

(5) *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).

(6) *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).

(7) *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 paragraph (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) *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 February 8, 2019.

(2) *Exception for non-calendar year RPE.* For purposes of determining QBI, W-2 wages, UBIA of qualified property, and the aggregate amount of qualified REIT dividends and qualified PTP income, 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.

[T.D. 9847, 84 FR 2989, Feb. 8, 2019]

§ 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 (or aggregated trade or business). 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 (or aggregated 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 (or aggregated trade or business).

(3) *UBIA of qualified property—(i) In general.* 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 (or aggregated trade or business) by the individual or RPE that directly conducts the trade or business (or aggregated trade or business). The UBIA of qualified property is presumed to be zero if not determined and reported for each trade or business (or aggregated trade or business).

(ii) *UBIA of qualified property held by a partnership.* In the case of qualified property held by a partnership, each partner's share of the UBIA of qualified property is determined in accordance with how the partnership would allocate depreciation under § 1.704-1(b)(2)(iv)(g) on the last day of the taxable year.

(iii) *UBIA of qualified property held by an S corporation.* In the case of qualified property held by an S corporation, each shareholder's share of the UBIA of

qualified property is the share of the unadjusted basis proportionate to the ratio of shares in the S corporation held by the shareholder on the last day of the taxable year over the total issued and outstanding shares of the S corporation.

(iv) *UBIA and section 743(b) basis adjustments*—(A) *In general.* A partner will be allowed to take into account UBIA with respect to an item of qualified property in addition to the amount of UBIA with respect to such qualified property determined under paragraphs (a)(3)(i) and (c) of this section and allocated to such partner under paragraph (a)(3)(ii) of this section to the extent of the partner's excess section 743(b) basis adjustment with respect to such item of qualified property.

(B) *Excess section 743(b) basis adjustments.* A partner's excess section 743(b) basis adjustment is an amount that is determined with respect to each item of qualified property and is equal to an amount that would represent the partner's section 743(b) basis adjustment with respect to the same item of qualified property, as determined under §§ 1.743-1(b) and 1.755-1, but calculated as if the adjusted basis of all of the partnership's property was equal to the UBIA of such property. The absolute value of the excess section 743(b) basis adjustment cannot exceed the absolute value of the total section 743(b) basis adjustment with respect to qualified property.

(C) *Computation of partner's share of UBIA with excess section 743(b) basis adjustments.* The partnership first computes its UBIA with respect to qualified property under paragraphs (a)(3)(i) and (c) of this section and allocates such UBIA under paragraph (a)(3)(ii) of this section. If the sum of the excess section 743(b) basis adjustment for all of the items of qualified property is a negative number, that amount will be subtracted from the partner's UBIA of qualified property determined under paragraphs (a)(3)(i) and (c) of this section and allocated under paragraph (a)(3)(ii) of this section. A partner's UBIA of qualified property may not be below \$0. Excess section 743(b) basis adjustments are computed with respect to all section 743(b) adjustments, including adjustments made as a result

of a substantial built-in loss under section 743(d).

(D) *Examples.* The provisions of this paragraph (a)(3)(iv) are illustrated by the following examples:

(1) *Example 1*—(i) *Facts.* A, B, and C are equal partners in partnership, PRS. PRS has a single trade or business that generates QBI. PRS has no liabilities and only one asset, a single item of qualified property with a UBIA equal to \$900,000. Each partner's share of the UBIA is \$300,000. A sells its one-third interest in PRS to T for \$350,000 when a section 754 election is in effect. At the time of the sale, the tax basis of the qualified property held by PRS is \$750,000. The amount of gain that would be allocated to T from a hypothetical transaction under § 1.743-1(d)(2) is \$100,000. Thus, T's interest in PRS's previously taxed capital is equal to \$250,000 (\$350,000, the amount of cash T would receive if PRS liquidated immediately after the hypothetical transaction, decreased by \$100,000, T's share of gain from the hypothetical transaction). The amount of T's section 743(b) basis adjustment to PRS's qualified property is \$100,000 (the excess of \$350,000, T's cost basis for its interest, over \$250,000, T's share of the adjusted basis to PRS of the partnership's property).

