the qualified property that does not exceed the transferor's UBIA of such property, the date such portion was first placed in service by the transferee is the date on which the transferor first placed the qualified property in service. Second, for the portion of the transferee's UBIA of the qualified property that exceeds

the transferor's UBIA of such property, if any, such portion is treated as separate qualified property that the transferee first placed in service on the date of the transfer. Thus, qualified property acquired in these non-recognition transactions will have two separate placed in service dates under the proposed regulations: For purposes of determining the UBIA of the property, the relevant placed in service date will be the date the acquired property is placed in service by the transferee (for instance, the date the partnership places in service property received in a section 721 transaction); for purposes of determining the depreciable period of the property, the relevant placed in service date generally will be the date the transferor first placed the property in service (for instance, the date the partner placed the property in service in his or her sole proprietorship). The proposed regulations contain an example illustrating these rules.

The Treasury Department and the IRS request comments concerning appropriate methods for accounting for non-recognition transactions, including rules to prevent the manipulation of the depreciable period of qualified property using transactions between related parties.

#### 6. Redetermination of UBIA and Subsequent Improvements to Qualified Property

The Treasury Department and the IRS have received comments requesting guidance on the treatment of subsequent improvements to qualified property. Subsequent improvements to qualified property are generally treated as a separate item of property under section 168(i)(6). The Treasury Department and the IRS do not believe a different approach is necessary for purposes of section 199A. Accordingly, proposed § 1.199A-2(c)(1)(ii) provides that, in the case of any addition to, or improvement of, qualified property that is already placed in service by the taxpayer, such addition or improvement is treated as separate qualified property that the taxpayer first placed in service on the date such addition or improvement is placed in service by the taxpayer for purposes of determining the depreciable period of the qualified property. For example, if a taxpayer acquired and placed in service a machine on March 26, 2018, and then incurs additional capital expenditures to improve the machine in May 2020, and places such improvements in service on May 27, 2020, the taxpayer has two qualified properties: The machine acquired and placed in service on March 26, 2018,

and the improvements to the machine incurred in May 2020 and placed in service on May 27, 2020.

#### 7. Allocation of UBIA of Qualified Property by RPEs

In the case of a trade or business conducted by an RPE, section 199A(f) provides that a partner's or shareholder's allocable share of the UBIA of qualified property is determined in the same manner as the partner's allocable share or shareholder's pro rata share of depreciation. Proposed § 1.199A-2(a)(3) provides that, 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 entity's total tax depreciation attributable to the property for the year. In the case of qualified property of 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 of an S corporation that does not produce tax depreciation during the year, each shareholder's share of the UBIA of the qualified property is a share of the UBIA proportionate to the ratio of shares in the S corporation held by the shareholder over the total shares of the S corporation.

### III. Proposed § 1.199A-3: QBI, Qualified REIT Dividends, Qualified PTP Income

Proposed § 1.199A-3 restates the definitions in section 199A(c) and provides additional guidance on the determination of QBI, qualified REIT dividends, and qualified PTP income.

#### A. QBI

Section 199A(c)(1) provides that the term "QBI" means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss attributable to any qualified trade or business of the taxpayer. QBI does not include any qualified REIT dividends or qualified PTP income. Section 199A(c)(3)(A) provides that the term "qualified items of income, gain, deduction, and loss" means items of income, gain, deduction, and loss to the



extent such items are (i) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting “qualified trade or business (within the meaning of section 199A)” for “nonresident alien individual or a foreign corporation” or for “a foreign corporation” each place it appears), and (ii) included or allowed in determining taxable income for the taxable year. Section 199A(c)(3)(B) provides a list of items that are not taken into account as qualified items of income, gain, deduction, and loss, including capital gain or loss, dividends, interest income other than interest income properly allocable to a trade or business, amounts received from an annuity other than in connection with a trade or business, certain items described in section 954, and items of deduction or loss properly allocable to these items. Section 199A(c)(4) provides that QBI does not include reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business, any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business, and to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business.

#### i. Treatment of Section 751 Gain

The Treasury Department and the IRS have received comments stating that it is unclear whether gain or loss that is treated as ordinary income under section 751 should be QBI if the section 751 income meets all of the other requirements to be QBI. This uncertainty is caused because section 199A(e)(5) lists: (i) The taxpayer’s allocable share of the QBI from a publicly traded partnership and (ii) income described in section 751(a) as separate categories of *qualified publicly traded partnership income*, which could be read to imply that income described in section 751 is not QBI. Section 1.199-5(f), issued under former section 199, specifically included section 751(a) or (b) gains as *domestic production gross receipts*.

The Treasury Department and the IRS do not view the statutory reference to section 751(a) gain as qualified PTP income to exclude section 751 gain from being QBI, but rather view such reference as clarifying the rules for PTPs. Accordingly, proposed § 1.199A-3(b)(1)(i) clarifies that any gain attributable to assets of a partnership giving rise to ordinary income under

section 751(a) or (b) is considered attributable to the trades or businesses conducted by the partnership, and therefore, may constitute QBI if the other requirements of section 199A and proposed § 1.199A-3 are satisfied.

#### ii. Guaranteed Payments for the Use of Capital

Because guaranteed payments for the use of capital under section 707(c) are determined without regard to the income of the partnership, proposed § 1.199A-3(b)(1)(ii) provides that such payments are not considered attributable to a trade or business, and thus do not constitute QBI. However, the partnership’s related expense for making the guaranteed payments may constitute QBI if the other requirements are satisfied.

#### iii. Section 481 Adjustments

Section 1.199-8(g), issued under former section 199, provides rules on how section 481(a) adjustments are taken into account for purposes of former section 199. Similarly, proposed § 1.199A-3(b)(1)(iii) provides that section 481 adjustments attributable to a trade or business, whether positive or negative, and arising in a taxable year ending after December 31, 2017, are treated as attributable to that trade or business. Accordingly, such section 481 adjustments will constitute QBI to the extent the requirements of section 199A, including proposed § 1.199A-3, are satisfied. Section 481 adjustments arising in a taxable year ending before January 1, 2018, do not constitute QBI.

#### iv. Previously Suspended Losses

Several sections of the Code, including sections 465, 469, 704(d), and 1366(d), provide for disallowance of losses and deductions in certain cases. Generally, the disallowed amounts are suspended and carried forward to the following year, at which point they are re-tested and may become allowable. Proposed § 1.199A-3(b)(1)(iv) provides that, to the extent that any previously disallowed losses or deductions are allowed in the taxable year, they are treated as items attributable to the trade or business. However, losses or deductions that were disallowed for taxable years beginning before January 1, 2018, are not taken into account for purposes of computing QBI in a later taxable year.

#### v. Net Operating Losses

Generally, items giving rise to a net operating loss are allowed in computing taxable income in the year incurred. Because those items would have been taken into account in computing QBI in

the year incurred, the net operating loss should not be treated as QBI in subsequent years. Otherwise, the same loss could be taken into account in multiple tax years. However, losses disallowed by section 461(l) give rise to a net operating loss without ever having been allowable in computing taxable income. Thus, if deductions are disallowed by reason of 461(l), those disallowed deductions will not be included in the QBI computation in the year incurred (because they are not includable in taxable income), and, if the resulting net operating loss also is not included in the QBI computation, the deduction would permanently escape the QBI rules. This result would be inappropriate. Accordingly, proposed § 1.199A-3(b)(1)(v) provides that generally, a deduction under section 172 for a net operating loss is not considered attributable to a trade or business and therefore, is not taken into account in computing QBI. However, to the extent the net operating loss is comprised of amounts attributable to a trade or business that were disallowed under section 461(l), the net operating loss is considered attributable to that trade or business, and will constitute QBI to the extent the requirements of section 199A, including proposed § 1.199A-3, are satisfied.

The Treasury Department and the IRS request comments regarding the interaction of section 199A and 461(l) generally.

#### vi. Requirement That an Item Be Effectively Connected With a U.S. Trade or Business

Section 199A applies to all noncorporate taxpayers, whether such taxpayers are domestic or foreign. Accordingly, section 199A applies to both U.S. citizens and resident aliens as well as nonresident aliens that have QBI. As noted previously in this Explanation of Provisions, QBI includes items of income, gain, deduction, and loss to the extent such items are (i) included or allowed in determining taxable income for the taxable year and (ii) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting “qualified trade or business (within the meaning of section 199A)” for “nonresident alien individual or a foreign corporation” or for “a foreign corporation” each place it appears).



a. Summary of Rules for Generally Determining Whether Income Is Effectively Connected With a United States Trade or Business

Section 864(c) provides rules that nonresident alien individuals and foreign corporations use to determine which items of income, gain, or loss are effectively connected with a United States trade or business. Section 873(a) permits nonresident aliens to deduct expenses only if and to the extent that they are connected with, or properly allocable and apportioned to, income effectively connected with a United States trade or business.

Thus, for example, a U.S. partner of a partnership that operates a trade or business in both the United States and in a foreign country would only include the items of income, gain, deductions, and loss that would be effectively connected with a United States trade or business. Similarly, a shareholder of an S corporation that is engaged in a trade or business in both the United States and in a foreign country would only take into account the items of income, gain, deduction, and loss that would be effectively connected to the portion of the business conducted by the S corporation in the United States, determined by applying the principles of section 864(c).

In general, whether a nonresident alien is engaged in a trade or business within the United States, as opposed to a trade or business conducted solely outside the United States, is based upon the all the facts and circumstances, as developed through case law and other published guidance. Pursuant to section 875(1), a nonresident alien is considered engaged in a trade or business within the United States if the partnership of which such individual is a member is so engaged.

Section 864(b) provides that the term “trade or business within the United States” includes (but is not limited to) the performance of personal services within the United States at any time during the taxable year, but excludes the performance of services described in section 864(b)(1) and (2). Section 864(b)(1) covers a limited set of nonresident aliens who perform services in the United States on behalf of foreign persons not otherwise engaged in a U.S. trade or business, or on behalf of U.S. persons through a foreign office, if the nonresident aliens are present in the United States less than 90 days during the taxable year and their compensation does not exceed \$3,000. Section 864(b)(2) generally treats foreign persons, including partnerships, who are trading in stocks, securities, and in

commodities for their own account or through a broker or other independent agent as not engaged in a United States trade or business.

b. Application to Section 199A

Although the cross reference in section 199A(c)(3)(A)(i) to section 864 is limited to paragraph (c) of that section, no income derived from excluded services under section 864(b)(1) or (2) could ever be effectively connected income in the hands of a nonresident alien. Accordingly, section 199A incorporates the specific rules regarding the scope of the term “trade or business in the United States” in determining QBI. As such, if a trade or business is not engaged in a U.S. trade or business by reason of section 864(b), items of income, gain, deduction, or loss from that trade or business will not be included in QBI because such items would not be effectively connected with the conduct of a U.S. trade or business.

If a trade or business is determined to be conducted in the United States, section 864(c)(3) generally treats all income of a nonresident alien from sources within the United States as effectively connected with the conduct of a U.S. trade or business. However, any income from sources within the United States described in section 871(a)(1) or (h) and any gain or loss from the sale of capital assets are only effectively connected if the income meets requirements of section 864(c)(2) and the regulations thereunder. Under section 864(c)(4), income from sources without the United States is generally not treated as effectively connected with the conduct of a U.S. trade or business unless an exception under section 864(c)(4)(B) applies. Thus, a trade or business’s foreign source income, gain, or loss, (and any deductions effectively connected with such foreign source income, gain, or loss) would generally not be included in QBI, unless the income meets an exception in section 864(c)(4)(B). Whether income is U.S. or foreign sourced is determined under sections 861, 862, 863, and 865, and the regulations thereunder.

This rule does not mean that any item that is effectively connected with the conduct of a trade or business with the United States is therefore QBI. As discussed previously, the item must also be “with respect to” a trade or business. Certain provisions of the Code allow items to be treated as effectively connected, even though they are not with respect to a trade or business. For example, section 871(d) allows a nonresident alien individual to elect to treat income from real property in the United States that would not otherwise

be treated as effectively connected with the conduct of a trade or business within the United States as effectively connected. However, for purposes of section 199A, if items are not attributable to a trade or business under 162, such items do not constitute QBI.

Similarly, the fact that a deduction is allowed for purposes of computing effectively connected taxable income does not necessarily mean that it is taken into account for purposes of section 199A. For example, for purposes of computing effectively connected taxable income, section 873(b) allows certain deductions, including for theft losses of property located within the United States and charitable contributions allowed under section 170, to be taken into account regardless of whether they are connected with income that is effectively connected with the conduct of a trade or business within the United States. However, for purposes of section 199A, these items would not be taken into account because section 199A only permits a deduction for income that is both attributable to a trade or business and that is also effectively connected income.

vii. Exclusion From QBI for Certain Items

a. Treatment of Section 1231 Gains and Losses

Section 199A(c)(3)(B)(i) provides that QBI does not include any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss. The Treasury Department and the IRS have received comments requesting guidance on the extent to which gains and losses subject to section 1231 may be taken into account in calculating QBI. Section 1231 provides rules under which gains and losses from certain involuntary conversions and the sale of certain property used in a trade or business are either treated as long-term capital gains or long-term capital losses, or not treated as gains and losses from sales or exchanges of capital assets.

Section 199A(c)(3)(B)(i) excludes capital gains or losses, regardless of whether those items arise from the sale or exchange of a capital asset. The legislative history of section 199A provides that QBI does not include any item taken into account in determining net long-term capital gain or net long-term capital loss. Conference Report page 30. Accordingly, proposed § 1.199A-3(b)(2)(ii)(A) clarifies that, to the extent gain or loss is treated as capital gain or loss, it is not included in QBI. Specifically, if gain or loss is

treated as capital gain or loss under section 1231, it is not QBI. Conversely, if section 1231 provides that gains or losses are not treated as gains and losses from sales or exchanges of capital assets, section 199A(c)(3)(B)(i) does not apply and thus, the gains or losses must be included in QBI (provided all other requirements are met).

#### b. Interest Income

Section 199A(c)(4)(C) provides that QBI does not include any interest income other than interest income that is properly allocable to a trade or business. The Treasury Department and the IRS believe that interest income received on working capital, reserves, and similar accounts is not properly allocable to a trade or business, and therefore should not be included in QBI, because such interest income, although held by a trade or business, is simply income from assets held for investment. Accordingly, proposed § 1.199A-3(b)(2)(ii)(C) provides that interest income received on working capital, reserves, and similar accounts is not properly allocable to a trade or business. In contrast, interest income received on accounts or notes receivable for services or goods provided by the trade or business is not income from assets held for investment, but income received on assets acquired in the ordinary course of trade or business.

#### c. Reasonable Compensation

Section 199A(c)(4)(A) provides that QBI does not include “reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business.” Similarly, guaranteed payments for services under section 707(c) are excluded from QBI. The phrase “reasonable compensation” is a well-known standard in the context of S corporations. Under Rev. Rul. 74-44, 1974-1 C.B. 287, S corporations must pay shareholder-employees “reasonable compensation for services performed” prior to making “dividend” distributions with respect to shareholder-employees’ stock in the S corporation under section 1368. *See also David E. Watson, P.C. v. United States*, 668 F.3d 1008, 1017 (8th Cir. 2012). The legislative history of section 199A confirms that the reasonable compensation rule was intended to apply to S corporations.

The Treasury Department and the IRS have received requests for guidance on whether the phrase “reasonable compensation” within the meaning of section 199A extends beyond the context of S corporations for purposes of

section 199A. The Treasury Department and the IRS believe “reasonable compensation” is best read as limited to the context from which it derives: Compensation of S corporation shareholders-employees. If reasonable compensation were to apply outside of the context of S corporations, a partnership could be required to apply the concept of reasonable compensation to its partners, regardless of whether amounts paid to partners were guaranteed. Such a result would violate the principle set forth in Rev. Rul. 69-184, 1969-1 CB 256, that a partner of a partnership cannot be an employee of that partnership. There is no indication that Congress intended to change this long-standing Federal income tax principle. Accordingly, proposed § 1.199A-3(b)(2)(ii)(H) provides that QBI does not include reasonable compensation paid by an S corporation but does not extend this rule to partnerships. Because the trade or business of performing services as an employee is not a qualified trade or business under section 199A(d)(1)(B), wage income received by an employee is never QBI. The rule for reasonable compensation is merely a clarification that, even if an S corporation fails to pay a reasonable wage to its shareholder-employees, the shareholder-employees are nonetheless prevented from including an amount equal to reasonable compensation in QBI.

#### d. Guaranteed Payments

Section 199A(c)(4)(B) provides that QBI does not include any guaranteed payment described in section 707(c) paid by a partnership to a partner for services rendered with respect to the trade or business. Proposed § 1.199A-3(b)(2)(ii)(I) restates this statutory rule and clarifies that the partnership’s deduction for such guaranteed payment is an item of QBI if it is properly allocable to the partnership’s trade or business and is otherwise deductible for Federal income tax purposes. It may be unclear whether a guaranteed payment to an upper-tier partnership for services performed for a lower-tier partnership is QBI for the individual partners of the upper-tier partnership if the upper-tier partnership does not itself make a guaranteed payment to its partners. Section 199A(c)(4)(B) does not limit the term “partner” to an individual. Consequently, for purposes of the guaranteed payment rule, a partner may be an RPE. Accordingly, proposed § 1.199A-3(b)(2)(ii)(I) clarifies that QBI does not include any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business,

regardless of whether the partner is an individual or an RPE. Therefore, for the purposes of this rule, 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 regardless of whether it is guaranteed to the ultimate recipient.

#### e. Section 707(a) Payments

Section 199A(c)(4)(C) provides that QBI does not include, to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business. Section 707(a) addresses arrangements in which a partner engages with the partnership other than in its capacity as a partner. Within the context of section 199A, payments under section 707(a) for services are similar to, and therefore, should be treated similarly as, guaranteed payments, reasonable compensation, and wages, none of which is includable in QBI. In addition, consistent with the tiered partnership rule for guaranteed payments described previously, to the extent an upper-tier RPE receives a section 707(a) payment, that income should not constitute QBI to the partners of the upper-tier entity. Accordingly, proposed § 1.199A-3(b)(2)(ii)(J) provides that QBI does not include any payment described in section 707(a) to a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. The Treasury Department and the IRS request comments on whether there are situations in which it is appropriate to include section 707(a) payments in QBI.

#### viii. Allocation of Items Not Clearly Attributable to a Single Trade or Business

Proposed § 1.199A-3(b)(5) provides that, if an individual or an RPE directly conducts multiple trades or businesses, and has items of QBI that are properly attributable to more than one trade or business, the taxpayer or entity must allocate those items among the several trades or businesses to which they are attributable using a reasonable method that is consistent with the purposes of section 199A. The chosen reasonable method for each item must be consistently applied from one taxable year to another and must clearly reflect the income of each trade or business. There are several different ways to allocate expenses, such as direct tracing or allocating based on gross income, but whether these are reasonable depends on the facts and circumstances of each

trade or business. The Treasury Department and the IRS are considering whether “reasonable method” should be defined to include the direct tracing method, allocations based on gross income, or other methods, within appropriate parameters. The Treasury Department and the IRS request comments on reasonable methods for the allocation of items not clearly attributable to a single trade or business and whether any safe harbors may be appropriate.

#### *B. Qualified REIT Dividends and Qualified PTP Income*

Proposed § 1.199A-3(c)(1) restates the statutory provisions regarding qualified REIT dividends and provides additional guidance relating to such dividends. Pursuant to the regulatory authority conferred under section 199A(f)(4), proposed § 1.199A-3(c) provides an anti-abuse rule to prevent dividend stripping and similar transactions aimed at capturing qualified REIT dividends without having economic exposure to the REIT stock for a meaningful period of time. The proposed anti-abuse rule incorporates the principles of section 246(c).

Proposed § 1.199A-3(c)(2) restates the statutory provisions regarding qualified PTP income and provides additional guidance regarding such income. One commenter questioned whether section 751 income recognized upon the sale of an interest in a PTP must meet the standards for QBI (such as the requirement that the income be effectively connected with a U.S. trade or business) to qualify as qualified PTP income. Section 199A includes special rules exempting qualified PTP income from the W-2 wage and UBIA of qualified property limitations. However, these statutory rules do not exempt qualified PTP income from the other QBI requirements. Accordingly, proposed § 1.199A-3(c)(3)(ii) clarifies that the other rules applicable to the determination of QBI apply to the determination of qualified PTP income.

### **IV. Proposed § 1.199A-4: Aggregation Rules**

#### *A. Overview*

The proposed regulations incorporate the rules under section 162 for determining whether a trade or business exists for purposes of section 199A. A taxpayer can have more than one trade or business for purposes of section 162. See § 1.446-1(d)(1). However, in most cases, a trade or business cannot be conducted through more than one entity.

The Treasury Department and the IRS have received comments requesting that the regulations provide that taxpayers be permitted to group or “aggregate” trades or businesses under section 199A using the grouping rules described in § 1.469-4 (grouping rules). Section 1.469-4 sets forth the rules 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” in determining the application of the limitation rules under section 469. 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 trade or business for section 199A purposes.

Additionally, 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 trade or business (that is, both active and passive owners of a trade or business may be entitled to a section 199A deduction if they otherwise satisfy the requirements of section 199A and these proposed regulations). Complicating matters further, a taxpayer’s section 469 groupings may include specified service trades or businesses, requiring separate rules to segregate the two categories of trades or businesses to calculate the section 199A deduction.

Therefore, the grouping rules under section 469 are not appropriate for determining a trade or business for section 199A purposes. Accordingly, the Treasury Department and the IRS are not adopting the section 469 grouping rules as the means by which taxpayers can aggregate trades or businesses for purposes of applying section 199A.

Although it is not appropriate to apply the grouping rules under section 469 to section 199A, the Treasury Department and the IRS agree with practitioners that some amount of aggregation should be permitted. It is not uncommon for what are commonly thought of as single trades or businesses to be operated across multiple entities. 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 trade or business for purposes of section 199A, section 162 trades or businesses should be permitted or required to be aggregated or disaggregated, and if so, whether such aggregation or disaggregation should

occur at the entity level or the individual 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 of qualified property limitations and potentially maximizing the deduction under section 199A. If such aggregation is not permitted, taxpayers could be forced to incur costs to restructure solely for tax purposes. In addition, business and non-tax law requirements may not permit many taxpayers to restructure their operations. Therefore, proposed § 1.199A-4 permits the aggregation of separate trades or businesses, provided certain requirements are satisfied.

