

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

(REIT) dividends and qualified publicly traded partnership (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 relevant passthrough entity (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* or *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 except to the extent properly allocable to a trade or business of the recipient. 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 ex-

tent 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. These losses shall be used, for purposes of section 199A and these regulations, in order from the oldest to the most recent on a first-in, first-out (FIFO) basis. 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 net operating loss deduction under section 172 is not considered with respect to a trade or business and therefore, is not taken into account in computing QBI. However, an excess business loss under section 461(l) is treated as a net operating loss carryover to the following taxable year and is taken into account for purposes of computing QBI in the subsequent taxable year in which it is deducted.

(vi) *Other deductions.* Generally, deductions attributable to a trade or business are taken into account for purposes of computing QBI to the extent that the requirements of section 199A and this section are otherwise satisfied. For purposes of section 199A only, deductions such as the deductible portion of the tax on self-employment income under section 164(f), the self-employed health insurance deduction under section 162(l), and the deduction for contributions to qualified retirement plans under section 404 are considered attributable to a trade or business to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction, on a proportionate basis to the gross income received from the trade or business.

(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 “non-resident 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) and (c)(4), the following items are not taken into account as qualified items of income, gain, deduction, or loss and thus are not included in determining QBI:

(A) Any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss, including any item treated as one of such items under any other provision of the Code. This provision does not apply to the extent an item is treated as anything other than short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.

(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 (within the meaning of section 199A)” for “controlled foreign corporation.”

(E) Any item of income, gain, deduction, or loss described in 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 (b)(3) 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 that 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 with respect to 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 (b)(5).

(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 paragraph (c)(2) of this section earned directly or through an RPE and the net amount of qualified PTP income as defined in paragraph (c)(3) of this section 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) The term qualified REIT dividend does not include any REIT dividend received with respect to any share of REIT stock—

(A) That is held by the shareholder for 45 days or less (taking into account the principles of section 246(c)(3) and (4)) during the 91-day period beginning on the date which is 45 days before the

date on which such share becomes ex-dividend with respect to such dividend; or

(B) To the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(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. The specified service trade or business limitations described in §§ 1.199A-1(d)(3) and 1.199A-5 also apply to income earned from a PTP. 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) [Reserved]

(e) *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 February 8, 2019.

(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, UBLA 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 3000, Feb. 8, 2019]

#### § 1.199A-4 Aggregation.

(a) *Scope and purpose.* An individual or 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 and RPEs 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.* Trades or businesses may be aggregated only if an individual or RPE can demonstrate that—

(i) The same person or group of persons, directly or by attribution under sections 267(b) or 707(b), 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, including the last day 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, property, or 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*—(i) *Individuals.* An individual may aggregate trades or businesses operated directly or through an RPE to the extent an aggregation is not inconsistent with the aggregation of an RPE. If an individual aggregates multiple trades or businesses under paragraph (b)(1) of this section, QBI, W-2 wages, and UBLA of qualified property must be combined for the aggregated trades or businesses for purposes of applying the W-2 wage and UBLA of qualified property limitations described in § 1.199A-1(d)(2)(iv). An individual may not subtract from the trades or businesses aggregated by an RPE but may aggregate additional trades or businesses with the RPE's aggregation if the rules of this section are otherwise satisfied.

(ii) *RPEs.* An RPE may aggregate trades or businesses operated directly or through a lower-tier RPE to the extent an aggregation is not inconsistent