(ii) [Reserved]

(iii) *Analysis.* In order for T to determine its UBIA, T must calculate its excess section 743(b) basis adjustment. T's excess section 743(b) basis adjustment is equal to an amount that would represent T's section 743(b) basis adjustment with respect to the same item of qualified property, as determined under §§ 1.743-1(b) and 1.755-1, but calculated as if the adjusted basis of all of PRS's property was equal to the UBIA of such property. T's section 743(b) basis adjustment calculated as if adjusted basis of the qualified property were equal to its UBIA is \$50,000 (the excess of \$350,000, T's cost basis for its interest, over \$300,000, T's share of the adjusted basis to PRS of the partnership's property). Thus, T's excess section 743(b) basis adjustment is equal to \$50,000. For purposes of applying the UBIA limitation to T's share of QBI from PRS's trade or business, T's UBIA is equal to \$350,000 (\$300,000, T's one-

third share of the qualified property's UBIA, plus \$50,000, T's excess section 743(b) basis adjustment).

(2) *Example 2—(i) Facts.* Assume the same facts as in *Example 1* of paragraph (a)(3)(iv)(D)(I) of this section, except that A sells its one-third interest in PRS to T for \$200,000 when a section 754 election is in effect. At the time of the sale, the tax basis of the qualified property held by PRS is \$750,000, and the amount of loss that would be allocated to T from a hypothetical transaction under § 1.743-1(d)(2) is \$50,000. Thus, T's interest in PRS's previously taxed capital is equal to \$250,000 (\$200,000, the amount of cash T would receive if PRS liquidated immediately after the hypothetical transaction, increased by \$50,000, T's share of loss from the hypothetical transaction). The amount of T's section 743(b) basis adjustment to PRS's qualified property is negative \$50,000 (the excess of \$250,000, T's share of the adjusted basis to PRS of the partnership's property, over \$200,000, T's cost basis for its interest).

(ii) *Analysis.* In order for T to determine its UBIA, T must calculate its excess section 743(b) basis adjustment. T's excess section 743(b) basis adjustment is equal to an amount that would represent T's section 743(b) basis adjustment with respect to the same item of qualified property, as determined under §§ 1.743-1(b) and 1.755-1, but calculated as if the adjusted basis of all of PRS's property was equal to the UBIA of such property. T's section 743(b) basis adjustment calculated as if adjusted basis of the qualified property were equal to its UBIA is negative \$100,000 (the excess of \$300,000, T's share of the adjusted basis to PRS of the partnership's property, over \$200,000, T's cost basis for its interest). T's excess section 743(b) basis adjustment to the qualified property is limited to the amount of T's section 743(b) basis adjustment of negative \$50,000. Thus, T's excess section 743(b) basis adjustment is equal to negative \$50,000. For purposes of applying the UBIA limitation to T's share of QBI from PRS's trade or business, T's UBIA is equal to \$250,000 (\$300,000, T's one-third share of the qualified property's UBIA, reduced by T's negative \$50,000 excess section 743(b) basis adjustment).

(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 to each trade or business (or aggregated 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, which are allocable to the QBI of the trade or business (or aggregated 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 (b)(2)(ii), persons that pay and report W-2 wages on behalf of or with respect to others can include, but are not limited to, 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 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 Form W-2 (or to correct a Form W-2c relating to Form W-2 that had not been filed with SSA on or before the 60th day after the due date (including extensions) of the Form W-2), then this Form W-2c will not be considered to have been filed with SSA on or before the 60th day after the due date (including extensions) for this Form W-2c (or corrected Form W-2), regardless of when the Form W-2c 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 paragraph (b) of this section.

(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 (or aggregated 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 of chapter 1 of subtitle A of the Code. 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 (or aggregated 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 (or aggregated 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 (or aggregated 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 (or aggregated 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).* Excess section 743(b) basis adjustments as defined in paragraph (a)(3)(iv)(B) of this section are treated as qualified property. Otherwise, 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 of acquisition 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.* Solely for purposes of paragraph (c)(2)(i) of this section, the following rules apply to qualified property acquired in a like-kind exchange or in an involuntary conversion (replacement property).