The Treasury Department and the IRS are aware that many commenters were concerned with having multiple regimes for grouping (that is, under sections 199A, 1411, and 469). Accordingly, comments are requested on the aggregation method described in proposed § 1.199A-4, including whether this would be an appropriate grouping method for purposes of sections 469 and 1411, in addition to section 199A.

#### *B. Aggregation Rules*

Under proposed § 1.199A-4, aggregation is permitted but is not required. However, an individual may aggregate trades or businesses only if the individual can demonstrate that the requirements in proposed § 1.199A-4(b)(1) are satisfied. First, consistent with other provisions in the proposed regulations, each trade or business must itself be a trade or business as defined in § 1.199A-1(b)(13).

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 the majority of the taxable year in which the items attributable to each trade or business are included in income. All of the items attributable to the trades or businesses must be reported on returns with the same taxable year (not including short years). Proposed § 1.199A-4(b)(3) provides rules allowing for family attribution. Because the proposed rules look to a group of persons, non-majority owners may benefit from the common ownership and are permitted to aggregate. The Treasury Department and the IRS considered certain reporting requirements in which the majority owner or group of owners would be required to provide information about all of the other pass-through entities in which they held a majority interest. Due to the complexity and potential burden

on taxpayers of such an approach, proposed § 1.199A-4 does not provide such a reporting requirement. The Treasury Department and the IRS request comments on whether a reporting or other information sharing requirement should be required.

Third, none of the aggregated trades or businesses can be an SSTB. Proposed § 1.199A-5 addresses SSTBs and trades or businesses with SSTB income.

Fourth, individuals and trusts must establish that the trades or businesses meet at least two of three factors, which demonstrate that the businesses are in fact part of a larger, integrated trade or business. These factors include: (1) The businesses 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) the businesses share facilities or share significant centralized business elements (for example, common personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources); or (3) the businesses are operated in coordination with, or reliance on, other businesses in the aggregated group (for example, supply chain interdependencies).

### C. Individuals

An individual 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.

An individual directly engaged in a trade or business must compute QBI, W-2 wages, and UBIA of qualified property for each trade or business before applying the aggregation rules. If an individual has aggregated two or more trades or businesses, then the combined QBI, W-2 wages, and UBIA of qualified property for all aggregated trades or businesses is used for purposes of applying the W-2 wage and UBIA of qualified property limitations described in proposed § 1.199A-1(d)(2)(iv).

### D. RPEs

RPEs must compute QBI, W-2 wages, and UBIA of qualified property for each trade or business. An RPE must provide its owners with information regarding QBI, W-2 wages, and UBIA of qualified property attributable to its trades or businesses.

The Treasury Department and the IRS considered permitting aggregation by an RPE in a tiered structure. The Treasury Department and the IRS considered

several approaches to tiered structures, including permitting only the operating entity to aggregate the trades or businesses or permitting each tier to add to the aggregated trade or business from a lower-tier, provided that the combined aggregated trade or business otherwise satisfied the requirements of proposed § 1.199A-4(b)(1) had the businesses all been owned by the lower-tier entity. The Treasury Department and the IRS are concerned that the reporting requirements needed for either of these rules would be overly complex for both taxpayers and the IRS to administer. In addition, because the section 199A deduction is in all cases taken at the individual level, it should not be detrimental, and in fact may provide flexibility to taxpayers, to provide for aggregation at only one level. The Treasury Department and the IRS request comments on the proposed approach to tiered structures and the reporting necessary to allow an individual to demonstrate to which trades or businesses his or her QBI, W-2 wages, and UBIA of qualified property are attributable for purposes of calculating his or her section 199A deduction.

### E. Reporting and Consistency

Proposed § 1.199A-4(c)(1) requires that once multiple trades or businesses are aggregated into a single aggregated trade or business, individuals must consistently report the aggregated group in subsequent tax years. Proposed § 1.199A-4(c)(1) provides rules for situations in which the aggregation rules are no longer met as well as rules for when a newly created or acquired trade or business can be added to an existing aggregated group.

Proposed § 1.199A-4(c)(2)(i) provides reporting and disclosure requirements for individuals that choose to aggregate, including identifying information about each trade or business that constitutes a part of the aggregated trade or business. Proposed § 1.199A-4(c)(2)(ii) allows the Commissioner to disaggregate trades or businesses if an individual fails to make the required aggregation disclosure. The Treasury Department and the IRS request comments as to whether it is administrable to create a standard under which trades or businesses will be disaggregated by the Commissioner and what that standard might be.

### V. Proposed § 1.199A-5: Specified Service Trade or Business and the Trade or Business of Performing Services as an Employee

Section 199A(c)(1) provides that only items attributable to a qualified trade or business are taken into account in

determining the section 199A deduction for QBI. Section 199A(d)(1) provides that a “qualified trade or business” means any trade or business other than (A) an SSTB, or (B) the trade or business of performing services as an employee.

### A. SSTB

This part V.A. explains the provisions under proposed § 1.199A-5 relating to SSTBs. First, the effect of classification as an SSTB is discussed. Second, the exceptions for taxpayers below the threshold amount and a *de minimis* exception are described. Third, guidance is provided on the meaning of the activities listed in the definition of SSTB. Fourth, the rules for determining whether a trade or business is treated as part of an SSTB are described. Finally, rules regarding classification as an employee for purposes of section 199A are discussed.

#### 1. Effect of being an SSTB

##### a. General Rule

Consistent with section 199A, proposed § 1.199A-5(a)(2) provides that, unless an exception applies, if a trade or business is an SSTB, none of its items are to be taken into account 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 participated in the SSTB. Similarly, none of the W-2 wages or UBIA of qualified property will be taken into account for purposes of section 199A. For example, because the field of athletics is an SSTB, if a partnership owns a professional sports team, the partners’ distributive shares of income from the partnership’s athletics trade or business is not QBI, regardless of whether the partners participate in the partnership’s trade or business. Proposed § 1.199A-5 contains further examples illustrating the operation of this rule.

##### b. Exceptions to the General Rule

Under section 199A(d)(3), individuals with taxable income below the threshold amount are not subject to a restriction with respect to SSTBs. Therefore, if an individual or trust has taxable income below the threshold amount, the individual or trust is

eligible to receive the deduction under section 199A notwithstanding that a trade or business is an SSTB. As described in part I.C of this Explanation of Provisions, the exclusion of QBI, W-2 wages, and UBIA of qualified property from the computation of the section 199A deduction is subject to a phase-in for individuals with taxable income within the phase-in range. 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. Therefore, if a partnership or an S corporation operates an SSTB, the application of the threshold does not depend on the partnership or S corporation's taxable income but rather, the taxable income of the individual partner or shareholder claiming the section 199A deduction. For example, if the partnership's taxable income is less than the threshold amount, but each of the partnership's individual partners have income that exceeds the threshold amount plus \$50,000 (\$100,000 in the case of a joint return) then none of the partners may claim a section 199A deduction with respect to any income from the partnership's SSTB.

An RPE conducting an SSTB may not know whether the taxable income of any of its equity owners is below the threshold amount. However, the RPE is best positioned to make the determination as to whether its trade or business is an SSTB. Therefore, reporting rules under proposed § 1.199A-6(b)(3)(B) requires each RPE to determine whether it conducts an SSTB and disclose that information to its partners, shareholders, or owners. With respect to each trade or business, once it is determined that a trade or business is an SSTB, it remains an SSTB and cannot be aggregated with other trades or business. In the case of a trade or business conducted by an individual, such as a sole proprietorship, disregarded entity, or grantor trust, the determination of whether the business is an SSTB is made by the individual.

Section 199A defines an SSTB to include any trade or business that "involves the performance of services in" a specified service activity. Although the statute, read literally, does not suggest that a certain quantum of specified service activity is necessary to find an SSTB, the Treasury Department and the IRS believe that requiring all taxpayers to evaluate and quantify any amount of specified service activity would create administrative complexity and undue burdens for both taxpayers and the IRS. Therefore, analogous to the regulations under section 448, it is appropriate to provide 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.

Accordingly, proposed § 1.199A-5(c)(1) provides that a trade or business (determined before the application of the aggregation rules in proposed § 1.199A-4) is not an SSTB if the trade or business has gross receipts of \$25 million or less (in a taxable year) and less than 10 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 5 percent of the gross receipts of the trade or business are attributable to the performance of services in an SSTB.

## 2. Definition of Specified Service Trade or Business

The definition of an SSTB set forth in section 199A incorporates, with modifications, the text of section 1202(e)(3)(A). The text of section 1202(e)(3)(A) substantially tracks the definition of "qualified personal service corporation" under section 448. Therefore, consistent with ordinary rules of statutory construction, the guidance in proposed § 1.199A-5(b) is informed by existing interpretations and guidance under both sections 1202 and 448 when relevant. However, existing guidance under those sections is sparse and the scope and purpose of those sections and section 199A are different. The Treasury Department and the IRS also note that, unlike sections 1202(e)(3)(A) and 448, the purpose of section 199A is to provide a deduction based on the character of the taxpayer's trade or business. Distinct guidance for section 199A is warranted. Therefore, the guidance in proposed § 1.199A-5(b) applies only to section 199A, not sections 1202 and 448.

### a. Guidance on the Meaning of the Listed Activities

Section 199A(d)(2)(A) provides that an SSTB is any trade or business described in section 1202(e)(3)(A) (applied without regard to the words "engineering [and] architecture") or that would be so described if the term "employees or owners" were substituted for "employees" therein. Section 199A(d)(2)(B) provides that an SSTB is 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)).

Section 1202 provides an exclusion from gross income for some or all of the gain on the sale of certain qualified small business stock. Section 1202 generally requires that, for stock to be qualified small business stock, the corporation must be engaged in a qualified trade or business. Section 1202(e)(3) provides that, for purposes of section 1201(e), the term "qualified trade or business" means any trade or business other than any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees; any banking, insurance, financing, leasing, investing, or similar business; any farming business (including the business of raising or harvesting trees); any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A; and any business of operating a hotel, motel, restaurant, or similar business.

Thus, after application of the modifications described in section 199A(d)(2)(A), the definition of an SSTB for purposes of section 199A is (1) any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or 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, and (2) 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)).

The Treasury Department and the IRS have received comments requesting guidance on the meaning and scope of the various trades or businesses described in the preceding paragraph. The Treasury Department and the IRS agree with commenters that guidance with respect to these trades or businesses is necessary for several reasons. Most importantly, section 199A is a new Code provision intended to benefit a wide range of businesses, and taxpayers need certainty in determining whether their trade or business generates income that is eligible for the

section 199A deduction. As previously discussed, given the differing scope, objectives, and, in some respects, language of sections 199A, 448, and 1202, the guidance under sections 1202(e)(3)(A) and 448(d)(2) is not an appropriate substitute for clear and distinct guidance governing what constitutes an SSTB under section 199A. In particular, some SSTBs are listed in section 1202(e)(3)(A), but not listed in section 448(d)(2), such as athletics, financial services, brokerage services, and 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. In addition, some activities are mentioned only in 199A, such as investment management, trading, and dealing. As described in the remainder of this part V.A.2., proposed § 1.199A–5(b) provides guidance on the definition of an SSTB based on the plain meaning of the statute, past interpretations of substantially similar language in other Code provisions, and other indicia of legislative intent.

#### i. SSTBs Listed in Section 199A(d)(2)(A)

The definition of an SSTB under section 199A is substantially similar to the list of service trades or businesses provided in section 448(d)(2)(A) and § 1.448–1T(e)(4)(i), as the legislative history notes. See Joint Explanatory Statement of the Committee of Conference, footnotes 44–46. Section 448 prohibits certain taxpayers from computing taxable income under the cash receipts and disbursements method of accounting. Under section 448, qualified personal service corporations generally are not subject to the prohibition from using the cash method. Section 448(d)(2) defines the term *qualified personal service corporation* to include certain employee-owned corporations, substantially all of the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. The regulations under section 448(d)(2), found in § 1.448–1T(e)(4)(i), provide additional guidance on several of the terms, including health, performing arts, and consulting. In addition, there have been several court opinions, technical advice memoranda, and private letter rulings interpreting the various fields listed in section 448(d)(2) and § 1.448–1T(e)(4)(i).

In general, the guidance under section 448(d)(2) emphasizes the direct provision of services by the employees of a trade or business, rather than the application of capital. Commenters have

suggested that the regulations under section 448 serve as a reasonable starting point for defining an SSTB for purposes of section 199A. However, commenters also noted that the objectives and included categories of trades or businesses within section 448 and section 199A are different. Consistent with ordinary rules of statutory construction and the legislative history of section 199A, proposed § 1.199A–5(b) draws upon the existing guidance under section 448(d)(2) when appropriate for purposes of section 199A. Proposed § 1.199A–5(b) generally follows the guidance issued under section 448(d)(2) with some modifications. In certain instances, the principles of section 448(d)(2) provide useful analogies in defining the particular fields listed in section 1202(e)(3)(A) (as modified by section 199A(d)(2)(A)) for purposes of section 199A.

In addition, section 1202(e)(3)(A) also includes “any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees.” Section 199A(d)(2)(A) modifies this clause by adding the words “or owners” to the end, to read as follows: “any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees or owners.” The meaning of this clause is best determined by examining the language of section 1202(e)(3)(A) in light of the purpose of section 199A.

Case law under section 448 provides that whether a service is performed in a qualifying field under section 448(d)(2) is to be decided by examining all relevant indicia and is not controlled by state licensing laws. See *Rainbow Tax Serv., Inc. v. Commissioner*, 128 T.C. 42 (2007); *Kraatz & Craig Surveying Inc., v. Commissioner*, 134 T.C. 167 (2010). This approach also is appropriate for section 199A purposes. Additionally, states can widely vary in what they require in terms of licensure or certification. The Treasury Department and the IRS believe that the Federal tax law should not treat similarly situated taxpayers differently based on a particular state’s decision that for consumer protection purposes or otherwise a particular business type requires a license or certification. Thus, proposed § 1.199A–5(b) does not adopt a bright-line licensing rule for purposes of determining whether a trade or business is within a certain field for purposes of section 199A.

#### a. Health

Proposed § 1.199A–5(b)(2)(ii) 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.

#### b. Law

Proposed § 1.199A–5(b)(2)(iii) 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 in the field of law does not include the provision of services by printers, delivery services, or stenography services.

#### c. Accounting

Proposed § 1.199A–5(b)(2)(iv) 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 proposed § 1.199A–5(b)(2)(iv) 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.

#### d. Actuarial Science

Proposed § 1.199A-5(b)(2)(v) 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. Accordingly, 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.

#### e. Performing Arts

Proposed § 1.199A-5(b)(2)(vi) 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. Similarly, 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.

#### f. Consulting

Proposed § 1.199A-5(b)(2)(vii) 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. This determination is made based on all the facts and circumstances of a person’s business.

Additionally, the Treasury Department and the IRS are 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. As described previously in this Explanation of Provisions, proposed § 1.199A-5(c) provides a *de minimis* rule, under which a trade or business is not an SSTB if less than 10 percent of the gross receipts (5 percent 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, proposed § 1.199A-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.

#### g. Athletics

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 Treasury Department and the IRS agree, 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, proposed § 1.199A-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.

#### h. Financial Services

Commenters requested guidance as to whether financial services includes banking. These commenters noted that section 1202(e)(3)(A) includes the term financial services, but that banking is 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, proposed § 1.199A-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.

#### i. Brokerage Services

Proposed § 1.199A-5(b)(2)(x) 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.

#### j. Any Trade or Business Where the Principal Asset of Such Trade or Business Is the Reputation or Skill of 1 or More of Its Employees or Owners

Guidance on the meaning of the “reputation or skill” clause in section



1202(e)(3)(A) is limited to dicta in one case. In *John P. Owen v. Commissioner*, T.C. Memo 2012–21, the Tax Court examined whether Mr. Owen, whose business was insurance, was entitled to benefits under section 1202 with respect to the sale of his interest in a corporation conducting such business. Under the facts described in the case, the corporation had extensive training programs and sales structures, but primarily relied on the services of independent contractors (including Mr. Owen) in conducting its business. Although the Tax Court acknowledged that the business' success was due to Mr. Owen's efforts, it found that the principal asset of the company in question was the training program and sales structure of the business rather than Mr. Owen's services.

The Treasury Department and the IRS received several comments regarding the meaning of the "reputation or skill" clause. Commenters described potential methods to give maximum effect to the literal language of the reputation or skill clause by describing ways to (1) determine the extent to which the reputation or skill of employees or owners constitutes an asset of the business under Federal tax accounting principles, and (2) measure whether such an asset is in fact the principal asset of the business.

One commenter suggested using an activity-based standard under which no service-based businesses would qualify for the section 199A deduction. An SSTB definition this broad would not comport with the statute and would deny a section 199A deduction to businesses that the statute does not appear to exclude. If the "reputation or skill" clause was intended to exclude all service businesses from section 199A, there would have been no reason to enumerate specific types of businesses in section 199A(d)(2); that language would be pure surplusage. A broad service-based test would also fail to provide a clear classification of businesses that combine services with sales of products, such as plumbing and HVAC services, if those businesses sell goods or equipment in the course of providing services. Therefore, the Treasury Department and the IRS do not believe it is consistent with the text, structure, or purpose of section 199A to exclude all service businesses above the threshold amount from qualifying for the section 199A deduction.

Another commenter described a balance sheet test that would compare the value of assets other than goodwill and workforce in place to the value of such goodwill and workforce in place. The commenter acknowledged that such

a test could also be broader than Congress intended. In addition, the commenter noted that such a test could easily lead to strange and unintuitive results, and may be difficult to apply in the case of small businesses that do not maintain audited financial statements and would both be ripe for abuse, and could potentially result in many legal disputes between taxpayers and the IRS.

Finally, one commenter described a standard based on whether the trade or business involves the provision of highly-skilled services. The commenter argued that the primary benefit of a standard like this is that it would harmonize the meaning of the reputation or skill phrase with the trades or businesses listed in section 1202(e)(3)(A), each of which involve the provision of services by professionals who either received a substantial amount of training (for example, doctors, nurses, lawyers, and accountants), or who have otherwise achieved a high degree of skill in a given field (for example, professional athletes or performing artists).

Congress enacted section 199A to provide a deduction from taxable income to trades or businesses conducted by sole proprietorships and passthrough entities that do not benefit from the income tax rate reduction afforded to C corporations under the TCJA. The Treasury Department and the IRS are concerned that a broad definition of the "reputation or skill" phrase that relied on a balance sheet test or numerical ratios would have several consequences inconsistent with the intent of section 199A. Testing businesses based on metrics, some of them subjective, that change over time could result in inappropriate year-over-year tax consequences and lead to distorted decision-making. As the commenters noted, such mechanical tests pose administrative difficulties and fail to provide taxpayers with needed certainty regarding the tax law necessary for conducting their business affairs. Most significantly, such mechanical rules might prevent trades or businesses that Congress intended to be eligible for the section 199A deduction from claiming the section 199A deduction.

In sum, the Treasury Department and the IRS believe 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, proposed § 1.199A–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). Proposed § 1.199A–5(b)(4) contains two examples illustrating the application of this definition. The Treasury Department and the IRS request comments on this rule, the clarity of definitions for the statutorily enumerated trades or businesses that are SSTBs under section 199A(d)(2)(A), and the accompanying examples.

ii. SSTBs Described in 199A(d)(2)(B)

As mentioned previously, 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 which 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.

#### a. Investing and Investment Management

Proposed § 1.199A-5(b)(2)(xi) 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.

#### b. Trading

Proposed § 1.199A-5(b)(2)(xii) 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 taking into account 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. 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).

#### c. Dealing in Securities, Partnership Interests, and Commodities

For purposes of proposed § 1.199A-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 § 1.475(c)-1(c)(2) and (4) for the definition of negligible sales.

For purposes of proposed § 1.199A-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 proposed § 1.199A-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.

#### 3. Defining What Is Included in an SSTB

The Treasury Department and the IRS are aware that some taxpayers have contemplated a strategy to separate out parts of what otherwise would be an integrated SSTB, such as the administrative functions, in an attempt to qualify those separated parts for the section 199A deduction. Such a strategy is inconsistent with the purpose of section 199A. Therefore, in accordance with section 199A(f)(4), in order to carry out the purposes of section 199A, proposed § 1.199A-5(c)(2) provides that an SSTB includes any trade or business with 50 percent or more common ownership (directly or indirectly) that provides 80 percent or more of its property or services to an SSTB. Additionally, if a trade or business has 50 percent 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). For example, A, a dentist, owns a dental practice and also owns an office building. A rents half the building to the dental practice and half the building to unrelated persons. Under proposed § 1.199A-5(c)(2), the renting of half of the building to the dental practice will be treated as an SSTB.

Additionally, proposed § 1.199A-5 provides a rule that if a trade or business (that would not otherwise be treated as an SSTB) has 50 percent or more common ownership with an SSTB and shared expenses, including wages or overhead expenses with the SSTB, it is treated as incidental to an SSTB and, therefore, as an SSTB, if the trade or business represents no more than five percent of gross receipts of the combined business.

#### B. Trade or Business of Performing Services as an Employee

Under section 199(d)(1)(B), the trade or business of performing services as an employee is not a qualified trade or business. Unlike an SSTB, there is no threshold amount that applies to the trade or business of performing services as an employee. Thus, wage or compensation income earned by any employee is not eligible for the section 199A deduction no matter the amount.

##### 1. Definition

An individual is an employee for Federal employment tax purposes if he or she has the status of an employee under the usual common law and statutory rules applicable in determining the employer-employee relationship. Guides for determining employment status are found in §§ 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1. As stated in the regulations, generally, the common law relationship of employer and employee exists when the person for whom the services are performed has the right to direct and control the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the direction and control of the employer not only as to what shall be done but how it shall be done. In this connection it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he or she has the right to do so.

In addition, the regulations and section 3401(c) state, generally, that an officer of a corporation (including an S Corporation) is an employee of the corporation. However, an officer of a

corporation who does not perform any services or performs only minor services in his or her capacity as officer and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is not considered to be an employee of the corporation. Whether an officer's services are minor is a question of fact that depends on the nature of the services, the frequency and duration of their performance, and the actual and potential importance or necessity of the services in relation to the conduct of the corporation's business. See Rev. Rul. 74-390.

To provide clarity, proposed § 1.199A-5(d) provides a general rule that income from the trade or business of performing services as an employee refers to all wages (within the meaning of section 3401(a)) and other income earned in a capacity as an employee, including payments described in § 1.6041-2(a)(1) (other than payments to individuals described in section 3121(d)(3)) and § 1.6041-2(b)(1). If an individual derives income in the course of a trade or business that is not described in section 3401(a), § 1.6041-2(a)(1) (other than payments to individuals described in section 3121(d)(3)), or § 1.6041-2(b)(1), that individual is not considered to be in the trade or business of performing services as an employee with regard to such income.