(A) *Replacement property received in a section 1031 or 1033 transaction.* The date on which replacement property that is of like-kind to relinquished property or is similar or related in service or use to involuntarily converted property was first placed in service by the individual or RPE is determined as follows—

(1) For the portion of the individual's or RPE's UBIA, as defined in paragraph (c)(3) of this section, in such replacement property that does not exceed the individual's or RPE's UBIA in the relinquished property or involuntarily converted property, the date such portion in the replacement property was first placed in service by the individual or RPE is the date on which the relinquished property or involuntarily converted property was first placed in service by the individual or RPE; and

(2) For the portion of the individual's or RPE's UBIA, as defined in paragraph (c)(3) of this section, in such replacement property that exceeds the individual's or RPE's UBIA in the relinquished property or involuntarily converted property, such portion in the replacement property is treated as separate qualified property that the individual or RPE first placed in service on the date on which the replacement property was first placed in service by the individual or RPE.

(B) *Other property received in a section 1031 or 1033 transaction.* Other property, as defined in paragraph (c)(3)(ii) or (iii) of this section, that is qualified property is treated as separate qualified property that the individual or RPE first placed in service on the date on which such other property was first placed in service by the individual or RPE.

(iv) *Qualified property acquired in transactions described in section 168(i)(7)(B).* 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 trans-

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

(A) For the portion of the transferee's UBIA in the qualified property that does not exceed the transferor's UBIA 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 UBIA in the qualified property that exceeds the transferor's UBIA in such property, such portion is treated as separate qualified property that the transferee first placed in service on the date of the transfer.

(v) *Excess section 743(b) basis adjustment.* Solely for purposes of paragraph (c)(2)(i) of this section, an excess section 743(b) basis adjustment with respect to an item of partnership property that is qualified property is treated as being placed in service when the transfer of the partnership interest occurs, and the recovery period for such property is determined under §1.743-1(j)(4)(i)(B) with respect to positive basis adjustments and §1.743-1(j)(4)(ii)(B) with respect to negative basis adjustments.

(3) *Unadjusted basis immediately after acquisition—(i) In general.* Except as provided in paragraphs (c)(3)(ii) through (v) of this section, 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 of the Code, including the provisions of 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 which the individual or RPE has elected to treat as an expense (for example, under sections 179, 179B, or

179C). However, UBI A 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.

(ii) *Qualified property acquired in a like-kind exchange—(A) In general.* Solely for purposes of this section, if property that is qualified property (replacement property) is acquired in a like-kind exchange that qualifies for deferral of gain or loss under section 1031, then the UBI A of such property is the same as the UBI A of the qualified property exchanged (relinquished property), decreased by excess boot or increased by the amount of money paid or the fair market value of property not of a like kind to the relinquished property (other property) transferred by the taxpayer to acquire the replacement property. If the taxpayer acquires more than one piece of qualified property as replacement property that is of a like kind to the relinquished property in an exchange described in section 1031, UBI A is apportioned between or among the qualified replacement properties in proportion to their relative fair market values. Other property received by the taxpayer in a section 1031 transaction that is qualified property has a UBI A equal to the fair market value of such other property.

(B) *Excess boot.* For purposes of paragraph (c)(3)(ii)(A) of this section, *excess boot* is the amount of any money or the fair market value of other property received by the taxpayer in the exchange over the amount of appreciation in the relinquished property. Appreciation for this purpose is the excess of the fair market value of the relinquished property on the date of the exchange over the fair market value of the relinquished property on the date of the acquisition by the taxpayer.

(iii) *Qualified property acquired pursuant to an involuntary conversion—(A) In general.* Solely for purposes of this section, if qualified property is compulsorily or involuntarily converted (converted property) within the meaning of section 1033 and qualified replacement property is acquired in a transaction that qualifies for deferral of gain under section 1033, then the UBI A of the replacement property is the same as the UBI A of the converted

property, decreased by excess boot or increased by the amount of money paid or the fair market value of property not similar or related in service or use to the converted property (other property) transferred by the taxpayer to acquire the replacement property. If the taxpayer acquires more than one piece of qualified replacement property that meets the similar or related in service or use requirements in section 1033, UBI A is apportioned between the qualified replacement properties in proportion to their relative fair market values. Other property acquired by the taxpayer with the proceeds of an involuntary conversion that is qualified property has a UBI A equal to the fair market value of such other property.