## 2. Presumption for Former Employees

Section 199A provides that the trade or business of providing services as an employee is not eligible for the section 199A deduction. Therefore, taxpayers and practitioners noted that it may be beneficial for employees to treat themselves as independent contractors or as having an equity interest in a partnership or S corporation in order to benefit from the deduction under section 199A.

Section 530(b) of the Revenue Act of 1978 (Pub. L. 95-600), as amended by section 9(d)(2) of Public Law 96-167, section 1(a) of Public Law 96-541, and section 269(c) of Public Law 97-248, provides a prohibition against regulations and rulings on employment status for purposes of employment taxes. Specifically, section 530(b) provides that no regulation or revenue ruling shall be published before the effective date of any law clarifying the employment status of individuals for purposes of the employment taxes by the Treasury Department (including the IRS) with respect to the employment status of any individual for purposes of the employment taxes. Section 530(c) of the Revenue Act of 1978 provides that, for purposes of section 530, the term

“employment tax” means any tax imposed by subtitle C of the Internal Revenue Code of 1954, and the term “employment status” means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship as an employee or as an independent contractor (or other individual who is not an employee). These longstanding rules of section 530 of the Revenue Act of 1978 limit the ability of the IRS to impose employment tax liability on employers for misclassifying employees as independent contractors but do not preclude challenging a worker's status for purposes of section 199A, an income tax provision under subtitle A of the Code.

Therefore, proposed § 1.199A-5(d)(3) provides that for purposes of section 199A, if an employer improperly treats an employee as an independent contractor or other non-employee, the improperly classified employee is in the trade or business of performing services as an employee notwithstanding the employer's improper classification. This issue is particularly important in the case of individuals who cease being treated as employees of an employer, but subsequently provide substantially the same services to the employer (or a related entity) but claim to do so in a capacity other than as an employee. However, it would not be appropriate to provide that someone who formerly was an employee of an employer is now “less likely” to be respected as an independent contractor. Such a rule would not treat similarly-situated taxpayers similarly: Two individuals who have a similar relationship with a company and each claim to be treated as independent contractors would be treated differently depending on any prior employment history with the company. Therefore, proposed § 1.199A-5(d)(3) does not provide any new or different standards to be properly classified as an independent contractor or owner of a business. Instead, proposed § 1.199A-5(d)(3) contains a presumption that applies in certain situations to ensure that individuals properly substantiate their status.

Specifically, proposed § 1.199A-5(d)(3) provides that, solely for purposes of section 199A(d)(1)(B) and the regulations thereunder, an individual who was treated as an employee for Federal employment tax purposes by the person to whom he or she provided services, and who is subsequently treated as other than an employee by such person with regard to the provision of substantially the same services

directly or indirectly to the person (or a related person), is presumed to be in the trade or business of performing services as an employee with regard to such services. This presumption may be rebutted only upon a showing by the individual that, under Federal tax rules, regulations, and principles (including common-law employee classification rules), the individual is performing services in a capacity other than as an employee. This presumption applies regardless of whether the individual provides services directly or indirectly through an entity or entities. This presumption is solely for purposes of section 199A and does not otherwise change the employment tax classification of the individual. Section 199A is in subtitle A of the Code, and this rule does not apply for purposes of any other subtitle, including subtitle C. Accordingly, this rule does not implicate section 530(b) of the Revenue Act of 1978. Proposed § 1.199A-5(d)(3)(ii) contains three examples illustrating this rule.

## VI. Proposed § 1.199A-6: Special Rules for RPEs, PTPs, Trusts, and Estates

Proposed § 1.199A-6 provides guidance that certain specified entities (for example, RPEs, PTPs, trusts, and estates) may need to follow for purposes of computing the entities' or their owners' section 199A deductions.

### A. Computational Steps for RPEs and PTPs

Although RPEs cannot take the section 199A deduction at the RPE level, each RPE must determine and report the information necessary for its direct and indirect owners to determine their own section 199A deduction. Proposed § 1.199A-6(b) follows the rules applicable to individuals with taxable income above the threshold amount set forth in § 1.199A-1(d) in directing RPEs to determine what amounts and information to report to their owners and the IRS, including QBI, W-2 wages, the UBIA of qualified property for each trade or business directly engaged in, and whether any of its trades or businesses are SSTBs. RPEs must also determine and report qualified REIT dividends and qualified PTP income received directly by the RPE. Proposed § 1.199A-6(b)(3) then requires each RPE to report this information on or with the Schedules K-1 issued to the owners. RPEs must report this information regardless of whether a taxpayer is below the threshold. The Treasury Department and the IRS request comments whether it is administrable to provide a special rule that if none of the owners of the

RPE have taxable income above the threshold amount, the RPE does not need to determine and report W-2 wages, UBIA of qualified property, or whether the trade or business is an SSTB. Although such a rule would relieve an RPE of an unnecessary burden, the RPE would need to have knowledge of the ultimate owner's taxable income.

The definition of an RPE does not include a PTP. However, PTPs must still determine and report QBI under the rules of proposed § 1.199A-3 for each trade or business in which the PTP is engaged and whether those trades or businesses are SSTBs. A PTP must also determine whether it has received any qualified REIT dividends or qualified PTP income or loss from another PTP. These items must be reported on or with the Schedule K-1. A PTP is not required to determine or report W-2 wages or the UBIA of qualified property.

#### *B. Application to Trusts, Estates, and Beneficiaries*

Proposed § 1.199A-6(d) contains special rules for applying section 199A to trusts and decedents' estates. To the extent that a grantor or another person is treated as owning all or part of a trust under sections 671 through 679 (grantor trust), including qualified subchapter S trusts (QSSTs) with respect to which the beneficiary has made an election under section 1361(d), the owner will compute its QBI with respect to the owned portion of the trust as if that QBI had been received directly by the owner.

In the case of a section 199A deduction claimed by a non-grantor trust or estate, section 199A(f)(1)(B) applies rules similar to the rules under former section 199(d)(1)(B)(i) for the apportionment of W-2 wages and the apportionment of UBIA of qualified property. In the case of a non-grantor trust or estate, the QBI and expenses properly allocable to the business, including the W-2 wages relevant to the computation of the wage limitation, and relevant UBIA of depreciable property must be allocated among the trust or estate and its various beneficiaries. Specifically, proposed § 1.199A-6(d)(3)(ii) provides that each beneficiary's share of the trust's or estate's W-2 wages is determined based on the proportion of the trust's or estate's DNI that is deemed to be distributed to that beneficiary for that taxable year. Similarly, the proportion of the entity's DNI that is not deemed distributed by the trust or estate will determine the entity's share of the QBI and W-2 wages. In addition, if the trust or estate has no DNI in a particular taxable year, any QBI and W-2 wages

are allocated to the trust or estate, and not to any beneficiary.

In addition, proposed § 1.199A-6(d)(3)(ii) provides that, to the extent the trust's or estate's UBIA of qualified property is relevant to a trust or estate and any beneficiary, the trust's or estate's UBIA of qualified property will be allocated among the trust or estate and its beneficiaries in the same proportion as DNI of the trust or estate is allocated. This is the case regardless of how any depreciation or depletion deductions resulting from the same property may be allocated under section 643(c) among the trust or estate and its beneficiaries for purposes other than section 199A.

Under section 199A, the threshold amount is determined at the trust level without taking into account any distribution deductions. Commenters have noted that taxpayers could circumvent the threshold amount by dividing assets among multiple trusts, each of which would claim its own threshold amount. This result is inappropriate and inconsistent with the purpose of section 199A. Therefore, proposed § 1.199A-6(d)(3)(v) provides that trusts formed or funded with a significant purpose of receiving a deduction under section 199A will not be respected for purposes of section 199A.

The Treasury Department and the IRS request comments with respect to whether taxable recipients of annuity and unitrust interests in charitable remainder trusts and taxable beneficiaries of other split-interest trusts may be eligible for the section 199A deduction to the extent that the amounts received by such recipients include amounts that may give rise to the deduction. Such comments should include explanations of how amounts that may give rise to the section 199A deduction would be identified and reported in the various classes of income of the trusts received by such recipients and how the excise tax rules in section 664(c) would apply to such amounts.

#### **VII. Proposed § 1.643(f)-1: Anti-Avoidance Rules for Multiple Trusts**

As described in section VI B of the Explanation of Provisions, under section 199A, the threshold amount is determined at the trust level without taking into account any distribution deductions. Therefore, taxpayers could circumvent the threshold amount by dividing assets among multiple trusts, each of which would claim its own threshold amount. This result is inappropriate and inconsistent with the

purpose of section 199A and general trust principles.

To address this and other concerns regarding the abusive use of multiple trusts, proposed § 1.643(f)-1 confirms the applicability of section 643(f). As noted in part II of the Background, section 643(f) permits the Secretary to prescribe regulations to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax. Proposed § 1.643(f)-1 provides that, in the case in which two or more trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and a principal purpose for establishing such trusts or contributing additional cash or other property to such trusts is the avoidance of Federal income tax, then such trusts will be treated as a single trust for Federal income tax purposes. For purposes of applying this rule, spouses are treated as only one person and, accordingly, multiple trusts established for a principal purpose of avoiding Federal income tax may be treated as a single trust even in cases where separate trusts are established or funded independently by each spouse. Proposed § 1.643(f)-1 further provides examples to illustrate specific situations in which multiple trusts will or will not be treated as a single trust under this rule, including a situation where multiple trusts are created with a principal purpose of avoiding the limitations of section 199A. The application of proposed § 1.643(f)-1, however, is not limited to avoidance of the limitations under section 199A and proposed §§ 1.199A-1 through 1.199A-6.

The rule in proposed § 1.643(f)-1 would apply to any arrangement involving multiple trusts entered into or modified on or after August 16, 2018. In the case of any arrangement involving multiple trusts entered into or modified before August 16, 2018, the determination of whether an arrangement involving multiple trusts is subject to treatment under section 643(f) will be made on the basis of the statute and the guidance provided regarding that provision in the legislative history of section 643(f). Pending the publication of final regulations, the position of the Treasury Department and the IRS is that the rule in proposed § 1.643(f)-1 generally reflects the intent of Congress regarding the arrangements involving multiple trusts that are appropriately subject to treatment under section 643(f).

## VIII. Specified Agricultural or Horticultural Cooperatives

In the TCJA and the 2018 Act, Congress provided special rules for applying section 199A in the case of specified agricultural and horticultural cooperatives. The Treasury Department and the IRS continue to study this area and intend to issue separate proposed regulations describing rules for applying section 199A to specified agricultural and horticultural cooperatives and their patrons later this year. As provided in section 199A(g)(6), such regulations will generally be based on the regulations applicable to cooperatives and their patrons under former section 199 (as in effect before its repeal). The Treasury Department and the IRS anticipate that the regulations will provide that section 199A(g) applies only to the patronage business of a relevant cooperative. The proposed regulations will also provide more information for taxpayers that must apply the reduction under section 199A(b)(7), which is a special rule with respect to income received from cooperatives.

### Availability of IRS Documents

IRS notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

### Proposed Effective/Applicability Date

Section 7805(b)(1)(A) and (B) of the Code generally provide that no temporary, proposed, or final regulation relating to the internal revenue laws may apply to any taxable period ending before the earliest of (A) the date on which such regulation is filed with the **Federal Register**, or (B) in the case of a final regulation, the date on which a proposed or temporary regulation to which the final regulation relates was filed with the **Federal Register**. However, section 7805(b)(2) provides that regulations filed or issued within 18 months of the date of the enactment of the statutory provision to which they relate are not prohibited from applying to taxable periods prior to those described in section 7805(b)(1). Furthermore, section 7805(b)(3) provides that the Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse.

Accordingly, proposed §§ 1.199A–1 through 1.199A–6 generally are proposed to apply to taxable years ending after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. However, taxpayers may rely on the rules set forth in proposed §§ 1.199A–1 through 1.199A–6, in their

entirety, until the date a Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. In addition, to prevent abuse of section 199A and the regulations thereunder, the anti-abuse rules of proposed §§ 1.199A–2(c)(1)(iv), 1.199A–3(c)(2)(B), 1.199A–5(c)(2), 1.199A–5(c)(3), 1.199A–5(d)(3), and 1.199A–6(d)(3)(v) are proposed to apply to taxable years ending after December 22, 2017, the date of enactment of the TCJA. Finally, the provisions of proposed § 1.643–1, which prevent abuse of the Code generally through the use of trusts, are proposed to apply to taxable years ending after August 16, 2018.

Section 199A(f)(1) provides that section 199A applies at the partner or S corporation shareholder level, and that each partner or shareholder takes into account such person's allocable share of each qualified item. Section 199A(c)(3) provides that the term "qualified item" means items that are effectively connected with a U.S. trade or business, and "included or allowed in determining taxable income from the taxable year." Section 199A applies to taxable years beginning after December 31, 2017. However, there is no statutory requirement under section 199A that a qualified item arise after December 31, 2017.

Section 1366(a) generally provides that, in determining the income tax of a shareholder for the shareholder's taxable year in which the taxable year of the S corporation ends, the shareholder's pro rata share of the corporation's items is taken into account. Similarly, section 706(a) generally provides that, in computing the taxable income of a partner for a taxable year, the partner includes items of the partnership for any taxable year of the partnership ending within or with the partner's taxable year. Therefore, income flowing to an individual from a partnership or S corporation is subject to the tax rates and rules in effect in the year of the individual in which the entity's year closes, not the year in which the item actually arose.

Accordingly, for purposes of determining QBI, W–2 wages, and UBIA of qualified property, the effective dates provisions provide that if an individual receives QBI, W–2 wages, or UBIA of qualified property from an RPE with a taxable year that begins before January 1, 2018, and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's tax year during which such RPE taxable year ends.

## Special Analyses

### I. Regulatory Planning and Review—Economic Analysis

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

These proposed regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Treasury Department has determined that the proposed rulemaking is subject to review as economically significant under section 1(c) of the Memorandum of Agreement, and OMB concurs with this designation. Accordingly, these proposed regulations have been reviewed by the Office of Management and Budget. For more detail on the economic analysis, please refer to the following analysis.

#### A. Overview

Congress enacted section 199A to provide individuals, estates, and trusts a deduction of up to 20 percent of QBI from domestic businesses, which includes trades or businesses operated as a sole proprietorship or through a partnership, S corporation, trust, or estate. As stated in the Explanation of Provisions, these proposed regulations are necessary to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding the application of section 199A. The proposed regulations provide guidance to taxpayers for purposes of calculating the section 199A deduction. They provide clarity for taxpayers in determining their eligibility for the deduction and the amount of the allowed deduction. Among other benefits, this clarity helps ensure that taxpayers all calculate the deduction in a similar manner, which encourages decision-making that is economically efficient contingent on the provisions of the overall Code.

The proposed regulations contain seven sections, six proposed under section 199A (proposed §§ 1.199A–1 through 1.199A–6) and one proposed under section 643(f) (proposed

§ 1.643(f)-1). Each of proposed §§ 1.199A-1 through 1.199A-6 provides rules relevant to the section 199A deduction and proposed § 1.643(f)-1 would establish anti-abuse rules to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax, including abuse of section 199A. This economic analysis describes the economic benefits and costs of each of the seven sections of the proposed regulations.

### B. Baseline

The analysis in this section compares the proposed regulation to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

### C. Economic Analysis of Proposed § 1.199A-1

#### 1. Background

Because the section 199A deduction has not previously been available, a large number of the relevant terms and necessary calculations taxpayers are currently required to apply under the statute can benefit from greater specificity. For example, the statute uses the term *trade or business* to refer to the enterprise whose income would be potentially eligible for the deduction but does not define what constitutes a trade or business for purposes of section 199A; the proposed regulations provide that taxpayers should generally apply the definition of a trade or business provided by section 162(a). The definition of trade or business in proposed § 1.199A-1 is extended beyond the section 162 definition if a taxpayer chooses to aggregate businesses under the rules of proposed § 1.199A-4. In addition, solely for purposes of section 199A, the rental or licensing of property to a related trade or business is treated as a trade or business if the rental or licensing and the other trade or business are commonly controlled under proposed § 1.199A-4(b)(1)(i). The proposed regulations also make clear that the section 199A deduction is allowed when calculating alternative minimum taxable income of individuals.

Because the section 199A deduction has multiple components that may interact in determining the deduction, it is also valuable to lay out rules for calculating the deduction since the statute does not provide each of those particulars.

Alternative approaches the Treasury Department and the IRS could have

proposed would be to remain silent on additional definitional specificities and to allow post-limitation netting in calculating the section 199A deduction. The Treasury Department and the IRS concluded these approaches would likely give rise to less economically efficient tax-related decisions than would relying on statutory language alone and requiring or leaving open the possibility of post-limitation netting.

#### 2. Anticipated Benefits of Proposed § 1.199A-1

The Treasury Department and the IRS expect that the definitions and guidance provided in § 1.199A-1 will implement the 199A deduction in an economically efficient manner. An economically efficient tax system generally aims to treat income derived from similar economic decisions similarly in order to reduce incentives to make choices based on tax rather than market incentives. In this context, the principal benefit of proposed § 1.199A-1 is to reduce taxpayer uncertainty regarding the calculation of the section 199A deduction relative to an alternative scenario in which no such regulations were issued. In the absence of the clarifications in proposed § 1.199A-1 regarding, for example, the definition of an eligible trade or business, similarly situated taxpayers might interpret the statutory rules of section 199A differently, given the statute's limited prescription of the implementation details. In addition, without these regulations it is likely that many taxpayers impacted by section 199A would take on more (or less) than the optimal level of risk in allocating resources within or across their businesses. Both of these actions would give rise to economic inefficiencies. The proposed regulations would provide a uniform signal to businesses and thus lead taxpayers to make decisions that are more economically efficient contingent on the overall Code. As an example, proposed § 1.199A-1 prescribes the steps taxpayers must take to calculate the QBI deduction in a manner that avoids perverse incentives for shifting wages and capital assets across businesses. The statute does not address the ordering for how the W-2 wages and UBIA of qualified property limitations should be applied when taxpayers have both positive and negative QBI from different businesses. The proposed regulations clarify that in such cases the negative QBI should offset positive QBI prior to applying the wage and capital limitations. For taxpayers who would have assumed in the alternate that negative QBI offsets positive QBI after applying the wage

and capital limitations, the proposed approach weakens the incentive to shift W-2 wage labor or capital (in the form of qualified property) from one business to another to maximize the section 199A deduction.

To illustrate this, consider a taxpayer who is above the statutory threshold and owns two non-service sector businesses, A and B. A has net qualified income of \$10,000, while B has net qualified income of -\$5,000. Suppose that A paid \$3,000 in W-2 wages, B paid \$1,000 in W-2 wages, and neither business has tangible capital. If negative QBI offsets positive QBI after applying the wage and capital limitations, then A generates a tentative deduction of \$1,500, while B generates a tentative deduction of -\$1,000, for a total deduction of \$500. After moving B's W-2 wages to A, A's tentative deduction rises to \$2,000, while B's remains -\$1,000, increasing the total deduction to \$1,000. If, on the other hand, negative QBI offsets positive QBI prior to applying the wage and capital limitations (as in the proposed regulations), then A and B have combined income of \$5,000, and the total deduction is \$1,000 because the wage and capital limitations are non-binding. After moving B's wages to A, the total deduction remains \$1,000. Thus, an incentive to shift wages arises if negative QBI offsets positive QBI after applying the wage and capital limitations. By taking the opposite approach, proposed § 1.199A-1 reduces incentives for such tax-motivated, economically inefficient reallocations of labor (or capital) relative to a scenario in which offsets were taken after wage and capital limitations were applied.

#### 3. Anticipated Costs of Proposed § 1.199A-1

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.199A-1 and request comment regarding this anticipated impact. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

### D. Economic Analysis of Proposed § 1.199A-2

#### 1. Background

Section 199A provides a deduction of up to 20 percent of the taxpayer's income from qualifying trades or businesses. Taxpayers with incomes above a threshold amount cannot enjoy the full 20 percent deduction unless

they determine that their businesses pay a sufficient amount of wages and/or maintain a sufficient stock of tangible capital, among other requirements.

Because this deduction has not previously been available, proposed § 1.199A-2 provides greater specificity than is available from the statute regarding the definitions of W-2 wages and UBLA of qualified property (that is, depreciable capital stock) relevant to this aspect of the deduction. For example, the proposed regulations make clear that property that is transferred or acquired within a specific timeframe with a principal purpose of increasing the section 199A deduction is not considered qualified property for purposes of the section 199A deduction. In addition, proposed § 1.199A-2 generally follows prior guidance for the former section 199 deduction in determining which W-2 wages are relevant for section 199A purposes, with additional rules for allocating wages amongst multiple trades or businesses. In these and other cases, the proposed regulations generally aim, within the context of the legislative language and other tax considerations, to ensure that only genuine business income is eligible for the section 199A deduction, and to reduce business compliance costs and government administrative costs.

Alternative approaches would be to remain silent or to choose different definitions of W-2 wages or qualified property for the purposes of claiming the deduction. The Treasury Department and the IRS rejected these alternatives as being inconsistent with other definitions or requirements under the Code and therefore unnecessarily costly for taxpayers to comply with and the IRS to administer.

## 2. Anticipated Benefits of Proposed § 1.199A-2

The Treasury Department and IRS expect that proposed § 1.199A-2 will implement the 199A deduction in an economically efficient manner. For example, proposed § 1.199A-2 will discourage some inefficient transfers of capital given the statute's silence regarding the circumstances in which certain property transfers would or would not be considered under section 199A. Specifically, the proposed rules make clear that property transferred or acquired within a specific timeframe with a principal purpose of increasing the section 199A deduction is not considered qualified for purposes of the 199A deduction.

The proposed regulations will also reduce taxpayer uncertainty regarding the implementation of the section 199A deduction relative to a scenario in

which no regulations were issued. In the absence of such clarification, similarly situated taxpayers would likely interpret the section 199A deduction differently to the extent that the statute does not adequately specify the particular implementation issues addressed by 199A-2; and as a result, taxpayers might take on more (or less) than the optimal level of risk in their interpretations. The proposed regulations would lead taxpayers to make decisions that were more economically efficient, conditional on the overall Code.

## 3. Anticipated Costs of Proposed § 1.199A-2

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.199A-2, and request comment regarding this anticipated impact. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

### E. Economic Analysis of Proposed § 1.199A-3

#### 1. Background

Section 199A provides a deduction of up to 20 percent of the taxpayer's income from qualifying trades or businesses. In the absence of legislative and regulatory constraints, taxpayers would have an incentive to count as income some income that, from an economic standpoint, did not accrue specifically from qualifying economic activity. The proposed regulations clarify what does and does not constitute QBI for purposes of the 199A deduction, providing greater implementation specificity than provided by the statute. Because guaranteed payments for capital, for example, are not at risk in the same way as other forms of income, they might reasonably be excluded from QBI. Similarly, Treasury proposes that income that is a guaranteed payment, but which is filtered through a tiered partnership in order to avoid being labeled as such, should be treated similarly to guaranteed payments in general and therefore excluded from QBI. This principle applies to other forms of income that similarly represent income that either is not at risk or does not flow from the specific economic value provided by a qualifying trade or business, such as returns on investments of working capital. The proposed regulations define and clarify the types of income that might

reasonably be considered QBI, within the constraints of the legislation.

## 2. Anticipated Benefits of Proposed § 1.199A-3

The Treasury Department and IRS expect that proposed § 1.199A-3 regulations will implement the 199A deduction in an economically efficient manner. For example, 199A-3 will discourage the creation of tiered partnerships purely for the purposes of increasing the section 199A deduction. In the absence of regulation, some taxpayers would likely create tiered partnerships under which a lower-tier partnership would make a guaranteed payment to an upper-tier partnership, and the upper-tier partnership would pay out this income to its partners without guaranteeing it. Such an organizational structure would likely be economically inefficient because it was, apparently, created solely for tax minimization purposes and not for reasons related to efficient economic decision-making.

The Treasury Department and the IRS further expect that the proposed regulations will reduce uncertainty over whether particular forms of income do or do not constitute QBI relative to a scenario in which no regulations were issued. In the absence of regulations, taxpayers would still need to determine what income is considered QBI and similarly situated taxpayers might interpret the statutory rules differently and pursue income-generating activities based on different assumptions about whether that income would qualify for QBI. Proposed § 1.199A-3 provides clearer guidance for how to determine QBI, helping to ensure that taxpayers face uniform incentives when making economic decisions, a tenet of economic efficiency.

## 3. Anticipated Costs of Proposed § 1.199A-3 Relative to the Baseline

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.199A-3, and request comment regarding this anticipated impact. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

### F. Economic Analysis of Proposed § 1.199A-4

#### 1. Background

Businesses may organize either as C corporations, which are owned by stockholders, or in a form generally



called a passthrough, which may take one of several legal forms including sole proprietorships, under which there does not exist a clear separation between the owners and the business's decision-makers. Each organizational structure, in some circumstance, may be economically efficient, depending on the risk profile, information asymmetries, and decision-making challenges pertaining to the specific business and on the risk preferences and economic situations of the individual owners. An economically efficient tax system would keep the choice among organizational structures neutral contingent on the provisions of the corporate income tax.

This principle of neutral tax treatment further applies to the various organizational structures that qualify as passthroughs. Many passthrough business entities are connected through ownership, management, or shared decision-making. The proposed aggregation rule allows individuals to aggregate their trades or businesses for the purposes of calculating the section 199A deduction. It thus helps ensure that significant choices over ownership and management relationships within businesses are not chosen solely to increase the section 199A deduction.

An alternative approach would be not to allow aggregation for purposes of claiming the deduction. The Treasury Department and the IRS decided to allow aggregation in the specified circumstances to minimize or avoid distortions in organizational form that could arise if aggregation were not allowed.

## 2. Anticipated Benefits of Proposed § 1.199A-4

The Treasury Department and the IRS expect that the aggregation guidance provided in proposed § 1.199A-4 will implement the 199A deduction in an economically efficient manner. Economic tax principles are called into play here because a large number of businesses that could commonly be thought of as a single trade or business actually may be divided across multiple entities for legal or economic reasons. Allowing taxpayers to aggregate trades or businesses offers taxpayers a means of putting together what they think of as their trade or business for the purposes of claiming the deduction under section 199A without otherwise changing ownership and management structures. If such aggregation were not permitted, certain taxpayers would restructure solely for tax purposes, with the resulting structures leading to less efficient economic decision-making.

## 3. Anticipated Costs of Proposed § 1.199A-4

The proposed regulations require common majority ownership to apply the aggregation rule. If no aggregation were allowed, taxpayers would have to combine businesses to calculate the deduction based on the combined income, wages, and capital. The majority ownership threshold may thus encourage owners to concentrate their ownership in order to benefit from the aggregation rule. The additional costs of the proposed regulations would be limited to those owners who would find merging entities too costly based on other market conditions, but under these regulations may find it beneficial to increase their ownership share in order to aggregate their businesses and maximize their QBI deduction.

Changes to the collective paperwork burden arising from proposed § 1.199A-4 and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis. The Treasury Department and the IRS request comments regarding these and other potential costs arising from the regulations.

## G. Economic Analysis of Proposed § 1.199A-5

### 1. Background

Section 199A provides a deduction of up to 20 percent of the taxpayer's income from qualifying trades or businesses. In the absence of legislative and regulatory constraints, taxpayers have an incentive to receive labor income as income earned as an independent contractor or through ownership of an RPE, even though this income may not derive from the risk-bearing or decision-making efficiencies that are unique to being an independent contractor or to owning an equity interest in an RPE. The Act provided several provisions that bear on this distinction.

Proposed § 1.199A-5 provides guidance on what trades or businesses would be characterized as an SSTB under each type of services trade or business listed in the legislative text. In addition, proposed § 1.199A-5 provides an exception to the SSTB exclusion if the trade or business only earns a small fraction of its gross income from specified service activities (de minimis exception). Finally, the proposed regulations state that former employees providing services as independent contractors to their former employer will be presumed to be acting as employees unless they provide evidence

that they are providing services in a capacity other than an employee.

An alternative approach to the de minimis exception would be to require businesses or their owners to trigger the SSTB exclusion regardless of the share of gross income from specified service activities. The Treasury Department concluded that providing a de minimis exception is necessary to avoid very small amounts of SSTB activity within a trade or business making the entire trade or business ineligible for the deduction, an outcome that is inefficient in the context of section 199A.

## 2. Anticipated Benefits of Proposed § 1.199A-5

The Treasury Department and the IRS expect that proposed § 1.199A-5 will implement the 199A deduction in an economically efficient manner. To this end, proposed § 1.199A-5 clarifies the definition of an SSTB. In the absence of such clarification, similarly situated taxpayers might interpret the legislative text differently, leading some taxpayers to invest in particular businesses under the assumption income earned from that entity was eligible for the deduction while other taxpayers might forgo that investment due to the opposite assumption. These disparate investment signals generate economic inefficiencies. The proposed regulations reduce this inefficiency relative to a scenario in which no regulation providing a de minimis exception was issued.

Furthermore, in the absence of the proposed regulations, some owners of businesses may find it advantageous to separate their business activity into SSTB and non-SSTB businesses in order to receive the section 199A deduction on their non-SSTB activity. The proposed regulations would disallow this behavior by stating that a taxpayer that provides property or services to an SSTB that is commonly-owned will have the portion of property or services provided to the SSTB treated as attributable to an SSTB. Additionally without these regulations, some businesses may have an incentive to pay a portion of their employees as independent contractors. Either of these actions would entail some loss of economic efficiency due to changes in businesses' decision-making structures based on tax incentives. They may also inefficiently provide incentives to change employment relationships in favor of independent contractors. The proposed regulations help to avoid these sources of inefficiency.

### 3. Anticipated Costs of Proposed § 1.199A-5 Relative to the Baseline

In addition to the statutory threshold amount, below which SSTB status is not relevant, proposed § 1.199A-5 provides a de minimis rule with tiered-thresholds of gross revenues arising from specified service activity in determining whether a trade or business with a smaller amount of specified service activity is classified as an SSTB. This threshold may cause businesses near the cutoff to decrease their specified service activities or increase their non-specified service activities to avoid being classified as an SSTB. Additionally, the de minimis rule may encourage smaller entities engaged in SSTBs to merge with larger entities not engaged in an SSTB. The economic costs of these mergers are difficult to quantify.

Changes to the collective paperwork burden arising from § 1.199A-5 and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis. The Treasury Department and IRS request comment regarding these and other potential costs arising from the regulations.

### H. Economic Analysis of Proposed § 1.199A-6

#### 1. Background

The 199A deduction is reduced below 20 percent for some businesses and taxpayers. The attributes that determine any such reduction must be determined by taxpayers claiming the section 199A deduction. Proposed § 1.199A-6 provides rules for RPEs, PTPs, trusts, and estates relevant to making these determinations. In particular, RPEs are required to calculate and report their owners' QBI, SSTB status, W-2 wages, UBIA of qualified property, REIT dividends, and PTP income. Similarly, PTPs must calculate and report their owners' QBI, SSTB status, REIT dividends, and other PTP income.

#### 2. Anticipated Benefits of Proposed § 1.199A-6

The Treasury Department and IRS expect that proposed § 1.199A-6 will implement the 199A deduction in an economically efficient manner. As with other proposed regulations discussed in this Analysis, a principal benefit of proposed § 1.199A-6 is to increase the likelihood that all taxpayers interpret the statutory rules of section 199A similarly. Additionally, we expect that requiring RPEs to determine and report the information necessary to compute the section 199A deduction will result in a more accurate and uniform

application of the regulations and statute relative to an alternative approach under which individual owners would most likely determine these items.

### 3. Anticipated Costs of Proposed § 1.199A-6 Relative to the Baseline

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.199A-6, and request comment on these estimated impacts. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

### I. Economic Analysis of Proposed § 1.643(f)-1

#### 1. Background

Proposed § 1.643(f)-1 provides that taxpayers cannot set up multiple trusts in certain cases with a principal purpose of tax avoidance, which would include the avoidance of the statutory threshold amounts under section 199A.

#### 2. Anticipated Benefits of Proposed § 1.643(f)-1 Relative to the Baseline

The Treasury Department and IRS expect that the proposed § 1.643(f)-1 will implement the 199A deduction in an economically efficient manner. Because proposed § 1.643(f)-1 defines the manner in which trusts are subject to the threshold amount where the statute is silent, the Treasury Department and the IRS anticipate that the proposed regulations will lead to fewer resources being devoted to setting up trusts in attempts to avoid the threshold amount rules under section 199A. If multiple trusts have substantially the same grantors and beneficiaries, and a principal purpose for establishing such trusts or contributing additional cash or other property to such trusts is the avoidance of Federal income tax, then the various trusts would be generally considered one trust, including for section 199A purposes.

### 3. Anticipated Costs of Proposed § 1.643(f)-1 Relative to the Baseline

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.643(f)-1, and request comment on these estimated impacts. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

### J. Anticipated Impacts on Administrative and Compliance Costs

#### 1. Discussion

The proposed regulations have a number of effects on taxpayers' compliance costs. Proposed § 1.199A-2 provides guidance in determining a taxpayer's share of W-2 wages and UBIA of qualified property. The Treasury Department and the IRS expect that this guidance reduces the tax compliance costs of making this determination and reduces uncertainty. In the absence of the proposed regulations, taxpayers would still need to determine how to allocate W-2 wages and UBIA of qualified property, among other calculations. These regulations provide clear instructions for how to do this, simplifying the process of complying with the law.

Proposed § 1.199A-4 requires that owners who decide to aggregate their trades or businesses report the aggregation annually. This reporting requirement adds to the tax compliance burden of these owners. For owners who consider aggregating, these regulations increase compliance costs because the owners must calculate their deduction for both disaggregated and aggregated trades or businesses to make the aggregation decision. These additional compliance costs would be voluntary and accrue only to owners who find it beneficial to aggregate for the purposes of calculating their section 199A deduction.

Proposed § 1.199A-5 includes a requirement for former employees working as independent contractors for their former employer to show that their employment relationship has changed in order to be eligible for the section 199A deduction. The burden to substantiate employment status exists without these proposed regulations; however, the proposed regulation may increase these individuals' compliance costs slightly.

Proposed § 1.199A-6 specifies that RPEs must report relevant section 199A information to owners. Due to these entity reporting requirements, the proposed regulations will increase compliance costs for RPEs. These entities will need to keep records of new information relevant to the calculation of their owners' section 199A deduction, such as QBI, W-2 wages, SSTB status, and UBIA of qualified property. This recordkeeping is costly. Without these regulations, it is likely that only some RPEs would engage in this record keeping.

Proposed § 1.199A-6 reduces the compliance burden on many individuals that own RPEs relative a

scenario in which no regulations were issued or regulatory alternatives that assigned each owner of an RPE the responsibility to acquire the required information were issued without any requirement for the RPE to provide such information. Under the proposed regulations, owners will receive information pertaining to the section 199A deduction from the RPE, such as whether a given trade or business is an SSTB, whereas in the alternate they could have been required to make such determinations themselves.

Overall, it is likely to be more efficient for RPEs, rather than individual owners, to keep records of section 199A deduction information. Therefore, the Treasury Department and the IRS expect that proposed § 1.199A-6 will reduce compliance costs on net and relative to these alternative scenarios.

2. Estimated Effect on Compliance Costs

As explained above, key provisions of proposed §§ 1.199A-1 through 1.199A-6 will reduce compliance costs that taxpayers would likely have incurred in the absence of the proposed rule. Most notably, the *de minimis* rule of proposed § 1.199A-5 provides that 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. This provision is expected to reduce compliance costs associated with section 199A for millions of U.S. businesses. In addition, the aggregation rules will reduce overall costs for taxpayers because some taxpayers would restructure their business

arrangements in order to receive the benefit of the deduction. These and other discretionary choices by the Treasury Department and the IRS in the proposed rule will substantially reduce taxpayers' compliance costs.

The Treasury Department and the IRS also assessed the provisions of the proposed rule that could increase compliance burdens. Estimates of the change in annual reporting burden associated with these proposed regulations are presented here and in further detail in the Paperwork Reduction Act (PRA) section. The Treasury Department and the IRS estimate a gross (not net) increase in total reporting burden of 25 million hours annually. The estimates primarily reflect two effects of the regulations. First, the Treasury Department and the IRS project that approximately 1.2 million individuals with more than one directly owned or pass-through business who voluntarily choose to aggregate will spend 0.66 hours annually complying with proposed § 1.199A-4. Second, the Treasury Department and the IRS project that—in complying with the proposed § 1.199A-6 requirement to report relevant section 199A information to their approximately 8.8 million owners—RPEs will spend 2.75 hours annually per owner. These estimates do not include the decrease in compliance costs to individuals who would no longer find it necessary to compute the quantities detailed in proposed § 1.199A-6 because they would receive this information from each RPE. Nor do these estimates reflect

the decrease in compliance costs outlined above.

Valuations of the burden hours of \$39/hour in the case of individuals making aggregation decisions and \$53/hour in the case of RPEs reporting section 199A information lead to a PRA-based estimate of the gross reporting annualized costs to taxpayers of approximately \$1.3 billion over ten years; this estimate does not account for the provisions of the proposed regulations that will substantially reduce compliance costs. Because these estimates assume that the costs are the same each year, the annualized costs do not vary with the discount rate. It is possible that costs will be higher in the first years that the deduction is allowed and lower in future years once taxpayers have more experience with the calculations and reporting requirements associated with the deduction. Finally, the estimates reflect data for entities of a size and form expected to be impacted by section 199A. More specifically, because of the scope of the section 199A deduction, the Treasury Department and the IRS expect the majority of affected entities to be largely small, and medium in size.

The Treasury Department and the IRS solicit comments on the assumptions and the methodology used to calculate the compliance costs imposed by the proposed regulations relative to the baseline. This includes, among other things, assumptions and methodology regarding the reporting burden per respondent, the number of impacted entities, and the hourly labor cost estimate for reporting.

Annualized monetized effect on compliance costs from proposed regulations	Years 2018 to 2027 (3% discount rate, millions \$2018)	Years 2018 to 2027 (7% discount rate, millions \$2018)
Estimated Gross Costs .....	\$1,317 .....	\$1,317.
Estimated Savings .....	Not quantified .....	Not quantified.

K. Executive Order 13771

The Treasury Department and the IRS request comment on the Executive Order 13771 designation for these proposed regulations. Details on the estimated costs of the proposed regulations can be found in this economic analysis.

II. Regulatory Flexibility Act

It is hereby certified that the collections of information in proposed §§ 1.199A-4 and 1.199A-6 will not have a significant economic impact on a substantial number of small entities. Although the Treasury Department and the IRS believe that the proposed

regulations may affect a substantial number of small entities, the economic impact on small entities as a result of the collections of information in this notice of proposed rulemaking is not expected to be significant.

The collection in proposed § 1.199A-4 may apply to individuals and certain trusts or estates that can claim the section 199A deduction and that choose to aggregate two or more trades or businesses for purposes of section 199A. If a taxpayer chooses to aggregate its trades or businesses, the taxpayer, must include an attachment to its tax return identifying and describing each trade or business aggregated, describing changes to the aggregated group, and providing

other information as the Commissioner may require in forms, instructions, or other published guidance. RPEs are not subject to the collection in proposed § 1.199A-4 because RPEs are not permitted to aggregate trades or businesses. Aggregation is not required by a person claiming the section 199A deduction, and therefore the collection of information in proposed § 1.199A-4 is required only if the person chooses to aggregate multiple trades or businesses. It is not known how many small entities will choose to aggregate multiple trades or businesses, therefore a number of affected entities is not estimated at this time.

The small entities subject to the collection of information in proposed § 1.199A-6 are business entities formed as estates, trusts, partnerships, or S corporations that conduct, directly or indirectly, one or more trades or businesses. Proposed § 1.199A-6 requires such an entity to attach a statement describing the QBI, W-2 wages, and UBIA of qualified property for each separate trade or business to the Schedule K-1 required under existing law to be issued to each beneficiary, partner, or shareholder. Although data is not available to estimate the number of small entities affected by the § 1.199A-6 requirements, the Treasury Department and the IRS believe that number would include a substantial number of small entities.

As discussed elsewhere in this preamble, the reporting burden is estimated at 30 minutes to 20 hours, depending on individual circumstances, with an estimated average of 2.5 hours for all affected entities, regardless of size. The burden on small entities is expected to be at the lower end of the range (30 minutes to 2.5 hours). Using the IRS's taxpayer compliance cost estimates, taxpayers who are self-employed with multiple businesses are estimated to have a monetization rate of \$39 per hour. Pass-throughs that issue K-1s have a monetization rate of \$53 per hour.

For these reasons, the Treasury Department and the IRS have determined that the collection of information in this notice of proposed rulemaking will not have a significant economic impact. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Notwithstanding this certification, the Treasury Department and the IRS invite comments from interested members of the public on both the number of entities affected and the economic impact on small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Requests for Public Hearing

The Treasury Department and the IRS request comments on all aspects of the proposed rules.

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. All

comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request.

### Drafting Information

The principal authors of these regulations are Frank J. Fisher, Wendy L. Kribell, Adrienne M. Mikolashek, and Benjamin H. Weaver, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

## PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 are amended by adding sectional authorities for §§ 1.199A-1 through 1.199A-6 and § 1.643(f) to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*  
Section § 1.199A-1 also issued under 26 U.S.C. 199A(f)(4).

Section § 1.199A-2 also issued under 26 U.S.C. 199A(b)(5), (f)(1)(A), (f)(4), and (h).

Section § 1.199A-3 also issued under 26 U.S.C. 199A(c)(4)(C) and (f)(4).

Section § 1.199A-4 also issued under 26 U.S.C. 199A(f)(4).

Section § 1.199A-5 also issued under 26 U.S.C. 199A(f)(4).

Section § 1.199A-6 also issued under 26 U.S.C. 199A(f)(1)(B) and (f)(4).

Section 1.643(f) 091 also issued under 26 U.S.C. 643(f).

■ **Par. 2.** Section 1.199A-0 is added to read as follows:

### § 1.199A-0 Table of Contents

This section lists the section headings that appear in §§ 1.199A-1 through 1.199A-6.

#### § 1.199A-1 Operational rules.

- (a) Overview.
  - (1) In general.
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- (b) Definitions.
  - (1) Aggregated trade or business.
  - (2) Applicable percentage.
  - (3) Phase-in range.
  - (4) Qualified business income (QBI).
  - (5) QBI component.
  - (6) Qualified PTP income.
  - (7) Qualified REIT dividends.
  - (8) Reduction amount.
  - (9) Relevant passthrough entity (RPE).
  - (10) Specified service trade or business (SSTB).
  - (11) Threshold amount.
  - (12) Total QBI amount.

- (13) Trade or business.
- (14) Unadjusted basis immediately after the acquisition of qualified property (UBIA of qualified property).
- (15) W-2 Wages.
- (c) Computation of the section 199A deduction for individuals with taxable income not exceeding threshold amount.
  - (1) In general.
  - (2) Carryover rules.
    - (i) Negative total QBI amount.
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  - (3) Examples.
  - (d) Computation of the section 199A deduction for individuals with taxable income above the threshold amount.
    - (1) In general.
    - (2) QBI component.
      - (i) SSTB exclusion.
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      - (iii) Netting and carryover.
        - (A) Netting.
        - (B) Carryover of negative total QBI amount.
      - (iv) QBI component calculation.
        - (A) General rule.
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    - (4) Examples.
    - (e) Special rules.
      - (1) Effect of deduction.
      - (2) Self-employment tax and net investment income tax.
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  - § 1.199A-2 Determination of W-2 Wages and unadjusted basis immediately after acquisition of qualified property.
    - (a) Scope.
      - (1) In general.
      - (2) W-2 Wages.
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        - (b) W-2 Wages.
          - (1) In general.
          - (2) Definition of W-2 Wages.
            - (i) In general.
            - (ii) Wages paid by a person other than a common law employer.
            - (iii) Requirement that wages must be reported on return filed with the Social Security Administration.
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■ **Par. 3.** Section 1.199A-1 is added to read as follows:

**§ 1.199A-1 Operational rules.**

(a) *Overview*—(1) *In general.* This section provides operational rules for calculating the section 199A(a) qualified business income deduction (section 199A deduction) under section 199A of the Internal Revenue Code (Code). This section refers to the rules in §§ 1.199A-2 through 1.199A-6. This paragraph (a) provides an overview of this section. Paragraph (b) of this section provides definitions that apply for purposes of section 199A and §§ 1.199A-1 through 1.199A-6. Paragraph (c) of this section provides computational rules and examples for individuals whose taxable income does not exceed the threshold amount. Paragraph (d) of this section provides computational rules and examples for individuals whose taxable income exceeds the threshold amount. Paragraph (e) of this section provides special rules for purposes of section 199A and §§ 1.199A-1 through 1.199A-6. This section and §§ 1.199A-2 through 1.199A-6 do not apply for purposes of calculating the deduction in section 199A(g) for specified agricultural and horticultural cooperatives.