(B) *Excess boot.* For purposes of paragraph (c)(3)(iii)(A) of this section, *excess boot* is the amount of any money or the fair market value of other property received by the taxpayer in the conversion over the amount of appreciation in the converted property. Appreciation for this purpose is the excess of the fair market value of the converted property on the date of the conversion over the fair market value of the converted property on the date of the acquisition by the taxpayer.

(iv) *Qualified property acquired in transactions described in section 168(i)(7)(B).* Solely for purposes of this section, if qualified property is acquired in a transaction described in section 168(i)(7)(B) (pertaining to treatment of transferees in certain non-recognition transactions), the transferee's UBI A in the qualified property shall be the same as the transferor's UBI A in the property, decreased by the amount of money received by the transferor in the transaction or increased by the amount of money paid by the transferee to acquire the property in the transaction.

(v) *Qualified property acquired from a decedent.* In the case of qualified property acquired from a decedent and immediately placed in service, the UBI A of the property will generally be the fair market value at the date of the decedent's death under section 1014. See section 1014 and the regulations thereunder. Solely for purposes of paragraph

(c)(2)(i) of this section, a new depreciable period for the property commences as of the date of the decedent's death.

(vi) *Property acquired in a nonrecognition transaction with principal purpose of increasing UBIA.* If qualified property is acquired in a transaction described in section 1031, 1033, or 168(i)(7) with the principal purpose of increasing the UBIA of the qualified property, the UBIA of the acquired qualified property is its basis as determined under relevant Code sections and not under the rules described in paragraphs (c)(3)(i) through (iv) of this section. For example, in a section 1031 transaction undertaken with the principal purpose of increasing the UBIA of the replacement property, the UBIA of the replacement property is its basis as determined under section 1031(d).

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

(i) *Example 1.* (A) On January 5, 2012, A purchases Real Property X for \$1 million and places it in service 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.

(B) 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).

(ii) *Example 2.* (A) The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, 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.

(B) A's UBIA in Real Property Y is \$1 million as determined under paragraph (c)(3)(ii) of this section. 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 Real Property X was first placed in service by A.

(iii) *Example 3.* (A) The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, 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 X has appreciated in value to \$1.3 million, and Real Property Y also has a value of \$1.3 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), is \$820,482.

(B) A's UBIA in Real Property Y is \$1 million as determined under paragraph (c)(3)(ii) of this section. 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 Real Property X was first placed in service by A.

(iv) *Example 4.* (A) The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, 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 X has appreciated in value to \$1.3 million, but Real Property Y has a value of \$1.5 million. A therefore adds \$200,000 in cash to the exchange of Real Property X for Real Property Y. On January 15, 2019, A places Real Property Y in service. As of January 15, 2019, A's basis in Real Property X, as adjusted under section 1016(a)(2), is \$820,482.

(B) A's UBIA in Real Property Y is \$1.2 million as determined under paragraph (c)(3)(ii) of this section (\$1 million in UBIA from Real Property X plus \$200,000 cash paid by A to acquire Real Property Y). Because the UBIA of Real Property Y exceeds the UBIA of Real Property X, Real Property Y is treated as being two separate qualified properties for purposes of applying paragraph (c)(2)(iii)(A) of this section. One property has a UBIA of \$1 million (the portion of A's UBIA of \$1.2 million

in Real Property Y that does not exceed A's UBIA of \$1 million in Real Property X) and it is first placed in service by A on January 5, 2012, which is the date on which Real Property X was first placed in service by A. The other property has a UBIA of \$200,000 (the portion of A's UBIA of \$1.2 million in Real Property Y that exceeds A's UBIA of \$1 million in Real Property X) and it is first placed in service by A on January 15, 2019, which is the date on which Real Property Y was first placed in service by A.