(2) *Usage of term individual.* For purposes of applying the rules of §§ 1.199A-1 through 1.199A-6, a reference to an individual includes a reference to a trust (other than a grantor trust) or an estate to the extent that the section 199A deduction is determined by the trust or estate under the rules of § 1.199A-6.

(b) *Definitions.* For purposes of section 199A and §§ 1.199A-1 through 1.199A-6, the following definitions apply:

(1) *Aggregated trade or business* means two or more trades or businesses that have been aggregated pursuant to § 1.199A-4.

(2) *Applicable percentage* means, with respect to any taxable year, 100 percent reduced (not below zero) by the percentage equal to the ratio that the taxable income of the individual for the taxable year in excess of the threshold

amount, bears to \$50,000 (or \$100,000 in the case of a joint return).

(3) *Phase-in range* means a range of taxable income, the lower limit of which is the threshold amount, and the upper limit of which is the threshold amount plus \$50,000 (or \$100,000 in the case of a joint return).

(4) *Qualified business income (QBI)* means the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business as determined under the rules of § 1.199A-3(b).

(5) *QBI component* means the amount determined under paragraph (d)(2) of this section.

(6) *Qualified PTP income* is defined in § 1.199A-3(c)(3).

(7) *Qualified REIT dividends* are defined in § 1.199A-3(c)(2).

(8) *Reduction amount* means, with respect to any taxable year, the excess amount multiplied by the ratio that the taxable income of the individual for the taxable year in excess of the threshold amount, bears to \$50,000 (or \$100,000 in the case of a joint return). For purposes of this paragraph (b)(8), the *excess amount* is 20 percent of QBI over the greater of 50 percent of W-2 wages or the sum of 25 percent of W-2 wages plus 2.5 percent of the UBIA of qualified property.

(9) *Relevant passthrough entity (RPE)* means a partnership (other than a PTP) or an S corporation that is owned, directly or indirectly by at least one individual, estate, or trust. A trust or estate is treated as an RPE to the extent it passes through QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, or qualified PTP income.

(10) *Specified service trade or business (SSTB)* means a specified service trade or business as defined in § 1.199A-5(b).

(11) *Threshold amount* means, for any taxable year beginning before 2019, \$157,500 (or \$315,000 in the case of a taxpayer filing a joint return). In the case of any taxable year beginning after 2018, the threshold amount is the dollar amount in the preceding sentence increased by an amount equal to such dollar amount, multiplied by the cost-of-living adjustment determined under section 1(f)(3) of the Code for the calendar year in which the taxable year begins, determined by substituting “calendar year 2017” for “calendar year 2016” in section 1(f)(3)(A)(ii). The amount of any increase under the preceding sentence is rounded as provided in section 1(f)(7) of the Code.

(12) *Total QBI amount* means the net total QBI from all trades or businesses (including the individual’s share of QBI

from trades or business conducted by RPEs).

(13) *Trade or business* means a section 162 trade or business other than the trade or business of performing services as an employee. In addition, rental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a section 162 trade or business is nevertheless treated as a trade or business for purposes of section 199A, if the property is rented or licensed to a trade or business which is commonly controlled under § 1.199A-4(b)(1)(i) (regardless of whether the rental activity and the trade or business are otherwise eligible to be aggregated under § 1.199A-4(b)(1)).

(14) *Unadjusted basis immediately after acquisition of qualified property (UBIA of qualified property)* is defined in § 1.199A-2(c).

(15) *W-2 wages* means a trade or business’s W-2 wages properly allocable to QBI as defined in § 1.199A-2(b).

(c) *Computation of the § 199A deduction for individuals with taxable income not exceeding threshold amount*—(1) *In general.* The section 199A deduction is determined for individuals with taxable income for the taxable year that does not exceed the threshold amount by adding 20 percent of the total QBI amount (including QBI attributable to an SSTB) and 20 percent 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 percent 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.

(2) *Carryover rules*—(i) *Negative total QBI amount.* If the total QBI amount is less than zero, the portion of the individual’s section 199A deduction related to QBI is zero for the taxable year. The negative total QBI amount is treated as negative QBI from a separate trade or business in the succeeding taxable year of the individual for purposes of section 199A and this section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the Code.

(ii) *Negative combined qualified REIT dividends/qualified PTP income.* 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 and qualified PTP income in the succeeding taxable year of the individual for purposes of section 199A and this section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the Code.

(3) *Examples.* The following examples illustrate the provisions of this paragraph (c). For purposes of these examples, unless indicated otherwise, assume that all of the trades or businesses are trades or businesses as defined in paragraph (b)(1) of this section and all of tax items are effectively connected to a trade or business within the United States within the meaning of section 864(c). Total taxable income does not include the section 199A deduction.

*Example 1 to paragraph (c)(3).* A, an unmarried individual, owns and operates a computer repair shop as a sole proprietorship. The business generated \$100,000 in net taxable income from operations in 2018. A has no capital gains or losses. After allowable deductions not relating to the business, A's total taxable income for 2018 is \$81,000. The business's QBI is \$100,000, the net amount of its qualified items of income, gain, deduction, and loss. A's section 199A deduction for 2018 is equal to \$16,200, the lesser of 20% of A's QBI from the business ( $\$100,000 \times 20\% = \$20,000$ ) and 20% of A's total taxable income for the taxable year ( $\$81,000 \times 20\% = \$16,200$ ).

*Example 2 to paragraph (c)(3).* Assume the same facts as in *Example 1* of this paragraph (c)(3), except that A also has \$7,000 in net capital gain for 2018 and that, after allowable deductions not relating to the business, A's taxable income for 2018 is \$74,000. A's taxable income minus net capital gain is \$67,000 ( $\$74,000 - \$7,000$ ). A's section 199A deduction is equal to \$13,400, the lesser of 20% of A's QBI from the business ( $\$100,000 \times 20\% = \$20,000$ ) and 20% of A's total taxable income minus net capital gain for the taxable year ( $\$67,000 \times 20\% = \$13,400$ ).

*Example 3 to paragraph (c)(3).* B and C are married and file a joint individual income tax return. B earned \$500,000 in wages as an employee of an unrelated company in 2018. C owns 100% of the shares of X, an S corporation that provides landscaping services. X generated \$100,000 in net income from operations in 2018. X paid C \$150,000 in wages in 2018. B and C have no capital gains or losses. After allowable deductions not related to X, B and C's total taxable income for 2018 is \$270,000. B's and C's wages are not considered to be income from a trade or business for purposes of the section 199A deduction. Because X is an S corporation, its QBI is determined at the S corporation level. X's QBI is \$100,000, the net amount of its qualified items of income, gain, deduction, and loss. The wages paid by X to C are considered to be a qualified item of deduction for purposes of determining X's

QBI. The section 199A deduction with respect to X's QBI is then determined by C, X's sole shareholder, and is claimed on the joint return filed by B and C. B and C's section 199A deduction is equal to \$20,000, the lesser of 20% of C's QBI from the business ( $\$100,000 \times 20\% = \$20,000$ ) and 20% of B and C's total taxable income for the taxable year ( $\$270,000 \times 20\% = \$54,000$ ).

*Example 4 to paragraph (c)(3).* Assume the same facts as in *Example 3* of this paragraph (c)(3) except that B also earns \$1,000 in qualified REIT dividends and \$500 in qualified PTP income in 2018, increasing taxable income to \$271,500. B and C's section 199A deduction is equal to \$20,300, the lesser of (i) 20% of C's QBI from the business ( $\$100,000 \times 20\% = \$20,000$ ) plus 20% of B's combined qualified REIT dividends and qualified PTP income ( $\$1,500 \times 20\% = \$300$ ) and (ii) 20% of B and C's total taxable for the taxable year ( $\$271,500 \times 20\% = \$54,300$ ).

(d) *Computation of the § 199A deduction for individuals with taxable income above threshold amount—(1) In general.* The section 199A deduction is determined for individuals with taxable income for the taxable year that exceeds the threshold amount by adding the QBI component and 20 percent 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 percent 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.

(2) *QBI component.* 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, then only the applicable percentage of QBI, W-2 wages, and UBIA of qualified property for each SSTB is taken into account for purposes of determining the individual's section 199A deduction. If the individual's taxable income exceeds the phase-in range, then none of the individual's share of QBI, W-2 wages, or UBIA of qualified property attributable to an SSTB may be taken into account 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 rules of § 1.199A-4, 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 paragraph (d)(2)(iv) of this section.

(iii) *Netting and Carryover—(A) Netting.* 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 in paragraph (d)(2)(iv) of this section. The W-2 wages and UBIA of qualified property from the trades or businesses which produced net negative QBI are not taken into account for purposes of this paragraph (d) and are not carried over to the subsequent year.

(B) *Carryover of negative total QBI amount.* 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 for purposes of section 199A and this section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the Code. The W-2 wages and UBIA of qualified property from the trades or businesses which produced net negative QBI are not taken into account for purposes of this paragraph (d) and are not carried over to the subsequent year.

(iv) *QBI component calculation—(A) General rule.* Except as provided in paragraph (d)(iv)(B) of this section, the QBI component is the sum of the amounts determined under this paragraph (d)(2)(iv)(A) for each trade or business. For each trade or business (including trades or businesses operated through RPEs) the individual must determine the lesser of—

(1) 20 percent of the QBI for that trade or business; or

(2) The greater of—

(i) 50 percent of W-2 wages with respect to that trade or business, or

(ii) the sum of 25 percent of W-2 wages with respect to that trade or business plus 2.5 percent of the UBIA of qualified property with respect to that trade or business.

(B) *Taxpayers with taxable income within phase-in range.* If the individual's taxable income is within the phase-in range and the amount determined under paragraph (d)(2)(iv)(A)(2) of this section for a trade or business is less than the amount determined under paragraph (d)(2)(iv)(A)(1) of this section for that trade or business, the amount



determined under paragraph (d)(2)(iv)(A) of this section for such trade or business is modified. Instead of the amount determined under paragraph (d)(2)(iv)(A)(2) of this section, the QBI component for the trade or business is the amount determined under paragraph (d)(2)(iv)(A)(1) of this section reduced by the reduction amount as defined in paragraph (b)(8) of this section. This reduction amount does not apply if the amount determined in paragraph (d)(2)(iv)(A)(2) of this section is greater than the amount determined under paragraph (d)(2)(iv)(A)(1) of this section (in which circumstance the QBI component for the trade or business will be the unreduced amount determined in paragraph (d)(2)(iv)(A)(1) of this section).

(3) *Negative combined qualified REIT dividends/qualified PTP income.* 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 for purposes of section 199A and this section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the Code.

(4) *Examples.* The following examples illustrate the provisions of this paragraph (d). For purposes of these examples, unless indicated otherwise, assume that all of the trades or businesses are trades or businesses as defined in paragraph (b)(13) of this section, none of the trades or businesses are SSTBs as defined in paragraph (b)(10) of this section and § 1.199A-5(b); and all of the tax items associated with the trades or businesses are effectively connected to a trade or business within the United States within the meaning of section 864(c). Also assume that the taxpayers report no capital gains or losses or other tax items not specified in the examples. Total taxable income does not include the section 199A deduction.

*Example 1 to paragraph (d)(4).* D, an unmarried individual, owns several parcels of land that D manages and which 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 to paragraph (d)(4).* Assume the same facts as in *Example 1* of this paragraph (d)(4), 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 will be 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 × 20% = \$796,000). Therefore, D's section 199A deduction for 2020 is \$250,000.

*Example 3 to paragraph (d)(4).* 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 20% of E's share of LLC's QBI or 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 25% of E's share of LLC's wages (\$300,000) or \$75,000 plus 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 20% of QBI (\$180,000) and the greater of the limitations amounts (\$150,000). E's section 199A deduction is equal to the lesser of 20% of the QBI from the business as limited (\$150,000) or 20% of E's taxable income (\$880,000 × 20% = \$176,000). Therefore, E's section 199A deduction is \$150,000 for 2018.

*Example 4 to paragraph (d)(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 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 25% of F's share of Z's W-2 wages (\$1,000,000) or \$250,000 plus 2.5% of F'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 20% of QBI (\$600,000) and 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 199A deduction is equal to the lesser of 20% of the QBI from the business as limited (\$500,000) or 20% of F's taxable income over net capital gain (\$1,880,000 × 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 to paragraph (d)(4).* *Phase-in range.* (i) 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.

(ii) 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.

(iii) 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 20% of the QBI from the business as limited (\$36,000) or (ii) 20% of B and C's taxable income (\$375,000  $\times$  20% = \$75,000). Therefore, B and C's section 199A deduction is \$36,000 for 2018.

*Example 6 to paragraph (d)(4).* (i) Assume the same facts as in *Example 5 to paragraph (d)(4)*, 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 application 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  $\times$  40% =) \$120,000, and the applicable percentage of B's share of W-2 wages is (\$40,000  $\times$  40% =) \$16,000. These reduced numbers must then be used to determine how B's section 199A deduction is limited.

(ii) 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 paragraph (i) of this example. 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.

(iii) 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 paragraph (i) of this example or \$24,000, over 50% of B's share of M's W-2 wages, as adjusted in paragraph (i) of this example, 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  $\times$  20% = \$75,000). Therefore, B and C's section 199A deduction is \$14,400 for 2018.

*Example 7 to paragraph (d)(4).* (i) F, an unmarried individual, owns as a sole proprietor 100 percent 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 § 1.199A-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.

(ii) 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 UBI 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  $\times$  20 percent = \$200,000) and 50% of Business X's W-2 wages (\$500,000  $\times$  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  $\times$  20% = \$200,000) and 50% of its W-2 wages (zero) is zero. For Business Z, the lesser of 20% of QBI (\$2,000  $\times$  20% = \$400) and 50% of W-2 wages (\$500,000  $\times$  50% = \$250,000) is \$400.

(iii) Next, F must then combine the amounts determined in paragraph (ii) 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 paragraph (ii) is \$200,400 (\$200,000 + 0 + 400). Twenty percent of F's taxable income is \$544,400 (\$2,722,000  $\times$  20%). Thus, F's section 199A deduction for 2018 is \$200,400.

*Example 8 to paragraph (d)(4).* (i) Assume the same facts as in *Example 7* of this paragraph (d)(4), except that F aggregates Business X, Business Y, and Business Z under the rules of § 1.199A-4.

(ii) 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 UBI 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  $\times$

20%) and 50% of W-2 wages from the aggregated businesses, which is \$500,000 (\$1,000,000  $\times$  50%). F's section 199A deduction is equal to the lesser of \$400,400 and 20% of F's taxable income (\$2,722,000  $\times$  20% = \$544,400). Thus, F's section 199A deduction for 2018 is \$400,400.

*Example 9 to paragraph (d)(4).* (i) Assume the same facts as in *Example 7* of this paragraph (d)(4), 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.

(ii) 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 UBI 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  $\times$  20% = \$140,000) and 50% of W-2 wages (\$500,000  $\times$  50% = \$250,000) is \$140,000. Business Y pays no W-2 wages. The lesser of 20% of Business Y's QBI (\$700,000  $\times$  20% = \$140,000) and 50% of its W-2 wages (zero) is zero.

(iii) F must combine the amounts determined in paragraph (ii) of this example 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 paragraph (ii) of this example is \$140,000 (\$140,000 + \$0) and 20% of F's taxable income is \$424,000 (\$2,120,000  $\times$  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 to paragraph (d)(4).* (i) Assume the same facts as in *Example 9* of this paragraph (d)(4), except that F aggregates Business X, Business Y, and Business Z under the rules of § 1.199A-4.

(ii) 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 UBI 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  $\times$  20% = \$280,000)

and 50% of W–2 wages from the aggregated businesses (\$1,000,000 × 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 × 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 to paragraph (d)(4).* (i) Assume the same facts as in *Example 7* of this paragraph (d)(4), 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 Code).

(ii) 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 this section, 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, minus 42.86% 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.

(iii) 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 × 20%) and 50% of W–2 wages is \$50,000 (\$100,000 × 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 × 20%) and 50% of its W–2 wages (zero) is zero, so the lesser amount is zero.

(iv) F must then compare the combined amounts determined in paragraph (iii) of this example to 20% of F’s taxable income. The section 199A deduction equals the lesser of these amounts. F’s combined amount from paragraph (iii) of this example is \$9,144 (\$9,144 plus zero) and 20% of F’s taxable income is \$192,000 (\$960,000 × 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 to paragraph (d)(4).* (i) Assume the same facts as in *Example 11* of this paragraph (d)(4), except that F aggregates Business X, Business Y, and Business Z under the rules of § 1.199A–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 Code).

(ii) 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).

(iii) 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 × 20% = \$16,000) and 50% of W–2 wages (\$100,500 × 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 × 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.

(e) *Special rules*—(1) *Effect of deduction.* In the case of a partnership or S corporation, section 199A is applied at the partner or shareholder level. The section 199A deduction has no effect on the adjusted basis of a partner’s interest in the partnership, the adjusted basis of a shareholder’s stock in an S corporation, or an S corporation’s accumulated adjustments account.

(2) *Self-employment tax and net investment income tax.* The deduction under section 199A does not reduce net earnings from self-employment under section 1402 or net investment income under section 1411.

(3) *Commonwealth of Puerto Rico.* If all of an individual’s QBI from sources within the Commonwealth of Puerto Rico is taxable under section 1 of the Code for a taxable year, then for purposes of determining the QBI of such individual for such taxable year, the term “United States” includes the Commonwealth of Puerto Rico.

(4) *Coordination with alternative minimum tax.* For purposes of determining alternative minimum taxable income under section 55, the deduction allowed under section 199A(a) for a taxable year is equal in amount to the deduction allowed under section 199A(a) in determining taxable income for that taxable year (that is, without regard to any adjustments under sections 56 through 59).

(5) *Imposition of accuracy-related penalty on underpayments.* For rules related to the imposition of the accuracy-related penalty on underpayments for taxpayers who claim the deduction allowed under section 199A, see section 6662(d)(1)(C).

(6) *Reduction for income received from cooperatives.* In the case of any trade or business of a patron of a specified agricultural or horticultural cooperative, as defined in section 199A(g)(4), the amount of section 199A deduction determined under paragraphs (c) or (d) of this section with respect to such trade or business must be reduced by the lesser of:

(i) Nine percent of the QBI with respect to such trade or business as is properly allocable to qualified payments received from such cooperative, or

(ii) 50 percent of the W–2 wages with respect to such trade or business as are so allocable as determined under § 1.199A–2.

(f) *Effective/applicability date*—(1) *General rule.* Except as provided in paragraph (f)(2) of this section, the provisions of this section apply to

taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exception for non-calendar year RPE.* For purposes of determining QBI, W-2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's taxable year in which or with which such RPE taxable year ends.

■ **Par. 4.** Section 1.199A-2 is added to read as follows:

**§ 1.199A-2 Determination of W-2 wages and unadjusted basis immediately after acquisition of qualified property.**

(a) *Scope—(1) In general.* This section provides guidance on calculating a trade or business's W-2 wages properly allocable to QBI (W-2 wages) and the trade or business's unadjusted basis immediately after acquisition of all qualified property (UBIA of qualified property). The provisions of this section apply solely for purposes of section 199A of the Internal Revenue Code (Code).

(2) *W-2 wages.* Paragraph (b) of this section provides guidance on the determination of W-2 wages. 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 § 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.

(3) *UBIA of qualified property.* Paragraph (c) of this section provides guidance on the determination of the 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 § 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 which 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 which 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 which 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.

(b) *W-2 wages—(1) In general.* Section 199A(b)(2)(B) provides limitations on the section 199A deduction based on the W-2 wages paid with respect each trade or business. Section 199A(b)(4)(B) provides that W-2 wages do not include any amount which is not properly allocable to QBI for purposes of section 199A(c)(1). This section provides a three step process for determining the W-2 wages paid with respect to a trade or business that are properly allocable to QBI. First, each individual or RPE must determine its total W-2 wages paid for the taxable year under the rules in paragraph (b)(2) of this section. Second, each individual or RPE must allocate its W-2 wages between or among one or more trades or businesses under the rules in paragraph (b)(3) of this section. Third, each individual or RPE must determine the amount of such wages with respect to each trade or business that are allocable to the QBI of the trade or business under the rules in paragraph (b)(4) of this section.

(2) *Definition of W-2 wages—(i) In general.* Section 199A(b)(4)(A) provides that the term W-2 wages means with respect to any person for any taxable year of such person, the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Thus, the term W-2 wages includes the total amount of wages as defined in section 3401(a) plus the total amount of elective deferrals (within the meaning of section 402(g)(3)), the compensation deferred under section 457, and the amount of designated Roth contributions (as

defined in section 402A). For this purpose, except as provided in paragraphs (b)(2)(iv)(C)(2) and (b)(2)(iv)(D) of this section, the Forms W-2, "Wage and Tax Statement," or any subsequent form or document used in determining the amount of W-2 wages are those issued for the calendar year ending during the individual's or RPE's taxable year for wages paid to employees (or former employees) of the individual or RPE for employment by the individual or RPE. For purposes of this section, employees of the individual or RPE are limited to employees of the individual or RPE as defined in section 3121(d)(1) and (2). (For purposes of section 199A, this includes officers of an S corporation and employees of an individual or RPE under common law.)

(ii) *Wages paid by a person other than a common law employer.* In determining W-2 wages, an individual or RPE may take into account any W-2 wages paid by another person and reported by the other person on Forms W-2 with the other person as the employer listed in Box c of the Forms W-2, provided that the W-2 wages were paid to common law employees or officers of the individual or RPE for employment by the individual or RPE. In such cases, the person paying the W-2 wages and reporting the W-2 wages on Forms W-2 is precluded from taking into account such wages for purposes of determining W-2 wages with respect to that person. For purposes of this paragraph, persons that pay and report W-2 wages on behalf of or with respect to others can include certified professional employer organizations under section 7705, statutory employers under section 3401(d)(1), and agents under section 3504.

(iii) *Requirement that wages must be reported on return filed with the Social Security Administration (SSA)—(A) In general.* Pursuant to section 199A(b)(4)(C), the term W-2 wages does not include any amount that is not properly included in a return filed with SSA on or before the 60th day after the due date (including extensions) for such return. Under § 31.6051-2 of this chapter, each Form W-2 and the transmittal Form W-3, "Transmittal of Wage and Tax Statements," together constitute an information return to be filed with SSA. Similarly, each Form W-2c, "Corrected Wage and Tax Statement," and the transmittal Form W-3 or W-3c, "Transmittal of Corrected Wage and Tax Statements," together constitute an information return to be filed with SSA. In determining whether any amount has been properly included in a return filed with SSA on or before

the 60th day after the due date (including extensions) for such return, each Form W-2 together with its accompanying Form W-3 will be considered a separate information return and each Form W-2c together with its accompanying Form W-3 or Form W-3c will be considered a separate information return. Section 6071(c) provides that Forms W-2 and W-3 must be filed on or before January 31 of the year following the calendar year to which such returns relate (but see the special rule in § 31.6071(a)-1T(a)(3)(1) of this chapter for monthly returns filed under § 31.6011(a)-5(a) of this chapter). Corrected Forms W-2 are required to be filed with SSA on or before January 31 of the year following the year in which the correction is made.

(B) *Corrected return filed to correct a return that was filed within 60 days of the due date.* If a corrected information return (Return B) is filed with SSA on or before the 60th day after the due date (including extensions) of Return B to correct an information return (Return A) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return A) and paragraph (b)(2)(iii)(C) of this section does not apply, then the wage information on Return B must be included in determining W-2 wages. If a corrected information return (Return D) is filed with SSA later than the 60th day after the due date (including extensions) of Return D to correct an information return (Return C) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return C), and if Return D reports an increase (or increases) in wages included in determining W-2 wages from the wage amounts reported on Return C, then such increase (or increases) on Return D will be disregarded in determining W-2 wages (and only the wage amounts on Return C may be included in determining W-2 wages). If Return D reports a decrease (or decreases) in wages included in determining W-2 wages from the amounts reported on Return C, then, in determining W-2 wages, the wages reported on Return C must be reduced by the decrease (or decreases) reflected on Return D.

(C) *Corrected return filed to correct a return that was filed later than 60 days after the due date.* If an information return (Return F) is filed to correct an information return (Return E) that was not filed with SSA on or before the 60th day after the due date (including extensions) of Return E, then Return F (and any subsequent information returns filed with respect to Return E)

will not be considered filed on or before the 60th day after the due date (including extensions) of Return F (or the subsequent corrected information return). Thus, if a Form W-2c (or corrected Form W-2) is filed to correct a Form W-2 that was not filed with SSA on or before the 60th day after the due date (including extensions) of the information return including the Form W-2 (or to correct a Form W-2c relating to an information return including a Form W-2 that had not been filed with SSA on or before the 60th day after the due date (including extensions) of the information return including the Form W-2), then the information return including this Form W-2c (or corrected Form W-2) will not be considered to have been filed with SSA on or before the 60th day after the due date (including extensions) for this information return including the Form W-2c (or corrected Form W-2), regardless of when the information return including the Form W-2c (or corrected Form W-2) is filed.

(iv) *Methods for calculating W-2 wages—(A) In general.* The Secretary may provide for methods to be used in calculating W-2 wages, including W-2 wages for short taxable years by publication in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter).

(B) *Acquisition or disposition of a trade or business—(1) In general.* In the case of an acquisition or disposition of a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business that causes more than one individual or entity to be an employer of the employees of the acquired or disposed of trade or business during the calendar year, the W-2 wages of the individual or entity for the calendar year of the acquisition or disposition are allocated between each individual or entity based on the period during which the employees of the acquired or disposed of trade or business were employed by the individual or entity, regardless of which permissible method is used for reporting predecessor and successor wages on Form W-2, “Wage and Tax Statement.” For this purpose, the period of employment is determined consistently with the principles for determining whether an individual is an employee described in § 1.199A-2(b).

(2) *Acquisition or disposition.* For purposes of this paragraph (b)(2)(iv)(B), the term *acquisition or disposition* includes an incorporation, a formation, a liquidation, a reorganization, or a purchase or sale of assets.

(C) *Application in the case of a person with a short taxable year—(1) In*

*general.* In the case of an individual or RPE with a short taxable year, subject to the rules of paragraph (b)(2) of this section, the W-2 wages of the individual or RPE for the short taxable year include only those wages paid during the short taxable year to employees of the individuals or RPE, only those elective deferrals (within the meaning of section 402(g)(3)) made during the short taxable year by employees of the individual or RPE and only compensation actually deferred under section 457 during the short taxable year with respect to employees of the individual or RPE.

(2) *Short taxable year that does not include December 31.* If an individual or RPE has a short taxable year that does not contain a calendar year ending during such short taxable year, wages paid to employees for employment by such individual or RPE during the short taxable year are treated as W-2 wages for such short taxable year for purposes of paragraph (b) of this section (if the wages would otherwise meet the requirements to be W-2 wages under this section but for the requirement that a calendar year must end during the short taxable year).

(D) *Remuneration paid for services performed in the Commonwealth of Puerto Rico.* In the case of an individual or RPE that conducts a trade or business in the Commonwealth of Puerto Rico, the determination of W-2 wages of such individual or RPE will be made without regard to any exclusion under section 3401(a)(8) for remuneration paid for services performed in the Commonwealth of Puerto Rico. The individual or RPE must maintain sufficient documentation (for example, Forms 499R-2/W-2PR) to substantiate the amount of remuneration paid for services performed in the Commonwealth of Puerto Rico that is used in determining the W-2 wages of such individual or RPE with respect to any trade or business conducted in the Commonwealth of Puerto Rico.

(3) *Allocation of wages to trades or businesses.* After calculating total W-2 wages for a taxable year, each individual or RPE that directly conducts more than one trade or business must allocate those wages among its various trades or businesses. W-2 wages must be allocated to the trade or business that generated those wages. In the case of W-2 wages that are allocable to more than one trade or business, the portion of the W-2 wages allocable to each trade or business is determined in the same manner as the expenses associated with those wages are allocated among the trades or businesses under § 1.199A-3(b)(5).

(4) *Allocation of wages to QBI.* Once W-2 wages for each trade or business have been determined, each individual or RPE must identify the amount of W-2 wages properly allocable to QBI for each trade or business. W-2 wages are properly allocable to QBI if the associated wage expense is taken into account in computing QBI under § 1.199A-3. In the case of an RPE, the wage expense must be allocated and reported to the partners or shareholders of the RPE as required by the Code, including subchapters K and S. The RPE must also identify and report the associated W-2 wages to its partners or shareholders.

(5) *Non-duplication rule.* Amounts that are treated as W-2 wages for a taxable year under any method cannot be treated as W-2 wages of any other taxable year. Also, an amount cannot be treated as W-2 wages by more than one trade or business.

(c) *UBIA of qualified property—(1) Qualified property—(i) In general.* The term *qualified property* means, with respect to any trade or business of an individual or RPE for a taxable year, tangible property of a character subject to the allowance for depreciation under section 167(a)—

(A) Which is held by, and available for use in, the trade or business at the close of the taxable year,

(B) Which is used at any point during the taxable year in the trade or business's production of QBI, and

(C) The depreciable period for which has not ended before the close of the individual's or RPE's taxable year.

(ii) *Improvements to qualified property.* In the case of any addition to, or improvement of, qualified property that has already been placed in service by the individual or RPE, such addition or improvement is treated as separate qualified property first placed in service on the date such addition or improvement is placed in service for purposes of paragraph (c)(2) of this section.

(iii) *Adjustments under sections 734(b) and 743(b).* Basis adjustments under sections 734(b) and 743(b) are not treated as qualified property.

(iv) *Property acquired at end of year.* Property is not qualified property if the property is acquired within 60 days of the end of the taxable year and disposed of within 120 days without having been used in a trade or business for at least 45 days prior to disposition, unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was a purpose other than increasing the section 199A deduction.

(2) *Depreciable period—(i) In general.* The term *depreciable period* means,

with respect to qualified property of a trade or business, the period beginning on the date the property was first placed in service by the individual or RPE and ending on the later of—

(A) The date that is 10 years after such date, or

(B) The last day of the last full year in the applicable recovery period that would apply to the property under section 168(c), regardless of any application of section 168(g).

(ii) *Additional first-year depreciation under section 168.* The additional first-year depreciation deduction allowable under section 168 (for example, under section 168(k) or (m)) does not affect the applicable recovery period under this paragraph for the qualified property.

(iii) *Qualified property acquired in transactions subject to section 1031 or section 1033.* For purposes of paragraph (c)(2)(i) of this section, qualified property that is acquired in a like-kind exchange, as defined in § 1.168(i)-6(b)(11), or in an involuntary conversion, as defined in § 1.168(i)-6(b)(12), is treated as replacement MACRS property as defined in § 1.168(i)-6(b)(1). For purposes of paragraph (c)(2)(i) of this section, the date on which the replacement MACRS property was first placed in service by the individual or RPE is determined as follows—

(A) Except as provided in paragraph (c)(2)(iii)(C) of this section, the date the exchanged basis, as defined in § 1.168(i)-6(b)(7), in the replacement MACRS property was first placed in service by the trade or business is the date on which the relinquished property was first placed in service by the individual or RPE; and

(B) Except as provided in paragraph (c)(2)(iii)(C) of this section, the date the excess basis, as defined in § 1.168(i)-6(b)(8), in the replacement MACRS property was first placed in service by the individual or RPE is the date on which the replacement MACRS property was first placed in service by the individual or RPE; or

(C) If the individual or RPE makes an election under § 1.168(i)-096(i)(1) (the election not to apply § 1.168(i)-096)), the date the exchanged basis and excess basis in the replacement MACRS property was first placed in service by the trade or business is the date on which the replacement MACRS property was first placed in service by the individual or RPE.

(iv) *Qualified property acquired in transactions subject to section 168(i)(7).* If an individual or RPE acquires qualified property in a transaction described in section 168(i)(7)(B) (pertaining to treatment of transferees in

certain nonrecognition transactions), the individual or RPE must determine the date on which the qualified property was first placed in service for purposes of paragraph (c)(2)(i) of this section as follows—

(A) For the portion of the transferee's unadjusted basis in the qualified property that does not exceed the transferor's unadjusted basis in such property, the date such portion was first placed in service by the transferee is the date on which the transferor first placed the qualified property in service; and

(B) For the portion of the transferee's unadjusted basis in the qualified property that exceeds the transferor's unadjusted basis in such property, such portion is treated as separate qualified property that the transferee first placed in service on the date of the transfer.

(3) *Unadjusted basis immediately after acquisition.* The term *unadjusted basis immediately after acquisition* (UBIA) means the basis on the placed in service date of the property as determined under section 1012 or other applicable sections of Chapter 1, including subchapters O (relating to gain or loss on dispositions of property), C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). UBIA is determined without regard to any adjustments described in section 1016(a)(2) or (3), to any adjustments for tax credits claimed by the individual or RPE (for example, under section 50(c)), or to any adjustments for any portion of the basis for which the individual or RPE has elected to treat as an expense (for example, under sections 179, 179B, or 179C). However, UBIA does reflect the reduction in basis for the percentage of the individual's or RPE's use of property for the taxable year other than in the trade or business.

(4) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples:

*Example 1 to paragraph (c)(4).* (i) 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.

(ii) 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 to paragraph (c)(4).* The facts are the same as in *Example 1 of this paragraph (c)(4)*, 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 to paragraph (c)(4).* (i) 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 10 years, and C depreciates Machinery Y under the general depreciation system by using the straight-line depreciation method, a 10-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.

(ii) 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. Pursuant to paragraph (c)(2)(iv)(A) of this section, 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.

(d) *Effective/applicability date*—(1) *General rule.* Except as provided in

paragraph (d)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exceptions*—(i) *Anti-abuse rules.* The provisions of paragraph (c)(1)(iv) of this section apply to taxable years ending after December 22, 2017.

(ii) *Non-calendar year RPE.* For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's taxable year in which or with which such RPE taxable year ends. ■ **Par. 5.** Section 1.199A–3 is added to read as follows:

**§ 1.199A–3 Qualified business income, qualified REIT dividends, and qualified PTP income.**

(a) *In general.* This section provides rules on the determination of a trade or business's QBI, as well as the determination of qualified REIT dividends and qualified PTP income. The provisions of this section apply solely for purposes of section 199A of the Internal Revenue Code (Code). Paragraph (b) of this section provides rules for the determination of QBI. Paragraph (c) of this section provides rules for the determination of qualified REIT dividends and qualified PTP income. QBI must be determined and reported for each trade or business by the individual or RPE that directly conducts the trade or business before applying the aggregation rules of § 1.199A–4.

(b) *Definition of qualified business income*—(1) *In general.* For purposes of this section, the term *qualified business income (QBI)* means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business of the taxpayer as described in paragraph (b)(2) of this section, provided the other requirements of this section and section 199A are satisfied (including, for example, the exclusion of income not effectively connected with a United States trade or business).

(i) *Section 751 gain.* With respect to a partnership, if section 751(a) or (b) applies, then gain or loss attributable to assets of the partnership giving rise to

ordinary income under section 751(a) or (b) is considered attributable to the trades or businesses conducted by the partnership, and is taken into account for purposes of computing QBI.

(ii) *Guaranteed payments for the use of capital.* Income attributable to a guaranteed payment for the use of capital is not considered to be attributable to a trade or business, and thus is not taken into account for purposes of computing QBI; however, the partnership's deduction associated with the guaranteed payment will be taken into account for purposes of computing QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(iii) *Section 481 adjustments.* Section 481 adjustments (whether positive or negative) are taken into account for purposes of computing QBI to the extent that the requirements of this section and section 199A are otherwise satisfied, but only if the adjustment arises in taxable years ending after December 31, 2017.

(iv) *Previously disallowed losses.* Generally, previously disallowed losses or deductions (including under sections 465, 469, 704(d), and 1366(d)) allowed in the taxable year are taken into account for purposes of computing QBI. However, losses or deductions that were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018 (including under sections 465, 469, 704(d), and 1366(d)), are not taken into account in a later taxable year for purposes of computing QBI.

(v) *Net operating losses.* Generally, a deduction under section 172 for a net operating loss is not considered with respect to a trade or business and therefore, is not taken into account in computing QBI. However, to the extent that the net operating loss is disallowed under section 461(l), the net operating loss is taken into account for purposes of computing QBI.

(2) *Qualified items of income, gain, deduction, and loss*—(i) *In general.* The term *qualified items of income, gain, deduction, and loss* means items of gross income, gain, deduction, and loss to the extent such items are—

(A) Effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting “trade or business (within the meaning of section 199A)” for “nonresident alien individual or a foreign corporation” or for “a foreign corporation” each place it appears), and

(B) Included or allowed in determining taxable income for the taxable year.



(ii) *Items not taken into account.* Notwithstanding paragraph (b)(2)(i) of this section and in accordance with section 199A(c)(3)(B), the following items are not taken into account as a qualified item of income, gain, deduction, or loss:

(A) Any item of short-term capital gain, short-term capital loss, long-term capital gain, long-term capital loss, including any item treated as one of such items, such as gains or losses under section 1231 which are treated as capital gains or losses.

(B) Any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G). Any amount described in section 1385(a)(1) is not treated as described in this clause.

(C) Any interest income other than interest income which is properly allocable to a trade or business. For purposes of section 199A and this section, interest income attributable to an investment of working capital, reserves, or similar accounts is not properly allocable to a trade or business.

(D) Any item of gain or loss described in section 954(c)(1)(C) (transactions in commodities) or section 954(c)(1)(D) (excess foreign currency gains) applied in each case by substituting “trade or business” for “controlled foreign corporation.”

(E) Any item of income, gain, deduction, or loss taken into account under section 954(c)(1)(F) (income from notional principal contracts) determined without regard to section 954(c)(1)(F)(ii) and other than items attributable to notional principal contracts entered into in transactions qualifying under section 1221(a)(7).

(F) Any amount received from an annuity which is not received in connection with the trade or business.

(G) Any qualified REIT dividends as defined in paragraph (c)(2) of this section or qualified PTP income as defined in paragraph (c)(3) of this section.

(H) Reasonable compensation received by a shareholder from an S corporation. However, the S corporation’s deduction for such reasonable compensation will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(I) Any guaranteed payment described in section 707(c) received by a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. However, the partnership’s deduction for such guaranteed payment will reduce QBI if such deduction is

properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(J) Any payment described in section 707(a) received by a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. However, the partnership’s deduction for such payment will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(3) *Commonwealth of Puerto Rico.* For the purposes of determining QBI, the term *United States* includes the Commonwealth of Puerto Rico in the case of any taxpayer with QBI for any taxable year from sources within the Commonwealth of Puerto Rico, if all of such receipts are taxable under section 1 for such taxable year. This paragraph only applies as provided in section 199A(f)(1)(C).

(4) *Wages.* Expenses for all wages paid (or incurred in the case of an accrual method taxpayer) must be taken into account in computing QBI (if the requirements of this section and section 199A are satisfied) regardless of the application of the W-2 wage limitation described in § 1.199A-1(d)(2)(iv).

(5) *Allocation of items among directly-conducted trades or businesses.* If an individual or an RPE directly conducts multiple trades or businesses, and has items of QBI which are properly attributable to more than one trade or business, the individual or RPE must allocate those items among the several trades or businesses to which they are attributable using a reasonable method based on all the facts and circumstances. The individual or RPE may use a different reasonable method for different items of income, gain, deduction, and loss. The chosen reasonable method for each item must be consistently applied from one taxable year to another and must clearly reflect the income and expenses of each trade or business. The overall combination of methods must also be reasonable based on all facts and circumstances. The books and records maintained for a trade or business must be consistent with any allocations under this paragraph.

(c) *Qualified REIT Dividends and Qualified PTP Income.*—(1) *In general.* Qualified REIT dividends and qualified PTP income are the sum of qualified REIT dividends as defined in § 1.199A-3(c)(2) earned directly or through an RPE and the net amount of qualified PTP income as defined in § 1.199A-3(c)(3) earned directly or through an RPE.

(2) *Qualified REIT dividend.*—(i) The term *qualified REIT dividend* means any dividend from a REIT received during the taxable year which—

(A) Is not a capital gain dividend, as defined in section 857(b)(3), and

(B) Is not qualified dividend income, as defined in section 1(h)(11).

(ii) A REIT dividend is not a qualified REIT dividend if the stock with respect to which it is received is held for fewer than 45 days, taking into account the principles of section 246(c)(3) and (4).

(3) *Qualified PTP income.*—(i) *In general.* The term *qualified PTP income* means the sum of—

(A) The net amount of such taxpayer’s allocable share of income, gain, deduction, and loss from a PTP as defined in section 7704(b) that is not taxed as a corporation under section 7704(a), plus

(B) Any gain or loss attributable to assets of the PTP giving rise to ordinary income under section 751(a) or (b) that is considered attributable to the trades or businesses conducted by the partnership.

(ii) *Special rules.* The rules applicable to the determination of QBI described in paragraph (b) of this section also apply to the determination of a taxpayer’s allocable share of income, gain, deduction, and loss from a PTP. An individual’s allocable share of income from a PTP, and any section 751 gain or loss is qualified PTP income only to the extent the items meet the qualifications of section 199A and this section including the requirement that the item is included or allowed in determining taxable income for the taxable year, and the requirement that the item be effectively connected with the conduct of a trade or business within the United States. For example, if an individual owns an interest in a PTP, and for the taxable year is allocated a distributive share of net loss which is disallowed under the passive activity rules of section 469, such loss is not taken into account for purposes of section 199A. Furthermore, each PTP is required to determine its qualified PTP income for each trade or business and report that information to its owners as described in § 1.199A-6(b)(3).

(d) *Effective/applicability date.*—(1) *General rule.* Except as provided in paragraph (d)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these

regulations as final regulations is published in the **Federal Register**.

(2) *Exceptions*—(i) *Anti-abuse rules*. The provisions of paragraph (c)(2)(ii) of this section apply to taxable years ending after December 22, 2017.

(ii) *Non-calendar year RPE*. For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's taxable year in which or with which such RPE taxable year ends.

■ **Par. 6.** Section 1.199A–4 is added to read as follows:

**§ 1.199A–4 Aggregation.**

(a) *Scope and purpose*. An individual or Relevant Passthrough Entity (RPE) may be engaged in more than one trade or business. Except as provided in this section, each trade or business is a separate trade or business for purposes of applying the limitations described in § 1.199A–1(d)(2)(iv). This section sets forth rules to allow individuals to aggregate trades or businesses, treating the aggregate as a single trade or business for purposes of applying the limitations described in § 1.199A–1(d)(2)(iv). Trades or businesses may be aggregated only to the extent provided in this section, but aggregation by taxpayers is not required.

(b) *Aggregation rules*—(1) *General rule*. Except as provided in paragraph (b)(3) of this section, trades or businesses may be aggregated only if an individual can demonstrate that—

(i) The same person or group of persons, directly or indirectly, owns 50 percent or more of each trade or business to be aggregated, meaning in the case of such trades or businesses owned by an S corporation, 50 percent or more of the issued and outstanding shares of the corporation, or, in the case of such trades or businesses owned by a partnership, 50 percent or more of the capital or profits in the partnership;

(ii) The ownership described in paragraph (b)(1)(i) of this section exists for a majority of the taxable year in which the items attributable to each trade or business to be aggregated are included in income;

(iii) All of the items attributable to each trade or business to be aggregated are reported on returns with the same taxable year, not taking into account short taxable years;

(iv) None of the trades or businesses to be aggregated is a specified service trade or business (SSTB) as defined in § 1.199A–5; and

(v) The trades or businesses to be aggregated satisfy at least two of the following factors (based on all of the facts and circumstances):

(A) The trades or businesses provide products and services that are the same or customarily offered together.

(B) The trades or businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.

(C) The trades or businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).

(2) *Operating rules*. An individual may aggregate trades or businesses operated directly and the individual's share of QBI, W–2 wages, and UBIA of qualified property from trades or businesses operated through RPEs. Multiple owners of an RPE need not aggregate in the same manner. For those trades or businesses directly operated by the individual, the individual computes QBI, W–2 wages, and UBIA of qualified property for each trade or business before applying these aggregation rules. If an individual aggregates multiple trades or businesses under paragraph (b)(1) of this section, the individual must combine the QBI, W–2 wages, and UBIA of qualified property for all aggregated trades or businesses for purposes of applying the W–2 wage and UBIA of qualified property limitations described in § 1.199A–1(d)(2)(iv).

(3) *Family attribution*. For purposes of determining ownership under paragraph (b)(1)(i) of this section an individual is considered as owning the interest in each trade or business owned, directly or indirectly, by or for—

(i) The individual's spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and

(ii) The individual's children, grandchildren, and parents.