(v) *Example 5.* (A) The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, 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 X has appreciated in value to \$1.3 million. Real Property Y has a fair market value of \$1 million. As of January 15, 2019, A's basis in Real Property X, as adjusted under section 1016(a)(2), is \$820,482. Pursuant to the exchange, A receives Real Property Y and \$300,000 in cash.

(B) A's UBIA in Real Property Y is \$1 million as determined under paragraph (c)(3)(ii) of this section (\$1 million in UBIA from Real Property X, less \$0 excess boot (\$300,000 cash received in the exchange over \$300,000 in appreciation in Property X, which is equal to the excess of the \$1.3 million fair market value of Property X on the date of the exchange over \$1 million fair market value of Property X on the date of acquisition by the taxpayer)). 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 Real Property X was first placed in service by A.

(vi) *Example 6.* (A) The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, 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 X has appreciated in value to \$1.3 million. Real Property Y has a fair market value of \$900,000. Pursuant to the exchange, A receives Real Property Y and \$400,000 in cash. As of January 15, 2019, A's basis in Real Property X, as ad-

justed under section 1016(a)(2), is \$820,482.

(B) A's UBIA in Real Property Y is \$900,000 as determined under paragraph (c)(3)(ii) of this section (\$1 million in UBIA from Real Property X less \$100,000 excess boot (\$400,000 in cash received in the exchange over \$300,000 in appreciation in Property X, which is equal to the excess of the \$1.3 million fair market value of Property X on the date of the exchange over the \$1 million fair market value of Property X on the date of acquisition by the taxpayer)). 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 Real Property X was first placed in service by A.

(vii) *Example 7.* (A) The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, 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 X has declined in value to \$900,000, and Real Property Y also has a value of \$900,000. 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), is \$820,482.

(B) Even though Real Property Y is worth only \$900,000, A's UBIA in Real Property Y is \$1 million as determined under paragraph (c)(3)(ii) of this section because no cash or other property was involved in the exchange. 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 Real Property X was first placed in service by A.

(viii) *Example 8.* (A) C operates a trade or business that is not an SSTB as a sole proprietorship. On January 5, 2011, C purchases Machinery Y for \$10,000 and places it in service 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.

(B) 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). The S corporation's basis 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)(3)(iv) of this section, S corporation's UBIA of Machinery Y is \$10,000, which is C's UBIA of Machinery Y. 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 of Machinery Y will be January 5, 2011, which is 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.

(ix) *Example 9.* (A) LLC, a partnership, operates a trade or business that is not an SSTB. On January 5, 2011, LLC purchases Machinery Z for \$30,000 and places it in service in LLC's trade or business. LLC's basis in Machinery Z under section 1012 is \$30,000. Machinery Z is qualified property within the meaning of section 199A(b)(6). Assume that Machinery Z's recovery period under section 168(c) is 10 years, and LLC depreciates Machinery Z 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, LLC's basis in Machinery Z, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is \$7,500. On January 1, 2019, LLC distributes Machinery Z to Partner A in full liquidation of Partner A's interest in LLC. Partner A's outside basis in LLC is \$35,000.

(B) For purposes of section 199A(b)(2)(B)(ii) and this section, LLC's UBIA of Machinery Z from 2011 through 2018 is its \$30,000 cost basis under section 1012, regardless of any later depreciation deductions under section 168(a) and resulting basis adjustments under section 1016(a)(2). Prior to the distribution to Partner A, LLC's basis of Machinery Z is \$7,500. Under section 732(b), Partner A's basis in Machinery Z is \$35,000. Pursuant to paragraph (c)(3)(iv) of this section, upon distribution of Machinery Z, Partner A's UBIA of Machinery Z is \$30,000, which was LLC's UBIA of Machinery Z.

(d) *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 February 8, 2019.

(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, UBIA of qualified property, and the aggregate amount of qualified REIT dividends and qualified PTP income 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.

[T.D. 9847, 84 FR 2995, Feb. 8, 2019]

§ 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 qualified business income (QBI), as well as the determination of qualified real estate investment trust