(c) *Reporting and consistency*—(1) *In general*. Once an individual chooses to aggregate two or more trades or businesses, the individual must consistently report the aggregated trades or businesses in all subsequent taxable years. However, an individual may add a newly created or newly acquired (including through non-recognition transfers) trade or business to an existing aggregated trade or business if the requirements of paragraph (b)(1) of this section are satisfied. In a subsequent year, if there is a change in facts and circumstances such that an individual's prior aggregation of trades

or businesses no longer qualifies for aggregation under the rules of this section, then the trades or businesses will no longer be aggregated within the meaning of this section, and the individual must reapply the rules in paragraph (b)(1) of this section to determine a new permissible aggregation (if any).

(2) *Individual disclosure*—(i) *Required annual disclosure*. For each taxable year, individuals must attach a statement to their returns identifying each trade or business aggregated under paragraph (b)(1) of this section. The statement must contain—

(A) A description of each trade or business;

(B) The name and EIN of each entity in which a trade or business is operated;

(C) Information identifying any trade or business that was formed, ceased operations, was acquired, or was disposed of during the taxable year; and

(D) Such other information as the Commissioner may require in forms, instructions, or other published guidance.

(ii) *Failure to disclose*. If an individual fails to attach the statement required in paragraph (c)(2)(i) of this section, the Commissioner may disaggregate the individual's trades or businesses.

(d) *Examples*. The following examples illustrate the principles of this section. For purposes of these examples, 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 § 1.199A–5. Except as otherwise specified, a single letter denotes an individual taxpayer.

*Example 1 to paragraph (d).* (i) *Facts*. 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 of the bookkeeping, tracks and issues statements on all of 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.

(ii) *Analysis*. 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) of this section, A satisfies the following factors: Paragraph (b)(1)(v)(A) is met as both businesses offer prepared food to customers; and paragraph (b)(1)(v)(B) of this section 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) through (v) of this section, A may treat the catering business and the restaurant as a single trade or business for purposes of applying § 1.199A-1(d).

*Example 2 to paragraph (d).* (i) *Facts.* Assume the same facts as in *Example 1 of this paragraph*, 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.

(ii) *Analysis.* Because under paragraph (b)(1)(i) of this section 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 § 1.199A-1(d).

*Example 3 to paragraph (d).* (i) *Facts.* 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.

(ii) *Analysis.* 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) of this section. Although W manages both S1 and PRS, W is not able to satisfy the requirements of paragraph (b)(1)(v) of this section 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 § 1.199A-1(d).

*Example 4 to paragraph (d).* (i) *Facts.* 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 as a whole. 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) of this section and reports PRS2 as a separate trade or business. Only PRS2 generates a net taxable loss.

(ii) *Analysis.* E owns more than 50% of the capital and profits of each partnership thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, the following factors are satisfied: Paragraph (b)(1)(v)(A) of this section because each partnership operates a hardware store; and paragraph (b)(1)(v)(B) of this section 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 § 1.199A-1(d) is permissible. The loss from PRS2 will be netted against the aggregate profits of PRS1, PRS3 and PRS4 pursuant to § 1.199A-1(d)(2)(iii).

*Example 5 to paragraph (d).* (i) *Facts.* Assume the same facts as *Example 4 of this paragraph*, and that F owns a 10% interest in the capital and profits of PRS1, PRS2, PRS3, and PRS4.

(ii) *Analysis.* Because under paragraph (b)(1)(i) of this section 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 § 1.199A-1(d), provided that F can demonstrate that the ownership test is met by E.

*Example 6 to paragraph (d).* (i) *Facts.* 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 of the bookkeeping, tracks and issues statements on all of the receivables, and prepares the payroll for each business. S3 is operated independently from the other businesses.

(ii) *Analysis.* D owns more than 50% of the stock of each S corporation thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, the grocery stores satisfy paragraph (b)(1)(v)(A) of this section because they are in the same trade or business. Only S1 and S2 satisfy paragraph (b)(1)(v)(B) of this section because of their centralized purchasing and accounting offices. D is only able to show that the requirements of paragraph (b)(1)(v)(B) of this section are satisfied for S1 and S2; therefore, D only may aggregate S1 and S2 into a single trade or business for purposes of § 1.199A-1(d). D must report S3 as a separate trade or business for purposes of applying § 1.199A-1(d).

*Example 7 to paragraph (d).* (i) *Facts.* Assume the same facts as *Example 6 of this paragraph* except each store is independently operated and S1 and S2 do not have centralized purchasing or accounting functions.

(ii) *Analysis.* Although the stores provide the same products and services within the meaning of paragraph (b)(1)(v)(A) of this section, D cannot show that another factor under paragraph (b)(1)(v) of this section is present. Therefore, D must report S1, S2, and S3 as separate trades or businesses for purposes of applying § 1.199A-1(d).

*Example 8 to paragraph (d).* (i) *Facts.* 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 of 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.

(ii) *Analysis.* 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) of this section. 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 § 1.199A-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 § 1.199A-1(b)(13) and meets the requirements of paragraph (b)(1) of this section.

*Example 9 to paragraph (d).* (i) *Facts.* Same facts as *Example 8 of this paragraph*, 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.

(ii) *Analysis.* Under the rules in paragraph (b)(3) of this section, 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 LLC1; G thus satisfies paragraph (b)(1)(i) of this section. G may aggregate his interests in LLC1, LLC2, and S1 as a single trade or business for purposes of applying § 1.199A-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 § 1.199A-1(b)(13) and meets the requirements of paragraph (b)(1) of this section.

*Example 10 to paragraph (d).* (i) *Facts.* 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 of the restaurants and as such he creates the menus and orders the food supplies.

(ii) *Analysis.* F owns more than 50% of capital and profits in the partnerships thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, the restaurants satisfy paragraph (b)(1)(v)(A) of this section because they are in the same trade or business, and paragraph (b)(1)(v)(B) of this section is satisfied as G is the executive chef of all of the restaurants and the businesses share a centralized function for ordering food and supplies. F can show the requirements under paragraph (b)(1) of this section are satisfied as to all of the restaurants. Because F owns a majority interest in each of the partnerships, G can demonstrate that paragraph (b)(1)(i) of this section is satisfied. G can also aggregate all five restaurants into a single trade or business for purposes of applying § 1.199A-1(d). H, however, only owns an interest in PRS1 and PRS2. Like G, H satisfies paragraph (b)(1)(i) of this section because F owns a majority interest. H can, therefore, aggregate PRS1 and PRS2 into a single trade or business for purposes of applying § 1.199A-1(d).

*Example 11 to paragraph (d).* (i) *Facts.* 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 of the entities satisfy 2 of the 3 factors under paragraph (b)(1)(v) of this section. 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.

(ii) *Analysis.* Under paragraph (b)(1)(i) of this section, 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 § 1.199A-1(d).

*Example 12 to paragraph (d).* (i) *Facts.* 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.

(ii) *Analysis.* L is able to meet (b)(1)(i) as the majority owner of PRS1 and PRS2. Under paragraph (b)(1)(v) of this section, 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) of this section. For purposes of applying § 1.199A-1(d), L must treat PRS1 and PRS2 as separate trades or businesses.

*Example 13 to paragraph (d).* (i) *Facts.* C owns a majority interest in a sailboat racing team and also 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.

(ii) *Analysis.* 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) of this section.

*Example 14 to paragraph (d).* (i) *Facts.* 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.

(ii) *Analysis.* Because Trust owns 100% of the interests in LLC1, LLC2, and LLC3, Trust satisfies paragraph (b)(1)(i) of this section. Trust can also show that it satisfies paragraph (b)(1)(v)(B) of this section as the trades or businesses have a centralized human resources department, payroll, and

accounting department. Trust also can show it meets paragraph (b)(1)(v)(C) of this section 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 § 1.199A-1(d).

(e) *Effective/applicability date*—(1) *General rule.* Except as provided in paragraph (e)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exception for non-calendar year RPE.* For purposes of determining QBI, W-2 wages, and UBLA of qualified property, if an individual receives any of these items from an RPE with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's taxable year in which or with which such RPE taxable year ends.

■ **Par. 7.** Section 1.199A-5 is added to read as follows:

**§ 1.199A-5 Specified service trades or businesses and the trade or business of performing services as an employee.**

(a) *Scope and Effect*—(1) *Scope.* This section provides guidance on specified service trades or businesses (SSTBs) and the trade or business of performing services as an employee. This paragraph (a) describes the effect of being an SSTB or the trade or business of performing services as an employee. Paragraph (b) of this section provides definitional guidance on SSTBs. Paragraph (c) of this section provides special rules related to SSTBs. Paragraph (d) of this section provides guidance on the trade or business of performing services as an employee. The provisions of this section apply solely for purposes of section 199A of the Internal Revenue Code (Code).

(2) *Effect of being an SSTB.* If a trade or business is an SSTB, no QBI, W-2 wages, or UBLA of qualified property from the SSTB may be taken into account by any individual whose taxable income exceeds the phase-in range as defined in § 1.199A-1(b)(3), even if the item is derived from an activity that is not itself a specified service activity. If a trade or business conducted by a relevant passthrough entity (RPE) is an SSTB, this limitation applies to any direct or indirect individual owners of the business,

regardless of whether the owner is passive or participated in any specified service activity. However, the SSTB limitation does not apply to individuals with taxable income below the threshold amount as defined in § 1.199A-1(b)(11). A phase-in rule, provided in § 1.199A-1(d)(2), applies to individuals with taxable income within the phase-in range, allowing them to take into account a certain “applicable percentage” of QBI, W-2 wages, and UBLA of qualified property from an SSTB. A direct or indirect owner of a trade or business engaged in the performance of a specified service is engaged in the performance of the specified service for purposes of section 199A and this section, regardless of whether the owner is passive or participated in the specified service activity.

(3) *Trade or business of performing services as an employee.* The trade or business of performing services as an employee is not a trade or business for purposes of section 199A and the regulations thereunder. Therefore, no items of income, gain, loss, or deduction from the trade or business of performing services as an employee constitute QBI within the meaning of section 199A and § 1.199A-3. No taxpayer may claim a section 199A deduction for wage income, regardless of the amount of taxable income.

(b) *Definition of specified service trade or business.* Except as provided in paragraph (c)(1) of this section, the term *specified service trade or business (SSTB)* means any of the following:

(1) *Listed SSTBs.* Any trade or business involving the performance of services in one or more of the following fields:

- (i) Health as described in paragraph (b)(2)(ii) of this section;
- (ii) Law as described in paragraph (b)(2)(iii) of this section;
- (iii) Accounting as described in paragraph (b)(2)(iv) of this section;
- (iv) Actuarial science as described in paragraph (b)(2)(v) of this section;
- (v) Performing arts as described in paragraph (b)(2)(vi) of this section;
- (vi) Consulting as described in paragraph (b)(2)(vii) of this section;
- (vii) Athletics as described in paragraph (b)(2)(viii) of this section;
- (viii) Financial services as described in paragraph (b)(2)(ix) of this section;
- (ix) Brokerage services as described in paragraph (b)(2)(x) of this section;
- (x) Investing and investment management as described in paragraph (b)(2)(xi) of this section;
- (xi) Trading as described in paragraph (b)(2)(xii) of this section;

(xii) Dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)) as described in paragraph (b)(2)(xiii) of this section; or

(xiii) 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) of this section.

(2) *Additional rules for applying section 199A(d)(2) and paragraph (b) of this section*—(i) *In general.* This paragraph (b)(2) provides additional rules for determining whether a business is an SSTB within the meaning of section 199A(d)(2) and paragraph (b) of this section only. The rules of this paragraph (b)(2) may not be taken into account for purposes of applying any provision of law or regulation other than section 199A and the regulations thereunder except to the extent such provision expressly refers to section 199A(d) or this section.

(ii) *Meaning of services performed in the field of health.* For purposes of section 199A(d)(2) and paragraph (b)(1)(i) of this section only, the *performance of services in the field of health* means the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists and other similar healthcare professionals performing services in their capacity as such who provide medical services directly to a patient (service recipient). The performance of services in the field of health does not include the provision of services not directly related to a medical services field, even though the services provided 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 the research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.

(iii) *Meaning of services performed in the field of law.* For purposes of section 199A(d)(2) and paragraph (b)(1)(ii) of this section only, the *performance of services in the field of law* means the performance of services by individuals such as lawyers, paralegals, legal arbitrators, mediators, and similar professionals performing services 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 in the field of law does not

include the provision of services by printers, delivery services, or stenography services.

(iv) *Meaning of services performed in the field of accounting.* For purposes of section 199A(d)(2) and paragraph (b)(1)(iii) of this section only, the *performance of services in the field of accounting* means the provision of services by individuals such as accountants, enrolled agents, return preparers, financial auditors, and similar professionals performing services in their capacity as such.

(v) *Meaning of services performed in the field of actuarial science.* For purposes of section 199A(d)(2) and paragraph (b)(1)(iv) of this section only, the *performance of services in the field of actuarial science* means the provision of services by individuals such as actuaries and similar professionals performing services in their capacity as such.

(vi) *Meaning of services performed in the field of performing arts.* For purposes of section 199A(d)(2) and paragraph (b)(1)(v) of this section only, the *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. Similarly, 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.

(vii) *Meaning of services performed in the field of consulting.* For purposes of section 199A(d)(2) and paragraph (b)(1)(vi) of this section only, the *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 manner in which 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.

(viii) *Meaning of services performed in the field of athletics.* For purposes of section 199A(d)(2) and paragraph (b)(1)(vii) of this section only, the *performance of services in the field of athletics* means the performance 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.

(ix) *Meaning of services performed in the field of financial services.* For purposes of section 199A(d)(2) and paragraph (b)(1)(viii) of this section only, the *performance of services in the field of financial services* means 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 a 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 performing services in their capacity as such.

(x) *Meaning of services performed in the field of brokerage services.* For purposes of section 199A(d)(2) and paragraph (b)(1)(ix) of this section only, the *performance of services in the field of brokerage services* includes transactions 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.

(xi) *Meaning of the provision of services in investing and investment management.* For purposes of section 199A(d)(2) and paragraph (b)(1)(x) of this section only, the *performance of services that consist of investing and investment management* refers to a trade or business involving the receipt of fees for providing investing, asset management, or investment management services, including providing advice with respect to buying and selling investments. The performance of services of investing and investment management does not include directly managing real property.

(xii) *Meaning of the provision of services in trading.* For purposes of section 199A(d)(2) and paragraph (b)(1)(xi) of this section only, the *performance of services that consist of trading* means a trade or business of trading in securities (as defined in section 475(c)(2)), commodities (as defined in section 475(e)(2)), or partnership interests. Whether a person is a trader in securities, commodities, or partnership interests is determined by taking into account all relevant facts and circumstances, 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.

(xiii) *Meaning of the provision of services in dealing—(A) Dealing in securities.* For purposes of section 199A(d)(2) and paragraph (b)(1)(xii) of this section only, 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, however, 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) and this section. See § 1.475(c)–1(c)(2) and (4) for the definition of negligible sales.

(B) *Dealing in commodities.* For purposes of section 199A(d)(2) and paragraph (b)(1)(xii) of this section only, 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.

(C) *Dealing in partnership interests.* For purposes of section 199A(d)(2) and paragraph (b)(1)(xii) of this section only, 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.

(xiv) *Meaning of trade or business where the principal asset of such trade or business is the reputation or skill of one or more employees or owners.* For purposes of section 199A(d)(2) and paragraph (b)(1)(xiii) of this section only, the term *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* means any trade or business that consists of any of the following (or any combination thereof):

(A) A trade or business in which a person receives fees, compensation, or other income for endorsing products or services,

(B) A trade or business in which a person licenses or receives fees, compensation or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity,

(C) Receiving fees, compensation, or other income for appearing at an event or on radio, television, or another media format.

(D) For purposes of paragraph (b)(2)(xiv)(A) through (C) of this section, the term *fees, compensation, or other income* includes the receipt of a partnership interest and the corresponding distributive share of income, deduction, gain or loss from the partnership, or the receipt of stock of an S corporation and the corresponding income, deduction, gain or loss from the S corporation stock.

(3) *Examples.* The following examples illustrate the rules in paragraphs (a) and (b) of this section. The examples do not address all types of services that may or may not qualify as specified services. Unless otherwise provided, the individual in each example has taxable income in excess of the threshold amount.

*Example 1 to paragraph (b)(3).* A, a singer, records a song. A is paid a mechanical royalty when the song is licensed or streamed. A is also paid a performance royalty when the recorded song is played publicly. A is engaged in the performance of services in an SSTB in the field of performing arts within the meaning of paragraphs (b)(1)(v) and (b)(2)(vi) of this section. The royalties that A receives for the song are not eligible for a deduction under section 199A.

*Example 2 to paragraph (b)(3).* B is a partner in Partnership, which solely owns and operates a professional sports team. Partnership employs athletes and sells tickets to the public to attend games in which the sports team competes. Therefore, Partnership is engaged in the performance of services in an SSTB in the field of athletics within the meaning of paragraphs (b)(1)(vii) and (b)(2)(viii) of this section. B is a passive owner in Partnership and B does not provide any services with respect to Partnership or the sports team. However, because Partnership is engaged in an SSTB in the field of athletics, B's distributive share of the income, gain, loss, and deduction with respect to Partnership is not eligible for a deduction under section 199A.

*Example 3 to paragraph (b)(3).* C is in the business of providing services that assist unrelated entities in making their personnel structures more efficient. C studies its client's organization and structure and compares it to peers in its industry. C then makes recommendations and provides advice to its client regarding possible changes in the client's personnel structure, including the use of temporary workers. C is engaged in the performance of services in an SSTB in the field of consulting within the meaning of paragraphs (b)(1)(vi) and (b)(2)(vii) of this section.

*Example 4 to paragraph (b)(3).* D is in the business of licensing software to customers. D discusses and evaluates the customer's software needs with the customer. The taxpayer advises the customer on the particular software products it licenses. D is



paid a flat price for the software license. After the customer licenses the software, D helps to implement the software. D is engaged in the trade or business of licensing software and not engaged in an SSTB in the field of consulting within the meaning of paragraphs (b)(1)(vi) and (b)(2)(vi) of this section.

*Example 5 to paragraph (b)(3).* E is in the business of providing services to assist clients with their finances. E will study a particular client's financial situation, including, the client's present income, savings and investments, and anticipated future economic and financial needs. Based on this study, E will then assist the client in making decisions and plans regarding the client's financial activities. Such financial planning includes the design of a personal budget to assist the client in monitoring the client's financial situation, the adoption of investment strategies tailored to the client's needs, and other similar services. E is engaged in the performance of services in an SSTB in the field of financial services within the meaning of paragraphs (b)(1)(viii) and (b)(2)(ix) of this section.

*Example 6 to paragraph (b)(3).* F is in the business of executing transactions for customers involving various types of securities or commodities generally traded through organized exchanges or other similar networks. Customers place orders with F to trade securities or commodities based on the taxpayer's recommendations. F's compensation for its services typically is based on completion of the trade orders. F is engaged in an SSTB in the field of brokerage services within the meaning of paragraphs (b)(1)(ix) and (b)(2)(x) of this section.

*Example 7 to paragraph (b)(3).* G owns 100% of Corp, an S corporation, which operates a bicycle sales and repair business. Corp has 8 employees, including G. Half of Corp's net income is generated from sales of new and used bicycles and related goods, such as helmets, and bicycle-related equipment. The other half of Corp's net income is generated from bicycle repair services performed by G and Corp's other employees. Corp's assets consist of inventory, fixtures, bicycle repair equipment, and a leasehold on its retail location. Several of the employees and G have worked in the bicycle business for many years, and have acquired substantial skill and reputation in the field. Customers often consult with the employees on the best bicycle for purchase. G is in the business of sales and repairs of bicycles and is not engaged in an SSTB within the meaning of paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

*Example 8 to paragraph (b)(3).* H is a well-known chef and the sole owner of multiple restaurants each of which is owned in a disregarded entity. Due to H's skill and reputation as a chef, H receives an endorsement fee of \$500,000 for the use of H's name on a line of cooking utensils and cookware. H is in the trade or business of being a chef and owning restaurants and such trade or business is not an SSTB. However, H is also in the trade or business of receiving endorsement income. H's trade or business consisting of the receipt of the endorsement fee for H's skill and/or reputation is an SSTB

within the meaning of paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

*Example 9 to paragraph (b)(3).* J is a well-known actor. J entered into a partnership with Shoe Company, in which J contributed her likeness and the use of her name to the partnership in exchange for a 50% interest in the capital and profits of the partnership and a guaranteed payment. J's trade or business consisting of the receipt of the partnership interest and the corresponding distributive share with respect to the partnership interest for J's likeness and the use of her name is an SSTB within the meaning of paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

(c) *Special rules.* (1) *De minimis rule.*—(i) *Gross receipts of \$25 million or less.* For a trade or business with gross receipts of \$25 million dollars or less for the taxable year, a trade or business is not an SSTB if less than 10 percent of the gross receipts of the trade or business are attributable to the performance of services in a field described in paragraph (b) of this section. For purposes of determining whether this 10 percent test is satisfied, the performance of any activity incident to the actual performance of services in the field is considered the performance of services in that field.

(ii) *Gross receipts of greater than \$25 million.* For a trade or business with gross receipts of greater than \$25 million for the taxable year, the rules of paragraph (c)(1)(i) of this section are applied by substituting “5 percent” for “10 percent” each place it appears.

(2) *Services or property provided to an SSTB.*—(i) *In general.* An SSTB includes any trade or business that provides 80 percent or more of its property or services to an SSTB if there is 50 percent or more common ownership of the trades or businesses.

(ii) *Less than substantially all of property or services provided.* If a trade or business provides less than 80 percent of its property or services to an SSTB within the meaning of this section and there is 50 percent or more common ownership of the trades or businesses, that portion of the trade or business of providing property or services to the 50 percent or more commonly-owned SSTB is treated as a part of the SSTB.

(iii) *50 percent or more common ownership.* For purposes of paragraphs (c)(2)(i) and (ii) of this section, 50 percent or more common ownership includes direct or indirect ownership by related parties within the meaning of sections 267(b) or 707(b).

(iv) *Example.* Law Firm is a partnership that provides legal services to clients, owns its own office building and employs its own administrative staff. Law Firm divides into three partnerships. Partnership 1 performs legal services to clients. Partnership 2 owns the office building and rents the entire

building to Partnership 1. Partnership 3 employs the administrative staff and through a contract with Partnership 1 provides administrative services to Partnership 1 in exchange for fees. All three of the partnerships are owned by the same people (the original owners of Law Firm). Because there is 50% or more common ownership of each of the three partnerships, Partnership 2 provides substantially all of its property to Partnership 1, and Partnership 3 provides substantially all of its services to Partnership 1, Partnerships 1, 2, and 3 will be treated as one SSTB under paragraph (a)(6) of this section.

(3) *Incidental to specified service trade or business.*—(i) *In general.* If a trade or business (that would not otherwise be treated as an SSTB) has 50 percent or more common ownership with an SSTB, including related parties (within the meaning of sections 267(b) or 707(b)), and has shared expenses with the SSTB, including shared wage or overhead expenses, then such trade or business is treated as incidental to and, therefore, part of the SSTB within the meaning of this section if the gross receipts of the trade or business represents no more than 5 percent of the total combined gross receipts of the trade or business and the SSTB in a taxable year.

(ii) *Example.* A, a dermatologist, provides medical services to patients on a regular basis through Dermatology LLC, a disregarded entity owned by A. In addition to providing medical services, Dermatology LLC also sells skin care products to A's patients. The same employees and office space are used for the medical services and sale of skin care products. The gross receipts with respect to the skin care product sales do not exceed 5% of the gross receipts of Dermatology LLC. Accordingly, the sale of the skin care products is treated as incidental to A's SSTB of performing services in the field of health (within the meaning of paragraph (b)(1)(i) and (b)(2)(ii) of this section) and is treated under paragraph (c)(3) of this section as part of such SSTB.

(d) *Trade or business of performing services as an employee.*—(1) *In general.* The trade or business of performing services as an employee is not a trade or business for purposes of section 199A and the regulations thereunder. Therefore, no items of income, gain, loss, and deduction from the trade or business of performing services as an employee constitute QBI within the meaning of section 199A and § 1.199A-3. Except as provided in paragraph (d)(3) of this section, income from the trade or business of performing services as an employee refers to all wages (within the meaning of section 3401(a)) and other income earned in a capacity as an employee, including payments described in § 1.6041-2(a)(1) (other than



payments to individuals described in section 3121(d)(3)) and § 1.6041-2(b)(1).

(2) *Employer's Federal employment tax classification of employee immaterial.* For purposes of determining whether wages are earned in a capacity as an employee as provided in paragraph (d)(1) of this section, the treatment of an employee by an employer as anything other than an employee for Federal employment tax purposes is immaterial. Thus, if a worker should be properly classified as an employee, it is of no consequence that the employee is treated as a non-employee by the employer for Federal employment tax purposes.

(3) *Presumption that former employees are still employees—(i) Presumption.* Solely for purposes of section 199A(d)(1)(B) and paragraph (d)(1) of this section, an individual that was properly treated as an employee for Federal employment tax purposes by the person to which he or she provided services and who is subsequently treated as other than an employee by such person with regard to the provision of substantially the same services directly or indirectly to the person (or a related person), is presumed to be in the trade or business of performing services as an employee with regard to such services. This presumption may be rebutted upon a showing by the individual that, under Federal tax law, regulations, and principles (including common-law employee classification rules), the individual is performing services in a capacity other than as an employee. This presumption applies regardless of whether the individual provides services directly or indirectly through an entity or entities.

(ii) *Examples.* The following examples illustrate the provision of paragraph (b)(3)(i) of this section. Unless otherwise provided, the individual in each example has taxable income in excess of the threshold amount.

*Example 1 to paragraph (d)(3).* A is employed by PRS, a partnership, as a fulltime employee and is treated as such for Federal employment tax purposes. A quits his job for PRS and enters into a contract with PRS under which A provides substantially the same services that A previously provided to PRS in A's capacity as an employee. Because A was treated as an employee for services he provided to PRS, and now is no longer treated as an employee with regard to such services, A is presumed (solely for purposes of section 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with regard to his services performed for PRS. Unless the presumption is rebutted with a showing that, under Federal tax law, regulations, and principles

(including the common-law employee classification rules), A is not an employee, any amounts paid by PRS to A with respect to such services will not be QBI for purposes of section 199A. The presumption would apply even if, instead of contracting directly with PRS, A formed a disregarded entity, or an S corporation, and the disregarded entity or the S corporation entered into the contract with PRS.

*Example 2 to paragraph (d)(3).* C is an attorney employed as an associate in a law firm (Law Firm 1) and was treated as such for Federal employment tax purposes. C and the other associates in Law Firm 1 have taxable income below the threshold amount. Law Firm 1 terminates its employment relationship with C and its other associates. C and the other former associates form a new partnership, Law Firm 2, which contracts to perform legal services for Law Firm 1. Therefore, in form, C is now a partner in Law Firm 2 which earns income from providing legal services to Law Firm 1. C continues to provide substantially the same legal services to Law Firm 1 and its clients. Because C was previously treated as an employee for services she provided to Law Firm 1, and now is no longer treated as an employee with regard to such services, C is presumed (solely for purposes of section 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with respect to the services C provides to Law Firm 1 indirectly through Law Firm 2. Unless the presumption is rebutted with a showing that, under Federal tax law, regulations, and principles (including common-law employee classification rules), C's distributive share of Law Firm 2 income (including any guaranteed payments) will not be QBI for purposes of section 199A. The results in this example would not change if, instead of contracting with Law Firm 1, Law Firm 2 was instead admitted as a partner in Law Firm 1.

*Example 3 to paragraph (d)(3).* E is an engineer employed as a senior project engineer in an engineering firm, Engineering Firm. Engineering Firm is a partnership and structured such that after 10 years, senior project engineers are considered for partner if certain career milestones are met. After 10 years, E meets those career milestones and is admitted as a partner in Engineering Firm. As a partner in Engineering Firm, E shares in the net profits of Engineering Firm, and also otherwise satisfies the requirements under Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner. E is presumed (solely for purposes of section 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with respect to the services E provides to Engineering Firm. However, E is able to rebut the presumption by showing that E became a partner in Engineering Firm as a career milestone, shares in the overall net profits in Engineering Firm, and otherwise satisfies the requirements under Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner.

(e) *Effective/applicability date—(1) General rule.* Except as provided in paragraph (e)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exceptions—(i) Anti-abuse rules.* The provisions of paragraphs (c)(2), (c)(3), and (d)(3) of this section apply to taxable years ending after December 22, 2017.

(ii) *Non-calendar year RPE.* For purposes of determining QBI, W-2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's taxable year in which or with which such RPE taxable year ends.

■ **Par. 8.** Section 1.199A-6 is added to read as follows:

**§ 1.199A-6 Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts, and estates.**

(a) *Overview.* This section provides special rules for RPEs, PTPs, trusts, and estates necessary for the computation of the section 199A deduction of their owners or beneficiaries. Paragraph (b) of this section provides computational and reporting rules for RPEs necessary for individuals who own interests in RPEs to calculate their section 199A deduction. Paragraph (c) of this section provides computational and reporting rules for PTPs necessary for individuals who own interests in PTPs to calculate their section 199A deduction. Paragraph (d) of this section provides computational and reporting rules for trusts (other than grantor trusts) and estates necessary for their beneficiaries to calculate their section 199A deduction.

(b) *Computational and reporting rules for RPEs—(1) In general.* An RPE must determine and report information attributable to any trades or businesses it is engaged in necessary for its owners to determine their section 199A deduction.

(2) *Computational rules.* Using the following four rules, an RPE must determine the items necessary for individuals who own interests in the RPE to calculate their section 199A deduction under § 1.199A-1(c) or (d):

(i) First, the RPE must determine if it is engaged in one or more trades or businesses. The RPE must also determine whether any of its trades or businesses is an SSTB under the rules of § 1.199A-5.

(ii) Second, the RPE must apply the rules in § 1.199A-3 to determine the QBI for each trade or business engaged in directly.

(iii) Third, the RPE must apply the rules in § 1.199A-2 to determine the W-2 wages and UBIA of qualified property for each trade or business engaged in directly.

(iv) Fourth, the RPE must determine whether it has any qualified REIT dividends as defined in 1.199A-3(c)(1) earned directly or through another RPE. The RPE must also determine the net amount of qualified PTP income as defined in § 1.199A-3(c)(2) earned directly or indirectly through investments in PTPs.

(3) *Reporting rules for RPEs*—(i) *Trade or business directly engaged in.* 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—

(A) Each owner's allocable share of QBI, W-2 wages, and UBIA of qualified property attributable to each such trade or business, and

(B) Whether any of the trades or businesses described in paragraph (b)(3)(i)(A) of this section is an SSTB.

(ii) *Other items.* An RPE must also 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).

(iii) *Failure to report information.* If an RPE fails to separately identify or report on the Schedule K-1 (or any attachments thereto) issued to an owner any items described in paragraph (b)(3)(i) of this section, 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.

(c) *Computational and reporting rules for PTPs*—(1) *Computational rules.* Each PTP must determine its QBI under the rules of § 1.199A-3 for each trade or business in which the PTP is engaged in directly. The PTP must also determine whether any of the trades or businesses it is engaged in directly is an SSTB.

(2) *Reporting rules.* Each PTP is required to separately identify and report the information described in paragraph (c)(1) of this section on Schedules K-1 issued to its partners. Each PTP must also determine and report any qualified REIT dividends or qualified PTP income or loss received by the PTP including through an RPE, a REIT, or another PTP. A PTP is not required to determine or report W-2 wages or the UBIA of qualified property attributable to trades or businesses it is engaged in directly.

(d) *Application to trusts, estates, and beneficiaries*—(1) *In general.* A trust or estate computes its section 199A deduction based on the QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income that are allocated to the trust or estate. An individual beneficiary of a trust or estate takes into account any QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income allocated from a trust or estate in calculating the beneficiary's section 199A deduction, in the same manner as though the items had been allocated from an RPE. For purposes of this section and §§ 1.199A-1 through 1.199A-5, a trust or estate is treated as an RPE to the extent it allocates QBI and other items to its beneficiaries, and is treated as an individual to the extent it retains the QBI and other items.

(2) *Grantor trusts.* To the extent that the grantor or another person is treated as owning all or part of a trust under sections 671 through 679, such person computes its section 199A deduction as if that person directly conducted the activities of the trust with respect to the portion of the trust treated as owned by the grantor or another person.

(3) *Non-grantor trusts and estates*—(i) *Calculation at entity level.* A trust or estate must calculate its QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income. The QBI of a trust or estate must be computed by allocating qualified items of deduction described in section 199A(c)(3) in accordance with the classification of those deductions under § 1.652(b)-3(a), and deductions not directly attributable within the meaning of § 1.652(b)-3(b) (other deductions) are allocated in a manner consistent with the rules in § 1.652(b)-3(b). Any depletion and depreciation deductions described in section 642(e) and any amortization deductions described in section 642(f) that otherwise are properly included in the computation of QBI are included in the computation of QBI of the trust or estate, regardless of how those

deductions may otherwise be allocated between the trust or estate and its beneficiaries for other purposes of the Code.

(ii) *Allocation among trust or estate and beneficiaries.* The QBI (including any amounts that may be less than zero as calculated at the trust or estate level), W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income of a trust or estate are allocated to each beneficiary and to the trust or estate based on the relative proportion of the trust's or estate's distributable net income (DNI), as defined by section 643(a), for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate. For this purpose, the trust's or estate's DNI is determined with regard to the separate share rule of section 663(c), but without regard to section 199A. If the trust or estate has no DNI for the taxable year, any QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income are allocated entirely to the trust or estate.

(iii) *Threshold amount.* The threshold amount applicable to a trust or estate is \$157,500 for any taxable year beginning before 2019. For taxable years beginning after 2018, the threshold amount shall be \$157,500 increased by the cost-of-living adjustment as outlined in § 1.199A-1(b)(11). For purposes of determining whether a trust or estate has taxable income that exceeds the threshold amount, the taxable income of a trust or estate is determined before taking into account any distribution deduction under sections 651 or 661.

(iv) *Electing small business trusts.* An electing small business trust (ESBT) is entitled to the deduction under section 199A. The S portion of the ESBT must take into account the QBI and other items from any S corporation owned by the ESBT, the grantor portion of the ESBT must take into account the QBI and other items from any assets treated as owned by a grantor or another person (owned portion) of a trust under sections 671 through 679, and the non-S portion of the ESBT must take into account any QBI and other items from any other entities or assets owned by the ESBT. See § 1.641(c)-1.

(v) *Anti-abuse rule for creation of multiple trusts to avoid exceeding the threshold amount.* Trusts formed or funded with a significant purpose of receiving a deduction under section 199A will not be respected for purposes of section 199A. See also § 1.643(f)-1 of the regulations.

(vi) The following example illustrates the application of paragraph (d) of this section.

*Example 1 to (d)(3)(vi).* (i) *Computation of DNI and inclusion and deduction amounts.* (A) *Trust's distributive share of partnership items.* Trust, an irrevocable testamentary complex trust, is a 25% partner in PRS, a family partnership that operates a restaurant that generates QBI and W–2 wages. In 2018, PRS properly allocates gross income from the restaurant of \$55,000, and expenses directly allocable to the restaurant of \$50,000 (including W–2 wages of \$25,000, miscellaneous expenses of \$20,000, and depreciation deductions of \$5,000) to Trust. These items are properly included in Trust's DNI. Trust's share of PRS' unadjusted basis of qualified depreciable property is \$125,000. PRS distributes \$5,000 of cash to Trust in 2018.

(B) *Trust's activities.* In addition to its interest in PRS, Trust also operates a family bakery conducted through an LLC wholly-owned by the Trust that is treated as a disregarded entity. In 2018, the bakery produced \$100,000 of gross income and \$150,000 of expenses directly allocable to operation of the bakery (including W–2 wages of \$50,000, rental expense of \$75,000, and miscellaneous expenses of \$25,000). (The net loss from the bakery operations is not subject to any loss disallowance provisions outside of section 199A.) Trust also has zero unadjusted basis of qualified depreciable property in the bakery. For purposes of computing its section 199A deduction, Trust has properly chosen to aggregate the family restaurant conducted through PRS with the bakery conducted directly by Trust under § 1.199A–4. Trust also owns various investment assets that produce portfolio-type income consisting of dividends (\$25,000), interest (\$15,000), and tax-exempt interest (\$15,000). Accordingly, Trust has the following items which are properly included in Trust's DNI:

Interest Income .....	15,000
Dividends .....	25,000
Tax-exempt interest .....	15,000
Net business loss from PRS and bakery .....	(45,000)
Trustee commissions .....	3,000
State and local taxes .....	5,000

(C) *Allocation of deductions under § 1.652(b)–3.* (1) *Directly attributable expenses.* In computing Trust's DNI for the taxable year, the distributive share of expenses of PRS are directly attributable under § 1.652(b)–3(a) to the distributive share of income of PRS. Accordingly, Trust has gross business income of \$155,000 (55,000 from PRS and 100,000 from the bakery) and direct business expenses of \$200,000 (\$50,000 from PRS and \$150,000 from the bakery). In addition, \$1,000 of the trustee commissions and \$1,000 of state and local taxes are directly attributable under § 1.652(b)–3(a) to Trust's business income. Accordingly, Trust has excess business deductions of \$47,000. Pursuant to its authority recognized under § 1.652(b)–3(d), Trust allocates the \$47,000 excess business deductions as follows: \$15,000 to the interest income, resulting in \$0 interest income, \$25,000 to the dividends, resulting in \$0 dividend income, and \$7,000 to the tax exempt interest.

(2) *Non-directly attributable expenses.* The trustee must allocate the sum of the balance of the trustee commissions (\$2,000) and state and local taxes (\$4,000) to Trust's remaining tax-exempt interest income, resulting in \$2,000 of tax exempt interest.

(D) *Amounts included in taxable income.* For 2018, Trust has DNI of \$2,000. Pursuant to Trust's governing instrument, Trustee distributes 50%, or \$1,000, of that DNI to A, an individual who is a discretionary beneficiary of Trust. In addition, Trustee is required to distribute 25%, or \$500, of that DNI to B, a current income beneficiary of Trust. Trust retains the remaining 25% of DNI. Consequently, with respect to the \$1,000 distribution A receives from Trust, A properly excludes \$1,000 of tax-exempt interest income under section 662(b). With respect to the \$500 distribution B receives from Trust, B properly excludes \$500 of tax exempt interest income under section 662(b). Because the DNI consists entirely of tax-exempt income, Trust deducts \$0 under section 661 with respect to the distributions to A and B.

(ii) *Section 199A deduction.* (A) *Trust's W–2 wages and QBI.* For the 2018 taxable year, Trust has \$75,000 (\$25,000 from PRS + \$50,000 of Trust) of W–2 wages. Trust also has \$125,000 of unadjusted basis in qualified depreciable property. Trust has negative QBI of (\$47,000) (\$155,000 gross income from aggregated businesses less the sum of \$200,000 direct expenses from aggregated businesses and \$2,000 directly attributable business expenses from Trust under the rules of § 1.652(b)–3(a)).

(B) *Section 199A deduction computation.*

(1) *A's computation.* Because the \$1,000 Trust distribution to A equals one-half of Trust's DNI, A has W–2 wages from Trust of \$37,500. A also has W–2 wages of \$2,500 from a trade or business outside of Trust (computed without regard to A's interest in Trust), which A has properly aggregated under § 1.199A–4 with the Trust's trade or businesses (the family's restaurant and bakery), for a total of \$40,000 of W–2 wages from the aggregate trade or businesses. A has \$100,000 of QBI from non-Trust trade or businesses in which A owns an interest. Because the \$1,000 Trust distribution to A equals one-half of Trust's DNI, A has (negative) QBI from Trust of (\$23,500). A's total QBI is determined by combining the \$100,000 QBI from non-Trust sources with the (\$23,500) QBI from Trust for a total of \$76,500 of QBI. Assume that A's taxable income exceeds the threshold amount for 2018 by \$200,000. A's tentative deduction is \$15,300 ( $.20 \times \$76,500$ ), limited under the W–2 wage limitation to \$20,000 ( $50\% \times \$40,000$  W–2 wages). Accordingly, A's section 199A deduction for 2018 is \$15,300.

(2) *B's computation.* For 2018, B's taxable income is below the threshold amount so B is not subject to the W–2 wage limitation. Because the \$500 Trust distribution to B equals one-quarter of Trust's DNI, B has a total of (\$11,750) of QBI. B also has no QBI from non-Trust trades or businesses, so B has a total of (\$11,750) of QBI. Accordingly, B's section 199A deduction for 2018 is zero. The (\$11,750) of QBI is carried over to 2019 as a loss from a qualified business in the hands of B pursuant to section 199A(c)(2).

(3) *Trust's computation.* For 2018, Trust's taxable income is below the threshold amount so it is not subject to the W–2 wage limitation. Because Trust retained 25% of Trust's DNI, Trust is allocated 25% of its QBI, which is (\$11,750). Trust's section 199A deduction for 2018 is zero. The (\$11,750) of QBI is carried over to 2019 as a loss from a qualified business in the hands of Trust pursuant to section 199A(c)(2).

(e) *Effective/applicability date—(1) General rule.* Except as provided in paragraph (e)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exceptions—(i) Anti-abuse rules.* The provisions of paragraph (d)(3)(v) of this section apply to taxable years ending after December 22, 2017.

(ii) *Non-calendar year RPE.* For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's taxable year in which or with which such RPE taxable year ends. ■ **Par. 9.** Section 1.643(f)–1 is added to read as follows:

#### § 1.643(f)–1 Treatment of multiple trusts.

(a) *General rule.* For purposes of subchapter J of chapter 1 of Title 26 of the United States Code, two or more trusts will be aggregated and treated as a single trust if such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and if a principal purpose for establishing such trusts or for contributing additional cash or other property to such trusts is the avoidance of Federal income tax. For purposes of applying this rule, spouses will be treated as one person.

(b) *A principal purpose.* A principal purpose for establishing or funding a trust will be presumed if it results in a significant income tax benefit unless there is a significant non-tax (or non-income tax) purpose that could not have been achieved without the creation of these separate trusts.

(c) *Examples.* The following examples illustrate the application of this section:

*Example 1 to paragraph (c).* (i) A owns and operates a pizzeria and several gas

stations. A's annual income from these businesses and other sources exceeds the threshold amount in section 199A(e)(2), and the W-2 wages properly allocable to these businesses are not sufficient for A to maximize the deduction allowable under section 199A. A reads an article in a magazine that suggests that taxpayers can avoid the W-2 wage limitation of section 199A by contributing portions of their family businesses to multiple identical trusts established for family members. Based on this advice, in 2018, A establishes three irrevocable, non-grantor trusts: Trust 1 for the benefit of A's sister, B, and A's brothers, C and D; Trust 2 for the benefit of A's second sister, E, and for C and D; and Trust 3 for the benefit of E. Under each trust instrument, the trustee is given discretion to pay any current or accumulated income to any one or more of the beneficiaries. The trust agreements otherwise have nearly identical terms. But for the enactment of section 199A and A's desire to avoid the W-2 wage limitation of that provision, A would not have created or funded such trusts. A names A's oldest son, F, as the trustee for each trust. A forms a family limited partnership, and contributes the ownership interests in the pizzeria and gas stations to the partnership in exchange

for a 50-percent general partner interest and a 50-percent limited partner interest. A later contributes to each trust a 15% limited partner interest. Under the partnership agreement, the trustee does not have any power or discretion to manage the partnership or any of its businesses on behalf of the trusts, or to dispose of the limited partnership interests without the approval of the general partner. Each of the trusts claims the section 199A deduction on its Form 1041 in full based on the amount of qualified business income (QBI) allocable to that trust from the limited partnership, as if such trust was not subject to the wage limitation in section 199A(b)(2)(B).

(ii) Under these facts, for Federal income tax purposes under this section, Trust 1, Trust 2, and Trust 3 would be aggregated and treated as a single trust.

*Example 2 to paragraph (c).* (i) X establishes two irrevocable trusts: One for the benefit of X's son, G, and the other for X's daughter, H. G is the income beneficiary of the first trust and the trustee is required to apply all income currently to G for G's life. H is the remainder beneficiary of the first trust. H is an income beneficiary of the second trust and the trust instrument permits the trustee to accumulate or to pay income,

in its discretion, to H for H's education, support, and maintenance. The trustee also may pay income or corpus for G's medical expenses. H is the remainder beneficiary of the second trust and will receive the trust corpus upon G's death.

(ii) Under these facts, there are significant non-tax differences between the substantive terms of the two trusts, so tax avoidance will not be presumed to be a principal purpose for the establishment or funding of the separate trusts. Accordingly, in the absence of other facts or circumstances that would indicate that a principal purpose for creating the two separate trusts was income tax avoidance, the two trusts will not be aggregated and treated as a single trust for Federal income tax purposes under this section.

(d) *Effective/applicability date.* The provisions of this section apply to taxable years ending after August 16, 2018.

**Kirsten Wielobob,**

*Deputy Commissioner for Services and Enforcement.*

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